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Federal Register

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Thursday, August 22, 2019

NUCLEAR REGULATORY COMMISSION

10 CFR Parts 26, 37, 50, 70, and 73

[NRC–2016–0145]

RIN 3150–AJ79

Access Authorization and Fitness-for-Duty Determinations

AGENCY: Nuclear Regulatory Commission.

ACTION: Discontinuation of rulemaking activity.

SUMMARY: The U.S. Nuclear Regulatory Commission (NRC) is discontinuing the rulemaking activity, ''Access Authorization and Fitness-for-Duty Determinations.'' The purposes of this document are to inform members of the public of the discontinuation of the rulemaking activity and to provide a brief explanation for this decision. The rulemaking activity will no longer be reported in the NRC's portion of the Unified Agenda of Regulatory and Deregulatory Actions (the Unified Agenda).

DATES: Effective August 22, 2019, the rulemaking activity discussed in this document is discontinued.

ADDRESSES: Please refer to Docket ID NRC–2016–0145 when contacting the NRC about the availability of information regarding this document. You may obtain publicly-available information related to this document using any of the following methods:

- *Federal Rulemaking Website:* Go to *https://www.regulations.gov* and search for Docket ID NRC–2016–0145. Address questions about NRC dockets to Carol Gallagher; telephone: 301–415–3463; email: *Carol.Gallagher@nrc.gov.* For technical questions, contact the individual listed in the **FOR FURTHER INFORMATION CONTACT** section of this document.
- *NRC's Agencywide Documents Access and Management System (ADAMS):* You may obtain publicly-available documents online in the ADAMS Public Documents collection at *https://www.nrc.gov/reading-rm/adams.html.* To begin the search, 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, at 301–415–4737, or by email to *pdr.resource@nrc.gov.* The ADAMS accession number for each document referenced in this document (if that document is available in ADAMS) is provided the first time that a document is referenced.
- *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.

FOR FURTHER INFORMATION CONTACT: Ilka Berrios, Office of Nuclear Material Safety and Safeguards, U.S. Nuclear Regulatory Commission, Washington, DC 20555–0001; telephone: 301–415–2404; email: *Ilka.Berrios@nrc.gov.*

SUPPLEMENTARY INFORMATION:

I. Background

On November 15, 2015, the staff submitted SECY–15–0149, ''Role of Third-Party Arbitrators in Licensee Access Authorization and Fitness-for-Duty Determinations at Nuclear Power Plants'' (ADAMS Accession No. ML16063A268). In this paper, the staff provided options to address and clarify the proper role of third parties in licensee access authorization and fitness-for-duty determinations. These options included the following: (1) Rulemaking to clarify that only licensees can make final access authorization or fitness-for-duty decisions; (2) development of a Commission policy statement that would clarify that only licensees can make final access authorization or fitness-for-duty decisions; or (3) maintaining the status quo. The staff recommended that the Commission authorize an expedited rulemaking.

In the staff requirements memorandum (SRM) for SECY–15–0149, ''Staff Requirements—SECY–15–0149—Role of Third-Party Arbitrators in Licensee Access Authorization and Fitness-for-Duty Determinations at Nuclear Power Plants,'' dated June 6, 2016 (ADAMS Accession No. ML16158A286), the Commission directed the staff to proceed with the normal rulemaking process, including the development of a regulatory basis. In addition to the staff's normal outreach efforts, the Commission directed the staff to make specific outreach to potentially affected labor organizations regarding the proposed content and timeframe for the proposed rule. The Commission further directed the staff to include in the proposed rule a robust appeal process for workers whose access authorization is denied or revoked and to address in the proposed rule third-party review of fitness-for-duty determinations.

II. Process for Discontinuing Rulemaking Activities

When the staff identifies a rulemaking activity that can be discontinued, the staff submits to the Commission a request for approval to discontinue the rulemaking. The Commission provides its decision in a SRM. If the Commission approves discontinuing the rulemaking activity, the staff informs the public of the Commission's decision through the publication of a **Federal Register** notice.

A rulemaking activity may be discontinued at any stage in the rulemaking process. For a rulemaking activity that the public has commented on, the NRC will consider those comments before discontinuing the rulemaking activity; however, the NRC will not provide individual comment responses. For rulemaking activities that have generated significant public interest, the NRC conducts a public meeting or other form of public engagement to communicate its intent before discontinuing the rulemaking.

After Commission approval to discontinue a rulemaking activity, the staff updates the next edition of the Unified Agenda to indicate that the rulemaking is discontinued. The rulemaking activity will appear in the completed section of that edition of the Unified Agenda but will not appear in future editions.

III. Access Authorization and Fitness for Duty Determinations

Consistent with Commission direction provided in SRM–SECY–15–0149, the staff initiated a rulemaking to determine whether a third party's reversal of a licensee reviewing official's access authorization determination or fitness-for-duty determination would adversely impact public health and safety or the common defense and security.

The NRC held two public meetings to discuss this rulemaking activity. During these meetings, the NRC obtained input from interested stakeholders, including union and industry representatives, concerning the use of third-party arbitration within the commercial nuclear power industry. The NRC posted summaries of these public meetings in ADAMS at Accession Nos. ML16336A034 and ML17067A171. The NRC also held a closed meeting with the International Brotherhood of Electrical Workers on December 12, 2016, to discuss several specific cases referenced in SECY–15–0149 and other cases that were relevant to this rulemaking activity. After the closed meeting, the International Brotherhood of Electrical Workers voluntarily provided the NRC with specific data on arbitration cases involving certain International Brotherhood of Electrical Workers members and the outcome of these cases. The NRC posted a summary of the closed meeting in ADAMS at Accession No. ML16355A092.

The data from the International Brotherhood of Electrical Workers showed that, over a span of 32 years, 371 individuals had their access authorizations terminated and were therefore removed from employment with licensees. Of those 371 individuals, 46 elected to arbitrate their termination, and 14 of those individuals ultimately returned to work. To date, none of these reinstatements have resulted in an adverse impact on public health and safety or the common defense and security. The data provided by the International Brotherhood of Electrical Workers was limited only to information provided by local union organizations and does not necessarily offer a complete list of all the International Brotherhood of Electrical Workers arbitration cases, arbitrations involving other unions, or arbitrations brought by individuals independent of any union involvement.

In February and March 2017, Exelon Generation gave the NRC information on four arbitration cases that had reversed access authorization decisions made by Exelon reviewing officials. The NRC is not aware of any safety or security issues associated with the reinstatement of unescorted access for the individuals involved in these cases. One of these cases, however, did result in the NRC issuing a noncited violation to Exelon. In this specific case, pursuant to an arbitrator's ruling, the licensee removed disqualifying information from an industry shared database. The disqualifying information was related to an individual to whom the licensee had previously denied unescorted access. Removal of this disqualifying information constituted a violation of the NRC's regulations, which require the licensee to ensure that any disqualifying information about an individual who applied for unescorted access authorization be retained in the shared database. This individual did not return to work, and there is no additional information regarding the performance of this individual.

Although allowing a third party, for example, an arbitrator, to overturn a licensee's access authorization and fitness-for-duty determination poses a potential risk, the staff does not consider this risk to present a significant safety or security threat. Licensees have maintained and implemented defense-in-depth security programs designed to ensure, in part, that individuals who maintain unescorted access to NRC-licensed commercial power reactors and Category I fuel cycle facilities are trustworthy and reliable and fit for duty. This is accomplished through the implementation of their insider mitigation, access authorization, fitness-for-duty, cyber protection, and physical protection programs. Additionally, the NRC will continue to maintain awareness of access authorization issues and take necessary actions should the need arise.

During the development of the regulatory basis, the staff considered the feedback received from external stakeholders, including the information from the International Brotherhood of Electrical Workers and Exelon. The staff used this external feedback and other information obtained during development of the draft regulatory basis to evaluate whether the issue of third-party arbitrators overturning licensee access authorization and fitness-for-duty decisions posed a security vulnerability that needed to be addressed through rulemaking. After considering this new information, the staff determined that third-party reversals of licensee access authorization and fitness-for-duty decisions do not present a significant safety or security concern that warranted engaging in rulemaking.

As part of the rulemaking process, the staff performed a preliminary cost analysis, which concluded that the rulemaking option would not be justified, based on a mean net cost of $ 4.5 million. Further, the staff identified no significant qualitative or quantitative benefits that would offset the cost to conduct the rulemaking.

Consistent with NRC procedures for discontinuing a rulemaking and because the staff's recommended approach was different from the recommended approach in SECY–15–0149, the staff conducted a public meeting on November 1, 2018. During the public meeting, the staff presented the status of this rulemaking and indicated that it intended to recommend to the Commission the discontinuation of this rulemaking effort for the reasons stated in this document. The staff did not receive any negative feedback on this proposed recommendation.

In consideration of Commission direction in SRM–SECY–15–0149 to include a robust appeals process in the proposed rule, the staff analyzed whether standalone activities, such as issuing guidance on appeals processes, would be necessary if the NRC determined that rulemaking was not needed to address third-party reviews. Based on stakeholder input, the NRC determined its regulations provide adequate appeals processes, and the NRC does not plan to issue NRC guidance.

IV. Conclusion

The NRC is no longer pursuing the ''Access Authorization and Fitness-for-Duty Determinations'' rulemaking for the reasons discussed in this document. In the next edition of the Unified Agenda, the NRC will update the entry for the rulemaking activity and reference this document to indicate that the rulemaking is no longer being pursued. The rulemaking activity will appear in the completed actions section of that edition of the Unified Agenda but will not appear in future editions. If the NRC decides to pursue a similar or related rulemaking activity in the future, it will inform the public through a new rulemaking entry in the Unified Agenda.

Dated at Rockville, Maryland, this 16th day of August 2019.

For the Nuclear Regulatory Commission.

Annette L. Vietti-Cook,

Secretary of the Commission.

[FR Doc. 2019–18067 Filed 8–21–19; 8:45 am]

BILLING CODE 7590–01–P

NUCLEAR REGULATORY COMMISSION

10 CFR Part 72

[NRC–2019–0126]

RIN 3150–AK35

List of Approved Spent Fuel Storage Casks: Holtec International Storage, Transport and Repository (HI–STAR) 100 Storage System, Certificate of Compliance No. 1008, Amendment No. 3

AGENCY: Nuclear Regulatory Commission.

ACTION: Direct final rule.

SUMMARY: The U.S. Nuclear Regulatory Commission (NRC) is amending its spent fuel storage regulations by revising the Holtec International Storage, Transport and Repository 100 Storage System listing within the ''List of approved spent fuel storage casks'' to include Amendment No. 3 to Certificate of Compliance No. 1008. Amendment No. 3 revises the technical specifications to: Include multipurpose canister (MPC)-32 for storage of pressurized-water reactor spent fuel in the HI–STAR 100 Storage System; include the Metamic neutron absorber for MPC–32, MPC–24, and MPC–68; credit the soluble boron in criticality analyses for both MPC–32 and MPC–24; incorporate standard system features and ancillaries such as the forced helium dehydration; allow for horizontal storage of the casks; provide updated drawings; and revise the MPC design pressure for accident condition to 200 pounds per square inch gauge. Amendment No. 3 also makes other administrative changes to the technical specifications.

DATES: This direct final rule is effective November 5, 2019, unless significant adverse comments are received by September 23, 2019. If this direct final rule is withdrawn as a result of such comments, timely notice of the withdrawal will be published in the **Federal Register**. Comments received after this date will be considered if it is practical to do so, but the NRC is able to ensure consideration only for comments received on or before this date. Comments received on this direct final rule will also be considered to be comments on a companion proposed rule published in the Proposed Rules section of this issue of the **Federal Register**.

ADDRESSES: You may submit comments by any of the following methods:

- *Federal Rulemaking Website:* Go to *http://www.regulations.gov* and search for Docket ID NRC–2019–0126. Address questions about NRC dockets to Carol Gallagher; telephone: 301–415–3463; email: *Carol.Gallagher@nrc.gov.* For technical questions contact the individuals listed in the **FOR FURTHER INFORMATION CONTACT** section of this document.
- *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 obtaining information and submitting comments, see ''Obtaining Information and Submitting Comments'' in the **SUPPLEMENTARY INFORMATION** section of this document.

FOR FURTHER INFORMATION CONTACT: Bernard H. White, Office of Nuclear Material Safety and Safeguards; telephone: 301–415–6577; email: *Bernard.White@nrc.gov* or Solomon Sahle, Office of Nuclear Material Safety and Safeguards; telephone: 301–415–3781; email: *Solomon.Sahle@nrc.gov.* Both are staff of the U.S. Nuclear Regulatory Commission, Washington, DC 20555–0001.

SUPPLEMENTARY INFORMATION:

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I. Obtaining Information and Submitting Comments

A. Obtaining Information

Please refer to Docket ID NRC–2019–0126 when contacting the NRC about the availability of information for this action. You may obtain publicly-available information related to this action by any of the following methods:

- *Federal Rulemaking Website:* Go to *http://www.regulations.gov* and search for Docket ID NRC–2019–0126.
- *NRC's Agencywide Documents Access and Management System (ADAMS):* You may obtain publicly-available documents online in the ADAMS Public Documents collection at *http://www.nrc.gov/reading-rm/adams.html.* To begin the search, 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.* For the convenience of the reader, instructions about obtaining materials referenced in this document are provided in the ''Availability of Documents'' section.
- *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–2019–0126 in your comment submission.

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 routinely 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 does not routinely edit comment submissions to remove such information before making the comment submissions available to the public or entering the comment into ADAMS.

II. Rulemaking Procedure

This direct final rule is limited to the changes contained in Amendment No. 3 to Certificate of Compliance No. 1008 and does not include other aspects of the Holtec International Storage, Transport and Repository (HI–STAR) 100 Storage System design. The NRC is using the direct final rule procedure to issue this amendment because it represents a limited and routine change to an existing certificate of compliance that is expected to be noncontroversial.

Adequate protection of public health and safety continues to be ensured. The amendment to the rule will become effective on November 5, 2019. However, if the NRC receives significant adverse comments on this direct final rule by September 23, 2019, then the NRC will publish a document that withdraws this action and will subsequently address the comments received in a final rule as a response to the companion proposed rule published in the Proposed Rules section of this issue of the **Federal Register**. Absent significant modifications to the proposed revisions requiring republication, the NRC will not initiate a second comment period on this action.

A significant adverse comment is a comment where the commenter explains why the rule would be inappropriate, including challenges to the rule's underlying premise or approach, or would be ineffective or unacceptable without a change. A comment is adverse and significant if:

(1) The comment opposes the rule and provides a reason sufficient to require a substantive response in a notice-and-comment process. For example, a substantive response is required when:

(a) The comment causes the NRC to reevaluate (or reconsider) its position or conduct additional analysis;

(b) The comment raises an issue serious enough to warrant a substantive response to clarify or complete the record; or

(c) The comment raises a relevant issue that was not previously addressed or considered by the NRC.

(2) The comment proposes a change or an addition to the rule, and it is apparent that the rule would be ineffective or unacceptable without incorporation of the change or addition.

(3) The comment causes the NRC to make a change (other than editorial) to the rule, certificate of compliance, or technical specifications.

For detailed instructions on filing comments, please see the companion proposed rule published in the Proposed Rules section of this issue of the **Federal Register**.

III. Background

Section 218(a) of the Nuclear Waste Policy Act of 1982, as amended, requires that ''the Secretary [of the Department of Energy] shall establish a demonstration program, in cooperation with the private sector, for the dry storage of spent nuclear fuel at civilian nuclear power reactor sites, with the objective of establishing one or more technologies that the [Nuclear Regulatory] Commission may, by rule, approve for use at the sites of civilian nuclear power reactors without, to the maximum extent practicable, the need for additional site-specific approvals by the Commission.'' Section 133 of the Nuclear Waste Policy Act states, in part, that ''[the Commission] shall, by rule, establish procedures for the licensing of any technology approved by the Commission under section [218(a)] for use at the site of any civilian nuclear power reactor.''

To implement this mandate, the Commission approved dry storage of spent nuclear fuel in NRC-approved casks under a general license by publishing a final rule that added a new subpart K in part 72 of title 10 of the *Code of Federal Regulations* (10 CFR) entitled ''General License for Storage of Spent Fuel at Power Reactor Sites'' (55 FR 29181; July 18, 1990). This rule also established a new subpart L in 10 CFR part 72 entitled ''Approval of Spent Fuel Storage Casks,'' which contains procedures and criteria for obtaining NRC approval of spent fuel storage cask designs. The NRC subsequently issued a final rule on September 3, 1999, that approved the HI–STAR 100 Storage System design and added it to the list of NRC-approved cask designs provided in § 72.214 as Certificate of Compliance No. 1008 (64 FR 48259).

IV. Discussion of Changes

On September 25, 2015, Holtec International submitted a request to the NRC to amend Certificate of Compliance No. 1008. Holtec International supplemented its request on January 15, 2016, April 29, 2016, December 15, 2017, July 2, 2018, and February 6, 2019. Amendment No. 3 revises the technical specifications to: (1) Include multipurpose canister (MPC)-32 for storage of pressurized-water reactor spent fuel in the Holtec International HI–STAR 100 Storage System; (2) include the Metamic neutron absorber for MPC–32, MPC–24, and MPC–68; (3) credit the soluble boron in criticality analyses for both MPC–32 and MPC–24; (4) incorporate standard system features and ancillaries such as the forced helium dehydration; (5) allow for horizontal storage of the casks; (6) provide updated drawings; (7) revise the MPC design pressure for accident condition to 200 pounds per square inch gauge; and (8) make other administrative changes to the technical specifications. This direct final rule revises the Holtec International HI–STAR 100 Storage System listing in § 72.214 by adding Amendment No. 3 to Certificate of Compliance No. 1008. The revised certificate of compliance and technical specifications are identified and evaluated in the preliminary safety evaluation report.

As documented in that preliminary safety evaluation report, the NRC performed a detailed safety evaluation of the proposed certificate of compliance amendment request. There are no significant changes to cask design requirements in the proposed amendment. Considering the specific design requirements for each accident condition, the design of the cask would prevent loss of containment, shielding, and criticality control in the event of an accident. This amendment does not reflect a significant change in design or fabrication of the cask. In addition, any resulting occupational exposure or offsite dose rates from the implementation of Amendment No. 3 would remain well within the limits specified by 10 CFR part 20, ''Standards for Protection Against Radiation.'' There will be no significant change in the types or amounts of any effluent released, no significant increase in the individual or cumulative radiation exposure, and no significant increase in the potential for, or consequences from, radiological accidents.

The amended Holtec International HI–STAR 100 Storage System cask design, when used under the conditions specified in the certificate of compliance, the technical specifications, and the NRC's regulations, will meet the requirements of 10 CFR part 72; therefore, adequate protection of public health and safety will continue to be ensured. When this direct final rule becomes effective, persons who hold a general license under § 72.210 may, consistent with the license conditions under § 72.212, load spent nuclear fuel into those Holtec International HI–STAR 100 Storage System casks that meet the criteria of Amendment No. 3 to Certificate of Compliance No. 1008.

V. Voluntary Consensus Standards

The National Technology Transfer and Advancement Act of 1995 (Pub. L. 104–113) requires that Federal agencies use technical standards that are developed or adopted by voluntary consensus standards bodies unless the use of such a standard is inconsistent with applicable law or otherwise impractical. In this direct final rule, the NRC will revise the Holtec International HI–STAR 100 Storage System design listed in § 72.214. This action does not constitute the establishment of a standard that contains generally applicable requirements.

VI. Agreement State Compatibility

Under the ''Policy Statement on Adequacy and Compatibility of Agreement State Programs'' approved by the Commission on June 30, 1997, and published in the **Federal Register** on September 3, 1997 (62 FR 46517), this rule is classified as Compatibility Category ''NRC.'' Compatibility is not required for Category ''NRC'' regulations. The NRC program elements in this category are those that relate directly to areas of regulation reserved to the NRC by the Atomic Energy Act of 1954, as amended, or the provisions of 10 CFR chapter I. Although an Agreement State may not adopt program elements reserved to the NRC, and the Category ''NRC'' does not confer regulatory authority on the State, the State may wish to inform its licensees of certain requirements by means consistent with the particular State's administrative procedure laws.

VII. Plain Writing

The Plain Writing Act of 2010 (Pub. L. 111–274) requires Federal agencies to write documents in a clear, concise, and well-organized manner. The NRC has written this document to be consistent with the Plain Writing Act as well as the Presidential Memorandum, ''Plain Language in Government Writing,'' published June 10, 1998 (63 FR 31885).

VIII. Environmental Assessment and Finding of No Significant Environmental Impact

Under the National Environmental Policy Act of 1969, as amended, and the NRC's regulations in subpart A of 10 CFR part 51, ''Environmental Protection Regulations for Domestic Licensing and Related Regulatory Functions,'' the NRC has determined that this direct final rule, if adopted, would not be a major Federal action significantly affecting the quality of the human environment and, therefore, an environmental impact statement is not required. The NRC has made a finding of no significant impact on the basis of this environmental assessment.

A. The Action

The action is to amend § 72.214 to revise the Holtec International HI–STAR 100 Storage System listing within the ''List of approved spent fuel storage casks'' to include Amendment No. 3 to Certificate of Compliance No. 1008.

B. The Need for the Action

This direct final rule amends the certificate of compliance for the Holtec International HI–STAR 100 Storage System design within the list of approved spent fuel storage casks that power reactor licensees can use to store spent fuel at reactor sites under a general license. Specifically, Amendment No. 3 updates the certificate of compliance to: (1) Include MPC–32 for storage of pressurized-water reactor spent fuel in the Holtec International HI–STAR 100 Storage System; (2) include the Metamic neutron absorber for MPC–32, MPC–24, and MPC–68; (3) credit the soluble boron in criticality analyses for both MPC–32 and MPC–24; (4) incorporate standard system features and ancillaries such as the forced helium dehydration; (5) allow for horizontal storage of the casks; (6) provide updated drawings; (7) revise the MPC design pressure for accident condition to 200 pounds per square inch gauge; and (8) make other administrative changes to the technical specifications.

C. Environmental Impacts of the Action

On July 18, 1990 (55 FR 29181), the NRC issued an amendment to 10 CFR part 72 to provide for the storage of spent fuel under a general license in cask designs approved by the NRC. The potential environmental impact of using NRC-approved storage casks was initially analyzed in the environmental assessment for the 1990 final rule. The environmental assessment for this Amendment No. 3 tiers off of the environmental assessment for the July 18, 1990, final rule. Tiering off past environmental assessments is a standard process under the National Environmental Policy Act of 1969, as amended.

Holtec International HI–STAR 100 Storage Systems are designed to mitigate the effects of design basis accidents that could occur during storage. Design basis accidents account for human-induced events and the most severe natural phenomena reported for the site and surrounding area. Postulated accidents analyzed for an independent spent fuel storage installation, the type of facility at which a holder of a power reactor operating license would store spent fuel in casks in accordance with 10 CFR part 72, include tornado winds and tornado-generated missiles, a design basis earthquake, a design basis flood, an accidental cask drop, lightning effects, fire, explosions, and other events.

Considering the specific design requirements for each accident condition, the design of the cask would prevent loss of confinement, shielding, and criticality control in the event of an accident. If there is no loss of confinement, shielding, or criticality control, the environmental impacts resulting from an accident would be insignificant. This amendment does not reflect a significant change in design or fabrication of the cask. Because there are no significant design or process changes, any resulting occupational exposure or offsite dose rates from the implementation of Amendment No. 3 would remain well within 10 CFR part 20 limits. Therefore, the proposed certificate of compliance changes will not result in any radiological or non-radiological environmental impacts that significantly differ from the environmental impacts evaluated in the environmental assessment supporting the July 18, 1990, final rule. There will be no significant change in the types or amounts of any effluent released, no significant increase in individual or cumulative radiation exposures, and no significant increase in the potential for, or consequences of, radiological accidents. The NRC documented its safety findings in a preliminary safety evaluation report.

D. Alternative to the Action

The alternative to this action is to deny approval of Amendment No. 3 and not issue the direct final rule. Consequently, any 10 CFR part 72 general licensee that seeks to load spent nuclear fuel into the Holtec International HI–STAR 100 Storage System in accordance with the changes described in Amendment No. 3 would have to request an exemption from the requirements of §§ 72.212 and 72.214. Under this alternative, interested licensees would have to prepare, and the NRC would have to review, a separate exemption request, thereby increasing the administrative burden upon the NRC and the costs to each licensee. Therefore, the environmental impacts of the alternative action would be the same as, or more likely greater than, the preferred action.

E. Alternative Use of Resources

Approval of Amendment No. 3 to Certificate of Compliance No. 1008 would result in no irreversible commitment of resources.

F. Agencies and Persons Contacted

No agencies or persons outside the NRC were contacted in connection with the preparation of this environmental assessment.

G. Finding of No Significant Impact

The environmental impacts of the action have been reviewed under the requirements in National Environmental Policy Act of 1969, as amended, and the NRC's regulations in subpart A of 10 CFR part 51, ''Environmental Protection Regulations for Domestic Licensing and Related Regulatory Functions.'' Based on the foregoing environmental assessment, the NRC concludes that this direct final rule entitled, ''List of Approved Spent Fuel Storage Casks: Holtec International HI–STAR 100 Storage System, Certificate of Compliance No. 1008, Amendment No. 3,'' will not have a significant effect on the human environment. Therefore, the NRC has determined that an environmental impact statement is not necessary for this direct final rule.

IX. Paperwork Reduction Act Statement

This direct final rule does not contain any new or amended collections of information subject to the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*). Existing collections of information were approved by the Office of Management and Budget, approval number 3150–0132.

Public Protection Notification

The NRC may not conduct or sponsor, and a person is not required to respond to, a request for information or an information collection requirement unless the requesting document displays a currently valid Office of Management and Budget control number.

X. Regulatory Flexibility Certification

Under the Regulatory Flexibility Act of 1980 (5 U.S.C. 605(b)), the NRC certifies that this direct final rule will not, if issued, have a significant economic impact on a substantial number of small entities. This direct final rule affects only nuclear power plant licensees and Holtec International. These entities do not fall within the scope of the definition of small entities set forth in the Regulatory Flexibility Act or the size standards established by the NRC (§ 2.810).

XI. Regulatory Analysis

On July 18, 1990 (55 FR 29181), the NRC issued an amendment to 10 CFR part 72 to provide for the storage of spent nuclear fuel under a general license in cask designs approved by the NRC. Any nuclear power reactor licensee can use NRC-approved cask designs to store spent nuclear fuel if it notifies the NRC in advance, the spent fuel is stored under the conditions specified in the cask's certificate of compliance, and the conditions of the general license are met. A list of NRC-approved cask designs is contained in § 72.214. On September 3, 1999 (64 FR 48259), the NRC issued an amendment to 10 CFR part 72 that approved the Holtec International HI–STAR 100 Storage System design by adding it to the list of NRC-approved cask designs in § 72.214.

On September 25, 2015, and as supplemented on January 15, 2016, April 29, 2016, December 15, 2017, July 2, 2018, and February 6, 2019, Holtec International submitted an application to amend the Holtec International HI–STAR 100 Storage System as described in Section IV, ''Discussion of Changes,'' of this document.

The alternative to this action is to withhold approval of Amendment No. 3 and to require any 10 CFR part 72 general licensee seeking to load spent nuclear fuel into the Holtec International HI–STAR 100 Storage System under the changes described in Amendment No. 3 to request an exemption from the requirements of §§ 72.212 and 72.214. Under this alternative, each interested 10 CFR part 72 licensee would have to prepare, and the NRC would have to review, a separate exemption request, thereby increasing the administrative burden upon the NRC and the costs to each licensee.

Approval of this direct final rule is consistent with previous NRC actions. Further, as documented in the preliminary safety evaluation report and environmental assessment, this direct final rule will have no adverse effect on public health and safety or the environment. This direct final rule has no significant identifiable impact or benefit on other Government agencies. Based on this regulatory analysis, the NRC concludes that the requirements of this direct final rule are commensurate with the NRC's responsibilities for public health and safety and the common defense and security. No other available alternative is believed to be as satisfactory, and therefore, this action is recommended.

XII. Backfitting and Issue Finality

The NRC has determined that the backfit rule (§ 72.62) does not apply to this direct final rule. Therefore, a backfit analysis is not required. This direct final rule revises Certificate of Compliance No. 1008 for the Holtec International HI–STAR 100 Storage System, as currently listed in § 72.214. The amendment consists of the changes to Amendment No. 3 previously described, as set forth in the revised certificate of compliance and technical specifications.

Amendment No. 3 to Certificate of Compliance No. 1008 for the Holtec International HI–STAR 100 Storage System was initiated by Holtec International and was not submitted in response to new NRC requirements, or an NRC request for amendment. Amendment No. 3 applies only to new casks fabricated and used under Amendment No. 3. These changes do not affect existing users of the Holtec International HI–STAR 100 Storage System, and the current Amendment No. 2 continues to be effective for existing users. While current certificate of compliance users may comply with the new requirements in Amendment No. 3, this would be a voluntary decision on the part of current users.

For these reasons, Amendment No. 3 to Certificate of Compliance No. 1008 does not constitute backfitting under § 72.62 or § 50.109(a)(1), or otherwise represent an inconsistency with the issue finality provisions applicable to combined licenses in 10 CFR part 52. Accordingly, the NRC has not prepared a backfit analysis for this rulemaking.

XIII. Congressional Review Act

This direct final rule is not a rule as defined in the Congressional Review Act.

XIV. Availability of Documents

The documents identified in the following table are available to interested persons through one or more of the following methods, as indicated.

Document	ADAMS Accession No.
Holtec International, Submittal of Certificate of Compliance Amendment Request (1008–3), dated September 25, 2015	ML15280A182.
Holtec International, Certificate of Compliance Amendment 1008–3—Summary of Proposed Changes, dated September 25, 2015.	ML15280A219.
Holtec International, Certificate of Compliance Amendment 1008–3—Revision 4 of the HI–STAR Final Safety Analysis Report, dated September 25, 2015.	ML15280A220.
Holtec International, Certificate of Compliance Amendment 1008–3—Final Safety Analysis Report on HI–STAR 100 MPC Storage System, dated September 25, 2015.	ML15280A223.
Certificate of Compliance for Spent Fuel Storage Casks, NRC Form 561, dated September 25, 2015	ML15280A224.

Document	ADAMS Accession No.
Certificate of Compliance No. 1008, Appendix A, Technical Specifications for the HI–STAR 100 Cask System, Amendment 3, dated September 25, 2015.	ML15280A225.
Certificate of Compliance No. 1008, Appendix B, Approved Contents and Design Features for the HI–STAR 100 Cask System, Amendment 3, dated September 25, 2015.	ML15280A222.
Holtec International—Supplemental Information for HI–STAR 100 System, Amendment Request (1008–3), dated January 15, 2016.	ML16041A041.
Submittal of Response to Request for Additional Information for Revision Request (1008–3) to HI–STAR 100 Certificate of Compliance, dated April 29, 2016.	ML16133A503.
Submittal of Response to Request for Additional Information for Revision Request (1008–3) to HI–STAR 100 Certificate of Compliance, Attachment 1—Request for Additional Information Responses on HI–STAR 100—Nonproprietary, dated April 29, 2016.	ML16133A509.
Submittal of Response to Request for Additional Information for Revision Request (1008–3) to HI–STAR 100 Certificate of Compliance, Attachment 3—HI–STAR 100 Certificate of Compliance Appendix A Request for Additional Information Mark-up, dated April 29, 2016.	ML16133A511.
Submittal of Response to Request for Additional Information for Revision Request (1008–3) to HI–STAR 100 Certificate of Compliance, Attachment 4—HI–STAR 100 Certificate of Compliance Appendix B Request for Additional Information Mark-up, dated April 29, 2016.	ML16133A512.
Submittal of Response to Request for Additional Information for Revision Request (1008–3) to HI–STAR 100 Certificate of Compliance, Attachment 5—Final Safety Analysis Report Changed Pages, dated April 29, 2016.	ML16133A513.
Holtec International Submittal of Responses to NRC's 2nd Round Requests for Additional Information for HI–STAR 100 Amendment Number 3, dated December 15, 2017.	ML17360A162.
Holtec International—Submittal of Supplemental Changes for HI–STAR 100 License Amendment Request 1008–3, dated July 2, 2018.	ML18183A448.
Holtec International—Supplemental Changes for HI–STAR 100 Amendment Request 1008–3, dated July 2, 2018	ML18183A449.
Holtec International—HI–STAR 100 Amendment Request (1008–3), Removal of Preferential Fuel Loading Requirement from Certificate of Compliance, dated February 6, 2019.	ML19037A152.
User Need for Rulemaking for Amendment No. 3 to the Holtec International Storage, Transport and Repository (HI–STAR) 100 Storage System, Enclosure 1: Proposed Certificate of Compliance No. 1008, Amendment No. 3.	ML19137A303.
User Need for Rulemaking for Amendment No. 3 to the Holtec International Storage, Transport and Repository (HI–STAR) 100 Storage System, Enclosure 2: Proposed Technical Specifications Appendix A.	ML19137A300.
User Need for Rulemaking for Amendment No. 3 to the Holtec International Storage, Transport and Repository (HI–STAR) 100 Storage System, Enclosure 3: Proposed Technical Specifications Appendix B.	ML19137A301.
User Need for Rulemaking for Amendment No. 3 to the Holtec International Storage, Transport and Repository (HI–STAR) 100 Storage System, Enclosure 4: Preliminary Safety Evaluation Report.	ML19137A302.

The NRC may post materials related to this document, including public comments, on the Federal Rulemaking website at *http://www.regulations.gov* under Docket ID NRC–2019–0126. The Federal Rulemaking website allows you to receive alerts when changes or additions occur in a docket folder. To subscribe: (1) Navigate to the docket folder (NRC–2019–0126); (2) click the ''Sign up for Email Alerts'' link; and (3) enter your email address and select how frequently you would like to receive emails (daily, weekly, or monthly).

List of Subjects in 10 CFR Part 72

Administrative practice and procedure, Hazardous waste, Indians, Intergovernmental relations, Nuclear energy, Penalties, Radiation protection, Reporting and recordkeeping requirements, Security measures, Whistleblowing.

For the reasons set out in the preamble and under the authority of the Atomic Energy Act of 1954, as amended; the Energy Reorganization Act of 1974, as amended; the Nuclear Waste Policy Act of 1982, as amended; and 5 U.S.C. 552 and 553; the NRC is adopting the following amendments to 10 CFR part 72:

PART 72—LICENSING REQUIREMENTS FOR THE INDEPENDENT STORAGE OF SPENT NUCLEAR FUEL, HIGH-LEVEL RADIOACTIVE WASTE, AND REACTOR-RELATED GREATER THAN CLASS C WASTE

■ 1. The authority citation for part 72 continues to read as follows:

Authority: Atomic Energy Act of 1954, secs. 51, 53, 57, 62, 63, 65, 69, 81, 161, 182, 183, 184, 186, 187, 189, 223, 234, 274 (42 U.S.C. 2071, 2073, 2077, 2092, 2093, 2095, 2099, 2111, 2201, 2210e, 2232, 2233, 2234, 2236, 2237, 2238, 2273, 2282, 2021); Energy Reorganization Act of 1974, secs. 201, 202, 206, 211 (42 U.S.C. 5841, 5842, 5846, 5851); National Environmental Policy Act of 1969 (42 U.S.C. 4332); Nuclear Waste Policy Act of 1982, secs. 117(a), 132, 133, 134, 135, 137, 141, 145(g), 148, 218(a) (42 U.S.C. 10137(a), 10152, 10153, 10154, 10155, 10157, 10161, 10165(g), 10168, 10198(a)); 44 U.S.C. 3504 note.

■ 2. In § 72.214, Certificate of Compliance 1008 is revised to read as follows:

§ 72.214 List of approved spent fuel storage casks.

* * * * *

Certificate Number: 1008.

Initial Certificate Effective Date: October 4, 1999.

Amendment Number 1 Effective Date: December 26, 2000.

Amendment Number 2 Effective Date: May 29, 2001.

Amendment Number 3 Effective Date: November 5, 2019.

SAR Submitted by: Holtec International.

SAR Title: Final Safety Analysis Report for the HI–STAR 100 Cask System.

Docket Number: 72–1008.

Certificate Expiration Date: October 4, 2019.

Model Number: HI–STAR 100 (MPC–24, MPC–32, MPC–68, MPC–68F).

* * * * *

Dated at Rockville, Maryland, this 9th day of August, 2019.

For the Nuclear Regulatory Commission.

Margaret M. Doane,

Executive Director for Operations.

[FR Doc. 2019–18107 Filed 8–21–19; 8:45 am]

BILLING CODE 7590–01–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 25

[Docket No. FAA–2019–0283; Special Conditions No. 25–326A–SC]

Special Conditions: Airbus Model A380 Airplanes; Stairways Between Decks

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Final amended special conditions.

SUMMARY: These amended special conditions are issued for the Airbus Model A380 airplane. By issuance of this amendment to the special condition, the FAA is correcting an error that appeared in the **Federal Register** on August 28, 2006, for Special Conditions No. 25–326–SC, Docket No. NM314. This airplane will have novel or unusual design features when compared to the state of technology envisioned in the airworthiness standards for transport category airplanes. This design feature is associated with the complex systems and the configuration of the airplane, including its full-length double deck. The applicable airworthiness regulations do not contain adequate or appropriate safety standards for this design feature. These special conditions contain the additional safety standards that the Administrator considers necessary to establish a level of safety equivalent to that established by the existing airworthiness standards.

DATES: Effective September 23, 2019.

FOR FURTHER INFORMATION CONTACT: Dan Jacquet, Airframe and Cabin Safety Section, AIR–675, Transport Standards Branch, Policy and Innovation Division, Aircraft Certification Service, Federal Aviation Administration, 2200 South 216th Street, Des Moines, Washington 98198; telephone and fax 206–231–3208; email *Daniel.Jacquet@faa.gov.*

SUPPLEMENTARY INFORMATION:

Background

Airbus requested an amendment to Special Condition No. 25–326–SC in letter L2578ME1831060 revision 1, dated November 21, 2018. This letter states:

The Special Conditions applicable to the stairways on full-length double-deck airplane were extensively discussed in the Very Large Transport Aircraft conference, on October 1998 in Noordwijkerhout, The Netherlands and in the Cabin Safety Meeting between FAA, EASA, and Airbus, held in Hamburg, Feb. 25, 2003. In the latter meeting, the Special Conditions have been aligned.

However, Airbus noticed that the Special Conditions for the availability of stairs published in the **Federal Register** (Special Condition No. 25–326–SC from September 11, 2006) require more when compared to Special Conditions of IP–C1 Stage 4 Airbus received June 13, 2003.

Special Condition No. 25–326–SC reads:

a. At least one stairway between decks must meet the following requirements: The stairway accommodates the carriage of an incapacitated person from one deck to the other. The crew member procedures for such carriage must be established.

b. There must be at least two stairways between decks that meet the following requirements: The stairways must be designed such that evacuees can achieve an adequate rate for going down or going up under probable emergency conditions, including a condition in which a person falls or is incapacitated while on a stairway. One of the stairways must be the stairway specified in paragraph a. above.

For whatever reasons, the consideration of the condition in which a person falls or is incapacitated while on the stairs re-appears. Resulting from the A380 Certification Meeting held in Hamburg this was agreed to be not required by the IP.

It was the FAA position that this type of demonstration is not required for the main passenger aisle in the airplane and therefore should not be required for the stairways.

The Stage 4 of the IP–C1, dated February 25, 2003 received for A380 Type Certificate thus reads as follows:

A. At least two stairways between decks must meet the following requirements:

(1) At least one of the stairways must accommodate the carriage of an incapacitated person from one deck to the other. The crew member procedures for such a carriage must be established.

(2) The stairways must be designed such that evacuees can be shown to achieve an adequate rate, for going down or going up, under probable emergency conditions.

All further Special Conditions published in the **Federal Register** (§§ c though e) are identical to the Special Conditions of the IP (§§ B though D), however using a different wording.

Since the IP–C1, Stage 4 is the bilateral agreement between FAA and Airbus, and the **Federal Register** is available to the public, Airbus would appreciate the correction of the Special Condition published in the **Federal Register** under 25–326–SC. This would avoid any misunderstanding in the A380 future.

During initial discussions with Airbus regarding the special conditions, the FAA had included a requirement that the stairways be designed such that evacuees can achieve an adequate rate going down or up under probable emergency conditions, including a condition in which a person falls or is incapacitated while on the stairway. Airbus agreed with the requirement except for the portion pertaining to a person falling or being incapacitated. The FAA documented agreement with Airbus's position. Unfortunately the special conditions were issued with the FAA's initial proposal rather than the final agreement, and stated that the stairs be designed such that evacuees can achieve an adequate rate going up or down the stairs under probable emergency conditions including a condition in which a person falls or is incapacitated while on the stairway.

Type Certification Basis

Under the provisions of 14 CFR 21.17, Airbus must show that the Model A380 airplane meets the applicable provisions of 14 CFR part 25, as amended by Amendments 25–1 through 25–98. If the Administrator finds that the applicable airworthiness regulations do not contain adequate or appropriate safety standards for the Airbus Model A380 airplane because of novel or unusual design features, special conditions are prescribed under the provisions of 14 CFR 21.16.

In addition to the applicable airworthiness regulations and special conditions, the Airbus Model A380 airplane must comply with the fuel vent and exhaust emission requirements of 14 CFR part 34 and the noise certification requirements of 14 CFR part 36.

Special conditions, as defined in 14 CFR 11.19, are issued in accordance with 14 CFR 11.38 and become part of the type certification basis in accordance with 14 CFR 21.17(a)(2).

Special conditions are initially applicable to the model for which they are issued. Should the type certificate for that model be amended later to include any other model that incorporates the same novel or unusual design feature, the special conditions would also apply to the other model under the provisions of 14 CFR 21.101.

Novel or Unusual Design Features

The Airbus Model A380 airplane will incorporate the following novel or unusual design features: This airplane has a full-length double deck. For these design features, the applicable airworthiness regulations do not contain adequate or appropriate safety standards regarding stairways between decks.

Discussion

The Model A380 airplane incorporates seating on two full-length passenger decks, each of which has the capacity of a typical wide body airplane. Two staircases, one located in the front of the cabin and one located in the rear, allow for the movement of persons between decks. With large seating capacities on the main deck and the upper deck of the Model A380 airplane, the staircases need to be able to support movement between decks in an inflight emergency. In addition, although compliance with the evacuation demonstration requirements of § 25.803 does not depend on the use of stairs, there must be a way for passengers on one deck to move to the other deck during an emergency evacuation. This need must be addressed in the certification of the airplane.

The regulations governing the certification of the Model A380 airplane do not adequately address a passenger airplane with two separate full-length decks for passengers. The Boeing Model 747 and the Lockheed Model L–1011 airplanes were certificated with limited seating capacity on two separate decks, and special conditions were issued to certificate those arrangements. When the seating capacity of the upper deck of the Boeing Model 747 airplane exceeded 24 passengers, the FAA issued Special Conditions 25–61–NW–1 for a maximum seating capacity of 32 passengers on the upper deck for take-off and landing. A second set of Special Conditions, 25–71–NW–3, was issued to cover airplanes with a maximum seating capacity of 45 passengers on the upper deck for take-off and landing. That second set of Special Conditions was later modified to address airplanes with a maximum seating capacity of 110 passengers on the upper deck. These previously issued special conditions provided a starting point for the development of special conditions for the Model A380 airplane.

In the case of both the Model L–1011 and the Model 747 airplanes, the special conditions were based on the requirements and associated level of safety in place at the time of application for type certificate. The requirements and the level of safety have improved significantly since that time, and these special conditions reflect those improvements.

In addition to the requirements of §§ 25.803 and 25.811 through 25.813, special conditions are needed to address the movement of passengers between the two full-length decks on the Model A380 airplane. These special conditions provide additional requirements for the stairways to ensure the safe passage of occupants between decks during moderate turbulence, an inflight emergency, or an emergency evacuation.

The special conditions contain the additional safety standards that the Administrator considers necessary to establish a level of safety equivalent to that established by the existing airworthiness standards.

Discussion of Comments

The FAA issued Notice of Proposed Amended Special Conditions No. 25–19–04–SC for the Airbus Model A380 airplane, which was published in the **Federal Register** on May 3, 2019 (84 FR 18997). The FAA received a response from one commenter.

The commenter feels that stairwells should be designed for ingress and egress above the minimum standards identified in the special condition. However, the commenter did not propose any additional standard that Airbus should meet nor specify why meeting the minimum standards, of the special condition, was unsafe. As a result, no changes have been made to the special condition.

Applicability

As discussed above, these special conditions are applicable to the Airbus Model A380 airplane. Should Airbus apply at a later date for a change to the type certificate to include another model incorporating the same novel or unusual design features, these special conditions would apply to that model as well under the provisions of § 21.101.

Conclusion

This action affects only certain novel or unusual design features of the Airbus Model A380 airplane. It is not a rule of general applicability.

List of Subjects in 14 CFR Part 25

Aircraft, Aviation safety, Reporting and recordkeeping requirements.

Authority Citation

The authority citation for these special conditions is as follows:

Authority: 49 U.S.C. 106(f), 106(g), 40113, 44701, 44702, 44704.

The Special Conditions

■ Accordingly, pursuant to the authority delegated to me by the Administrator, the following special conditions are issued as part of the type certification basis for the Airbus Model A380 airplane.

Airbus Model A380, Stairways Between Decks

1. At least one stairway between decks must meet the following requirements:

The stairway accommodates the carriage of an incapacitated person from one deck to the other. The crew member procedures for such carriage must be established.

2. There must be at least two stairways between decks that meet the following requirements: The stairways must be designed such that evacuees can achieve an adequate rate for going down or going up under probable emergency conditions. One of the stairways must be the stairway specified in paragraph 1. above.

3. Each stairway between decks must meet the following requirements:

a. It must have an entrance, exit, and gradient characteristics that, with the assistance of a crew member, would allow the passengers of one deck to merge with passengers of the other deck during an evacuation and exit the airplane. These entrance, exit, and gradient characteristics must occur with the airplane in level attitude and in each attitude resulting from the collapse of any one or more legs of the landing gear. These requirements must be demonstrated by tests or analysis.

b. The stairway must have a handrail on at least one side in order to allow people to steady themselves during foreseeable conditions, including but not limited to the condition of gear collapse on the ground and moderate turbulence in flight. The handrails must be constructed so that there will be no obstruction on them which will cause the user to release their grip on the handrail, or will hinder the continuous movement of the hands along the handrail. Handrails must be terminated in a manner which will not obstruct pedestrian travel or create a hazard. Adequacy of the design must be demonstrated by using persons representative of the 5% female and the 95% male.

c. The stairway must be designed and located to minimize damage to it during an emergency landing or ditching.

d. The stairway must have a wall or the equivalent on each side to minimize the risk of falling and to facilitate use of the stairway under conditions of abnormal airplane attitude.

e. Treads and landings must be designed and demonstrated to be free of hazard. The landing area at each deck level must be demonstrated to be adequate in terms of flow rate for the maximum number of people that will be using the stair in an emergency. Treads and risers must be designed to ensure an easy and safe use of the stairway.

f. General emergency illumination must be provided so that, when measured along the centerlines of each tread and landing-, the illumination is not less than 0.05 foot-candle.

g. In normal operation, the general illumination level must not be less than 0.05 foot-candles. The assessment must be done under daylight and dark of night conditions.

h. Both stairway ends must be indicated by an exit sign visible to passengers when in the stairway. This exit sign must meet the requirements of § 25.812(b)(1)(ii).

i. A floor-proximity path-marking system, which meets the requirements of § 25.812(e), must be available to guide passengers in the stairway to the stairway ends. It must not direct the occupants of the cabin to the stair entrance.

j. The public address system must be audible in the stairway during all flight phases.

k. ''No smoking'' and ''return to seat'' signs must be installed and must be visible in the stairway both going up and down, and at the stairway entrances.

4. Cabin crew procedures and positions must be established to manage the use of the stairs on the ground and in flight under both normal and emergency situations. This may require that cabin crew members have specific dedicated duties for the management of the stairs during emergency and precautionary evacuations.

5. It should not be hazardous for crew members or passengers who are returning to their seats to use the stairways during moderate turbulence.

Issued in Des Moines, Washington, on August 16, 2019.

Mary A. Schooley,

Acting Manager, Transport Standards Branch, Policy and Innovation Division, Aircraft Certification Service.

[FR Doc. 2019–18061 Filed 8–21–19; 8:45 am]

BILLING CODE 4910–13–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. FAA–2019–0606; Product Identifier 2019–NM–120–AD; Amendment 39–19706; AD 2019–16–03]

RIN 2120–AA64

Airworthiness Directives; Airbus SAS Airplanes

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Final rule; request for comments.

SUMMARY: The FAA is adopting a new airworthiness directive (AD) for certain Airbus SAS Model A350–941 and –1041 airplanes. This AD was prompted by a report of a front engine mount primary pin which moved axially out of place; investigation revealed that incorrect washers had been installed on the engine mount pins. This AD requires a one-time inspection of the washers installed on the front and rear engine mount primary pins and thrust link pins of both engines, depending on configuration, and corrective actions if necessary, as specified in a European Union Aviation Safety Agency (EASA) AD, which is incorporated by reference. The FAA is issuing this AD to address the unsafe condition on these products.

DATES: This AD becomes effective September 6, 2019.

The Director of the Federal Register approved the incorporation by reference of a certain publication listed in this AD as of September 6, 2019.

The FAA must receive comments on this AD by October 7, 2019.

ADDRESSES: You may send comments, using the procedures found in 14 CFR 11.43 and 11.45, by any of the following methods:

- *Federal eRulemaking Portal:* Go to *http://www.regulations.gov.* Follow the instructions for submitting comments.
- *Fax:* 202–493–2251.
- *Mail:* U.S. Department of Transportation, Docket Operations, M–30, West Building Ground Floor, Room W12–140, 1200 New Jersey Avenue SE, Washington, DC 20590.
- *Hand Delivery:* U.S. Department of Transportation, Docket Operations, M–30, 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.

For the material incorporated by reference (IBR) in this AD, contact the EASA, at Konrad-Adenauer-Ufer 3, 50668 Cologne, Germany; telephone +49 221 89990 1000; email *ADs@easa.europa.eu;* internet *www.easa.europa.eu.* You may find this IBR material on the EASA website at *https://ad.easa.europa.eu.* You may view this IBR material at the FAA, Transport Standards Branch, 2200 South 216th St., Des Moines, WA. For information on the availability of this material at the FAA, call 206–231–3195. It is also available in the AD docket on the internet at *http://www.regulations.gov* by searching for and locating Docket No. FAA–2019–0606.

Examining the AD Docket

You may examine the AD docket on the internet at *http://www.regulations.gov* by searching for and locating Docket No. FAA–2019–0606; or in person at Docket Operations 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 street address for Docket Operations is listed above. Comments will be available in the AD docket shortly after receipt.

FOR FURTHER INFORMATION CONTACT: Kathleen Arrigotti, Aerospace Engineer, International Section, Transport Standards Branch, FAA, 2200 South 216th St., Des Moines, WA 98198; telephone and fax: 206–231–3218.

SUPPLEMENTARY INFORMATION:

Discussion

The EASA, which is the Technical Agent for the Member States of the European Union, has issued EASA AD 2019–0175, dated July 19, 2019 (''EASA AD 2019–0175'') (also referred to as the Mandatory Continuing Airworthiness Information, or ''the MCAI''), to correct an unsafe condition for certain Airbus SAS Model A350–941 and –1041 airplanes. The MCAI states:

> A case was reported by an A350–1041 operator where a front engine mount primary pin had moved axially out of place. Investigations revealed that washers with incorrect P/N [part number] had been installed on the subject engine mount pins. A350–941 aeroplanes are also considered as potentially affected. The engine mount assembly has a fail-safe design, loads are carried by two links in the left-hand and right-hand positions and in case of failure, a ''fail-safe'' link pin in the centre position is activated and takes the loads.
>
> This condition, if not detected and corrected, may lead to disengagement of a primary engine mount pin, which along with an additional failure of the ''fail-safe'' link pin, could possibly result in in-flight detachment of an engine, with consequent reduced control of the aeroplane.
>
> To address this potential unsafe condition, Airbus issued the AOT [All Operators Transmission] to provide inspection instructions.
>
> For the reasons described above, this [EASA] AD requires a one-time inspection of the washers installed on the front and rear engine mount primary pins and thrust links pins of both engines, and depending on findings, accomplishment of applicable corrective action(s).

Related IBR Material Under 1 CFR Part 51

EASA AD 2019–0175 describes procedures for a one-time inspection of the washers installed on the front and rear engine mount primary pins and thrust link pins of both engines, depending on configuration, and corrective actions. Corrective actions include replacing any affected washer with a serviceable part and repair.

This material is reasonably available because the interested parties have access to it through their normal course of business or by the means identified in the **ADDRESSES** section.

FAA's Determination

This product has been approved by the aviation authority of another country, and is approved for operation in the United States. Pursuant to a bilateral agreement with the State of Design Authority, the FAA has been notified of the unsafe condition described in the MCAI referenced above. The FAA is issuing this AD because the agency evaluated all pertinent information and determined the unsafe condition exists and is likely to exist or develop on other products of the same type design.

Requirements of This AD

This AD requires accomplishing the actions specified in EASA AD 2019–0175 described previously, as incorporated by reference, except for any differences identified as exceptions in the regulatory text of this AD. This AD also requires sending the inspection results to Airbus.

Explanation of Required Compliance Information

In the FAA's ongoing efforts to improve the efficiency of the AD process, the FAA worked with Airbus and EASA to develop a process to use certain EASA ADs as the primary source of information for compliance with requirements for corresponding FAA ADs. As a result, EASA AD 2019–0175 will be incorporated by reference in the FAA final rule. This AD, therefore, requires compliance with EASA AD 2019–0175 in its entirety, through that incorporation, except for any differences identified as exceptions in the regulatory text of this AD. Using common terms that are the same as the heading of a particular section in the EASA AD does not mean that operators need comply only with that section. For example, where the AD requirement refers to ''all required actions and compliance times,'' compliance with this AD requirement is not limited to the section titled ''Required Action(s) and Compliance Time(s)'' in the EASA AD. Service information specified in EASA AD 2019–0175 that is required for compliance with EASA AD 2019–0175 will be available on the internet at *http://www.regulations.gov* by searching for and locating Docket No. FAA–2019–0606 after the FAA final rule is published.

FAA's Justification and Determination of the Effective Date

An unsafe condition exists that requires the immediate adoption of this AD without providing an opportunity for public comments prior to adoption. The FAA has found that the risk to the flying public justifies waiving notice and comment prior to adoption of this rule because the unsafe condition could result in the in-flight detachment of an engine, and consequent reduced control of the airplane. Therefore, the FAA finds good cause that notice and opportunity for prior public comment are impracticable. In addition, for the reasons stated above, the FAA finds that good cause exists for making this amendment effective in less than 30 days.

Comments Invited

This AD is a final rule that involves requirements affecting flight safety, and the FAA did not precede it by notice and opportunity for public comment. The FAA invites you to send any written relevant data, views, or arguments about this AD. Send your comments to an address listed under the **ADDRESSES** section. Include ''Docket No. FAA–2019–0606; Product Identifier 2019–NM–120–AD'' at the beginning of your comments. The FAA specifically invites comments on the overall regulatory, economic, environmental, and energy aspects of this AD. The FAA will consider all comments received by the closing date and may amend this AD based on those comments.

The FAA will post all comments received, without change, to *http://www.regulations.gov,* including any personal information you provide. The FAA will also post a report summarizing each substantive verbal contact received about this AD.

Costs of Compliance

The FAA estimates that this AD affects 13 airplanes of U.S. registry. The FAA estimates the following costs to comply with this AD:

ESTIMATED COSTS FOR REQUIRED ACTIONS *

Labor cost	Parts cost	Cost per product	Cost on U.S. operators
4 work-hours × $85 per hour = $340	$0	$340	$4,420

* Table does not include estimated costs for reporting.

We estimate that it would take about 1 work-hour per product to comply with the reporting requirement in this AD. The average labor rate is $85 per hour. Based on these figures, we estimate the cost of reporting the inspection results on U.S. operators to be $1,105, or $85 per product.

The FAA has received no definitive data that would enable the agency to provide cost estimates for the on-condition actions specified in this AD.

Paperwork Reduction Act

A federal agency may not conduct or sponsor, and a person is not required to respond to, nor shall a person be subject to penalty for failure to comply with a collection of information subject to the requirements of the Paperwork Reduction Act unless that collection of information displays a current valid OMB control number. The control number for the collection of information required by this AD is 2120–0056. The paperwork cost associated with this AD has been detailed in the Costs of Compliance section of this document and includes time for reviewing instructions, as well as completing and reviewing the collection of information. Therefore, all reporting associated with this AD is mandatory. Comments concerning the accuracy of this burden and suggestions for reducing the burden should be directed to the FAA at 800 Independence Ave. SW, Washington, DC 20591, ATTN: Information Collection Clearance Officer, AES–200.

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.

The FAA is 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.

This AD is issued in accordance with authority delegated by the Executive Director, Aircraft Certification Service, as authorized by FAA Order 8000.51C. In accordance with that order, issuance of ADs is normally a function of the Compliance and Airworthiness Division, but during this transition period, the Executive Director has delegated the authority to issue ADs applicable to transport category airplanes and associated appliances to the Director of the System Oversight Division.

Regulatory Findings

The FAA determined that 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) Will not affect intrastate aviation in Alaska, and

(3) 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):

2019–16–03 Airbus SAS: Amendment 39–19706; Docket No. FAA–2019–0606; Product Identifier 2019–NM–120–AD.

(a) Effective Date

This AD becomes effective September 6, 2019.

(b) Affected ADs

None.

(c) Applicability

This AD applies to Airbus SAS Model A350–941 and –1041 airplanes, certificated in any category, as identified in European Union Aviation Safety Agency (EASA) AD 2019–0175, dated July 19, 2019 (''EASA AD 2019–0175'').

(d) Subject

Air Transport Association (ATA) of America Code 71, Power Plant.

(e) Reason

This AD was prompted by a report of a front engine mount primary pin which moved axially out of place; investigation revealed that incorrect washers had been installed on the engine mount pins. The FAA is issuing this AD to address disengagement of a primary engine mount pin, which, along with an additional failure of the ''fail-safe'' link pin, could result in the in-flight detachment of an engine, and consequent reduced control of the airplane.

(f) Compliance

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

(g) Requirements

Except as specified in paragraph (h) of this AD: Comply with all required actions and compliance times specified in, and in accordance with, EASA AD 2019–0175.

(h) Exceptions to EASA AD 2019–0175

(1) For purposes of determining compliance with the requirements of this AD: Where EASA AD 2019–0175 refers to its effective date, this AD requires using the effective date of this AD.

(2) Paragraph (4) of EASA AD 2019–0175 specifies to report inspection results to Airbus within a certain compliance time. For this AD, report inspection results at the applicable time specified in paragraph (h)(2)(i) or (h)(2)(ii) of this AD.

(i) If the inspection was done on or after the effective date of this AD: Submit the report within 60 days after the inspection.

(ii) If the inspection was done before the effective date of this AD: Submit the report within 60 days after the effective date of this AD.

(3) The ''Remarks'' section of EASA AD 2019–0175 does not apply to this AD.

(i) Other FAA AD Provisions

The following provisions also apply to this AD:

(1) *Alternative Methods of Compliance (AMOCs):* The Manager, International Section, Transport Standards Branch, 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 International Section, send it to the attention of the person identified in paragraph (j) of this AD. Information may be emailed to: *9-ANM-116-AMOC-REQUESTS@faa.gov.* 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.

(2) *Contacting the Manufacturer:* For any requirement in this AD to obtain instructions from a manufacturer, the instructions must be accomplished using a method approved by the Manager, International Section, Transport Standards Branch, FAA; or EASA; or Airbus SAS's EASA Design Organization Approval (DOA). If approved by the DOA, the approval must include the DOA-authorized signature.

(3) *Required for Compliance (RC):* For any service information referenced in EASA AD 2019–0175 that contains RC procedures and tests: Except as required by paragraph (i)(2) of this AD, RC procedures and tests must be done to comply with this AD; any procedures or tests that are not identified as RC are recommended. Those procedures and tests that are not identified as RC may be deviated from using accepted methods in accordance with the operator's maintenance or inspection program without obtaining approval of an AMOC, provided the procedures and tests identified as RC can be done and the airplane can be put back in an airworthy condition. Any substitutions or changes to procedures or tests identified as RC require approval of an AMOC.

(4) *Paperwork Reduction Act Burden Statement:* A federal agency may not conduct or sponsor, and a person is not required to respond to, nor shall a person be subject to a penalty for failure to comply with a collection of information subject to the requirements of the Paperwork Reduction Act unless that collection of information displays a current valid OMB Control Number. The OMB Control Number for this information collection is 2120–0056. Public reporting for this collection of information is estimated to be approximately 1 hour per response, including the time for reviewing instructions, completing and reviewing the collection of information. All responses to this collection of information are mandatory. Comments concerning the accuracy of this burden and suggestions for reducing the burden should be directed to the FAA at: 800 Independence Ave. SW, Washington, DC 20591, Attn: Information Collection Clearance Officer, AES–200.

(j) Related Information

For more information about this AD, contact Kathleen Arrigotti, Aerospace Engineer, International Section, Transport Standards Branch, FAA, 2200 South 216th St., Des Moines, WA 98198; telephone and fax: 206–231–3218.

(k) 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 this AD specifies otherwise.

(i) European Union Aviation Safety Agency (EASA) AD 2019–0175, dated July 19, 2019.

(ii) [Reserved]

(3) For EASA AD 2019–0175, contact the EASA, at Konrad-Adenauer-Ufer 3, 50668 Cologne, Germany; telephone +49 221 89990 6017; email *ADs@easa.europa.eu;* internet *www.easa.europa.eu.* You may find this EASA AD on the EASA website at *https://ad.easa.europa.eu.*

(4) You may view this EASA AD at the FAA, Transport Standards Branch, 2200 South 216th St., Des Moines, WA. For information on the availability of this material at the FAA, call 206–231–3195. EASA AD 2019–0175 may be found in the AD docket on the internet at *http://www.regulations.gov* by searching for and locating Docket No. FAA–2019–0606.

(5) You may view this material 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 Des Moines, Washington, on August 8, 2019.

Michael Kaszycki,

Acting Director, System Oversight Division, Aircraft Certification Service.

[FR Doc. 2019–17975 Filed 8–21–19; 8:45 am]

BILLING CODE 4910–13–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. FAA–2019–0577; Product Identifier 2019–NM–119–AD; Amendment 39–19695; AD 2019–15–02]

RIN 2120–AA64

Airworthiness Directives; Airbus SAS Airplanes

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Final rule; request for comments.

SUMMARY: The FAA is adopting a new airworthiness directive (AD) for all Airbus SAS Model A321–251N, A321–252N, A321–253N, A321–271N, A321–272N, A321–251NX, A321–252NX, A321–253NX, A321–271NX, and A321–272NX airplanes. This AD was prompted by analysis of the behavior of the elevator aileron computer (ELAC) L102 that revealed that excessive pitch attitude can occur in certain conditions and during specific maneuvers. This AD requires revising the airplane flight manual (AFM) to incorporate updated procedures and operational limitations, as specified in a European Union Aviation Safety Agency (EASA) AD, which is incorporated by reference. The FAA is issuing this AD to address the unsafe condition on these products.

DATES: This AD becomes effective September 6, 2019.

The Director of the Federal Register approved the incorporation by reference of certain publications listed in this AD as of September 6, 2019.

The FAA must receive comments on this AD by October 7, 2019.

ADDRESSES: You may send comments, using the procedures found in 14 CFR 11.43 and 11.45, by any of the following methods:

- *Federal eRulemaking Portal:* Go to *http://www.regulations.gov.* Follow the instructions for submitting comments.
- *Fax:* 202–493–2251.
- *Mail:* U.S. Department of Transportation, Docket Operations, M–30, West Building Ground Floor, Room W12–140, 1200 New Jersey Avenue SE, Washington, DC 20590.
- *Hand Delivery:* U.S. Department of Transportation, Docket Operations, M–30, 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.

For the material incorporated by reference (IBR) in this AD, contact the EASA, at Konrad-Adenauer-Ufer 3, 50668 Cologne, Germany; telephone +49 221 89990 1000; email *ADs@easa.europa.eu*; internet *www.easa.europa.eu.* You may find this IBR material on the EASA website at *https://ad.easa.europa.eu.* You may view this IBR material at the FAA, Transport Standards Branch, 2200 South 216th St., Des Moines, WA. For information on the availability of this material at the FAA, call 206–231–3195. It is also available in the AD docket on the internet at *http://www.regulations.gov* by searching for and locating Docket No. FAA–2019–0577.

Examining the AD Docket

You may examine the AD docket on the internet at *http://www.regulations.gov* by searching for and locating Docket No. FAA–2019–0577; or in person at Docket Operations 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 street address for Docket Operations (telephone 800–647–5527) is listed above. Comments will be available in the AD docket shortly after receipt.

FOR FURTHER INFORMATION CONTACT: Sanjay Ralhan, Aerospace Engineer, International Section, Transport Standards Branch, FAA, 2200 South 216th St., Des Moines, WA 98198; telephone and fax 206–231–3223.

SUPPLEMENTARY INFORMATION:

Discussion

The EASA, which is the Technical Agent for the Member States of the European Union, has issued EASA AD 2019–0171, dated July 17, 2019 (''EASA AD 2019–0171'') (also referred to as the Mandatory Continuing Airworthiness Information, or ''the MCAI''), to correct an unsafe condition for all Airbus SAS Model A321–251N, A321–252N, A321–253N, A321–271N, A321–272N, A321–251NX, A321–252NX, A321–253NX, A321–271NX, and A321–272NX airplanes. The MCAI states:

> Analysis of the behaviour of the ELAC L102 installed on A321neo revealed that excessive pitch attitude can occur in certain conditions and during specific manoeuvres.
>
> This condition, if not corrected, could result in reduced control of the aeroplane.
>
> To address this potential unsafe condition, Airbus issued the applicable AFM TR [temporary revision] to provide operational limitations.
>
> For the reason described above, this AD requires amendment of the respective AFM, with AFM TR, as applicable.
>
> This AD is considered to be an interim action and further AD action may follow.

Related IBR Material Under 1 CFR Part 51

EASA AD 2019–0171 describes procedures for revising the AFM to incorporate operational limitations, and for certain airplanes, updated procedures, related to center of gravity with ELAC L102 installed.

This material is reasonably available because the interested parties have access to it through their normal course of business or by the means identified in the **ADDRESSES** section.

FAA's Determination

This product has been approved by the aviation authority of another country, and is approved for operation in the United States. Pursuant to the FAA's bilateral agreement with the State of Design Authority, the agency has been notified of the unsafe condition described in the MCAI referenced above. The FAA is issuing this AD because it has evaluated all pertinent information and determined the unsafe condition exists and is likely to exist or develop on other products of the same type design.

Requirements of This AD

This AD requires accomplishing the actions specified in EASA AD 2019–0171 described previously, as incorporated by reference, except for any differences identified as exceptions in the regulatory text of this AD.

Explanation of Required Compliance Information

In the FAA's ongoing efforts to improve the efficiency of the AD process, the FAA worked with Airbus and EASA to develop a process to use certain EASA ADs as the primary source of information for compliance with requirements for corresponding FAA ADs. As a result, EASA AD 2019–0171 will be incorporated by reference in the FAA final rule. This AD, therefore, requires compliance with EASA AD 2019–0171 in its entirety, through that incorporation, except for any differences identified as exceptions in the regulatory text of this AD. Using common terms that are the same as the heading of a particular section in the EASA AD does not mean that operators need comply only with that section. For example, where the AD requirement refers to ''all required actions and compliance times,'' compliance with this AD requirement is not limited to the section titled ''Required Action(s) and Compliance Time(s)'' in the EASA AD. Service information specified in EASA AD 2019–0171 that is required for compliance with EASA AD 2019–0171 will be available on the internet at *http://www.regulations.gov* by searching for and locating Docket No. FAA–2019–0577 after the FAA final rule is published.

Justification for Immediate Adoption and Determination of the Effective Date

Section 553(b)(3)(B) of the Administrative Procedure Act (APA) (5 U.S.C.) authorizes agencies to dispense with notice and comment procedures for rules when the agency, for ''good cause,'' finds that those procedures are ''impracticable, unnecessary, or contrary to the public interest.'' Under this section, an agency, upon finding good cause, may issue a final rule without seeking comment prior to the rulemaking. Similarly, Section 553(d) of the APA authorizes agencies to make rules effective in less than thirty days, upon a finding of good cause.

As noted above and in EASA AD 2019–0171, these airplanes are subject, given certain conditions and specific maneuvers, to excessive pitch attitude which can result in loss of airplane control. The FAA considers the prevention of this unsafe condition to be an urgent safety issue. Accordingly, notice and opportunity for prior public comment are impracticable and contrary to the public interest pursuant to 5 U.S.C. 553(b)(3)(B). In addition, the FAA finds that good cause exists pursuant to 5 U.S.C. 553(d) for making this amendment effective in less than 30 days.

Regulatory Flexibility Act (RFA)

The requirements of the RFA do not apply when an agency finds good cause pursuant to 5 U.S.C. 553 to adopt a rule without prior notice and comment. Because the FAA has determined that it has good cause to adopt this rule without notice and comment, RFA analysis is not required.

Comments Invited

This AD is a final rule that involves requirements affecting flight safety, and was not preceded by notice and opportunity for public comment. The FAA invites you to send any written relevant data, views, or arguments about this AD. Send your comments to an address listed under the **ADDRESSES** section. Include ''Docket No. FAA–2019–0577; Product Identifier 2019–NM–119–AD'' at the beginning of your comments. The FAA specifically invites comments on the overall regulatory, economic, environmental, and energy aspects of this AD. The agency will consider all comments received by the closing date and may amend this AD based on those comments.

The FAA will post all comments received, without change, to *http://www.regulations.gov,* including any personal information you provide. The agency will also post a report summarizing each substantive verbal contact received about this AD.

Costs of Compliance

The FAA estimates that this AD affects 35 airplanes of U.S. registry. The agency estimates the following costs to comply with this AD:

ESTIMATED COSTS FOR REQUIRED ACTIONS

Labor cost	Parts cost	Cost per product	Cost on U.S. operators
1 work-hour × $85 per hour = $85	$0	$85	$2,975

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.

The FAA is 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.

This AD is issued in accordance with authority delegated by the Executive Director, Aircraft Certification Service, as authorized by FAA Order 8000.51C. In accordance with that order, issuance of ADs is normally a function of the Compliance and Airworthiness Division, but during this transition period, the Executive Director has delegated the authority to issue ADs applicable to transport category airplanes and associated appliances to the Director of the System Oversight Division.

Regulatory Findings

The FAA determined that 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, and

(2) Will not affect intrastate aviation in Alaska.

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):

2019–15–02 Airbus SAS: Amendment 39–19695; Docket No. FAA–2019–0577; Product Identifier 2019–NM–119–AD.

(a) Effective Date

This AD becomes effective September 6, 2019.

(b) Affected ADs

None.

(c) Applicability

This AD applies to all Airbus SAS Model A321–251N, A321–252N, A321–253N, A321–271N, A321–272N, A321–251NX, A321–252NX, A321–253NX, A321–271NX, and A321–272NX airplanes, certificated in any category.

(d) Subject

Air Transport Association (ATA) of America Code 27, Flight controls.

(e) Reason

This AD was prompted by analysis of the behavior of the elevator aileron computer (ELAC) L102 that revealed that excessive pitch attitude can occur in certain conditions and during specific maneuvers. The FAA is issuing this AD to address this excessive pitch attitude, which could result in reduced control of the airplane.

(f) Compliance

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

(g) Requirements

Except as specified in paragraph (h) of this AD: Comply with all required actions and compliance times specified in, and in accordance with, European Union Aviation Safety Agency (EASA) AD 2019–0171, dated July 17, 2019 (''EASA AD 2019–0171'').

(h) Exceptions to EASA AD 2019–0171

(1) For purposes of determining compliance with the requirements of this AD: Where EASA AD 2019–0171 refers to its effective date, this AD requires using the effective date of this AD.

(2) The ''Remarks'' section of EASA AD 2019–0171 does not apply to this AD.

(i) Other FAA AD Provisions

The following provisions also apply to this AD:

(1) *Alternative Methods of Compliance (AMOCs):* The Manager, International Section, Transport Standards Branch, 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 International Section, send it to the attention of the person identified in paragraph (j) of this AD. Information may be emailed to: *9-ANM-116-AMOC-REQUESTS@faa.gov.* 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.

(2) *Contacting the Manufacturer:* For any requirement in this AD to obtain instructions from a manufacturer, the instructions must be accomplished using a method approved by the Manager, International Section, Transport Standards Branch, FAA; or EASA; or Airbus SAS's EASA Design Organization Approval (DOA). If approved by the DOA, the approval must include the DOA-authorized signature.

(3) *Required for Compliance (RC):* For any service information referenced in EASA AD 2019–0171 that contains RC procedures and tests: Except as required by paragraph (i)(2) of this AD, RC procedures and tests must be done to comply with this AD; any procedures or tests that are not identified as RC are recommended. Those procedures and tests that are not identified as RC may be deviated from using accepted methods in accordance with the operator's maintenance or inspection program without obtaining approval of an AMOC, provided the procedures and tests identified as RC can be done and the airplane can be put back in an airworthy condition. Any substitutions or changes to procedures or tests identified as RC require approval of an AMOC.

(j) Related Information

For more information about this AD, contact Sanjay Ralhan, Aerospace Engineer, International Section, Transport Standards Branch, FAA, 2200 South 216th St., Des Moines, WA 98198; telephone and fax 206–231–3223.

(k) 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 this AD specifies otherwise.

(i) European Union Aviation Safety Agency (EASA) AD 2019–0171, dated July 17, 2019.

(ii) [Reserved]

(3) For EASA AD 2019–0171, contact the EASA, at Konrad-Adenauer-Ufer 3, 50668 Cologne, Germany; telephone +49 221 89990 6017; email *ADs@easa.europa.eu*; internet *www.easa.europa.eu.* You may find this EASA AD on the EASA website at *https://ad.easa.europa.eu.*

(4) You may view this EASA AD at the FAA, Transport Standards Branch, 2200 South 216th St., Des Moines, WA. For information on the availability of this material at the FAA, call 206–231–3195. EASA AD 2019–0171 may be found in the AD docket on the internet at *http://www.regulations.gov* by searching for and locating Docket No. FAA–2019–0577.

(5) You may view this material 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 Des Moines, Washington, on July 26, 2019.

Dionne Palermo,

Acting Director, System Oversight Division, Aircraft Certification Service.

[FR Doc. 2019–17978 Filed 8–21–19; 8:45 am]

BILLING CODE 4910–13–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. FAA–2019–0018; Product Identifier 2018–NM–116–AD; Amendment 39–19681; AD 2019–14–03]

RIN 2120–AA64

Airworthiness Directives; Airbus SAS Airplanes

AGENCY: Federal Aviation Administration (FAA), Department of Transportation (DOT).

ACTION: Final rule.

SUMMARY: The FAA is superseding Airworthiness Directive (AD) 2016–07–12, which applied to certain Airbus SAS Model A318, A319, A320, and A321 series airplanes. AD 2016–07–12 required repetitive inspections for damage and cracking of the aft fixed fairing (AFF) of the pylons, and repair if necessary. This AD retains the requirements of AD 2016–07–12 and requires additional repetitive inspections at the upper spar at a certain rib area and corrective actions if necessary, as specified in an European Aviation Safety Agency (EASA) AD, which is incorporated by reference. This AD was prompted by reports of cracking of the AFF of the pylons due to fatigue damage of the structure and reports of cracks on a certain rib of a modified AFF of the pylons. The FAA is issuing this AD to address the unsafe condition on these products.

DATES: This AD is effective September 26, 2019.

The Director of the Federal Register approved the incorporation by reference of certain publications listed in this AD as of September 26, 2019.

ADDRESSES: For the material incorporated by reference (IBR) in this

AD, contact the EASA, at Konrad-Adenauer-Ufer 3, 50668 Cologne, Germany; telephone +49 221 89990 1000; email *ADs@easa.europa.eu;* internet *www.easa.europa.eu.* You may find this IBR material on the EASA website at *https://ad.easa.europa.eu.* You may view this IBR material at the FAA, Transport Standards Branch, 2200 South 216th St., Des Moines, WA. For information on the availability of this material at the FAA, call 206–231–3195. It is also available in the AD docket on the internet at *http://www.regulations.gov* by searching for and locating Docket No. FAA–2019–0018.

Examining the AD Docket

You may examine the AD docket on the internet at *http://www.regulations.gov* by searching for and locating Docket No. FAA–2019–0018; or in person at Docket Operations between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays. The AD docket contains this final rule, the regulatory evaluation, any comments received, and other information. The address for Docket Operations is 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:
Sanjay Ralhan, Aerospace Engineer, International Section, Transport Standards Branch, FAA, 2200 South 216th St., Des Moines, WA 98198; telephone and fax 206–231–3223.

SUPPLEMENTARY INFORMATION:

Discussion

The FAA issued a notice of proposed rulemaking (NPRM) to amend 14 CFR part 39 to supersede AD 2016–07–12, Amendment 39–18457 (81 FR 19482, April 5, 2016) (''AD 2016–07–12''). AD 2016–07–12 applied to certain Airbus SAS Model A318, A319, A320, and A321 series airplanes. The NPRM published in the **Federal Register** on February 22, 2019 (84 FR 5617). The NPRM was prompted by reports of cracking of the AFF of the pylons due to fatigue damage of the structure and reports of cracks on a certain rib of a modified AFF of the pylons. The NPRM proposed to continue to require repetitive inspections for damage and cracking of the AFF of the pylons. The NPRM also proposed to require additional repetitive inspections at the upper spar at a certain rib area and corrective actions if necessary. The FAA is issuing this AD to address damage and cracking of the AFF of the pylons, which could result in detachment of a pylon and consequent reduced structural integrity of the airplane.

The EASA, which is the Technical Agent for the Member States of the European Union, has issued EASA AD 2018–0137R1, dated January 9, 2019 (''EASA AD 2018–0137R1'') (also referred to as the Mandatory Continuing Airworthiness Information, or ''the MCAI''), to correct an unsafe condition for certain Airbus SAS Model A318–111, and -112; Model A319–111, –112, –113, –114, and –115; Model A320–211, –212, –214, and –216; and Model A321–111, –112, –211, –212, and –213 airplanes. The MCAI states:

On aeroplanes equipped with post-mod 33844 CFM pylons, several operators reported finding cracks on the Aft Fixed Fairing (AFF). After material analysis, it appeared that the pylon AFF structure, especially on this configuration, was subject to fatigue-induced damage which could lead to pylon AFF cracks.

This condition, if not detected and corrected, could lead to detachment of a pylon AFF from the aeroplane, possibly resulting in injury to persons on the ground.

To address this unsafe condition, Airbus published Alert Operators Transmission (AOT) A54N002–12, providing inspection instructions. Thereafter, Airbus issued Service Bulletin (SB) A320–54–1027, later revised, superseding AOT A54N002–12. EASA issued AD 2014–0154 [which corresponds to FAA AD 2016–07–12] to require repetitive inspections of the pylon AFF and, depending on findings, replacement.

After that [EASA] AD was issued, Airbus developed mod 156593 to increase the fatigue life of the pylon AFF structure by using a different material and introducing thermal treatment of the aluminium sheets parts. Prompted by new findings of cracks on rib 15, it was determined that this area also needs to be inspected to ensure the structural integrity of the new pylon AFF. Airbus revised SB A320–54–1027, including instructions for repetitive inspection of that area. Repetitive inspections are also required on post-mod 156593 aeroplanes.

Airbus also developed mod 159806 and 156765, redesigning the corner fittings at the junction upper spar and rib 15, which constitutes terminating action for the repetitive inspections. For retrofit purposes, Airbus issued SB A320–54–1035 and SB A320–54–1036, later revised, providing instructions to modify and re-identify the pylon AFF, which constitutes terminating action for the repetitive inspections.

For the reasons described above, EASA issued AD 2018–0137 [which was referred to as the appropriate source of service information for accomplishing the actions specified in the FAA NPRM], retaining the requirements of EASA AD 2014–0154, which was superseded, and requiring repetitive inspections of the upper spar at rib 15 area and, depending on findings, accomplishment of applicable corrective action(s). This [EASA] AD also included references to optional terminating actions, and provided installation requirements for the new pylon AFF.

Since that [EASA] AD was issued, comments and requests for clarification have been received from operators. This [EASA] AD is revised, merging the restatement of requirements of AD 2014–0154 with the new requirements.

You may examine the MCAI in the AD docket on the internet at *http://www.regulations.gov* by searching for and locating Docket No. FAA–2019–0018.

Comments

The FAA gave the public the opportunity to participate in developing this final rule. The following presents the comments received on the NPRM and the FAA's response to each comment.

Support for the NPRM

Commenters Delta Air Lines (DAL), Jeff Hymen, and Megan Neeley indicated their support for the NPRM.

Request To Reference the Latest EASA AD

Alaska Airlines (Alaska) and DAL requested that the FAA refer to EASA AD 2018–0137R1 in lieu of EASA AD 2018–0137, dated July 12, 2018 (''EASA AD 2018–0137''). Alaska requested revision of paragraphs (c) and (g) of the proposed AD to cite EASA AD 2018–0137R1.

The FAA agrees with the commenters' requests. No additional work is required for airplanes on which the requirements of EASA AD 2018–0137, dated June 28, 2018 (''EASA AD 2018–0137''), have been accomplished. The FAA has revised paragraphs (c) and (g) of this AD to cite EASA AD 2018–0137R1 in addition to EASA AD 2018–0137. The FAA has also revised paragraph (h)(1)(i) of this AD to require the use of the effective date of this AD rather than the effective date of EASA 2018–0137 (July 12, 2018), as referenced in EASA ADs 2018–0137 and 2018–0137R1, to determine compliance.

Request To Remove Paragraph (h)(4) of the Proposed AD

DAL requested that paragraph (h)(4) of the proposed AD be removed, which did not allow for the provisions of paragraph (5) of EASA AD 2018–0137 (credit for actions done using certain service information). DAL argued that if the provisions of paragraph (5) of EASA AD 2018–0137R1 are disallowed, the result would be a requirement that is more restrictive to U.S. operators. DAL further noted that disallowing paragraph (5) of EASA AD 2018–0137R1, which allows credit for initial inspections using additional revisions of certain service information, would mean the initial inspections would have to be accomplished faster and may require special scheduled inspections, which often results in utilizing less experienced mechanics. DAL requested that the AD specify which revision of the EASA AD will be allowed. Accordingly, DAL requests that, if this AD is updated to reflect EASA AD 2018–0137R1, that paragraph (h)(4) of this AD be removed.

The FAA agrees with the request for the reasons provided. Also note that paragraph (5) of EASA AD 2018–0137R1 adds credit for initial inspections performed in accordance with Airbus Service Bulletin A320–54–1027, dated April 10, 2014; and Airbus Service Bulletin A320–54–1027, Revision 1, dated January 14, 2015; which were not included in paragraph (5) of EASA AD 2018–0137. Paragraph (h)(4) of the proposed AD is removed and paragraphs (h)(5) and (h)(6) of the proposed AD are redesignated as paragraphs (h)(4) and (h)(5) of this AD to reflect this request.

Request To Allow Re-Installation of an Affected Part Under Certain Circumstances

DAL requested that the AD allow for the re-installation of an affected AFF if it was removed for reasons other than meeting the requirement of the AD, such as routine maintenance. DAL pointed out that an affected AFF may need to be removed for access to perform either unrelated maintenance or for compliance with certain service information referenced in EASA ADs 2018–0137 and 2018–0137R1. DAL's interpretation of the ''do not install'' language in paragraph (11) of EASA AD 2018–0137 led it to believe that operators would struggle to comply with the instructions as written, and recommended that the FAA adds a statement that would allow the re-installation of an AFF that was removed from the airplane for the purpose of maintenance or inspections.

The FAA agrees to clarify. Group 1 airplanes, as specified in EASA ADs 2018–0137 and 2018–0137R1, are those that, as of the effective date of this AD, have an affected AFF installed. The intent of paragraph (11.1) of EASA ADs 2018–0137 and 2018–0137R1 is to prevent an affected AFF from being re-installed on a Group 1 airplane only if the modification specified in paragraph (9) or (10) of EASA AD 2018–0137 or EASA AD 2018–0137R1 has already been accomplished on that airplane. An operator has the full compliance time to accomplish the modification, and, up until the modification is accomplished, an affected AFF may be re-installed for reasons such as routine maintenance.

Group 2 airplanes, as specified in EASA ADs 2018–0137 and 2018–0137R1, are those airplanes that, as of the effective date of this AD, do not have an affected AFF installed. For Group 2 airplanes, the intent of paragraph (11.2) of EASA ADs 2018–0137 and 2018–0137R1 is to prevent an affected AFF from being installed on an airplane on which an affected AFF was not already installed as of the effective date of this AD. The AD has not been changed in this regard.

Request To Use Later Approved Revisions of Service Information

DAL pointed out that the reference publications section of EASA ADs 2018–0137 and 2018–0137R1 allows the use of later-approved revisions to the specified service information for compliance. DAL requested clarification to determine if this statement is applicable to this AD.

The AD does not exclude the ''Ref. Publications'' section of EASA ADs 2018–0137 and 2018–0137R1, so that section is applicable to this AD. The AD has not been changed in this regard.

Request To Add Exceptions for Alternative Methods of Compliance

DAL requested that the proposed AD be revised to add an exception that allows the use of consumable material list (CML) 10ABE1, ''touch up alodine,'' in addition to CML 10ABC1, ''tank alodine.'' DAL noted that while Airbus commonly specifies tank alodine, DAL prefers to use touch up alodine. DAL explained that they contacted Airbus on this issue and Airbus confirmed that touch up alodine can be used instead of tank alodine for the embodiment of Airbus Service Bulletin A320–54–1027; Airbus Service Bulletin A320–54–1035; and Airbus Service Bulletin A320–54–1036.

DAL claimed that Airbus Service Bulletin A320–54–1027 and Airbus Service Bulletin A320–54–1035 state that all steps in the Procedure and Test sections are required for compliance (RC). DAL also maintained that some of those steps are corrosion prevention control program (CPCP) controlled tasks. Because corrosion inhibition compound (CIC) is part of CPCP, DAL argued that application of CIC should be managed by each individual operator regardless of the AD requirement. As a result, DAL requested language added to the proposed AD that allows for operators to control the reapplication of CICs as an alternative to the service information specifications.

DAL also noted that the ''Preparation'' section of the service information referenced in EASA ADs 2018–0137 and 2018–0137R1 contains references to a certain aircraft maintenance manual (AMM) section for basic aircraft configuration. The basic aircraft configuration of the AMM states that the aircraft is in the ''weight on wheels'' configuration. DAL noted that sometimes their airplanes are on jacks and that having the airplane in a weight on wheels configuration may limit the ability of their maintenance technicians to perform the required actions. DAL requested an exception to the proposed AD that allows for the required actions to be performed with either weight on wheels or while the aircraft is in a jacked configuration.

The FAA agrees with the request to add an exception that allows the use of CML 10ABE1, touch up alodine for the reasons provided. This AD has been revised to change the content of paragraph (h)(6) of this AD to state that where any service information referenced in EASA ADs 2018–0137 and 2018–0137R1 specifies to use CML material number 10ABC1, this AD allows the use of CML material number 10ABE1 as an additional method of compliance.

The FAA disagrees with the request to add language to the proposed AD that allows for operators to control the reapplication of CICs via CPCP because not all U.S. operators have a standardized CPCP. If DAL cannot follow the CIC specified by Airbus in the service information, then they can reference the Airbus CML for an alternative CIC. Airbus's CML document contains a list of the latest consumables and alternatives that can be used. Operators may apply for an alternative method of compliance (AMOC) using the procedures in paragraph (j)(1) of this AD for using alternate consumables allowed in the CML with appropriate substantiations. The AD has not been changed in this regard.

The FAA agrees to clarify regarding the request for airplanes in a jacked configuration. The step the commenter referred to says to ''refer to'' the AMM. As noted in the service information, when the words ''refer to'' are used and the operator has a FAA accepted alternative procedure, the accepted alternative procedure can be used. Operators therefore have latitude in how to accomplish any work steps that use the term ''refer to.'' This AD has not been changed in this regard.

Request for Clarification of Repetitive Inspection Intervals

DAL requested clarification regarding the interval of the repetitive inspection specified in paragraph (3) of EASA ADs 2018–0137 and 2018–0137R1. DAL noted that, based on its understanding, the first repetitive inspection interval threshold is not to exceed 10,000 flight cycles or 15,000 flight hours, whichever occurs first. DAL remarked that it appears this threshold is based on the assumption that the initial inspections were done close to the initial threshold of 5,000 flight cycles or 7,500 flight hours, whichever occurred first. DAL requested clarification for a scenario in which an operator performed the specified inspection at 1,000 flight cycles or 1,000 flight hours, and asked if the first repetitive inspection interval would still be required before exceeding 10,000 flight cycles or 15,000 flight hours, whichever occurs first. DAL inquired if, in that same scenario, a grace period from the previous inspection would be more appropriate.

The FAA agrees to clarify. For the DAL scenario, the repetitive inspection will be due before exceeding 5,000 flight cycles or 7,500 flight hours, whichever occurs first since the last inspection. As stated previously, this AD now refers to EASA AD 2018–0137R1, as well as EASA AD 2018–0137. Paragraph (3) of EASA AD 2018–0137R1 has been revised to include multiple compliance times, including a grace period for airplanes on which an inspection has already been accomplished using earlier revisions of the service information or accomplishment of a certain maintenance planning document (MPD) task or a certain AOT. The AD has not been changed in this regard.

Request To Clarify Revision Level for Optional Terminating Modification

DAL noted that paragraph (9) of EASA ADs 2018–0137 and 2018–0137R1 reference service information without a revision level. DAL inquired if the intent of the reference is to use only the original issue of the service information, or if any revision level is acceptable for compliance.

The FAA agrees to clarify. Operators may use any approved revision of the service information to perform the optional terminating modification, so long as the modification meets the provisions of paragraph (9) of EASA ADs 2018–0137 and 2018–0137R1.

Conclusion

The FAA reviewed the relevant data, considered the comments received, and determined that air safety and the public interest require adopting this final rule with the changes described previously and minor editorial changes. The FAA determined that these minor changes:

- Are consistent with the intent that was proposed in the NPRM for addressing the unsafe condition; and
- Do not add any additional burden upon the public than was already proposed in the NPRM.

The FAA also determined that these changes will not increase the economic burden on any operator or increase the scope of this final rule.

Related IBR Material Under 1 CFR Part 51

EASA AD 2018–0137 and EASA AD 2018–0137R1 describe procedures for repetitive inspections for pre- and post-Airbus SAS modification 156593 airplanes, corrective actions, and optional terminating actions for the repetitive inspections. Corrective actions include modifications and repair. These documents are distinct since EASA AD 2018–0137R1 omits certain language, provides credit for additional service information, and clarifies certain compliance times. This material is reasonably available because the interested parties have access to it through their normal course of business or by the means identified in the **ADDRESSES** section.

Costs of Compliance

The FAA estimates that this AD affects 205 airplanes of U.S. registry. The FAA estimates the following costs to comply with this AD:

ESTIMATED COSTS FOR REQUIRED ACTIONS

Action	Labor cost	Parts cost	Cost per product	Cost on U.S. operators
Retained actions from AD 2016–07–12.	4 work-hours × $85 per hour = $340.	$0	$340	$69,700.
New proposed actions	Up to 21 work-hours × $85 per hour = Up to $1,785.	0	Up to $1,785	Up to $365,925.

ESTIMATED COSTS FOR OPTIONAL ACTIONS

Labor cost	Parts cost	Cost per product
Up to 70 work-hours × $85 per hour = Up to $5,950	Up to $32,800	Up to $38,750.

The FAA has received no definitive data that would enable the agency to provide cost estimates for the on-condition actions specified in this AD.

According to the manufacturer, some or all of the costs of this AD may be covered under warranty, thereby reducing the cost impact on affected individuals. The FAA does not control warranty coverage for affected individuals. As a result, the FAA has included all known costs in our cost estimate.

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.

The FAA is 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.

This AD is issued in accordance with authority delegated by the Executive Director, Aircraft Certification Service, as authorized by FAA Order 8000.51C. In accordance with that order, issuance of ADs is normally a function of the Compliance and Airworthiness Division, but during this transition period, the Executive Director has delegated the authority to issue ADs applicable to transport category airplanes and associated appliances to the Director of the System Oversight Division.

Regulatory Findings

The FAA determined that 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;

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 removing Airworthiness Directive (AD) 2016–07–12, Amendment 39–18457 (81 FR 19482, April 5, 2016), and adding the following new AD:

2019–14–03 Airbus SAS: Amendment 39–19681; Docket No. FAA–2019–0018; Product Identifier 2018–NM–116–AD.

(a) Effective Date

This AD is effective September 26, 2019.

(b) Affected ADs

This AD replaces AD 2016–07–12, Amendment 39–18457 (81 FR 19482, April 5, 2016) (''AD 2016–07–12'').

(c) Applicability

This AD applies to Airbus SAS Model A318–111, –112; Model A319–111, –112, –113, –114, –115; Model A320–211, –212, –214, –216; and Model A321–111, –112, –211, –212, –213 airplanes, certificated in any category, as identified in European Aviation Safety Agency (EASA) AD 2018–0137R1, dated January 9, 2019 (''EASA AD 2018–0137R1'').

(d) Subject

Air Transport Association (ATA) of America Code 54, Nacelles/pylons.

(e) Reason

This AD was prompted by reports of cracking of the aft fixed fairing (AFF) of the pylons due to fatigue damage of the structure and reports of cracks on a certain rib of a modified AFF of the pylons. The FAA is issuing this AD to address damage and cracking of the AFF of the pylons, which could result in detachment of a pylon and consequent reduced structural integrity of the airplane.

(f) Compliance

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

(g) Requirements

Except as specified in paragraph (h) of this AD: Comply with all required actions and compliance times specified in, and in accordance with, EASA AD 2018–0137, dated June 28, 2018 (''EASA AD 2018–0137''); or EASA AD 2018–0137R1.

(h) Exceptions to EASA ADs 2018–0137 and 2018–0137R1

(1) For purposes of determining compliance with the requirements of this AD, use the following paragraphs.

(i) Where EASA ADs 2018–0137 and 2018–0137R1 refer to the effective date of EASA AD 2018–0137 (July 12, 2018), this AD requires using the effective date of this AD.

(ii) Where EASA AD 2018–0137 refers to a compliance time of after July 16, 2014, this AD requires using May 10, 2016 (the effective date of AD 2016–07–12).

(2) The ''Remarks'' section of EASA ADs 2018–0137 and 2018–0137R1 do not apply.

(3) Where paragraph (3) of EASA ADs 2018–0137 and 2018–0137R1 requires that airplanes that have embodied Airbus modification 156593 accomplish the initial inspection of the AFF of the pylons before exceeding 10,000 flight cycles or 15,000 flight hours, whichever occurs first since airplane first flight, this AD requires inspection of those airplanes before exceeding 10,000 flight cycles or 15,000 flight hours since embodiment of Airbus modification 156593, whichever occurs first.

(4) Where paragraph (6) of EASA AD 2018–0137 gives credit for ''the initial requirements of paragraph (4)'' of EASA AD 2018–0137, this AD gives credit for ''the requirements of paragraph (4)'' of EASA AD 2018–0137.

(5) Where EASA ADs 2018–0137 and 2018–0137R1 require any approval from EASA or Airbus SAS's Design Organization Approval (DOA), this AD requires approval by the Manager, International Section, Transport Standards Branch, FAA; or EASA; or Airbus SAS's EASA DOA. If approved by the DOA, the approval must include the DOA-authorized signature.

(6) Where any service information referenced in EASA ADs 2018–0137 and 2018–0137R1 specifies to use consumable material list (CML) material number 10ABC1, this AD allows the use of CML material number 10ABE1 as an additional method of compliance.

(i) No Reporting Requirement

Although the service information referenced in EASA ADs 2018–0137 and 2018–0137R1 specifies to submit certain information to the manufacturer, this AD does not include that requirement.

(j) Other FAA AD Provisions

The following provisions also apply to this AD:

(1) *Alternative Methods of Compliance (AMOCs):* The Manager, International Section, Transport Standards Branch, 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 International Section, send it to the attention of the person identified in paragraph (k) of this AD. Information may be emailed to: *9-ANM-116-AMOC-REQUESTS@faa.gov.* 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.

(2) *Contacting the Manufacturer:* For any requirement in this AD to obtain instructions from a manufacturer, the instructions must be accomplished using a method approved by the Manager, International Section, Transport Standards Branch, FAA; or EASA; or Airbus SAS's EASA DOA. If approved by the DOA, the approval must include the DOA-authorized signature.

(3) *Required for Compliance (RC):* For any service information referenced in EASA AD 2018–0137 or EASA AD 2018–0137R1 that contains RC procedures and tests: Except as required by paragraphs (h)(6) and (j)(2) of this AD, RC procedures and tests must be done to comply with this AD; any procedures or tests that are not identified as RC are recommended. Those procedures and tests that are not identified as RC may be deviated from using accepted methods in accordance with the operator's maintenance or inspection program without obtaining approval of an AMOC, provided the procedures and tests identified as RC can be done and the airplane can be put back in an airworthy condition. Any substitutions or changes to procedures or tests identified as RC require approval of an AMOC.

(k) Related Information

For more information about this AD, contact Sanjay Ralhan, Aerospace Engineer, International Section, Transport Standards Branch, FAA, 2200 South 216th St., Des Moines, WA 98198; telephone and fax 206–231–3223.

(l) 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 this AD specifies otherwise.

(i) European Aviation Safety Agency (EASA) AD 2018–0137, dated June 28, 2018.

(ii) EASA AD 2018–0137R1, dated January 9, 2019.

(3) For EASA AD 2018–0137 and EASA AD 2018–0137R1, contact the EASA, Konrad-Adenauer-Ufer 3, 50668 Cologne, Germany; telephone +49 221 89990 6017; email *ADs@easa.europa.eu;* internet *www.easa.europa.eu.* You may find these EASA ADs on the EASA website at *https://ad.easa.europa.eu.*

Note 1 to paragraph (l)(3): EASA AD 2018–0137 can be accessed in the zipped file at the bottom of the web page for EASA AD 2018–0137R1. When EASA posts a revised AD on their website, they watermark the previous AD as ''Revised,'' alter the file name by adding ''_revised'' to the end, and move it into a zipped file attached at the bottom of the AD web page.

(4) You may view these EASA ADs at the FAA, Transport Standards Branch, 2200 South 216th St., Des Moines, WA. For information on the availability of this material at the FAA, call 206–231–3195. EASA AD 2018–0137 and EASA AD 2018–0137R1 may be found in the AD docket on the internet at *http://www.regulations.gov* by searching for and locating Docket No. FAA–2019–0018.

(5) You may view this material 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 Des Moines, Washington, on July 16, 2019.

Michael Millage,

Acting Director, System Oversight Division, Aircraft Certification Service.

[FR Doc. 2019–18045 Filed 8–21–19; 8:45 am]

BILLING CODE 4910–13–P

DEPARTMENT OF TRANSPORTATION

Federal Highway Administration

23 CFR Part 658

[Docket No. FHWA–2018–0042]

RIN 2125–AF86

FAST Act Section 5516 ''Additional State Authority'' Implementation

AGENCY: Federal Highway Administration (FHWA), U.S. Department of Transportation (DOT).

ACTION: Final rule.

SUMMARY: This final rule implements Section 5516, ''Additional State Authority,'' of the Fixing America's Surface Transportation (FAST) Act, which provides the State of South Dakota with the opportunity to update and revise the routes for Longer Combination Vehicles (LCV) and commercial motor vehicles (CMV) with two or more cargo-carrying units.

DATES: This rule is effective September 23, 2019.

FOR FURTHER INFORMATION CONTACT: Vince Mantero, FHWA Office of Freight Management and Operations, (202) 366–2997, or by email at *Vince.Mantero@dot.gov*, or William Winne, FHWA Office of the Chief Counsel, (202) 366–1397, or by email at *William.Winne@dot.gov.* Business hours for FHWA are from 8:00 a.m. to 4:30 p.m., e.t., Monday through Friday, except Federal holidays.

SUPPLEMENTARY INFORMATION:

Electronic Access

The Notice of Proposed Rulemaking (NPRM), the comments received, and this document may be viewed online through the Federal eRulemaking portal at: *http://www.regulations.gov* under docket ID FHWA–2018–0042. Copies of this document also may be downloaded by accessing the Office of the Federal Register's home page at: *http://www.archives.gov* or the Government Publishing Office's web page at: *http://www.gpoaccess.gov/nara.*

Background

The Intermodal Surface Transportation Efficiency Act (ISTEA) of 1991 (Pub. L. 102–240, 105 Stat. 1914, Dec. 18, 1991) restricts the operation of LCVs on the Interstate Highway System (Sec. 1023(b), 105 Stat. 1952) and CMV combinations with two or more cargo-carrying units on the National Network (NN) (Sec. 4006, 105 Stat. 2148) to the types of vehicles in use on or before June 1, 1991, subject to whatever State rules, regulations, or restrictions were in effect on that date. A listing of these vehicles and restrictions is found in 23 CFR part 658, Appendix C.

The FHWA is modifying its regulations, as found in 23 CFR part 658, Appendix C, governing vehicles covered by 23 U.S.C. 127(d) (LCVs) and 49 U.S.C. 31112 (CMVs with two or more cargo-carrying units) in the State of South Dakota, as proposed in a NPRM published on February 6, 2019, at 84 FR 2071.

This action is necessary to implement the provisions of Section 5516 of the FAST Act, which provides South Dakota the opportunity to update and revise the routes designated as qualifying Federal-aid Primary System highways as long as the update shifts routes to divided highways or does not increase centerline miles by more than 5 percent and is expected to increase safety performance. The FAST Act Conference Report to Accompany H.R. 22 (House of Representatives 114th Congress 1st Session Report 114–357, December 1, 2015) states, ''Conferees expect that the implementation of section 5516 will provide the maximum flexibility possible to re-route longer combination vehicles in the affected State to divided highways, highway facilities designed for freight transportation, or along routes that will enhance overall highway safety.''

In an August 30, 2016, letter to FHWA, the South Dakota Department of Transportation (SDDOT) requested that FHWA add the additional routes for South Dakota's LCV network and provided a map and listing of those routes.

All of the proposed routes are on the NN, which is comprised of the Interstate Highway System and routes designated as qualifying Federal-aid Primary System highways. Combinations with a cargo-carrying length of 81.5 feet or less may use all NN routes. Combinations with a cargo-carrying length over 81.5 feet are restricted to the Interstate System and the routes listed in 23 CFR part 658, Appendix C. This listing of routes is applicable to both double trailers and triple trailers.

There were errors in the tables published in the ''Background'' section of the NPRM, on page 2075, regarding existing and proposed routes of operation for LCVs and trucks in excess of the lengths designated by the Surface Transportation Assistance Act (STAA) of 1982 for use on the NN. The route segments that were incorrect include a portion of US 14 and US 14B in Pierre, South Dakota. In addition, incorrect mileage is shown on several existing and proposed routes. The correct routes were provided to FHWA in a letter from the SDDOT dated June 6, 2018, which was added to the docket for this rulemaking. Nevertheless, all routes identified in the regulatory text of the NPRM were correct and included both existing and proposed routes of operation for LCVs and trucks over STAA lengths on the NN.

The FHWA finds that this update shifts routes to divided highways or does not increase centerline miles by more than 5 percent and is expected to increase safety performance. Based on this information and the comments received, FHWA is revising the Federal Regulations at 23 CFR part 658,

Appendix C for vehicles covered by 23 U.S.C. 127(d) (LCVs), and 49 U.S.C. 31112 (CMVs with two or more cargo-carrying units), in the State of South Dakota.

The revised routes are as follows:

Highway	From	To
US12	North Dakota State Line	Jct I–29 at Summit.
US14	Jct US83 at Ft. Pierre	Jct US14B in Pierre.
US14	Jct US14B east of Pierre	W Jct US14 Bypass at Brookings.
US14B	Jct US14 in Pierre	Jct US14 east of Pierre.
US14B	W Jct US14 at Brookings	Jct I–29 Exit 133 at Brookings.
US16B	Jct SD79 south of Rapid City	Jct I–90 at Rapid City.
US18	E Jct US18B at Hot Springs	Jct US385 at Oelrichs.
US18B	W Jct US18 at Hot Springs	E Jct US18 at Hot Springs.
US212	Wyoming State Line	Jct US85 at Belle Fourche.
US212	W Jct US83 west of Gettysburg	E Jct US83 west of Gettysburg.
US212	W Jct US281 in Redfield	E Jct US281 in Redfield.
US281	Jct I–90 Exit 310 at Plankinton	S Jct US14 west of Huron.
US281	Jct US14 north of Wolsey	W Jct US212 in Redfield.
US281	E Jct US212 in Redfield	North Dakota State Line.
US83	Jct I–90 near Vivian	Jct US14 at Ft. Pierre.
US83	Jct US14 east of Pierre	W Jct US212 west of Gettysburg.
US83	E Jct US212 west of Gettysburg	Jct US12 south of Selby.
US83	Jct US12 west of Selby	North Dakota State Line.
US85	I–90 Exit 10 at Spearfish	North Dakota State Line.
SD34	W Jct SD37	E Jct SD37.
SD37	Jct I–90 at Mitchell	E Jct SD34.
SD37	W Jct SD34	Jct US14 at Huron.
SD50	Burleigh Street in Yankton	Jct I–29 Exit 26.
SD79	Jct US18 & US385 at Oelrichs	Jct US16B south of Rapid City.

Summary of Comments and Responses

The FHWA received eight comments to the docket in response to the NPRM. Comments were submitted by two individuals, one State government agency (SDDOT), and four industry associations (the American Trucking Associations, the South Dakota Trucking Association, the South Dakota Agri-Business Association, and the South Dakota Retailers Association), and one trucking company.

A majority of the commenters expressed strong support for the proposed revisions, while one individual commenter opposed the proposed additional routes and length allowances.

Commenters in support of the updated routes expressed their opinion that the additional routes would overall improve highway safety and efficiency. One commenter thought the additional routes pose a safety threat to the driving public if the LCVs were to be allowed to operate along mixed travel lanes, but this commenter did not provide any data in support of this assertion.

The owner and operator of the highway system in South Dakota, SDDOT, presented a Safety Assessment in its June 6, 2018, letter addressing how it concludes the expanded access would improve traffic safety. The SDDOT asserted, for example, that hauling with LCVs would reduce the number of vehicles needed to carry payload, proportionally reducing the number of crashes, and that expanding the number and extent of routes would allow LCVs to take more direct and suitable routes, reducing miles traveled, accident exposure, fuel consumption, and vehicle emissions. The letter also concludes that none of the rural segments demonstrate unusual crash histories indicating marginal or hazardous operating conditions for commercial vehicles. The FHWA concurs with this Safety Assessment.

Based on the comments received, the SDDOT transmittal letter of June 6, 2018, and the authority provided in FAST Act Section 5516 for the State of South Dakota, FHWA concurs with the additional routes and vehicles as proposed by the SDDOT, for addition to 23 CFR part 658, appendix C.

Executive Order 13771 (Reducing Regulation and Controlling Regulatory Costs), Executive Order 12866 (Regulatory Planning and Review), Executive Order 13563 (Improving Regulation and Regulatory Review), and DOT Regulatory Policies and Procedures

The FHWA has determined that this action does not constitute a significant regulatory action within the meaning of Executive Order (E.O.) 12866 or within the meaning of DOT regulatory policies and procedures. The amendments update and revise the routes of the vehicles covered by 23 U.S.C. 127(d) (LCVs), and 49 U.S.C. 31112 (CMVs with two or more cargo-carrying units), in South Dakota, as found in 23 CFR part 658, appendix C. In addition, this action complies with the principles of E.O. 13563. After evaluating the costs and benefits of these amendments, FHWA finds that the economic impact of this rulemaking would be minimal. These changes are not anticipated to adversely affect, in any material way, any sector of the economy. In addition, these changes will not create a serious inconsistency with any other agency's action or materially alter the budgetary impact of any entitlements, grants, user fees, or loan programs. The FHWA anticipates that the economic impact of this rulemaking will be minimal; therefore, a full regulatory evaluation is not necessary. Finally, this rule is not an E.O. 13771 regulatory action because it is not significant under E.O. 12866.

Regulatory Flexibility Act

In compliance with the Regulatory Flexibility Act (Pub. L. 96–354; 5 U.S.C. 60l–612), FHWA has evaluated the effects of this action on small entities, such as local governments and businesses. Based on the evaluation, FHWA anticipates that this action would not have a significant economic impact on a substantial number of small entities. The proposed amendments would update the routes of the vehicles covered by 23 U.S.C. 127(d) (LCVs), and 49 U.S.C. 31112 (CMVs with two or more cargo-carrying units), in South Dakota, as found in 23 CFR part 658, appendix C. Therefore, I certify that this action would not have a significant economic impact on a substantial number of small entities.

Unfunded Mandates Reform Act of 1995

The FHWA has determined that this action would not impose unfunded mandates as defined by the Unfunded Mandates Reform Act of 1995 (Pub. L. 104–4, March 22, 1995, 109 Stat. 48). The actions in this final rule would not result in the expenditure by State, local, and Tribal governments, in the aggregate, or by the private sector, of $155 million or more in any 1 year (when adjusted for inflation) in 2014 dollars for either State, local, and Tribal governments in the aggregate, or by the private sector.

Executive Order 13132 (Federalism Assessment)

The FHWA has analyzed this rule in accordance with the principles and criteria contained in E.O. 13132. The FHWA has determined that this action would not have sufficient federalism implications to warrant the preparation of a federalism assessment. The FHWA has also determined that this action would not preempt any State law or State regulation or affect the States' ability to discharge traditional State governmental functions.

Executive Order 12372 (Intergovernmental Review)

The regulations implementing E.O. 12372 regarding intergovernmental consultation on Federal programs and activities apply to this program. This E.O. applies because State and local governments would be directly affected by the regulation, which is a condition of Federal highway funding. Local entities should refer to the Catalog of Federal Domestic Assistance Program Number 20.205, Highway Planning and Construction, for further information.

Paperwork Reduction Act

Under the Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3501, *et seq.*), Federal agencies must obtain approval from the Office of Management and Budget for each collection of information they conduct, sponsor, or require through regulations. The FHWA has determined that the rule does not contain collection of information requirements for the purposes of the PRA.

National Environmental Policy Act

The FHWA has analyzed this rule for the purposes of the National Environmental Policy Act (NEPA) (42 U.S.C. 4321, *et seq.*). Agencies are required to adopt implementing procedures for NEPA that establish specific criteria for, and identification of, three classes of actions: Those that normally require preparation of an Environmental Impact Statement; those that normally require preparation of an Environmental Assessment; and those that are categorically excluded from further NEPA review (40 CFR 1507.3(b)). The action is the amendment to the routes listed for vehicles covered by 23 U.S.C. 127(d) (LCVs), and 49 U.S.C. 31112 (CMVs with two or more cargo-carrying units) in South Dakota as found in 23 CFR part 658, Appendix C, as allowed by Section 5516 of the FAST Act. This action qualifies for categorical exclusions under 23 CFR 771.117(c)(20) (promulgation of rules, regulations, and directives). The FHWA has evaluated whether the action would involve unusual circumstances or extraordinary circumstances and has determined that this rulemaking action would not involve such circumstances. As a result, FHWA finds that this rulemaking would not result in significant impacts on the human environment.

Executive Order 13175 (Tribal Consultation)

The FHWA has analyzed this rule under E.O. 13175, and believes that it would not have substantial direct effects on one or more Indian Tribes, would not impose substantial direct compliance costs on Indian Tribal governments, and would not preempt Tribal law. This rule would not impose any direct compliance requirements on Indian Tribal governments nor would it have any economic or other impacts on the viability of Indian Tribes. Therefore, a Tribal summary impact statement is not required.

Executive Order 13211 (Energy Effects)

The FHWA has analyzed this rule under E.O. 13211, Actions Concerning Regulations that Significantly Affect Energy Supply, Distribution, or Use. The FHWA has determined that this action is not a significant energy action under the E.O. and is not likely to have a significant adverse effect on the supply, distribution, or use of energy. Therefore, a Statement of Energy Effects is not required.

Executive Order 12630 (Taking of Private Property)

The FHWA has analyzed this rule under E.O. 12630, Governmental Actions and Interference with Constitutionally Protected Property Rights. The FHWA does not anticipate that this action would affect a taking of private property or otherwise have taking implications under E.O. 12630.

Executive Order 12988 (Civil Justice Reform)

This action meets applicable standards in sections 3(a) and 3(b)(2) of E.O. 12988, Civil Justice Reform, to minimize litigation, eliminate ambiguity, and reduce burden.

Executive Order 13045 (Protection of Children)

The FHWA has analyzed this action under E.O. 13045, Protection of Children from Environmental Health Risks and Safety Risks. The FHWA certifies that this action would not cause an environmental risk to health or safety that may disproportionately affect children.

Regulation Identifier Number

A Regulation Identifier Number (RIN) is assigned to each regulatory action listed in the Unified Agenda of Regulatory and Deregulatory Actions. The Regulatory Information Service Center publishes the Unified Agenda in the spring and fall of each year. The RIN number contained in the heading of this document can be used to cross-reference this action with the Unified Agenda.

List of Subjects in 23 CFR Part 658

Grant programs-transportation, Highways and roads, Motor carrier size and weight.

Issued on: August 15, 2019.

Nicole R. Nason,

Administrator, Federal Highway Administration.

In consideration of the foregoing, FHWA amends 23 CFR part 658 as follows:

PART 658—TRUCK SIZE AND WEIGHT, ROUTE DESIGNATIONS–LENGTH, WIDTH AND WEIGHT LIMITATIONS

■ 1. The authority citation for part 658 is amended to read as follows:

Authority: 23 U.S.C. 127 and 315; 49 U.S.C. 31111, 31112, and 31114; sec. 347, Pub. L. 108–7, 117 Stat. 419; sec. 756, Pub. L. 109–58, 119 Stat. 829; sec. 1309, Pub. L. 109–59, 119 Stat. 1219; sec. 115, Pub. L. 109–115, 119 Stat. 2408; sec. 5516, Pub. L. 114–94, 129 Stat. 1312, 1557; 49 CFR 1.81(a)(3).

■ 2. Amend appendix C to part 658 by revising the entry for ''State: South Dakota, Combination: Truck tractor and two trailing units—LVC'' to read as follows:

Appendix C to Part 658—Trucks Over 80,000 Pounds on the Interstate System and Trucks Over STAA Lengths on the National Network

* * * * *

State: South Dakota.

Combination: Truck tractor and two trailing units—LCV.

Length of Cargo-Carrying Units: 100 feet.

Maximum Allowable Gross Weight: 129,000 pounds.

Operational Conditions:

Weight: For all combinations, the maximum gross weight on two or more consecutive axles is limited by the Federal Bridge Formula but cannot exceed 129,000 pounds. The weight on single axles or tandem axles spaced 40 inches or less apart may not exceed 20,000 pounds. Tandem axles spaced more than 40 inches but 96 inches or less may not exceed 34,000 pounds. Two consecutive sets of tandem axles may carry a gross load of 34,000 pounds each, provided the overall distance between the first and last axles of the tandems is 36 feet or more. The weight on the steering axle may not exceed 600 pounds per inch of tire width.

For combinations with a cargo-carrying length greater than 81.5 feet the following additional regulations also apply. The weight on all axles (other than the steering axle) may not exceed 500 pounds per inch of tire width. Lift axles and belly axles are not considered load-carrying axles and will not count when determining allowable vehicle weight.

Driver: The driver must have a commercial driver's license with the appropriate endorsement.

Vehicle: For all combinations, a semitrailer or trailer may neither be longer than nor weigh 3,000 pounds more than the trailer located immediately in front of it. Towbars longer than 19 feet must be flagged during daylight hours and lighted at night.

For combinations with a cargo-carrying length of 81.5 feet or less, neither trailer may exceed 45 feet, including load overhang. Vehicles may be 12 feet wide when hauling baled feed during daylight hours.

For combinations with a cargo-carrying length over 81.5 feet long, neither trailer may exceed 48 feet, including load overhang. Loading the rear of the trailer heavier than the front is not allowed. All axles except the steering axle require dual tires. Axles spaced 8 feet or less apart must weigh within 500 pounds of each other. The trailer hitch offset may not exceed 6 feet. The maximum effective rear trailer overhang may not exceed 35 percent of the trailer's wheelbase. The power unit must have sufficient power to maintain 40 miles per hour. A ''LONG LOAD'' sign measuring 18 inches high by 7 feet long with black on yellow lettering 10 inches high is required on the rear. Offtracking is limited to 8.75 feet for a turning radius of 161 feet.

$$\text{Offtracking Formula} = 161 - [161^2 - (L_1^2 + L_2^2 + L_3^2 + L_4^2 + L_5^2 + L_6^2 + L_7^2 + L_8^2)]^{1/2}$$

Note. L_1 through L_8 are measurements between points of articulation or vehicle pivot points. Squared dimensions to stinger steer points of articulation are negative. For two trailing unit combinations where at least one trailer is 45 feet long or longer, all the dimensions used to calculate offtracking must be written in the ''Permit Restriction'' area of the permit along with the offtracking value derived from the calculation.

Permit: For combinations with a cargo-carrying length of 81.5 feet or less, a single-trip permit is required for movement on the Interstate System if the gross vehicle weight exceeds 80,000 pounds. An annual or single-trip permit is required for hauling baled feed over 102 inches wide.

For combinations with a cargo-carrying length greater than 81.5 feet, a single-trip permit is required for all movements. Operations must be discontinued when roads are slippery due to moisture, visibility must be good, and wind conditions must not cause trailer whip or sway.

For all combinations, a fee is charged for any permit.

Access: For combinations with a cargo-carrying length of 81.5 feet or less, access is statewide off the NN unless restricted by the South Dakota DOT.

For combinations with a cargo-carrying length greater than 81.5 feet, access to operating routes must be approved by the South Dakota DOT.

Routes: Combinations with a cargo-carrying length of 81.5 feet or less may use all NN routes. Combinations with a cargo-carrying length over 81.5 feet, are restricted to the Interstate System and:

Highway	From	To
US12	North Dakota State Line	Jct I–29 at Summit.
US14	Jct US83 at Ft. Pierre	Jct US14B in Pierre.
US14	Jct US14B east of Pierre	W Jct US14 Bypass at Brookings.
US14B	Jct US14 in Pierre	Jct US14 east of Pierre.
US14B	W Jct US14 at Brookings	Jct I–29 Exit 133 at Brookings.
US16B	Jct SD79 south of Rapid City	Jct I–90 at Rapid City.
US18	E Jct US18B at Hot Springs	Jct US385 at Oelrichs.
US18B	W Jct US18 at Hot Springs	E Jct US18 at Hot Springs.
US212	Wyoming State Line	Jct US85 at Belle Fourche.
US212	W Jct US83 west of Gettysburg	E Jct US83 west of Gettysburg.
US212	W Jct US281 in Redfield	E Jct US281 in Redfield.
US281	Jct I–90 Exit 310 at Plankinton	S Jct US14 west of Huron.
US281	Jct US14 north of Wolsey	W Jct US212 in Redfield.
US281	E Jct US212 in Redfield	North Dakota State Line.
US83	Jct I–90 near Vivian	Jct US14 at Ft. Pierre.
US83	Jct US14 east of Pierre	W Jct US212 west of Gettysburg.
US83	E Jct US212 west of Gettysburg	Jct US12 south of Selby.
US83	Jct US12 west of Selby	North Dakota State Line.
US85	I–90 Exit 10 at Spearfish	North Dakota State Line.
SD34	W Jct SD37	E Jct SD37.
SD37	Jct I–90 at Mitchell	E Jct SD34.
SD37	W Jct SD34	Jct US14 at Huron.
SD50	Burleigh Street in Yankton	Jct I–29 Exit 26.
SD79	Jct US18 & US385 at Oelrichs	Jct US16B south of Rapid City.

Legal Citations: SDCL 32–22–8.1, –38, –39, –41, –42, and –52; and Administrative Rules 70:03:01:37,:47,:48, and:60 through:70.

* * * * *

[FR Doc. 2019–18093 Filed 8–21–19; 8:45 am]

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DEPARTMENT OF JUSTICE

Parole Commission

28 CFR Part 2

[Docket No. USPC–2019–01]

Paroling, Recommitting, and Supervising Federal Prisoners: Prisoners Serving Sentences Under the United States and District of Columbia Codes

AGENCY: United States Parole Commission, Justice.

ACTION: Final rule.

SUMMARY: The United States Parole Commission is amending its regulations and eliminating the term ''Executive Hearing Officer'' in order to allow for more clarity.

DATES: The regulation is effective August 22, 2019.

FOR FURTHER INFORMATION CONTACT: Helen Krapels, General Counsel, U.S. Parole Commission, 90 K Street NE, Third Floor, Washington, DC 20530, telephone (202) 346–7030. Questions about this publication are welcome, but inquiries concerning individual cases cannot be answered over the telephone.

SUPPLEMENTARY INFORMATION: The United States Parole Commission is adopting final rules to amend its rules describing the delegation to hearing examiners in § 2.23 and also the hearing procedures for prisoners transferred pursuant to treaty in § 2.68. The amendments are part of our ongoing effort to make our rules easier to understand for those persons affected by the rules and other interested persons and organizations.

More specifically, both of these rule amendments involve the term ''Executive Hearing Examiner.'' This term is not defined in the regulations and is not clearly translatable to the agency. The agency has interpreted the term to refer to the role of the person who is reviewing the case as the second hearing examiner, and not the actual title of a person's position. Therefore, whomever is reviewing the case as a second hearing examiner, is considered the Executive Hearing Examiner. An amendment of the regulations that removes the reference to the Executive Hearing Examiner will help clarify that any of the agency's hearing examiners can be the second vote on the hearing examiner panel, and there is no requirement for someone with the title of Executive Hearing Examiner or a senior hearing examiner to review the case before it is submitted to the Commission.

Public Comment

In the notice of proposed rulemaking, we encourage the public to comment on our proposed changes. However, regarding these final rule amendments, only the terminology is changed and the term ''Executive Hearing Examiner'' is removed for clarity. The way that the actual hearings are conducted, and by whom, is not affected by these rule amendments. Thus, public comment is not required in this matter and the amended rules will take effect upon publication in the **Federal Register**.

Executive Orders 12866 and 13563

These regulations have been drafted and reviewed in accordance with Executive Order 12866, ''Regulation Planning and Review,'' section 1(b), Principles of Regulation, and in accordance with Executive Order 13565, ''Improving Regulation and Regulatory Review,'' section 1(b), General Principles of Regulation. The Commission has determined that these rules are not a ''significant regulatory action'' under Executive Order 12866, section 3(f), Regulatory Planning and Review, and accordingly these rules have not been reviewed by the Office of Management and Budget.

Executive Order 13132

These rules will not have substantial direct effects 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. Under Executive Order 13132, these rules do not have sufficient federalism implications requiring a Federalism Assessment.

Regulatory Flexibility Act

These rules will not have a significant economic impact upon a substantial number of small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 605(b).

Unfunded Mandates Reform Act of 1995

These rules will not cause State, local, or tribal governments, or the private sector, to spend $100,000,000 or more in any one year, and it will not significantly or uniquely affect small governments. No action under the Unfunded Mandates Reform Act of 1995 is necessary.

Small Business Regulatory Enforcement Fairness Act of 1996 (Subtitle E—Congressional Review Act)

None of these rules are a ''major rule'' as defined by Section 804 of the Small Business Regulatory Enforcement Fairness Act of 1996 Subtitle E–Congressional Review Act, now codified at 5 U.S.C. 804(2). These rules will not result in an annual effect on the economy of $100,000,000 or more; a major increase in costs or prices; or significant adverse effects on the ability of United States-based companies to compete with foreign-based companies. Moreover, these are rules of agency practice or procedure that does not substantially affect the rights or obligations of non-agency parties, and does not come within the meaning of the term ''rule'' as used in Section 804(3)(C), now codified at 5 U.S.C. 804(3)(C). Therefore, the reporting requirement of 5 U.S.C. 801 does not apply.

List of Subjects in 28 CFR Part 2

Administrative practice and procedure, Prisoners, Probation and parole.

The Final Rule

Accordingly, the U. S. Parole Commission adopts the following revisions to 28 CFR part 2 as set forth below:

PART 2—[AMENDED]

■ 1. The authority citation for 28 CFR part 2 continues to read as follows:

Authority: 18 U.S.C. 4203(a)(1) and 4204(a)(6).

■ 2. Revise § 2.23 to read as follows:

§ 2.23 Delegation to hearing examiners.

(a) There is hereby delegated to hearing examiners the authority necessary to conduct hearings and make recommendations relative to the grant or denial of parole or reparole, revocation or reinstatement of parole or mandatory release, and conditions of parole. Any hearing may be conducted by a single examiner or by a panel of examiners. Notwithstanding the provisions of §§ 2.48 through 2.51, §§ 2.101 through 2.104 and §§ 2.214 through 2.217, there is also delegated to hearing examiners the authority necessary to make a probable cause finding, to determine the location of a revocation hearing, and to determine the witnesses who will attend the hearing, including the authority to issue subpoenas for witnesses and evidence.

(b) The concurrence of two examiners shall be required to obtain a panel recommendation to the Regional

Commissioner. A panel recommendation is required in each case decided by a Regional Commissioner after the holding of a hearing.

(c) An examiner panel recommendation exists of two concurring examiner votes. In the event of divergent votes, the case shall be referred to another hearing examiner for another vote. If concurring votes do not result from such a referral, the case shall be referred to any available hearing examiner until a panel recommendation is obtained.

3. Revise § 2.68(h)(6) to read as follows:

§ 2.68 Prisoners transferred pursuant to treaty.

* * * * *

(h) * * *

(6) The transferee shall be notified of the examiner's recommended findings of fact, and the examiner's recommended determination and reasons therefore, at the conclusion of the hearing. The case shall thereafter be reviewed by a second hearing examiner, and the Commission shall make its determination upon a panel recommendation.

* * * * *

Patricia K. Cushwa,

Chairman (Acting), U.S. Parole Commission.

[FR Doc. 2019–17239 Filed 8–21–19; 8:45 am]

BILLING CODE 4410–31–P

DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Part 100

[Docket Number USCG–2019–0437]

RIN 1625–AA08

Special Local Regulations; Upper Mississippi River, 839.5 to 840.5 St. Paul, MN

AGENCY: Coast Guard, DHS.

ACTION: Temporary final rule.

SUMMARY: The Coast Guard is establishing special local regulations during the ''Red Bull Flugtag'' event to be held on the navigable waters of the Upper Mississippi River in St. Paul, MN on September 7, 2019. These special local regulations are necessary to provide for the safety of life on navigable waters during the event. These special local regulations will establish primary and secondary exclusion areas, and a spectator area. Additionally, these areas will have a specific set of restrictions as described in Section IV.

DATES: This rule is effective 8 a.m. to 5 p.m. on September 7, 2019.

ADDRESSES: To view documents mentioned in this preamble as being available in the docket, go to *https://www.regulations.gov,* type USCG–2019–0437 in the ''SEARCH'' box and click ''SEARCH.'' Click on Open Docket Folder on the line associated with this rule.

FOR FURTHER INFORMATION CONTACT: If you have questions on this rule, call or email Lieutenant Commander Christian Barger, Waterways Management Division, Sector Upper Mississippi River, U.S. Coast Guard; telephone 314–269–2560, email *Christian.J.Barger@uscg.mil.*

SUPPLEMENTARY INFORMATION:

I. Table of Abbreviations

CFR Code of Federal Regulations
COTP Captain of the Port Sector Upper Mississippi River
DHS Department of Homeland Security
FR Federal Register
NPRM Notice of proposed rulemaking
§ Section
U.S.C. United States Code

II. Background Information and Regulatory History

On May 15, 2019, Red Bull North America notified the Coast Guard that it will be holding a Red Bull Flugtag event on the Upper Mississippi River at Harriett Island Park in St. Paul, MN from 11 a.m. to 4 p.m. on September 7, 2019. Flugtag is a homemade, non-powered flying machine competition. Contestants launch their machines from a 22 feet high platform built over the Upper Mississippi River. Potential hazards from this event include the temporary installation of a structure along the right descending bank of the river, temporary channel obstructions until the Flugtag machines are recovered from the river, and the presence of debris and persons in the water within the event perimeter. In response, on June 14, 2019 the Coast Guard published a notice of proposed rulemaking (NPRM) titled Special Local Regulations, Upper Mississippi River, St. Paul MN. (84 FR 27743). During the comment period that ended July 15, 2019 we received three comments.

Under 5 U.S.C. 553(d)(3), the Coast Guard finds that good cause exists for making this rule effective less than 30 days after publication in the **Federal Register**. Delaying the effective date of this rule would be contrary to the public interest because the regulated area must be established by September 7, 2019 to ensure the safety of vessels, persons, and the navigable waters in the regulated area before, during, and after the scheduled event.

III. Legal Authority and Need for Rule

The Coast Guard is issuing this rule under authority in 46 U.S.C. 70034 (previously 33 U.S.C. 1231). The purpose of this rule is to ensure the safety of vessels, persons, and the navigable waters in the regulated area before, during, and after the scheduled event.

IV. Discussion of Comments, Changes, and the Rule

The Coast Guard received three comments in response to the NPRM.

The sponsor for the event submitted a comment via email requesting to extend the duration of the regulated area from 8 a.m. to 5 p.m. to account for the setup and break down of the event. As a result of this email, the duration of the regulated area has been extended.

Another comment was received from an industry representative in regards to maintaining proper patrol vessel span of control to ensure the safety of not only the spectators and the participants, but anyone wishing to transit in the area. He cited issues experienced during a previous event. Additionally, the duration of the waterway closure was a concern as it would hinder commercial transit on the waterway. The Coast Guard acknowledges the concerns based on previous events of similar nature and the need to ensure an adequate number of patrol craft to enforce these regulations. The Coast Guard is working very closely with our port partners and law enforcement agencies to ensure adequate resources are available to maintain the safety of the event. Additionally, the Coast Guard is modifying the rule as proposed in the NPRM to establish a total of three zones. The primary and secondary exclusion areas will be closed to general vessel traffic from 8 a.m. to 5 p.m., however, the spectator zone which encompasses the majority of the river width in the regulated area will only be regulated from 10:30 a.m. to 4:30 p.m. The zones will be described in detail in the actual text of this temporary final rule.

Another comment was received from the president of a business that operates passenger vessels in the area of the Flugtag event. This person was concerned about their ability to safely operate around the estimated 300 spectator vessels that could be on the waterway. As a result of this comment, the Coast Guard adjusted the special local regulation restrictions from those proposed in the NPRM to provide for a safe passenger vessel transit area throughout the duration of the event as detailed below.

With consideration to the comments received, the Coast Guard is establishing special local regulations on specified waters of the Upper Mississippi River on September 7, 2019. The regulated area extends from mile marker 839.5 to 840.5 across the entire width of the Upper Mississippi River. The regulations will be effective from 8 a.m. to 5 p.m. for the primary and secondary exclusion areas as described below. The designated spectator area will be regulated from 10:30 a.m. to 4:30 p.m.

Within the overall regulated area, there are three unique areas, each with their own specific restrictions. The areas are as follows: A primary exclusion area, a secondary exclusion area, and a designated spectator area.

The primary exclusion area, where all persons and vessels, except those persons and vessels participating in the competition, are prohibited from entering, transiting through, anchoring in, or remaining within, is established within lines connecting the following points: From point one, at position latitude 44°56′23″ N, longitude 93°05′44″ W to point two at position latitude 44°56′24″ N, longitude 93°05′46″ W; from point two to point three at position latitude 44°56′18″ N, longitude 93°05′54″ W; and from point three to point four at position latitude 44°56′17″ N longitude 93°05′52″ W. This area will be enforced from 8 a.m. to 5 p.m.

The secondary exclusion area, where all persons and vessels, except commercial vessels are prohibited from entering, anchoring in, or remaining within, with the exception of continuous transverse travel across the area, is established within lines connecting the following points: From point five, at position latitude 44°56′17″ N, longitude 93°05′52″ W; to point six at position latitude 44°56′18″ N, longitude 93°05′54″ W; from point six to point seven at latitude 44°56′00″ N, longitude 93°06′15″ W; from point seven to point eight on latitude 44°55′57″ N, longitude 93°06′12″ W. This area will be enforced from 8 a.m. to 5 p.m.

The designated spectator area is located between mile markers 840.5 and 839.5, outside of the primary and secondary exclusion areas. All vessels are prohibited from transiting in excess of idle speed, unless authorized by the Coast Guard Patrol Commander. Spectator vessels are authorized to enter, transit through, anchor in, or remain within all waters of the spectator area from 10:30 a.m. until 4:30 p.m. Vessels other than spectator vessels and those directly involved in the event will only be allowed to safely transit the regulated area when the Coast Guard Patrol Commander has deemed it safe to do so. All spectator vessels must disperse from the navigational channel by 4:30 p.m. at which time the standard navigation rules will be enforced.

Due to the need for vessel control during the event, the Coast Guard will temporarily restrict vessel traffic in the regulated exclusion area to provide for the safety of participants, spectators and other transiting vessels. The Coast Guard will provide notice of the special local regulations by Local Notice to Mariners (LNM), Broadcast Notice to mariners (BNM) and press release.

V. Regulatory Analyses

We developed this rule after considering numerous statutes and Executive orders related to rulemaking. Below we summarize our analyses based on a number of these statutes and Executive orders, and we discuss First Amendment rights of protestors.

A. Regulatory Planning and Review

Executive Orders 12866 and 13563 direct agencies to assess the costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits. Executive Order 13771 directs agencies to control regulatory costs through a budgeting process. This rule has not been designated a ''significant regulatory action,'' under Executive Order 12866. Accordingly, this rule has not been reviewed by the Office of Management and Budget (OMB), and pursuant to OMB guidance it is exempt from the requirements of Executive Order 13771.

This regulatory action determination is based on data collected from previous events in regards to the risk associated with this event.

B. Impact on Small Entities

The Regulatory Flexibility Act of 1980, 5 U.S.C. 601–612, as amended, requires Federal agencies to consider the potential impact of regulations on small entities during rulemaking. The term ''small entities'' comprises small businesses, not-for-profit organizations that are independently owned and operated and are not dominant in their fields, and governmental jurisdictions with populations of less than 50,000. The Coast Guard received no comments from the Small Business Administration on this rulemaking. The Coast Guard certifies under 5 U.S.C. 605(b) that this rule will not have a significant economic impact on a substantial number of small entities.

While some owners or operators of vessels intending to transit the regulated area may be small entities, for the reasons stated in section V.A above, this rule will not have a significant economic impact on any vessel owner or operator due to the event taking place for one day, for a only a nine hour period and on a one mile stretch of the Upper Mississippi River.

Under section 213(a) of the Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121), we want to assist small entities in understanding this rule. If the rule would affect your small business, organization, or governmental jurisdiction and you have questions concerning its provisions or options for compliance, please contact the person listed in the **FOR FURTHER INFORMATION CONTACT** section.

Small businesses may send comments on the actions of Federal employees who enforce, or otherwise determine compliance with, Federal regulations to the Small Business and Agriculture Regulatory Enforcement Ombudsman and the Regional Small Business Regulatory Fairness Boards. The Ombudsman evaluates these actions annually and rates each agency's responsiveness to small business. If you wish to comment on actions by employees of the Coast Guard, call 1–888–REG–FAIR (1–888–734–3247). The Coast Guard will not retaliate against small entities that question or complain about this rule or any policy or action of the Coast Guard.

C. Collection of Information

This rule will not call for a new collection of information under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520).

D. Federalism and Indian Tribal Governments

A rule has implications for federalism under Executive Order 13132, Federalism, if it has 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. We have analyzed this rule under that Order and have determined that it is consistent with the fundamental federalism principles and preemption requirements described in Executive Order 13132.

Also, this rule does not have tribal implications under Executive Order 13175, Consultation and Coordination with Indian Tribal Governments, because it does not have a substantial direct effect on one or more Indian tribes, on the relationship between the Federal Government and Indian tribes, or on the distribution of power and responsibilities between the Federal Government and Indian tribes. If you believe this rule has implications for federalism or Indian tribes, please contact the person listed in the **FOR FURTHER INFORMATION CONTACT** section.

E. Unfunded Mandates Reform Act

The Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531–1538) requires Federal agencies to assess the effects of their discretionary regulatory actions. In particular, the Act addresses actions that may result in the expenditure by a State, local, or tribal government, in the aggregate, or by the private sector of $100,000,000 (adjusted for inflation) or more in any one year. Though this rule will not result in such an expenditure, we do discuss the effects of this rule elsewhere in this preamble.

F. Environment

We have analyzed this rule under Department of Homeland Security Directive 023–01 and Environmental Planning COMDTINST 5090.1 (series), which guide the Coast Guard in complying with the National Environmental Policy Act of 1969 (42 U.S.C. 4321–4370f), and have determined that this action is one of a category of actions that do not individually or cumulatively have a significant effect on the human environment. This rule involves a special local regulation lasting nine hours that will prohibit entry of vessels at certain zones on certain waters of the Upper Mississippi River. It is categorically excluded from further review under paragraph L61 in Table 3–1 of U.S. Coast Guard Environmental Planning Implementing Procedures 5090.1. A Record of Environmental Consideration supporting this determination is available in the docket where indicated under **ADDRESSES**.

G. Protest Activities

The Coast Guard respects the First Amendment rights of protesters. Protesters are asked to contact the person listed in the **FOR FURTHER INFORMATION CONTACT** section to coordinate protest activities so that your message can be received without jeopardizing the safety or security of people, places or vessels.

List of Subjects in 33 CFR Part 100

Marine safety, Navigation (water), Reporting and recordkeeping requirements, Waterways.

For the reasons discussed in the preamble, the Coast Guard amends 33 CFR part 100 as follows:

PART 100—SAFETY OF LIFE ON NAVIGABLE WATERS

■ 1. The authority citation for part 100 continues to read as follows:

Authority: 46 U.S.C 70041; 33 CFR 1.05–1.

■ 2. Add § 100.35–T08–0437 to read as follows:

§ 100.35–T08–0437 Special Local Regulation; Upper Mississippi River, 839.5 to 840.5 St. Paul, MN.

(a) *Regulated areas.* The following regulated areas are established as special local regulations. All coordinates are North American Datum 1983.

(1) *General regulated area.* All waters of the Upper Mississippi River, contained within mile markers 839.5 to 840.5.

(2) *Primary exclusion area.* All waters of the Upper Mississippi River, contained within lines connecting the following points: From point one, at position latitude 44°56′23″ N, longitude 93°05′44″ W to point two at position latitude 44°56′24″ N, longitude 93°05′46″ W; from point two to point three at position latitude 44°56′18″ N, longitude 93°05′54″ W; and from point three to point four at position latitude 44°56′17″ N, longitude 93°05′52″ W. This area will be enforced from 8 a.m. to 5 p.m.

(3) *Secondary exclusion area.* All waters of the Upper Mississippi River, contained within lines connecting the following points: From point five, at position latitude 44°56′17″ N, longitude 93°05′52″ W; to point six at position latitude 44°56′18″ N, longitude 93°05′54″ W; from point six to point seven at latitude 44°56′00″ N, longitude 93°06′15″ W; from point seven to point eight at position latitude 44°55′57″ N, longitude 93°06′12″ W. This area will be enforced from 8 a.m. to 5 p.m.

(3) *Designated spectator area.* All other waters of the Upper Mississippi River between mile markers 839.5 (Wabasha St. Bridge) and 840.5 (Smith Avenue Bridge). The designated spectator area will be enforced from 10:30 a.m. to 4:30 p.m. Spectator vessels are required to disperse by 4:30 p.m. to allow the river to re-open to all vessel traffic.

(b) *Definitions.* (1) *Coast Guard Patrol Commander* means a commissioned, warrant, or petty officer of the U.S. Coast Guard who has been designated by the Captain of the Port Sector Upper Mississippi River (COTP).

(2) *Official Patrol Craft* means any vessel assigned or approved by the COTP with a commissioned, warrant, or petty officer on board and displaying a Coast Guard ensign.

(3) *Participant* means all persons and vessels participating in the Red Bull Flugtag event under the auspices of the Marine Event Permit issued to the event sponsor and approved by the COTP.

(4) *Spectator* means all persons and vessels not registered with the event sponsor as participants or official patrol who are present on the water to observe the event.

(c) *Special local regulations.* (1) The Coast Guard Patrol Commander may forbid and control the movement of all vessels and persons in the regulated area. When hailed or signaled by an official patrol vessel, a vessel or person in the regulated area shall immediately comply with the directions given. Failure to do so may result in expulsion from the area, citation for failure to comply, or both.

(2) The Coast Guard Patrol Commander may terminate the event, or the operation of any participant in the event, at any time it is deemed necessary for the protection of life or property.

(3) All Coast Guard vessels enforcing this regulated area can be contacted on marine band radio VHF–FM channel 16 (156.8 MHz).

(4) Only participants and official patrol vessels are allowed to enter the primary exclusion area.

(5) Only commercial vessels, other vessels transiting transversely, and official patrol are allowed to enter the secondary exclusion area.

(6) Spectators are allowed inside the regulated area only if they remain within the designated spectator area. Spectators will be permitted to anchor within the designated spectator area. All vessels moving within the designated spectator area shall do so at the slowest safe speed.

(7) Commercial vessels, and vessels other than participants and spectator vessels, may contact the Coast Guard Patrol Commander to request permission to pass through the regulated area. If permission is granted, vessels must pass directly through the regulated area, remaining outside the exclusion areas, at the slowest safe speed and without loitering.

(d) *Notice.* The Coast Guard will publish a notice in the Eighth Coast Guard District Local Notice to Mariners and issue a marine information broadcast on VHF–FM marine band radio announcing specific event date and times.

(e) *Enforcement period.* (1) The designated spectator area will be enforced from 10 a.m. to 4:30 p.m.

(2) The primary and secondary exclusion areas will be enforced from 8 a.m. to 5 p.m.

Dated: August 15, 2019.

S.A. Stoermer,

Captain, U.S. Coast Guard, Captain of the Port Sector Upper Mississippi River.

[FR Doc. 2019–18110 Filed 8–21–19; 8:45 am]

BILLING CODE 9110–04–P

DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Part 165

[Docket Number USCG–2019–0589]

RIN 1625–AA87

Security Zone; Los Angeles Fleet Week, San Pedro, California

AGENCY: Coast Guard, DHS.

ACTION: Temporary final rule.

SUMMARY: The U.S. Coast Guard is establishing a temporary security zone in the Port of Los Angeles Main Channel, in support of Los Angeles Fleet Week. This action is necessary to protect the area surrounding the LA World Cruise Center, public vessels moored, and the people attending the event. This regulation prohibits vessels from entering into, transiting through, or remaining within the designated area unless specifically authorized by the Captain of the Port Sector Los Angeles—Long Beach, or a designated representative.

DATES: This rule is effective from midnight on August 27, 2019, through 11:59 p.m. on September 3, 2019. The rule will be enforced from midnight to 11:59 p.m. each day.

ADDRESSES: To view documents mentioned in this preamble as being available in the docket, go to *http://www.regulations.gov,* type USCG–2019–0589 in the ''SEARCH'' box and click ''SEARCH.'' Click on Open Docket Folder on the line associated with this rule.

FOR FURTHER INFORMATION CONTACT: If you have questions about this proposed rulemaking, call or email MST1 Benjamin Martin, Waterways Management Branch, U.S. Coast Guard Sector Los Angeles—Long Beach; telephone (310) 521–3860, email *D11-SMB-SectorLALB-WWM@uscg.mil.*

SUPPLEMENTARY INFORMATION:

I. Table of Abbreviations

CFR Code of Federal Regulations
DHS Department of Homeland Security
FR Federal Register
LLNR Light List Number
NPRM Notice of proposed rulemaking
Pub. L. Public Law
§ Section
U.S.C. United States Code

II. Background Information and Regulatory History

The Coast Guard is issuing this temporary rule without prior notice and opportunity to comment pursuant to authority under section 4(a) of the Administrative Procedure Act (APA) (5 U.S.C. 553(b)). This provision authorizes an agency to issue a rule without prior notice and opportunity to comment when the agency for good cause finds that those procedures are ''impracticable, unnecessary, or contrary to the public interest.'' Under 5 U.S.C. 553(b)(B), the Coast Guard finds that good cause exists for not publishing a notice of proposed rulemaking (NPRM) with respect to this rule because it is impracticable due to the lack of sufficient time to provide a reasonable comment period and consider those comments before issuing the rule and establishing the security zone by August 27, 2019.

Under 5 U.S.C. 553(d)(3), the Coast Guard finds that good cause exists for making this rule effective less than 30 days after publication in the **Federal Register**. Delaying the effective date of this rule would be contrary to the public interest because immediate action is needed to protect the area surrounding the LA World Cruise Center, public vessels moored, and the people attending the event.

III. Legal Authority and Need for Rule

The Coast Guard is issuing this rule under authority in 46 U.S.C. 70034. The Captain of the Port, Sector Los Angeles—Long Beach (COTP) has determined that potential hazards associated with the event security may arise due to the expected high concentration of people in attendance for the event, including potential visits from dignitaries and VIP participants, within the main shipping channel of the nation's most economically vital port complex. There is increased awareness regarding recent national and worldwide events that have demonstrated direct threats to the security of large crowds in attendance for various high profile events. For these reasons the Coast Guard believes that a temporary security zone is necessary to ensure the safety of, and reduce the risk to, the public, and mariners, in the Port of Los Angeles.

IV. Discussion of the Rule

This rule establishes a temporary security zone from midnight on August 27, 2019 through 11:59 p.m. on September 3, 2019, encompassing all navigable waters from the surface to the sea floor consisting of a line connecting the following coordinates: 33°44.921′ N, 118°16.701′ W; 33°44.818′ N, 118°16.494′ W; 33°44.626′ N, 118°16.590′ W; 33°44.609′ N, 118°16.485′ W; 33°44.768′ N, 118°16.393′ W; 33°44.908′ N, 118°16.475′ W; and 33°44.966′ N, 118°16.665′ W. All coordinates displayed are referenced by North American Datum of 1983, World Geodetic System, 1984.

No vessel or person is permitted to operate in the security zone without obtaining permission from the COTP or the COTP's designated representative. A designated representative is a Coast Guard Patrol Commander, including a Coast Guard coxswain, petty officer, or other officer operating a Coast Guard vessel and a Federal, State, and local officer designated by or assisting the COTP in the enforcement of the security zone. To seek permission to enter, hail Coast Guard Sector Los Angeles—Long Beach on VHF–FM Channel 16 or call at (310) 521–3801. Those in the security zone must comply with all lawful orders or directions given to them by the COTP or the COTP's designated representative. Upon being hailed by a Coast Guard vessel or designated representative, by siren, radio, flashing light or other means, the operator of the vessel shall proceed as directed.

The general boating public will be notified prior to the enforcement of the temporary security zone via Broadcast Notice to Mariners.

V. Regulatory Analyses

We developed this rule after considering numerous statutes and executive orders (E.O.s) related to rulemaking. Below we summarize our analyses based on a number of these statutes and E.O.s, and we discuss First Amendment rights of protestors.

A. Regulatory Planning and Review

E.O.s 12866 (''Regulatory Planning and Review'') and 13563 (''Improving Regulation and Regulatory Review'') direct agencies to assess the costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits including potential economic, environmental, public health and safety effects, distributive impacts, and equity. E.O.13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility. Executive Order 13771 (''Reducing Regulation and Controlling Regulatory Costs'' directs agencies to reduce regulation and control regulatory costs and provides that ''for every one new regulation issued, at least two prior regulations be identified for elimination, and that the cost of planned regulations be prudently managed and controlled through a budgeting process.''

This regulatory action determination is based on the size, location, and duration of the security zone. Although this rule restricts access to the waters encompassed by the temporary security zone, the local waterway users will be notified via public Broadcast Notice to Mariners and will be able to plan their route in advance, which will minimize the access restriction. The entities most likely to be affected are waterfront facilities, commercial vessels, and pleasure craft engaged in recreational activities.

B. Impact on Small Entities

The Regulatory Flexibility Act of 1980, 5 U.S.C. 601–612, as amended, requires Federal agencies to consider the potential impact of regulations on small entities during rulemaking. The term ''small entities'' comprises small businesses, not-for-profit organizations that are independently owned and operated and are not dominant in their fields, and governmental jurisdictions with populations of less than 50,000. The Coast Guard certifies under 5 U.S.C. 605(b) that this rule will not have a significant economic impact on a substantial number of small entities.

While some owners or operators of vessels intending to transit the temporary security zone may be small entities, for the reasons stated in section V.A above, this rule will not have a significant economic impact on any vessel owner or operator. Under section 213(a) of the Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121), we want to assist small entities in understanding this rule. If the rule would affect your small business, organization, or governmental jurisdiction and you have questions concerning its provisions or options for compliance, please contact the person listed in the **FOR FURTHER INFORMATION CONTACT** section.

Small businesses may send comments on the actions of Federal employees who enforce, or otherwise determine compliance with, Federal regulations to the Small Business and Agriculture Regulatory Enforcement Ombudsman and the Regional Small Business Regulatory Fairness Boards. The Ombudsman evaluates these actions annually and rates each agency's responsiveness to small business. If you wish to comment on actions by employees of the Coast Guard, call 1–888–REG–FAIR (1–888–734–3247). The Coast Guard will not retaliate against small entities that question or complain about this rule or any policy or action of the Coast Guard.

C. Collection of Information

This rule will not call for a new collection of information under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520).

D. Federalism and Indian Tribal Governments

A rule has implications for federalism under E.O. 13132, Federalism, if it has 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. We have analyzed this rule under that Order and have determined that it is consistent with the fundamental federalism principles and preemption requirements described in E.O. 13132.

Also, this rule does not have tribal implications under E.O. 13175, Consultation and Coordination with Indian Tribal Governments, because it does not have a substantial direct effect on one or more Indian tribes, on the relationship between the Federal Government and Indian tribes, or on the distribution of power and responsibilities between the Federal Government and Indian tribes. If you believe this rule has implications for federalism or Indian tribes, please contact the person listed in the **FOR FURTHER INFORMATION CONTACT** section above.

E. Unfunded Mandates Reform Act

The Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531–1538) requires Federal agencies to assess the effects of their discretionary regulatory actions. In particular, the Act addresses actions that may result in the expenditure by a State, local, or tribal government, in the aggregate, or by the private sector of $100,000,000 (adjusted for inflation) or more in any one year. Though this rule will not result in such an expenditure, we do discuss the effects of this rule elsewhere in this preamble.

F. Environment

We have analyzed this rule under Department of Homeland Security Management Directive 023–01 and Environmental Planning COMDTINST 5090.1 (series), which guide the Coast Guard in complying with the National Environmental Policy Act of 1969 (42 U.S.C. 4321–4370f), and have determined that this action is one of a category of actions that do not individually or cumulatively have a significant effect on the human environment. This rule involves a security zone encompassing an area around the Los Angeles Fleet Week events. Such actions are categorically excluded from further review under paragraph L60 (a) in Table 3–1 of U.S. Coast Guard Environmental Planning Implementing Procedures 5090.1. An environmental analysis checklist supporting this determination and Record of Environmental Consideration (REC) are available in the docket where indicated under **ADDRESSES**.

G. Protest Activities

The Coast Guard respects the First Amendment rights of protesters. Protesters are asked to contact the person listed in the **FOR FURTHER INFORMATION CONTACT** section to coordinate protest activities so that your message can be received without jeopardizing the safety or security of people, places or vessels.

List of Subjects in 33 CFR Part 165

Harbors, Marine safety, Navigation (water), Reporting and recordkeeping requirements, Security measures, Waterways.

For the reasons discussed in the preamble, the Coast Guard addresses 33 CFR part 165 as follows:

PART 165—REGULATED NAVIGATION AREAS AND LIMITED ACCESS AREAS

■ 1. The authority citation for part 165 continues to read as follows:

Authority: 46 U.S.C. 70034, 70051; 33 CFR 1.05–1, 6.04–1, 6.04–6, and 160.5; Department of Homeland Security Delegation No. 0170.1.

■ 2. Add § 165. T11–0589 to read as follows:

§ 165. T11–0589 Security Zone; Los Angeles Fleet Week, San Pedro, California.

(a) *Location.* The following area is a security zone: All navigable waters in the Port of Los Angeles Main Channel from the surface to the sea floor consisting of a line connecting the following coordinates: 33°44.921′ N, 118°16.701′ W; 33°44.818′ N, 118°16.494′ W; 33°44.626′ N, 118°16.590′ W; 33°44.609′ N, 118°16.485′ W; 33°44.768′ N, 118°16.393′ W; 33°44.908′ N, 118°16.475′ W; and 33°44.966′ N, 118°16.665′ W. All coordinates displayed are referenced by North American Datum of 1983, World Geodetic System, 1984.

(b) *Definitions.* For the purposes of this section:

Designated representative means a Coast Guard Patrol Commander, including a Coast Guard coxswain, petty officer, or other officer operating a Coast Guard vessel and a Federal, State, and local officer designated by or assisting the Captain of the Port Sector Los Angeles-Long Beach (COTP) in the enforcement of the security zone.

(c) *Regulations.* (1) Under the general security zone regulations in subpart D of this part, you may not enter the security zone described in paragraph (a) of this section unless authorized by the COTP or the COTP's designated representative.

(2) To seek permission to enter, hail Coast Guard Sector Los Angeles—Long Beach on VHF–FM Channel 16 or call at (310) 521–3801. Those in the security zone must comply with all lawful orders or directions given to them by the COTP or the COTP's designated representative.

(3) Upon being hailed by a Coast Guard vessel or his designated representative, by siren, radio, flashing light or other means, the operator of the vessel shall proceed as directed.

(d) *Enforcement period.* This section will be enforced each day from midnight to 11:59 p.m. during the Los Angeles Fleet Week event from August 27, 2019, to September 3, 2019. No vessel or person will be permitted to operate in the security zone without obtaining permission from the COTP or designated representative. General boating public will be notified prior to the enforcement of the temporary security zone via Broadcast Notice to Mariners.

Dated: August 16, 2019.

R.E. Ore,

Captain, U.S. Coast Guard, Acting, Captain of the Port Sector Los Angeles—Long Beach.

[FR Doc. 2019–18119 Filed 8–21–19; 8:45 am]

BILLING CODE 9110–04–P

DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Part 165

[Docket No. USCG–2019–0685]

RIN 1625–AA00

Safety Zone; Waterview Loft Wedding, Detroit River, MI

AGENCY: Coast Guard, DHS.

ACTION: Temporary final rule.

SUMMARY: The Coast Guard is establishing a temporary safety zone for navigable waters within a 120-yard radius of a portion of the Detroit River, Detroit, MI. This zone is necessary to protect spectators and vessels from potential hazards associated with the Waterview Loft Wedding Fireworks.

DATES: This temporary final rule is effective from 9:30 p.m. through 10 p.m. on August 31, 2019.

ADDRESSES: To view documents mentioned in this preamble as being available in the docket, go to *http://www.regulations.gov,* type USCG–2019–0685 in the ''SEARCH'' box and click ''SEARCH.'' Click on Open Docket Folder on the line associated with this rule.

FOR FURTHER INFORMATION CONTACT: If you have questions on this temporary rule, call or email Tracy Girard, Prevention Department, Sector Detroit, Coast Guard; telephone 313–568–9564, or email *Tracy.M.Girard@uscg.mil.*

SUPPLEMENTARY INFORMATION:

I. Table of Abbreviations

CFR Code of Federal Regulations
COTP Captain of the Port Detroit
DHS Department of Homeland Security
FR Federal Register
NPRM Notice of Proposed Rulemaking
§ Section
U.S.C. United States Code

II. Background Information and Regulatory History

The Coast Guard is issuing this temporary rule without prior notice and opportunity to comment pursuant to authority under section 4(a) of the Administrative Procedure Act (APA) (5 U.S.C. 553(b)). This provision authorizes an agency to issue a rule without prior notice and opportunity to comment when the agency for good cause finds that those procedures are ''impracticable, unnecessary, or contrary to the public interest.'' Under 5 U.S.C. 553(b)(B), the Coast Guard finds that good cause exists for not publishing a notice of proposed rulemaking (NPRM) with respect to this rule because doing so would be impracticable. The Coast Guard did not receive the final details of this fireworks display in time to publish an NPRM. As such, it is impracticable to publish an NPRM because we lack sufficient time to provide a reasonable comment period and then consider those comments before issuing the rule. Furthermore, immediate action is needed to allow the Coast Guard to enhance the safety of this event.

Under 5 U.S.C. 553(d)(3), the Coast Guard finds that good cause exists for making this rule effective less than 30 days after publication in the **Federal Register**. Delaying the effective date of this rule would inhibit the Coast Guard's ability to protect participants, mariners and vessels from the hazards associated with this event.

III. Legal Authority and Need for Rule

The Coast Guard is issuing this rule under authority in 46 U.S.C. 70034. The Captain of the Port Detroit (COTP) has determined that potential hazard associated with fireworks from 9:30 p.m. through 10 p.m. on August 31, 2019 will be a safety concern to anyone within a 120-yard radius of the launch site. This rule is needed to protect personnel, vessels, and the marine environment in the navigable waters within the safety zone while the fireworks are being displayed.

IV. Discussion of the Rule

This rule establishes a safety zone from 9:30 p.m. through 10 p.m. on August 31, 2019. The safety zone will encompass all U.S. navigable waters of the Detroit River, Detroit, MI, within a 120-yard radius of position 42°19.529′ N, 083°02.436′ W (NAD 83). No vessel or person will be permitted to enter the safety zone without obtaining permission from the COTP or a designated representative.

V. Regulatory Analyses

We developed this rule after considering numerous statutes and Executive orders related to rulemaking. Below we summarize our analyses based on a number of these statutes and Executive orders, and we discuss First Amendment rights of protestors.

A. Regulatory Planning and Review

Executive Orders 12866 and 13563 direct agencies to assess the costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits. Executive Order 13771 directs agencies to control regulatory costs through a budgeting process. This rule has not been designated a ''significant regulatory action,'' under Executive Order 12866. Accordingly, this rule has not been reviewed by the Office of Management and Budget (OMB), and pursuant to OMB guidance it is exempt from the requirements of Executive Order 13771.

This regulatory action determination is based on the size, location, duration, and time-of-year of the safety zone. Vessel traffic will be able to safely transit around this safety zone which will impact a small designated area of the Detroit River from 9:30 p.m. through 10 p.m. on August 31, 2019. Moreover, the Coast Guard will issue Broadcast Notice to Mariners (BNM) via VHF–FM marine channel 16 about the zone and the rule allows vessels to seek permission to enter the zone.

B. Impact on Small Entities

The Regulatory Flexibility Act of 1980, 5 U.S.C. 601–612, as amended, requires Federal agencies to consider the potential impact of regulations on small entities during rulemaking. The term ''small entities'' comprises small businesses, not-for-profit organizations that are independently owned and operated and are not dominant in their fields, and governmental jurisdictions with populations of less than 50,000. The Coast Guard certifies under 5 U.S.C. 605(b) that this rule will not have a significant economic impact on a substantial number of small entities.

While some owners or operators of vessels intending to transit the safety zone may be small entities, for the reasons stated in section V.A above, this rule will not have a significant economic impact on any vessel owner or operator.

Under section 213(a) of the Small Business Regulatory Enforcement Fairness Act of 1996 (Pub. L. 104–121), we want to assist small entities in understanding this rule. If the rule would affect your small business, organization, or governmental jurisdiction and you have questions concerning its provisions or options for compliance, please contact the person listed in the **FOR FURTHER INFORMATION CONTACT** section.

Small businesses may send comments on the actions of Federal employees who enforce, or otherwise determine compliance with, Federal regulations to the Small Business and Agriculture Regulatory Enforcement Ombudsman and the Regional Small Business Regulatory Fairness Boards. The Ombudsman evaluates these actions annually and rates each agency's responsiveness to small business. If you wish to comment on actions by employees of the Coast Guard, call 1–888–REG–FAIR (1–888–734–3247). The Coast Guard will not retaliate against small entities that question or complain about this rule or any policy or action of the Coast Guard.

C. Collection of Information

This rule will not call for a new collection of information under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520).

D. Federalism and Indian Tribal Governments

A rule has implications for federalism under Executive Order 13132, Federalism, if it has 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. We have analyzed this rule under that Order and have determined that it is consistent with the fundamental federalism principles and preemption requirements described in Executive Order 13132.

Also, this rule does not have tribal implications under Executive Order 13175, Consultation and Coordination with Indian Tribal Governments, because it does not have a substantial direct effect on one or more Indian tribes, on the relationship between the Federal Government and Indian tribes, or on the distribution of power and responsibilities between the Federal Government and Indian tribes. If you believe this rule has implications for federalism or Indian tribes, please contact the person listed in the **FOR FURTHER INFORMATION CONTACT** section above.

E. Unfunded Mandates Reform Act

The Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531–1538) requires Federal agencies to assess the effects of their discretionary regulatory actions. In particular, the Act addresses actions that may result in the expenditure by a State, local, or tribal government, in the aggregate, or by the private sector of $100,000,000 (adjusted for inflation) or more in any one year. Though this rule will not result in such an expenditure, we do discuss the effects of this rule elsewhere in this preamble.

F. Environment

We have analyzed this rule under Department of Homeland Security Directive 023–01 and Environmental Planning COMDTINST 5090.1 (series), which guide the Coast Guard in complying with the National Environmental Policy Act of 1969 (42 U.S.C. 4321–4370f), and have determined that this action is one of a category of actions that do not individually or cumulatively have a significant effect on the human environment. This rule involves a safety zone lasting one and a half hours on two nights that will prohibit entry into a designated area. It is categorically excluded from further review under paragraph L[60](a) in Table 3–1 of U.S. Coast Guard Environmental Planning Implementing Procedures 5090.1. A Record of Environmental Consideration supporting this determination is available in the docket where indicated under **ADDRESSES**.

G. Protest Activities

The Coast Guard respects the First Amendment rights of protesters. Protesters are asked to contact the person listed in the **FOR FURTHER INFORMATION CONTACT** section to coordinate protest activities so that your message can be received without jeopardizing the safety or security of people, places or vessels.

List of Subjects in 33 CFR Part 165

Harbors, Marine safety, Navigation (water), Reporting and recordkeeping requirements, Security measures, Waterways.

For the reasons discussed in the preamble, the Coast Guard amends 33 CFR part 165 as follows:

PART 165—REGULATED NAVIGATION AREAS AND LIMITED AC

■ 1. The authority citation for part 165 continues to read as follows:

Authority: 46 U.S.C. 70034, 70051; 33 CFR 1.05–1, 6.04–1, 6.04–6, and 160.5; Department of Homeland Security Delegation No. 0170.1.

■ 2. Add § 165.T09–0685 to read as follows:

§ 165.T09–0685 Safety Zone; Waterview Loft Wedding, Detroit, MI.

(a) *Location.* A safety zone is established to include all U.S. navigable waters of the Detroit River, Detroit, MI, within a 120-yard radius of position 42°19.529′ N, 083°02.436′ W (NAD 83).

(b) *Enforcement period.* The regulated area described in paragraph (a) will be enforced from 9:30 p.m. until 10 p.m. on August 31, 2019.

(c) *Regulations.* (1) No vessel or person may enter, transit through, or anchor within the safety zone unless authorized by the Captain of the Port Detroit (COTP), or his or her on-scene representative.

(2) The safety zone is closed to all vessel traffic, except as may be

permitted by the COTP or his or her on-scene representative.

(3) The ''on-scene representative'' of COTP is any Coast Guard commissioned, warrant or petty officer or a Federal, State, or local law enforcement officer designated by or assisting the Captain of the Port Detroit to act on his or her behalf.

(4) Vessel operators shall contact the COTP or his or her on-scene representative to obtain permission to enter or operate within the safety zone. The COTP or his or her on-scene representative may be contacted via VHF Channel 16 or at (313) 568–9464. Vessel operators given permission to enter or operate in the regulated area must comply with all directions given to them by the COTP or his or her on-scene representative.

Dated: August 16, 2019.

Jeffrey W. Novak,

Captain, U.S. Coast Guard, Captain of the Port Detroit.

[FR Doc. 2019–18106 Filed 8–21–19; 8:45 am]

BILLING CODE 9110–04–P

DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Part 165

[Docket No. USCG–2019–0692]

RIN 1625–AA00

Safety Zone; Waterview Loft ASM Event Fireworks, Detroit River, MI

AGENCY: Coast Guard, DHS.

ACTION: Temporary final rule.

SUMMARY: The Coast Guard is establishing a temporary safety zone for navigable waters within a 120-yard radius of a portion of the Detroit River, Detroit, MI. This zone is necessary to protect spectators and vessels from potential hazards associated with the Waterview Loft ASM Event Fireworks.

DATES: This temporary final rule is effective from 8 p.m. through 8:30 p.m. on October 16, 2019.

ADDRESSES: To view documents mentioned in this preamble as being available in the docket, go to *http://www.regulations.gov,* type USCG–2019–0692 in the ''SEARCH'' box and click ''SEARCH.'' Click on Open Docket Folder on the line associated with this rule.

FOR FURTHER INFORMATION CONTACT: If you have questions on this temporary rule, call or email Tracy Girard, Prevention Department, Sector Detroit, Coast Guard; telephone 313–568–9564, or email *Tracy.M.Girard@uscg.mil.*

SUPPLEMENTARY INFORMATION:

I. Table of Abbreviations

CFR Code of Federal Regulations
COTP Captain of the Port Detroit
DHS Department of Homeland Security
FR Federal Register
NPRM Notice of Proposed Rulemaking
§ Section
U.S.C. United States Code

II. Background Information and Regulatory History

The Coast Guard is issuing this temporary rule without prior notice and opportunity to comment pursuant to authority under section 4(a) of the Administrative Procedure Act (APA) (5 U.S.C. 553(b)). This provision authorizes an agency to issue a rule without prior notice and opportunity to comment when the agency for good cause finds that those procedures are ''impracticable, unnecessary, or contrary to the public interest.'' Under 5 U.S.C. 553(b)(B), the Coast Guard finds that good cause exists for not publishing a notice of proposed rulemaking (NPRM) with respect to this rule because doing so would be impracticable. The Coast Guard did not receive the final details of this fireworks display in time to publish an NPRM. As such, it is impracticable to publish an NPRM because we lack sufficient time to provide a reasonable comment period and then consider those comments before issuing the rule. Furthermore, immediate action is needed to allow the Coast Guard to enhance the safety of this event.

III. Legal Authority and Need for Rule

The Coast Guard is issuing this rule under authority in 46 U.S.C. 70034. The Captain of the Port Detroit (COTP) has determined that potential hazard associated with fireworks from 8 p.m. through 8:30 p.m. on October 16, 2019 will be a safety concern to anyone within a 120-yard radius of the launch site. This rule is needed to protect personnel, vessels, and the marine environment in the navigable waters within the safety zone while the fireworks are being displayed.

IV. Discussion of the Rule

This rule establishes a safety zone from 8 p.m. through 8:30 p.m. on October 16, 2019. The safety zone will encompass all U.S. navigable waters of the Detroit River, Detroit, MI, within a 120-yard radius of position 42°19.529′ N, 083°02.436′ W (NAD 83). No vessel or person will be permitted to enter the safety zone without obtaining permission from the COTP or a designated representative.

V. Regulatory Analyses

We developed this rule after considering numerous statutes and Executive orders related to rulemaking. Below we summarize our analyses based on a number of these statutes and Executive orders, and we discuss First Amendment rights of protestors.

A. Regulatory Planning and Review

Executive Orders 12866 and 13563 direct agencies to assess the costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits. Executive Order 13771 directs agencies to control regulatory costs through a budgeting process. This rule has not been designated a ''significant regulatory action,'' under Executive Order 12866. Accordingly, this rule has not been reviewed by the Office of Management and Budget (OMB), and pursuant to OMB guidance it is exempt from the requirements of Executive Order 13771.

This regulatory action determination is based on the size, location, duration, and time-of-year of the safety zone. Vessel traffic will be able to safely transit around this safety zone which will impact a small designated area of the Detroit River from 8 p.m. through 8:30 p.m. on October 16, 2019. Moreover, the Coast Guard will issue Broadcast Notice to Mariners (BNM) via VHF–FM marine channel 16 about the zone and the rule allows vessels to seek permission to enter the zone.

B. Impact on Small Entities

The Regulatory Flexibility Act of 1980, 5 U.S.C. 601–612, as amended, requires Federal agencies to consider the potential impact of regulations on small entities during rulemaking. The term ''small entities'' comprises small businesses, not-for-profit organizations that are independently owned and operated and are not dominant in their fields, and governmental jurisdictions with populations of less than 50,000. The Coast Guard certifies under 5 U.S.C. 605(b) that this rule will not have a significant economic impact on a substantial number of small entities.

While some owners or operators of vessels intending to transit the safety zone may be small entities, for the reasons stated in section V.A above, this rule will not have a significant economic impact on any vessel owner or operator.

Under section 213(a) of the Small Business Regulatory Enforcement

Fairness Act of 1996 (Pub. L. 104–121), we want to assist small entities in understanding this rule. If the rule would affect your small business, organization, or governmental jurisdiction and you have questions concerning its provisions or options for compliance, please contact the person listed in the **FOR FURTHER INFORMATION CONTACT** section.

Small businesses may send comments on the actions of Federal employees who enforce, or otherwise determine compliance with, Federal regulations to the Small Business and Agriculture Regulatory Enforcement Ombudsman and the Regional Small Business Regulatory Fairness Boards. The Ombudsman evaluates these actions annually and rates each agency's responsiveness to small business. If you wish to comment on actions by employees of the Coast Guard, call 1–888–REG–FAIR (1–888–734–3247). The Coast Guard will not retaliate against small entities that question or complain about this rule or any policy or action of the Coast Guard.

C. Collection of Information

This rule will not call for a new collection of information under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520).

D. Federalism and Indian Tribal Governments

A rule has implications for federalism under Executive Order 13132, Federalism, if it has 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. We have analyzed this rule under that Order and have determined that it is consistent with the fundamental federalism principles and preemption requirements described in Executive Order 13132.

Also, this rule does not have tribal implications under Executive Order 13175, Consultation and Coordination with Indian Tribal Governments, because it does not have a substantial direct effect on one or more Indian tribes, on the relationship between the Federal Government and Indian tribes, or on the distribution of power and responsibilities between the Federal Government and Indian tribes. If you believe this rule has implications for federalism or Indian tribes, please contact the person listed in the **FOR FURTHER INFORMATION CONTACT** section above.

E. Unfunded Mandates Reform Act

The Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531–1538) requires Federal agencies to assess the effects of their discretionary regulatory actions. In particular, the Act addresses actions that may result in the expenditure by a State, local, or tribal government, in the aggregate, or by the private sector of $100,000,000 (adjusted for inflation) or more in any one year. Though this rule will not result in such an expenditure, we do discuss the effects of this rule elsewhere in this preamble.

F. Environment

We have analyzed this rule under Department of Homeland Security Directive 023–01 and Environmental Planning COMDTINST 5090.1 (series), which guide the Coast Guard in complying with the National Environmental Policy Act of 1969 (42 U.S.C. 4321–4370f), and have determined that this action is one of a category of actions that do not individually or cumulatively have a significant effect on the human environment. This rule involves a safety zone lasting one and a half hours on two nights that will prohibit entry into a designated area. It is categorically excluded from further review under paragraph L[60](a) in Table 3–1 of U.S. Coast Guard Environmental Planning Implementing Procedures 5090.1. A Record of Environmental Consideration supporting this determination is available in the docket where indicated under **ADDRESSES**.

G. Protest Activities

The Coast Guard respects the First Amendment rights of protesters. Protesters are asked to contact the person listed in the **FOR FURTHER INFORMATION CONTACT** section to coordinate protest activities so that your message can be received without jeopardizing the safety or security of people, places or vessels.

List of Subjects in 33 CFR Part 165

Harbors, Marine safety, Navigation (water), Reporting and recordkeeping requirements, Security measures, Waterways.

For the reasons discussed in the preamble, the Coast Guard amends 33 CFR part 165 as follows:

PART 165—REGULATED NAVIGATION AREAS AND LIMITED ACCESS AREAS

■ 1. The authority citation for part 165 continues to read as follows:

Authority: 46 U.S.C. 70034, 70051; 33 CFR 1.05–1, 6.04–1, 6.04–6, and 160.5; Department of Homeland Security Delegation No. 0170.1.

■ 2. Add § 165.T09–0692 to read as follows:

§ 165.T09–0692 Safety Zone; Waterview Loft ASM Event Fireworks, Detroit, MI.

(a) *Location.* A safety zone is established to include all U.S. navigable waters of the Detroit River, Detroit, MI, within a 120-yard radius of position 42°19.529′ N, 083°02.436′ W (NAD 83).

(b) *Enforcement period.* The regulated area described in paragraph (a) will be enforced from 8 p.m. until 8:30 p.m. on October 16, 2019.

(c) *Regulations.* (1) No vessel or person may enter, transit through, or anchor within the safety zone unless authorized by the Captain of the Port Detroit (COTP), or his or her on-scene representative.

(2) The safety zone is closed to all vessel traffic, except as may be permitted by the COTP or his or her on-scene representative.

(3) The ''on-scene representative'' of COTP is any Coast Guard commissioned, warrant or petty officer or a Federal, State, or local law enforcement officer designated by or assisting the Captain of the Port Detroit to act on his or her behalf.

(4) Vessel operators shall contact the COTP or his or her on-scene representative to obtain permission to enter or operate within the safety zone. The COTP or his or her on-scene representative may be contacted via VHF Channel 16 or at (313) 568–9464. Vessel operators given permission to enter or operate in the regulated area must comply with all directions given to them by the COTP or his or her on-scene representative.

Dated: August 16, 2019.

Jeffrey W. Novak,

Captain, U.S. Coast Guard, Captain of the Port Detroit.

[FR Doc. 2019–18105 Filed 8–21–19; 8:45 am]

BILLING CODE 9110–04–P

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 52

[EPA–R07–OAR–2019–0293; FRL–9998–39–Region 7]

Air Plan Approval; Missouri; Revision to Reference Methods Rule

AGENCY: Environmental Protection Agency.

ACTION: Final rule.

SUMMARY: The Environmental Protection Agency (EPA) is taking final action to

approve a State Implementation Plan (SIP) revision submitted by the State of Missouri on January 14, 2019. The revision submitted by the state is an amendment to a rule relating to reference methods for determining ambient air/atmosphere data and information necessary for the enforcement of air pollution control regulations throughout Missouri. The revision is administrative in nature and either incorporates by reference or updates state rules to match Federal regulations. This revision does not have an adverse effect on air quality. The EPA's approval of this rule revision is being done in accordance with the requirements of the Clean Air Act (CAA).

DATES: This final rule is effective on September 23, 2019.

ADDRESSES: The EPA has established a docket for this action under Docket ID No. EPA–R07–OAR–2019–0293. All documents in the docket are listed on the *https://www.regulations.gov* website. Although listed in the index, some information is not publicly available, *i.e.,* CBI or other information whose disclosure is restricted by statute. Certain other material, such as copyrighted material, is not placed on the internet and will be publicly available only in hard copy form. Publicly available docket materials are available through *https://www.regulations.gov* or please contact the person identified in the **FOR FURTHER INFORMATION CONTACT** section for additional information.

FOR FURTHER INFORMATION CONTACT: Jonathan Meyer, Environmental Protection Agency, Region 7 Office, Air Quality Planning Branch, 11201 Renner Boulevard, Lenexa, Kansas 66219; telephone number (913) 551–7140; email address *meyer.jonathan@epa.gov.*

SUPPLEMENTARY INFORMATION: Throughout this document "we," "us," and "our" refer to the EPA.

Table of Contents

I. Background

On June 11, 2019, the EPA proposed approval of revisions to the Missouri SIP in the **Federal Register** that amend a rule relating to reference methods for determining ambient air/atmosphere data and information necessary for the enforcement of air pollution control regulations throughout Missouri. *See* 84 FR 27053. The EPA solicited comments on the proposed revision to Missouri's SIP, and did not receive any comments.

II. What is being addressed in this document?

The EPA is approving a revision to Missouri's SIP by approving the state's request to revise 10 CSR 10–6.040, *Reference Methods,* received January 14, 2019. Specifically, the revision updates the state's incorporation by reference of all reference methods found in 40 CFR part 50 appendices A through R, as well as equivalent methods as specified in 40 CFR part 53. The 40 CFR part 50 appendices describe the methods for measuring ambient concentrations of various pollutants for which NAAQS have been established. In addition, the revision updates American Society for Testing and Materials (ASTM) standards and includes numerous ASTM standards that are referenced in separate state rules.

A detailed discussion of Missouri's SIP revision was provided in the EPA's June 11, 2019, **Federal Register** document and in a Technical Support Document (TSD) that is available in the docket for this action. *See* 84 FR 27053.

III. Have the requirements for approval of a SIP revision been met?

The state submission has met the public notice requirements for SIP submissions in accordance with 40 CFR 51.102. The submission also satisfied the completeness criteria of 40 CFR part 51, appendix V. The state provided public notice on this SIP revision from June 25, 2018 to August 2, 2018 and received zero comments. In addition, the revision meets the substantive SIP requirements of the CAA, including section 110 and implementing regulations.

IV. What action is the EPA taking?

We are taking final action to approve the revisions to 10 CSR 6.040, *Reference Methods.*

V. Incorporation by Reference

In this document, the EPA is finalizing regulatory text that includes incorporation by reference. In accordance with requirements of 1 CFR 51.5, the EPA is finalizing the incorporation by reference of the Missouri Regulations described in the amendments to 40 CFR part 52 set forth below. The EPA has made, and will continue to make, these materials generally available through *www.regulations.gov* and at the EPA Region 7 Office (please contact the person identified in the **FOR FURTHER INFORMATION CONTACT** section of this preamble for more information).

Therefore, these materials have been approved by the EPA for inclusion in the State implementation plan, have been incorporated by reference by EPA into that plan, are fully federally enforceable under sections 110 and 113 of the CAA as of the effective date of the final rulemaking of the EPA's approval, and will be incorporated by reference in the next update to the SIP compilation.[1]

VI. Statutory and Executive Order Reviews

Under the CAA, the Administrator is required to approve a SIP submission that complies with the provisions of the Act and applicable Federal regulations. 42 U.S.C. 7410(k); 40 CFR 52.02(a). Thus, in reviewing SIP submissions, the EPA's role is to approve state choices, provided that they meet the criteria of the CAA. Accordingly, this action merely approves state law as meeting Federal requirements and does not impose additional requirements beyond those imposed by state law. For that reason, this action:

- Is not a significant regulatory action subject to review by the Office of Management and Budget under Executive Orders 12866 (58 FR 51735, October 4, 1993) and 13563 (76 FR 3821, January 21, 2011);
- Is not an Executive Order 13771 (82 FR 9339, February 2, 2017) regulatory action because SIP approvals are exempted under Executive Order 12866.
- Does not impose an information collection burden under the provisions of the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*);
- Is certified as not having a significant economic impact on a substantial number of small entities under the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*);
- Does not contain any unfunded mandate or significantly or uniquely affect small governments, as described in the Unfunded Mandates Reform Act of 1995 (Pub. L. 104–4);
- Does not have Federalism implications as specified in Executive Order 13132 (64 FR 43255, August 10, 1999);
- Is not an economically significant regulatory action based on health or safety risks subject to Executive Order 13045 (62 FR 19885, April 23, 1997);
- Is not a significant regulatory action subject to Executive Order 13211 (66 FR 28355, May 22, 2001);
- Is not subject to requirements of the National Technology Transfer and Advancement Act (NTTA) because this

[1] 62 FR 27968 (May 22, 1997).

rulemaking does not involve technical standards; and

• Does not provide EPA with the discretionary authority to address, as appropriate, disproportionate human health or environmental effects, using practicable and legally permissible methods, under Executive Order 12898 (59 FR 7629, February 16, 1994).

In addition, the SIP is not approved to apply on any Indian reservation land or in any other area where the EPA or an Indian tribe has demonstrated that a tribe has jurisdiction. In those areas of Indian country, the rule does not have tribal implications and will not impose substantial direct costs on tribal governments or preempt tribal law as specified by Executive Order 13175 (65 FR 67249, November 9, 2000).

The Congressional Review Act, 5 U.S.C. 801 *et seq.,* as added by the Small Business Regulatory Enforcement Fairness Act of 1996, generally provides that before a rule may take effect, the agency promulgating the rule must submit a rule report, which includes a copy of the rule, to each House of the Congress and to the Comptroller General of the United States. EPA will submit a report containing this action and other required information to the U.S. Senate, the U.S. House of Representatives, and the Comptroller General of the United States prior to publication of the rule in the **Federal Register**. A major rule cannot take effect until 60 days after it is published in the **Federal Register**. This action is not a ''major rule'' as defined by 5 U.S.C. 804(2).

Under section 307(b)(1) of the CAA, petitions for judicial review of this action must be filed in the United States Court of Appeals for the appropriate circuit by October 21, 2019. Filing a petition for reconsideration by the Administrator of this final rule does not affect the finality of this action for the purposes of judicial review nor does it extend the time within which a petition for judicial review may be filed and shall not postpone the effectiveness of such rule or action. This action may not be challenged later in proceedings to enforce its requirements. (See section 307(b)(2)).

List of Subjects in 40 CFR Part 52

Environmental protection, Air pollution control, Carbon monoxide, Incorporation by reference, Intergovernmental relations, Lead, Nitrogen dioxide, Ozone, Particulate matter, Reporting and recordkeeping requirements, Sulfur oxides, Volatile organic compounds.

Dated: August 15, 2019.

Edward Chu,

Acting Regional Administrator, Region 7.

For the reasons stated in the preamble, the EPA amends 40 CFR part 52 as set forth below:

PART 52—APPROVAL AND PROMULGATION OF IMPLEMENTATION PLANS

■ 1. The authority citation for part 52 continues to read as follows:

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

Subpart AA—Missouri

■ 2. In § 52.1320, the table in paragraph (c) is amended by revising the entry for ''10–6.040'' to read as follows:

§ 52.1320 Identification of plan.

* * * * *

(c) * * *

EPA-APPROVED MISSOURI REGULATIONS

Missouri citation	Title	State effective date	EPA approval date	Explanation
Missouri Department of Natural Resources				
* * * * * * *				
Chapter 6—Air Quality Standards, Definitions, Sampling and Reference Methods, and Air Pollution Control Regulations for the State of Missouri				
* * * * * * *				
10–6.040	Reference Methods	1/30/2019	8/22/2019, [insert ***Federal Register*** citation]	
* * * * * * *				

* * * * *

[FR Doc. 2019–18035 Filed 8–21–19; 8:45 am]

BILLING CODE 6560–50–P

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Parts 52 and 70

[EPA–R07–OAR–2019–0300; FRL–9998–41–Region 7]

Air Plan Approval; Missouri; Revision to Emission Data, Emission Fees and Process Information Rule

AGENCY: Environmental Protection Agency (EPA).

ACTION: Final rule.

SUMMARY: The Environmental Protection Agency (EPA) is taking final action to approve a State Implementation Plan (SIP) and Operating Permits Program revision submitted by the State of Missouri on January 15, 2019. The revisions add definitions, remove language referring to outdated emission fees, and update incorporations by reference in the rule. The revision is administrative in nature and does not have an adverse effect on air quality. The EPA's approval of this rule revision is being done in accordance with the requirements of the Clean Air Act (CAA).

DATES: This final rule is effective on September 23, 2019.

ADDRESSES: The EPA has established a docket for this action under Docket ID No. EPA–R07–OAR–2019–0300. All documents in the docket are listed on the *https://www.regulations.gov* website. Although listed in the index, some information is not publicly available, *i.e.,* CBI or other information whose disclosure is restricted by statute. Certain other material, such as copyrighted material, is not placed on the internet and will be publicly available only in hard copy form. Publicly available docket materials are available through *https://www.regulations.gov* or please contact the person identified in the **FOR FURTHER INFORMATION CONTACT** section for additional information.

FOR FURTHER INFORMATION CONTACT: Jonathan Meyer, Environmental Protection Agency, Region 7 Office, Air Quality Planning Branch, 11201 Renner Boulevard, Lenexa, Kansas 66219; telephone number (913) 551–7140; email address *meyer.jonathan@epa.gov.*

SUPPLEMENTARY INFORMATION: Throughout this document ''we,'' ''us,'' and ''our'' refer to the EPA.

Table of Contents

I. Background

On June 11, 2019, the EPA proposed to approve revisions to the Missouri SIP and Operating Permits Program in the **Federal Register**. *See* 84 FR 27055. The proposed revisions added definitions, removed language referring to outdated emission fees, and updated incorporations by reference in the rule. The EPA solicited comments on the proposed revisions to Missouri's SIP and Operating Permits Program, and received one comment. The comment was not related to the proposed rule and therefore a response is not required.

II. What is being addressed in this document?

The EPA is approving a revision to Missouri's SIP by approving the state's request to revise 10 CSR 10–6.110, *Reporting Emission Data, Emission Fees, and Process Information,* received January 15, 2019. Missouri revised 10 CSR 10–6.110 to correct minor typographical errors.

A detailed discussion of the revision to Missouri's SIP and Operating Permits Program was provided in EPA's June 11, 2019, **Federal Register** doument. *See* 84 FR 27055.

III. Have the requirements for approval of a SIP revision and operating permits program been met?

The state submission has met the public notice requirements for SIP submissions in accordance with 40 CFR 51.102. The submission also satisfied the completeness criteria of 40 CFR part 51, appendix V. The state provided public notice on this SIP revision from June 25, 2018, to August 2, 2018, and received comments from the EPA and a regulated entity. The state adequately addressed the public comments. In addition, the revision meets the substantive SIP requirements of the CAA, including section 110 and implementing regulations.

IV. What action is the EPA taking?

We are taking final action to approve the revisions to Missouri's SIP and Missouri's Operating Permits Program by approving the state's request to revise 10 CSR 10–6.110, *Reporting Emission Data, Emission Fees, and Process Information.*

V. Incorporation by Reference

In this document, the EPA is finalizing regulatory text that includes incorporation by reference. In accordance with requirements of 1 CFR 51.5, the EPA is finalizing the incorporation by reference of the Missouri Regulations described in the amendments to 40 CFR part 52 set forth below. The EPA has made, and will continue to make, these materials generally available through *www.regulations.gov* and at the EPA Region 7 Office (please contact the person identified in the **FOR FURTHER INFORMATION CONTACT** section of this preamble for more information).

Therefore, these materials have been approved by the EPA for inclusion in the State implementation plan, have been incorporated by reference by EPA into that plan, are fully federally enforceable under sections 110 and 113 of the CAA as of the effective date of the final rulemaking of the EPA's approval, and will be incorporated by reference in the next update to the SIP compilation.[1]

VI. Statutory and Executive Order Reviews

Under the CAA, the Administrator is required to approve a SIP submission that complies with the provisions of the Act and applicable Federal regulations. 42 U.S.C. 7410(k); 40 CFR 52.02(a). Thus, in reviewing SIP submissions, the EPA's role is to approve state choices, provided that they meet the criteria of the CAA. Accordingly, this action merely approves state law as meeting Federal requirements and does not impose additional requirements beyond those imposed by state law. For that reason, this action:

- Is not a significant regulatory action subject to review by the Office of Management and Budget under Executive Orders 12866 (58 FR 51735, October 4, 1993) and 13563 (76 FR 3821, January 21, 2011);
- Is not an Executive Order 13771 (82 FR 9339, February 2, 2017) regulatory action because SIP approvals are exempted under Executive Order 12866.
- Does not impose an information collection burden under the provisions of the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*);
- Is certified as not having a significant economic impact on a substantial number of small entities under the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*);
- Does not contain any unfunded mandate or significantly or uniquely affect small governments, as described in the Unfunded Mandates Reform Act of 1995 (Pub. L. 104–4);
- Does not have Federalism implications as specified in Executive Order 13132 (64 FR 43255, August 10, 1999);
- Is not an economically significant regulatory action based on health or safety risks subject to Executive Order 13045 (62 FR 19885, April 23, 1997);
- Is not a significant regulatory action subject to Executive Order 13211 (66 FR 28355, May 22, 2001);
- Is not subject to requirements of the National Technology Transfer and Advancement Act (NTTA) because this rulemaking does not involve technical standards; and
- Does not provide EPA with the discretionary authority to address, as appropriate, disproportionate human health or environmental effects, using practicable and legally permissible methods, under Executive Order 12898 (59 FR 7629, February 16, 1994).

In addition, the SIP is not approved to apply on any Indian reservation land or in any other area where the EPA or an Indian tribe has demonstrated that a tribe has jurisdiction. In those areas of Indian country, the rule does not have tribal implications and will not impose substantial direct costs on tribal governments or preempt tribal law as specified by Executive Order 13175 (65 FR 67249, November 9, 2000).

The Congressional Review Act, 5 U.S.C. 801 *et seq.,* as added by the Small Business Regulatory Enforcement Fairness Act of 1996, generally provides that before a rule may take effect, the agency promulgating the rule must submit a rule report, which includes a copy of the rule, to each House of the Congress and to the Comptroller General of the United States. EPA will submit a report containing this action and other required information to the U.S. Senate, the U.S. House of Representatives, and the Comptroller General of the United States prior to publication of the rule in the **Federal Register**. A major rule cannot take effect until 60 days after it is published in the **Federal Register**.

[1] 62 FR 27968 (May 22, 1997).

This action is not a ''major rule'' as defined by 5 U.S.C. 804(2).

Under section 307(b)(1) of the CAA, petitions for judicial review of this action must be filed in the United States Court of Appeals for the appropriate circuit by October 21, 2019. Filing a petition for reconsideration by the Administrator of this final rule does not affect the finality of this action for the purposes of judicial review nor does it extend the time within which a petition for judicial review may be filed, and shall not postpone the effectiveness of such rule or action. This action may not be challenged later in proceedings to enforce its requirements. (See section 307(b)(2)).

List of Subjects

40 CFR Part 52

Environmental protection, Air pollution control, Carbon monoxide, Incorporation by reference, Intergovernmental relations, Lead, Nitrogen dioxide, Ozone, Particulate matter, Reporting and recordkeeping requirements, Sulfur oxides, Volatile organic compounds.

40 CFR Part 70

Environmental protection, Administrative practice and procedure, Air pollution control, Intergovernmental relations, Operating permits, Reporting and recordkeeping requirements.

Dated: August 15, 2019.

Edward Chu,

Acting Regional Administrator, Region 7.

For the reasons stated in the preamble, the EPA amends 40 CFR parts 52 and 70 as set forth below:

PART 52—APPROVAL AND PROMULGATION OF IMPLEMENTATION PLANS

■ 1. The authority citation for part 52 continues to read as follows:

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

Subpart AA—MISSOURI

■ 2. In § 52.1320, the table in paragraph (c) is amended by revising the entry for ''10–6.110'' to read as follows:

§ 52.1320 Identification of plan.

* * * * *

(c) * * *

EPA-APPROVED MISSOURI REGULATIONS

Missouri citation	Title	State effective date	EPA approval date	Explanation
Missouri Department of Natural Resources				
* * * * * * *				
Chapter 6—Air Quality Standards, Definitions, Sampling and Reference Methods, and Air Pollution Control Regulations for the State of Missouri				
* * * * * * *				
10–6.110	Reporting Emission Data, Emission Fees, and Process Information.	1/30/2019	8/22/2019, [insert *Federal Register* citation].	Section (3)(A), Emissions Fees, has not been approved as part of the SIP.
* * * * * * *				

* * * * *

PART 70—STATE OPERATING PERMIT PROGRAMS

■ 3. The authority citation for part 70 continues to read as follows:

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

■ 4. Appendix A to part 70 is amended by adding paragraph (hh) under ''*Missouri*'' to read as follows:

Appendix A to Part 70—Approval Status of State and Local Operating Permits Programs

* * * * *

Missouri

* * * * *

(hh) The Missouri Department of Natural Resources submitted revisions to Missouri rule 10 CSR 10–6.110, ''Reporting Emission Data, Emission Fees, and Process Information'' on January 15, 2019. The state effective date is January 30, 2019. Approval of Section 3(A) of 10 CSR 10–6.110 is effective September 23, 2019.

* * * * *

[FR Doc. 2019–18036 Filed 8–21–19; 8:45 am]

BILLING CODE 6560–50–P

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 180

[EPA–HQ–OPP–2018–0244; FRL–9997–94]

Lipochitooligosaccharide (LCO) MOR116; Exemption From the Requirement of a Tolerance

AGENCY: Environmental Protection Agency (EPA).

ACTION: Final rule.

SUMMARY: This regulation establishes an exemption from the requirement of a tolerance for residues of lipochitooliosaccharide (LCO) MOR116 in or on all food commodities when used in accordance with label directions and good agricultural practices. Monsanto Company (now known as Bayer Crop Science LP), submitted a petition to EPA under the Federal Food, Drug, and Cosmetic Act (FFDCA), requesting an exemption from the requirement of a tolerance. This regulation eliminates the need to establish a maximum permissible level for residues of LCO MOR116 under FFDCA.

DATES: This regulation is effective August 22, 2019. Objections and requests for hearings must be received on or before October 21, 2019, and must be filed in accordance with the instructions provided in 40 CFR part 178 (see also Unit I.C. of the SUPPLEMENTARY INFORMATION).

ADDRESSES: The docket for this action, identified by docket identification (ID) number EPA–HQ–OPP–2018–0244, is available at *http://www.regulations.gov* or at the Office of Pesticide Programs Regulatory Public Docket (OPP Docket) in the Environmental Protection Agency Docket Center (EPA/DC), West William Jefferson Clinton Bldg., Rm. 3334, 1301 Constitution Ave. NW, Washington, DC 20460–0001. The Public Reading Room is open from 8:30 a.m. to 4:30 p.m., Monday through Friday, excluding legal holidays. The telephone number for the Public Reading Room is (202) 566–1744, and the telephone number for the OPP Docket is (703) 305–5805. Please review the visitor instructions and additional information about the docket available at *http://www.epa.gov/dockets.*

FOR FURTHER INFORMATION CONTACT: Robert McNally, Biopesticides and Pollution Prevention Division (7511P), Office of Pesticide Programs, Environmental Protection Agency, 1200 Pennsylvania Ave. NW, Washington, DC 20460–0001; main telephone number: (703) 305–7090; email address: *BPPDFRNotices@epa.gov.*

SUPPLEMENTARY INFORMATION:

I. General Information

A. Does this action apply to me?

You may be potentially affected by this action if you are an agricultural producer, food manufacturer, or pesticide manufacturer. The following list of North American Industrial Classification System (NAICS) codes is not intended to be exhaustive, but rather provides a guide to help readers determine whether this document applies to them. Potentially affected entities may include:

- Crop production (NAICS code 111).
- Animal production (NAICS code 112).
- Food manufacturing (NAICS code 311).
- Pesticide manufacturing (NAICS code 32532).

B. How can I get electronic access to other related information?

You may access a frequently updated electronic version of 40 CFR part 180 through the Government Publishing Office's e-CFR site at *http://www.ecfr.gov/cgi-bin/text-idx?&c=ecfr&tpl=/ecfrbrowse/Title40/40tab_02.tpl.*

C. How can I file an objection or hearing request?

Under FFDCA section 408(g), 21 U.S.C. 346a(g), any person may file an objection to any aspect of this regulation and may also request a hearing on those objections. You must file your objection or request a hearing on this regulation in accordance with the instructions provided in 40 CFR part 178. To ensure proper receipt by EPA, you must identify docket ID number EPA–HQ–OPP–2017–0487 in the subject line on the first page of your submission. All objections and requests for a hearing must be in writing and must be received by the Hearing Clerk on or before October 21, 2019. Addresses for mail and hand delivery of objections and hearing requests are provided in 40 CFR 178.25(b).

In addition to filing an objection or hearing request with the Hearing Clerk as described in 40 CFR part 178, please submit a copy of the filing (excluding any Confidential Business Information (CBI)) for inclusion in the public docket. Information not marked confidential pursuant to 40 CFR part 2 may be disclosed publicly by EPA without prior notice. Submit the non-CBI copy of your objection or hearing request, identified by docket ID number EPA–HQ–OPP–2018–0244, by one of the following methods:

- *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the online instructions for submitting comments. Do not submit electronically any information you consider to be CBI or other information whose disclosure is restricted by statute.
- *Mail:* OPP Docket, Environmental Protection Agency Docket Center (EPA/DC), (28221T), 1200 Pennsylvania Ave., NW, Washington, DC 20460–0001.
- *Hand Delivery:* To make special arrangements for hand delivery or delivery of boxed information, please follow the instructions at *http://www.epa.gov/dockets/contacts.html.* Additional instructions on commenting or visiting the docket, along with more information about dockets generally, is available at *http://www.epa.gov/dockets.*

II. Background

In the **Federal Register** of July 24, 2018 (83 FR 34968) (FRL–9980–31), EPA issued a document pursuant to FFDCA section 408(d)(3), 21 U.S.C. 346a(d)(3), announcing the filing of a pesticide tolerance petition (PP 8F8670) by Monsanto Company (now known as Bayer Crop Science LP), 800 N. Lindbergh Blvd., St. Louis, MO 63167. The petition requested that 40 CFR part 180 be amended by establishing an exemption from the requirement of a tolerance for residues of LCO MOR116 in or on all food commodities. That document referenced a summary of the petition prepared by the petitioner, Monsanto Company (now known as Bayer Crop Science LP), which is available in the docket via *http://www.regulations.gov.* There were no comments received in response to the notice of filing.

III. Final Rule

A. EPA's Safety Determination

Section 408(c)(2)(A)(i) of FFDCA allows EPA to establish an exemption from the requirement for a tolerance (the legal limit for a pesticide chemical residue in or on a food) only if EPA determines that the exemption is ''safe.'' Section 408(c)(2)(A)(ii) of FFDCA defines ''safe'' to mean that ''there is a reasonable certainty that no harm will result from aggregate exposure to the pesticide chemical residue, including all anticipated dietary exposures and all other exposures for which there is reliable information.'' This includes exposure through drinking water and in residential settings but does not include occupational exposure. Pursuant to FFDCA section 408(c)(2)(B), in establishing or maintaining in effect an exemption from the requirement of a tolerance, EPA must take into account the factors set forth in FFDCA section 408(b)(2)(C), which require EPA to give special consideration to exposure of infants and children to the pesticide chemical residue in establishing a tolerance or tolerance exemption, and to ''ensure that there is a reasonable certainty that no harm will result to infants and children from aggregate exposure to the pesticide chemical residue . . . .'' Additionally, FFDCA section 408(b)(2)(D) requires that EPA consider ''available information concerning the cumulative effects of [a particular pesticide's] . . . residues and other substances that have a common mechanism of toxicity.''

EPA evaluated the available toxicity and exposure data on LCO MOR116 and considered its validity, completeness, and reliability, as well as the relationship of this information to human risk. EPA also considered available information concerning the variability of the sensitivities of major identifiable subgroups of consumers, including infants and children.

LCO MOR116 a synthetically derived member of the lipochitooligosaccharide (LCO) chemical class. Naturally occurring LCOs function as signaling molecules in the initiation of plant-microbe endosymbioses in an estimated 70–80% of land plants. As a biopesticide, LCO MOR116 is intended to be used as a plant growth regulator (PGR) to increase growth and decrease stress in growing crops. LCO MOR116 has low acute toxicity, low subchronic toxicity and is not a skin sensitizer or mutagen based on the toxicity information presented for the active ingredient and structurally-similar compounds. Dietary and drinking water exposure to LCO MOR116 is not expected for the proposed use as a seed treatment for soybean and application rates are expected to be very low (5.89 X 10–11 lb ai/lb seed). Although no field trial or residue data are available, significant residues are not expected and, therefore, quantitative dietary and drinking water assessments were not conducted.

There are currently no residential uses proposed for LCO MOR116. There is a potential for occupational exposure, however, no toxicological endpoints have been identified. The Agency has determined that no further acute or subchronic toxicity studies are needed at this time considering all the available hazard and exposure data on LCOs and structurally similar compounds. Based on the available toxicity and exposure information, no unreasonable adverse effects to the U.S. population in general, and to infants and children in particular, will result from the use of LCO MOR116 as a pesticide when label instructions are followed.

An explanation of the data upon which EPA relied and its risk assessment based on those data can be found within the (July 30, 2019), document entitled ''Federal Food, Drug, and Cosmetic Act (FFDCA) Safety Assessment for Exemption from the Requirement of a Tolerance for Residues of Lipochitooligosaccharide (LCO) MOR116.'' This document, as well as other relevant information, is available in the docket for this action as described under **ADDRESSES**.

Based on its safety determination, EPA is establishing an exemption from the requirement of a tolerance for residues of LCO MOR116 in or on all food commodities when used on accordance with label directions and good agricultural practices.

B. Analytical Enforcement Methodology

An analytical method is not required for enforcement purposes due to lack of concern for exposures, which supports the establishment of an exemption for residues of LCO MOR116.

IV. Statutory and Executive Order Reviews

This action establishes a tolerance exemption under FFDCA section 408(d) in response to a petition submitted to EPA. The Office of Management and Budget (OMB) has exempted these types of actions from review under Executive Order 12866, entitled ''Regulatory Planning and Review'' (58 FR 51735, October 4, 1993). Because this action has been exempted from review under Executive Order 12866, this action is not subject to Executive Order 13211, entitled ''Actions Concerning Regulations That Significantly Affect Energy Supply, Distribution, or Use'' (66 FR 28355, May 22, 2001), or Executive Order 13045, entitled ''Protection of Children from Environmental Health Risks and Safety Risks'' (62 FR 19885, April 23, 1997), nor is it a regulatory action under Executive Order 13771, entitled ''Reducing Regulations and Controlling Regulatory Costs'' (82 FR 9339, February 3, 2017). This action does not contain any information collections subject to OMB approval under the Paperwork Reduction Act (PRA), 44 U.S.C. 3501 *et seq.,* nor does it require any special considerations under Executive Order 12898, entitled ''Federal Actions to Address Environmental Justice in Minority Populations and Low-Income Populations'' (59 FR 7629, February 16, 1994).

Since tolerances and exemptions that are established on the basis of a petition under FFDCA section 408(d), such as the tolerance exemption in this action, do not require the issuance of a proposed rule, the requirements of the Regulatory Flexibility Act (RFA) (5 U.S.C. 601 *et seq.*) do not apply.

This action directly regulates growers, food processors, food handlers, and food retailers, not States or tribes. As a result, this action does not alter the relationships or distribution of power and responsibilities established by Congress in the preemption provisions of FFDCA section 408(n)(4). As such, EPA has determined that this action will not have a substantial direct effect on States or tribal governments, on the relationship between the national government and the States or tribal governments, or on the distribution of power and responsibilities among the various levels of government or between the Federal Government and Indian tribes. Thus, EPA has determined that Executive Order 13132, entitled ''Federalism'' (64 FR 43255, August 10, 1999), and Executive Order 13175, entitled ''Consultation and Coordination with Indian Tribal Governments'' (65 FR 67249, November 9, 2000), do not apply to this action. In addition, this action does not impose any enforceable duty or contain any unfunded mandate as described under Title II of the Unfunded Mandates Reform Act (UMRA) (2 U.S.C. 1501 *et seq.*).

This action does not involve any technical standards that would require EPA's consideration of voluntary consensus standards pursuant to section 12(d) of the National Technology Transfer and Advancement Act (NTTAA) (15 U.S.C. 272 note).

V. Congressional Review Act

Pursuant to the Congressional Review Act (5 U.S.C. 801 *et seq.*), EPA will submit a report containing this rule and other required information to the U.S. Senate, the U.S. House of Representatives, and the Comptroller General of the United States prior to publication of the rule in the **Federal Register**. This action is not a ''major rule'' as defined by 5 U.S.C. 804(2).

List of Subjects in 40 CFR Part 180

Environmental protection, Administrative practice and procedure, Agricultural commodities, Pesticides and pests, Reporting and recordkeeping requirements.

Dated: August 7, 2019

Richard Keigwin,

Director, Office of Pesticide Programs.

Therefore, 40 CFR chapter I is amended as follows:

PART 180—[AMENDED]

■ 1. The authority citation for part 180 continues to read as follows:

Authority: 21 U.S.C. 321(q), 346a and 371.

■ 2. Add § 180.1370 to subpart D to read as follows:

§ 180.1370 Lipochitoolgiosaccharide (LCO) MOR116; exemption from the requirement of a tolerance.

Residues of the plant growth regulator Lipochitoolgiosaccharide (LCO) MOR116 in or on all food commodities are exempt from the requirement of a tolerance, when used in accordance with label directions and good agricultural practices.

[FR Doc. 2019–17994 Filed 8–21–19; 8:45 am]

BILLING CODE 6560–50–P

FEDERAL COMMUNICATIONS COMMISSION

47 CFR Parts 1, 43, and 54

[WC Docket Nos. 11–10 and 19–195, FCC No. 19–79]

Establishing the Digital Opportunity Data Collection and Modernizing the FCC Form 477 Data Program

AGENCY: Federal Communications Commission.

ACTION: Final rule.

SUMMARY: In this document, the Federal Communications Commission

(Commission) adopts the Digital Opportunity Data Collection, which requires all fixed broadband providers to submit granular maps of the areas where they have broadband-capable networks and make service available. To complement this granular broadband availability data, the Report and Order also adopts a process to begin collecting public input, sometimes known as ''crowdsourcing,'' on the accuracy of fixed providers' broadband deployment data. In addition, the Report and Order leaves in place for now the existing Form 477 data collection, but makes targeted changes to reduce reporting burdens for all providers by removing and clarifying certain requirements and modifying the collection.

DATES: Effective September 23, 2019, except for paragraphs 44 through 51 and 57 through 65 of the Report and Order and the addition of 47 CFR 54.1401 and 54.1402(b) and (c), (d)(2), and (e), which are delayed. The Commission will publish a document in the **Federal Register** announcing the delayed effective date

FOR FURTHER INFORMATION CONTACT: Wireline Competition Bureau, Kirk Burgee, at (202) 418–1599, *Kirk.Burgee@fcc.gov,* or, Wireless Telecommunications Bureau, Garnet Hanly, at (202) 418–0995, *Garnet.Hanly@fcc.gov.* For additional information concerning the Paperwork Reduction Act information collection requirements contained in this document, send an email to *PRA@fcc.gov* or contact Nicole Ongele at (202) 418–2991.

SUPPLEMENTARY INFORMATION: This is a summary of the *Report and Order* as part of the Commission's *Report and Order and Second Further Notice of Proposed Rulemaking* in WC Docket Nos. 11–10 and 19–195, FCC 19–79, adopted August 1, 2019 and released August 6, 2019. The full text of this document is available for public inspection during regular business hours in the FCC Reference Information Center, Portals II, 445 12th Street SW, Room CY–A257, Washington, DC 20554. It also is available on the Commission's website at *https://www.fcc.gov/document/fcc-improves-broadband-mapping-0.* This document contains new and modified information collection requirements. The Commission, as part of its continuing effort to reduce paperwork burdens, will invite the general public to comment on the information collection requirements contained herein as required by the Paperwork Reduction Act of 1995, Public Law 104–13. The effective date for paragraphs 44 through 51 and 57 through 65 of the Report and Order and the addition of 47 CFR 54.1401 and 54.1402(b) and (c), (d)(2), and (e), will be effective 30 days after the announcement in the **Federal Register** of Office of Management and Budget (OMB) approval of information collection requirements modified in the Report and Order and the effective date for the CFR additions.

Synopsis

I. Introduction

1. Accurate broadband deployment data is critical to the Commission's efforts to bridge the digital divide. Effectively targeting federal and state spending efforts to bring broadband to those areas most in need of it means understanding where broadband is available and where it is not. The census-block level fixed broadband service availability reporting the Commission currently requires has been an effective tool for helping the Commission target universal service support to the least-served areas of the country, but has made it difficult for the Commission to direct funding to the ''gaps'' in broadband coverage—those areas where some, but not all, homes and businesses have access to modern communications services.

2. We therefore initiate a new data collection, the Digital Opportunity Data Collection, that is distinct from the existing Form 477 collection and that will gather geospatial broadband service availability data specifically targeted toward advancing our universal service goals. Pursuant to the Digital Opportunity Data Collection, we require all broadband service providers to submit granular maps of the areas where they have broadband-capable networks and make service available. Given the Commission's ongoing investigation into the coverage maps of one or more major mobile operators, we limit the new data collection obligations to fixed broadband providers at present and seek comment on how best to incorporate mobile wireless coverage data into the Digital Opportunity Data Collection.

3. Service providers—who are uniquely situated to know where their own networks are deployed—must determine in the first instance the availability of broadband in their service areas, taking into account their individual circumstances and their on-the-ground knowledge and experience. At the same time, to complement this granular broadband availability data, we adopt a process to begin collecting public input, sometimes known as ''crowdsourcing,'' on the accuracy of service providers' broadband deployment data. Through this new tool, State, local, and Tribal governmental entities and members of the public will be able to submit fixed broadband availability data, leveraging their experience concerning service availability. In addition, because we leave in place for now the existing Form 477 data collection, we make targeted changes to reduce reporting burdens for all providers by removing and clarifying certain requirements and modifying the collection.

II. Background

5. First established in 2000, the Commission's Form 477 began as a collection of subscription and connection data for local telephone and broadband services that helped the Commission to, among other things, meet statutory annual reporting obligations and monitor local voice competition. Over time, the Form 477 data collection has evolved into the primary data source for many Commission actions, including reporting to Congress and the public about the availability of broadband services, informing transaction reviews, and supporting our universal service policies. At the same time, it has become increasingly clear that the fixed and mobile broadband deployment data collected on the Form 477 are not sufficient to understanding where universal service support should be targeted and supporting the imperative of our broadband-deployment policy goals.

6. For purposes of broadband deployment reporting, the Commission currently requires fixed providers to report the census blocks in which their broadband service is available. Fixed broadband connections are available in a census block ''if the provider does, or could, within a service interval that is typical for that kind of connection—that is, without an extraordinary commitment of resources—provision two-way data transmission to and from the internet with *advertised* speeds exceeding 200 kbps in at least one direction to *end-user premises* in the census block.'' However, census-block based fixed deployment data have limitations—providers report whether or not fixed broadband service is available in at least some part of each census block, but not whether there is availability at all areas within a block.

7. Providers of fixed voice and broadband service report on their end-user subscriptions by submitting the total number of connections in each census tract in which they provide service. Providers of mobile voice and broadband service report their total

subscribers for each state in which they provide service to customers. Facilities-based providers of mobile broadband service report on deployment by submitting, for each technology and frequency band employed, polygons in geographic information system (GIS) mapping files that digitally represent the geographic areas in which a customer could expect to receive the minimum speed the service provider advertises for that area. In addition, mobile service providers must report the census tracts in which their service is advertised and available to potential customers.

8. In establishing the Form 477 as its primary vehicle for collecting information about the deployment of broadband services, the Commission predicted that the data from the Form 477 would ''materially improve'' its ability to develop, evaluate, and revise broadband policy, as well as provide valuable benchmarks for Congress, the Commission, other policymakers, and consumers. In its comments in this proceeding, the National Telecommunications and Information Administration (NTIA) states that its analysts ''routinely refer to the Commission's Form 477 data, including both deployment and subscription data, to help inform policymakers and enhance [its] technical support of broadband infrastructure investment.'' The Commission has used aggregate broadband data reported by providers on Form 477 to, among other things: (1) Meet our statutory obligation to annually report on the state of broadband availability; (2) update our universal service policies and monitor whether our universal service goals are being achieved in a cost-effective manner; (3) meet our public safety obligations; and (4) maintain coverage maps to inform stakeholders, including industry and the public.

9. In an effort to collect and develop better quality, more useful, and more granular broadband deployment data, the Commission adopted the *2017 Data Collection Improvement FNPRM* in August 2017. In the *2017 Data Collection Improvement FNPRM,* the Commission sought comment on: (1) Ways in which the Commission might increase the quality and accuracy of the broadband information we collect; and (2) ways in which the Commission might streamline its broadband reporting requirements and thereby reduce the burdens on filers. The Commission also noted that one of its primary objectives is to ensure that the data collected will be closely aligned with the uses to which they will be put, and sought comment on those uses to inform our analysis. In response, we received a voluminous amount of comments, reply comments, and ex parte presentations with specific recommendations on how best to improve our broadband reporting process.

III. Report and Order

10. As the record in this proceeding amply demonstrates, there is a compelling and immediate need to develop granular, high-quality fixed broadband deployment data to improve our ability to target support from our Universal Service Fund (USF) programs. It has become increasingly clear that the fixed and mobile broadband deployment data collected on the Form 477 are not sufficient to support the specific imperative of our USF policy goals. We conclude that in order to continue to advance our statutory universal service obligations, it is necessary to create a new data collection, calculated to produce broadband deployment maps that will allow the Commission to precisely target scarce universal service dollars to where broadband service is lacking. In the *2017 Data Collection Improvement FNPRM,* the Commission sought comment on requiring more granularity in fixed broadband deployment data, noting that it collected location-level data from recipients of USF funding to assess whether they are meeting their buildout requirements, and that this more granular data had been ''extremely useful'' in understanding issues surrounding fixed broadband deployment in these contexts. We find that establishing a new collection requiring fixed providers to submit maps of the areas in which their service is available is the best way to meet those needs expeditiously.

11. We therefore direct the Universal Service Administrative Company (USAC), under the oversight of the Commission's Office of Economics and Analytics (OEA), the Wireline Competition Bureau (WCB), Wireless Telecommunications Bureau (WTB), and the International Bureau (IB), to develop a new portal to accept broadband coverage maps (polygons) from fixed providers, as well as public feedback on the accuracy of these broadband maps. For the time being, we leave the current Form 477 in place, subject to several modifications that eliminate collection of unnecessary data, and seek comment on whether we should sunset some or all of the Form 477 deployment collection. We believe the Form 477 deployment data will continue to be a useful reference point for its existing purposes as well as in relation to the new Digital Opportunity Data Collection. Accordingly, we generally preserve the Form 477 instructions for submitting fixed broadband deployment data, except as may be required to implement the streamlining and other changes set forth below.

A. Establishing Granular Maps of Fixed Broadband Service Availability

12. We require all fixed providers to submit broadband coverage polygons depicting the areas where they actually have broadband-capable networks and make fixed broadband service available to end-user locations. The filings must reflect the maximum download and upload speeds actually made available in each area, the technology used to provide the service, and a differentiation between residential-only, business-only, or residential-and-business broadband services. Fixed providers in the new collection must submit a broadband coverage polygon for each combination of download speed, upload speed, and technology. Where fixed providers offer different maximum speeds to residential and business customers, even if using the same network facilities, they must file separate polygons. Where the offered speed varies by location or distance from network facilities, fixed providers must submit separate polygons to reflect those differing maximum offered speeds.

13. For purposes of the Digital Opportunity Data Collection, service is actually available in an area if the reporting fixed provider has a current broadband connection or it could provide such a connection within ten business days of a customer request, without an extraordinary commitment of resources, and without construction charges or fees exceeding an ordinary service activation fee. The filer must be able to establish a connection within this timeframe to every end-user location contained in the reported broadband coverage polygon. Under this standard, a fixed provider must have fiber or cable in place proximate, if not connected, to the locations within its reported polygons—for example, we expect a residence would be included only if the utility pole or conduit on the right of way adjacent to the residence is already wired and awaiting just a drop cable; additional buildout of the network would represent an extraordinary commitment of resources. A fixed wireless provider must have already installed enough base stations to cover and meet reasonably anticipated customer capacity demands; the installation of an additional base

station, for example, would constitute an extraordinary commitment of resources. Fixed broadband services are not actually available for purposes of the Digital Opportunity Data Collection in any area where the filer does not meet this standard.

14. Although we agree with commenters that it would be ideal for providers to have more precise technical standards to follow in determining whether fixed broadband is available in an area (for example, defining availability based on specific proximity to network facilities), we find insufficient evidence currently in the record to prescribe such technical standards. Without additional information, we risk setting under- and over-inclusive technical standards, likely to result in the drawing of less accurate maps. We therefore seek comment in the *Second Further Notice of Proposed Rulemaking* (*Second FNPRM*) in this item about what standards fixed providers should use to establish the broadband coverage polygons.

15. We direct OEA to oversee USAC in developing the new online portal and the filing processes that will enable fixed providers to submit broadband coverage polygons. We also direct OEA, in consultation with WCB, IB, WTB, and USAC, to carry out the implementation details of the new collection including (but not limited to): (1) Publishing complete instructions for filing data and issuing an order, based on the record received in response to the *Second FNPRM,* that designates the precise specifications for the broadband coverage polygons, subject to the constraints laid out herein; (2) modifying (as needed) the list of fixed-broadband technologies that should be reported in the new collection; and (3) defining the GIS compatible file format(s) in which fixed providers will be required to submit their polygons, taking into account any potential burdens on filers.

16. This new data collection will take effect after the release of the order designating the specifications for the coverage polygons, and after OEA issues a public notice announcing the availability of the new collection platform and the reporting deadlines. Fixed broadband service providers must file initial service availability reports within six months of the public notice announcing availability of the new collection platform. Fixed providers also must submit updates within six months of completing new broadband deployments; making changes to (including upgrading or discontinuing) existing offerings; or otherwise acquiring new, or selling existing, broadband-capable network facilities that affect the data submitted on their Digital Opportunity Data Collection filings. Service providers that become subject to filing requirements subsequent to the initial filing deadline must file initial service availability reports within six months of becoming so obligated and must report data from that initial period. Failure to timely file the new collection data may lead to enforcement action and/or penalties as set forth in the Communications Act and other applicable laws. In addition, fixed providers must revise their filings any time they discover a significant reporting error in the original broadband deployment data that they submit. An appropriate official of each filer must include with any filing a certification that the filer's service availability data is true and accurate to the best of the certifying official's knowledge and must report the title of the certifying official. Filers must additionally certify on or before June 30 of each calendar year that as of December 31 of the previous year, all of the filer's service availability data continues to be accurate, taking into account the filer's data that has been updated during the calendar year.

17. In order to ensure an accurate and detailed picture of broadband deployment, we require all fixed providers to make the required Digital Opportunity Data Collection filings, although we direct WCB, in coordination with OEA, WTB, and IB, to determine whether any category of very small fixed providers (*e.g.,* those with less than 250 subscribers and who are not eligible telecommunications carriers (ETCs) under the USF program) should have additional time in filing their initial reports. We note that any service provider must nevertheless timely file in order to be eligible to participate in any USF program and those that fail to file in a timely manner risk their service areas being deemed unserved in future USF decisions.

18. *Incorporating Public Input into Broadband Coverage Maps.* Collecting broadband coverage polygons will allow fixed providers to apply their expertise concerning their networks and service areas to define their service coverages in the first instance. However, input from the people who live and work in the areas that a service provider purports to serve also plays a vital role in ensuring the quality of these maps, helping to identify areas where the data submitted do not align with the reality on the ground. We therefore direct OEA to work with USAC to create an online portal for local, state, and Tribal governmental entities and members of the public to review and dispute the broadband coverage polygons filed by fixed providers under the new collection. This input will identify locations where a member of the public or a governmental entity indicates that the fixed provider is not able to provision broadband service despite the location being within a broadband coverage polygon. We also seek comment in the *Second FNPRM* about the types of data to be collected through this portal, how to treat crowdsourced data, and the procedures that fixed providers should follow if their broadband coverage polygons are disputed.

19. We believe that public input on fixed broadband service coverage will be most effective if some types of data collected in this process are routinely made available to the public. We therefore direct USAC to make public the information about the location that is the subject of the dispute—including the street address and/or coordinates (latitude and longitude) provided by the complainant, along with the name of the service provider(s) and any relevant details concerning the basis for challenging the reported fixed broadband coverage.

20. We direct USAC to make the crowdsourced data publicly available as soon as is practical after submission and direct OEA to work with USAC to establish an appropriate method for doing so. We do not specify a timeline for making such data publicly available but expect that there will be regular releases of crowdsourcing data. We direct USAC not to make publicly available private information submitted with the challenges. USAC may share such information (for example with the fixed provider about whom the dispute is being made) only to the extent it will be helpful to improve the quality of fixed broadband data reporting. We also direct USAC to develop mechanisms in the new platform to prevent malicious or unreliable filings, including automated mass filings.

21. *Benefits of Reporting Service Availability Maps Clearly Outweigh the Filing Burdens on Fixed Providers.* In establishing the Digital Opportunity Data Collection, we are cognizant of the need to ensure that the benefits resulting from use of the data outweigh the reporting burdens imposed on filers. We agree with commenters who contend that broadband coverage polygons will allow more granular analysis than the census-block data currently collected in the Form 477—and will do so with reasonable costs and burdens on fixed providers. We find that the approach we adopt, in which

fixed providers will create broadband coverage polygons that depict their actual service areas, would, as NCTA asserts, ''be a significant improvement over census-block reporting because *unserved* areas within served census blocks would no longer be counted as served.'' In turn, more granular data about areas where broadband is available will enable us to target unserved locations more precisely, especially in many rural areas that continue to lack broadband service.

22. For now, we continue to maintain the collection of fixed broadband deployment data on Form 477 in census-block format. While there will be additional reporting burdens for fixed providers to supply broadband deployment data as part of the new collection and through the Form 477, this approach will ensure that we have continuous access to consistent broadband deployment data for the purposes for which we require it. Given that service providers are already accustomed to submitting census-block level data, and the census-block data is much less detailed than their Digital Opportunity Data Collection filings will be, the burden of continuing to also file census-block level data will be minimal.

23. We find that any additional burdens imposed by our new reporting approach will be relatively light for fixed providers in comparison to the significant benefit to be gained from more precise broadband deployment data. As an initial matter, many fixed providers already are familiar with the use of geospatial data because of its use in other contexts by the Commission and other federal and state agencies, thus making the transition reasonably simple. As Connected Nation notes, some fixed providers already have either internal GIS capabilities or have vendor relationships for the production of GIS files. In addition, Connected Nation suggests several online resources that can help fixed providers ''create their own polygons of service availability, such as ESRI's ArcGIS software.'' Connected Nation expresses concern, however, that small service providers will struggle to comply with the new polygon-based reporting requirements unless they get some assistance in the generation of accurate broadband coverage polygons. To lessen the burdens on all fixed providers, we direct OEA to oversee USAC in making service-desk help available, as well as providing clear instructions on the form for the new collection, to aid filers in preparing their broadband coverage polygons. We disagree with commenters, such as the Broadband Mapping Coalition, who contend that a map-based approach is a burdensome and insufficient fix to the problem of fixed broadband mapping. We also disagree with Alexicon, which argues that small fixed providers be allowed to report broadband deployment subject to a certain margin of error. Although we recognize the burdens imposed on small fixed providers (and all fixed providers) as a result of the Digital Opportunity Data Collection, we find that such burdens are outweighed by the need for more granular and precise fixed broadband deployment data—especially in rural areas where smaller providers are more likely to be providing service.

24. With regard to the benefits to be realized from the new collection, we find that the adoption of polygon-based reporting will enable crowdsourcing and similar approaches to act as a check on the deployment data submitted by fixed providers, which is not possible with census-block reporting. Rather than listing the census blocks where a fixed provider's broadband service is available, broadband coverage polygons will show the actual service areas covered by fixed broadband providers. This, in turn, will result in more precise information about where fixed broadband is available. The use of crowdsourcing to verify the polygon coverage areas submitted by fixed providers will further improve the validity of broadband deployment data.

25. Another critical benefit of transitioning to a polygon-based reporting format is the speed in which such a solution can be implemented. We are mindful of concerns voiced by commenters such as USTelecom that without a database of broadband-addressable locations (which USTelecom terms a ''Broadband Serviceable Location Fabric''), broadband coverage polygons provide no information on how many, and which, specific locations in the service area do not actually have service available. However, we disagree with the Broadband Mapping Coalition that the submission of coverage polygons should wait until after a process has been established to identify and geolocate all of the broadband serviceable locations that exist in a given area. Instead, we agree with commenters, such as Connected Nation, that GIS data such as polygons will ''provide significant granularity without the need to first create an underlying dataset of structures/locations with which the data can be paired.''

26. We agree with commenters who argue that timing is crucial in getting more granular fixed broadband deployment data. We also agree that the mandatory collection of broadband coverage polygons best achieves the objectives of greater granularity in fixed broadband reporting within the shortest timeframe. As Connected Nation states, ''implementing a system based on shapefile reporting would most likely result in the creation of a new more granular National Broadband Map in the shortest amount of time so that Federal agencies can more quickly utilize the map to guide funding decisions and support broadband buildout to the places that still desperately need it.'' We find that collecting broadband coverage polygons offers the best approach to more granular broadband deployment data, and that we have an opportunity to move forward quickly to significantly improve the data collection in the near term.

27. *Public Availability of Service Availability Data.* We agree with NTIA that the Commission should release broadband deployment datasets with more public information, particularly ''with tables, charts and maps, granular visualization tools for both localized areas and specific technologies, and other mechanisms that summarize the information.'' To better allow for crowdsourcing, mapping, and other uses of fixed broadband deployment data, all service provider information filed as part of the Digital Opportunity Data Collection will be presumed to be non-confidential unless the Commission specifically directs that it be withheld. Filers seeking confidential treatment of data submitted as part of the new collection must submit a request that the data be treated as confidential, along with the reasons for withholding the information from the public. The Commission will make decisions regarding non-disclosure of confidential information. We find that this approach strikes an appropriate balance between the protection of confidential information and the need for public disclosure of fixed broadband deployment data to help with crucial crowdsourcing functionality and mapping capabilities.

28. *USAC Verification of Broadband Coverage Maps.* In addition to incorporating feedback from state, local, and Tribal governmental entities, along with the public, we conclude that we must also take steps to independently verify coverage data submitted by service providers. As part of its Connect America Fund (CAF) responsibility, USAC maintains the High Cost Universal Broadband (HUBB) portal. CAF support recipients report through the HUBB portal latitude and longitude coordinates, address, deployment date, speed, and number of units for every location where service is available. This

information forms the foundation for the Connect America Fund Broadband Map. We direct USAC to integrate the geolocation data contained in the HUBB with the broadband coverage polygons submitted pursuant to the Digital Opportunity Data Collection. Doing so will benefit our overall understanding of how high-cost support dollars are used in conjunction with overall broadband deployment and will aid the data collection verification effort.

29. In the CAF context, USAC performs real-time validation of the CAF data submitted to the HUBB through a series of automated checks of the information (*e.g.,* that the latitude/longitude falls within an eligible area and that the location is not a duplicate of one already submitted). The HUBB also provides USAC the platform to conduct verification reviews to ''substantiate broadband deployment and confirm that carriers are in fact building out service that meets the FCC's minimum performance standards to the locations reported.'' Many elements of the process USAC uses for the CAF could potentially be used for verifying broadband deployment data as part of the Digital Opportunity Data Collection. We therefore direct USAC to propose and submit a plan to OEA for independently verifying the fixed broadband coverage polygons filed pursuant to the Digital Opportunity Data Collection. The verification process it proposes to use could parallel how USAC currently verifies deployment data submitted by CAF support recipients in the HUBB. USAC should propose other appropriate means of verifying the accuracy of filers' broadband coverage polygons, including site visits.

30. *Incorporating Location-Specific Data into the Digital Opportunity Database.* We note that our decision to require broadband coverage area maps does not preclude the use of location-specific coverage data in the future. We agree with USTelecom and NTCA that we ''should not adopt an 'either/or' approach to improvements to data collection, but should both adopt shapefiles as a reporting methodology and move forward towards a uniform national dataset on top of which carriers can report broadband availability (via shapefile or other potential methods).'' As a result, we intend to pursue a multi-faceted approach that also incorporates location-specific data into the Digital Opportunity Data Collection, informed by input received in response to the *Second FNPRM* on the best way to implement such an approach. We agree with NTCA that the submission of broadband coverage polygons ''would certainly improve granularity in the near-term . . . but another significant benefit is the prospect of integrating this approach seamlessly with broader, longer-term efforts to identify availability or lack thereof on a location basis.'' Location-based proposals such as the one put forth by the Broadband Mapping Coalition are ''designed to produce the most accurate, precise data available, and be a flexible, long-term solution'' to the problem of fixed broadband deployment accuracy and granularity.

31. While we intend to pursue development of a location-specific database, we will not delay implementation of the new data collection while we make a determination of how best to incorporate location-specific data. We agree with commenters like ACA who argue that location-specific reporting will impose substantial costs and complexity on fixed broadband providers, especially smaller providers, and will take significant time to complete. As a result, we find it is prudent to take this next step to improve the fixed broadband deployment data we collect in the near term. As a means of moving the location-based process forward as we work to establish our polygon-based approach, we seek comment in the *Second FNPRM* on the best and fastest way to implement a location-based approach to fixed broadband deployment reporting, including whether to run such a process in parallel, or closely aligned, with the establishment of the new online portal for the Digital Opportunity Data Collection.

32. *Alternatives Not Adopted.* We decline to adopt the approach set forth by Comcast and ACA to collect fixed broadband deployment data at the street segment level. According to ACA, while large providers have the capability and resources to collect broadband deployment data at a more granular level, smaller providers will face much greater burdens reporting deployment data with more precision. We find that a street-level approach to fixed broadband deployment reporting has the same problem with granularity as the current census-block approach, especially in rural areas. Specifically, fixed providers claiming broadband service availability on an entire street, when only part of the street actually is served, would overstate broadband deployment much more so than a GIS file-based approach. We also agree with WISPA that a street-segment approach is not appropriate for fixed wireless providers, as streets and roads do not dictate how or where fixed wireless service is constructed, and consequently where service is provided and where it is available. Finally, given the familiarity that fixed providers have with GIS files, we find that is the better approach.

33. In addition, we find that NTIA's recommendation to collect sub-census-block level broadband deployment data only for larger census blocks does not go far enough. While we understand NTIA's desire to keep burdens low for filers, especially for small providers, we find that it is crucial to determine unserved broadband areas wherever they may be—in large, medium, or small census blocks. We do not agree with NTIA's assertion that we should only require more granular broadband deployment reporting in large census blocks—deployment data are critical for all areas and will allow federal and state governments (and providers) to determine with better particularity where broadband funding and buildout is most needed. In fact, the data suggest that there are likely unserved locations within even small blocks that are reported as served on Form 477. Granular reporting for all areas also would reduce customer confusion when attempting to determine broadband availability on a map produced from GIS-based data.

34. We also decline to adopt Connected Nation's proposal to establish a neutral, third-party clearinghouse for the collection of fixed broadband deployment data. We conclude that such a clearinghouse would be largely redundant in light of the revised framework for collecting and reporting fixed deployment data that we adopt in this *Report and Order.*

B. Improving the Existing Form 477 Data Collection

35. As USAC begins undertaking the Digital Opportunity Data Collection, we will continue to use Form 477 for certain intended uses, such as evaluating local telephone competition, gathering broadband deployment and voice subscription data, and collecting certain public safety information. However, we propose in the *Second FNPRM* to transition the collection of mobile broadband-capable network deployment data to the same USAC-administered portal created for fixed data and seek comment on sunsetting Form 477. We maintain the Commission's current Form 477 data collection for mobile broadband and voice data in the interim and take several actions to reduce the burden on service providers required to submit the form.

36. Publish Minimum Advertised or Expected Speed Data and Provider-Specific Coverage Data for Mobile Broadband Services. We adopt our proposal from the 2017 Data Collection Improvement FNPRM to no longer treat as confidential service providers' minimum advertised or expected speed data for mobile broadband services. After review of the record and considering what service providers already make public on their websites, we conclude that minimum advertised or expected speed data filed for mobile broadband services will not be treated as confidential and, therefore, such data will be publicly released for all subsequent filings. Currently, the bulk of the speed data that providers file relating to minimum advertised or expected speeds is treated as confidential because most, if not all, providers choose to check the non-disclosure box that is available to them on the form. This box allows providers to claim confidential treatment for what is otherwise publicly available speed information. Doing so, however, unnecessarily limits the ability of consumers and policy makers to effectively analyze the data submitted.

37. We also conclude that provider-specific coverage data will be publicly released for all subsequent Form 477 filings. This action is necessary to ensure that consumers can easily use the information that is disclosed to the public, including minimum advertised or expected speed data, because such information is only beneficial if consumers know where service coverage is available. Because the Commission already makes provider-specific coverage data publicly available on its website by publishing each provider's shapefiles, filers will no longer be permitted to request confidential treatment for such information upon filing.

38. We expect that disclosing minimum advertised or expected speed data, combined with already publicly available coverage information, will serve the public interest by promoting a more informed, transparent, and efficient marketplace. The dissemination of such information will allow consumers to determine what services are offered in specific geographic areas. It will also enable consumers to compare competing service offerings and make informed decisions regarding service plans and providers. In addition, it will provide consumers with the opportunity to review the data to ensure its accuracy.

39. We are not persuaded that this coverage and speed data is competitively sensitive. Providers routinely publish and advertise the expected upload and download speeds they offer. Because coverage and speed data are already publicly available, we find that such information is not commercially sensitive, and conclude that its public release will not cause competitive harm to service providers. Most commenters agree that service providers often publicize this information by including it on their websites or in their advertising materials, which shows that they do not consider such information to be confidential or commercially sensitive.

40. When balancing the public and private interests at stake, we conclude that public release of these data will not result in competitive harm and that the public interest in releasing coverage and speed information substantially outweighs any interest that service providers have in keeping confidential information that is already publicly available. Accordingly, going forward we will publish nationwide, provider-specific coverage maps depicting minimum advertised or expected speed data.

41. *Eliminating Requirement to Report Broadband Network Coverage by Spectrum Band.* Under the current Form 477 reporting framework, mobile facilities-based providers are required to submit separate coverage maps depicting their broadband network coverage areas for each transmission technology and each frequency band. Eliminating this requirement is necessary to enhance focus on aspects of the data that are more important while decreasing burdens, so we therefore eliminate this unnecessary requirement.

42. The Commission had hoped that collecting deployment information by spectrum band would enable it ''to analyze deployment in different spectrum bands,'' but that has not come to pass. We agree with commenters that eliminating this requirement will streamline the reporting process and reduce the number of coverage maps (and the associated underlying data processing) that reporting entities must submit. As Verizon notes, the Commission usually requests band-specific information directly from licensees in the context of analyzing build-out and license renewal representations, and does not look at the current data collected. The burdens of submitting these data outweigh the benefits, particularly in light of the Commission's limited use of these data.

43. We disagree that the Commission and consumer advocates may find it difficult to monitor providers' buildout requirements without this information. We are also not persuaded by Institute for Local Self-Reliance's (ILSR) unsupported argument that we should continue to collect information that might be useful in the future. ILSR provides no meaningful examples of how the Commission might use these data. We also disagree with ILSR's claim that information on deployment by spectrum band is ''essential'' to determine if mobile providers are offering mobile broadband service of 10 Mbps download and 1 Mbps upload. Mobile broadband service providers already separately provide deployment data, including information on minimum advertised speeds. Moreover, given that service providers are deploying technologies (*e.g.,* LTE) in multiple bands, we find this information is even less useful today than it was in 2013 when we originally imposed this requirement. We should not impose collection burdens based solely on the possibility that we might use the information at some point in the future.

44. *Adding a 5G–NR Technology Code.* In the *2017 Data Collection Improvement FNPRM,* the Commission sought comment on whether it should require separate reporting of 5G mobile broadband deployment and, if so, whether and how it should define 5G for the purposes of the Form 477 data collection. Given the industry's increasing deployment of 5G and our goal of facilitating 5G services to consumers, we will now require providers to report 5G technology deployments as part of their filings. Gathering 5G deployment data for all areas of the country as well as creating 5G deployment maps based on such data is necessary so that consumers can understand where they can receive such services and to help guide us for future policies on 5G technology. We find that adding 5G technology deployments to our mobile broadband data collection and maps—and specifically defining it for purposes of Form 477 collection—is consistent with the Commission's goal of tailoring its policies to evolution in technologies. We therefore adopt the 5G–NR (New Radio) technology standards developed by the 3rd Generation Partnership Project (3GPP) with Release 15 and require providers to submit 5G deployment data that meet the specifications of Release 15 (or any successor release that may be adopted by the Commission's Bureaus).

45. We disagree with some commenters' claims that requiring submission of 5G deployment data would lead to inconsistent results based on an absence of 5G industry standards. The 3GPP 5G–NR technology standards provide adequate guidance for filers to

determine which deployments meet the 5G–NR technology definition. We reject CTIA's suggestion that providers be allowed to voluntarily report 5G deployments. To ensure that both the Commission and consumers have an accurate account of 5G deployments, we will make such submissions mandatory.

46. *Eliminating Outdated Technology Codes.* In the *2017 Data Collection Improvement FNPRM,* the Commission sought comment on whether to eliminate or modify the requirement that mobile broadband providers report coverage information for each technology deployed in their networks. Specifically, the Commission asked whether reporting entities should provide coverage maps for four categories of technology—3G, 4G non-LTE, 4G LTE, and 5G—rather than the nine mobile broadband technology codes that it currently uses and, if so, how the Commission should define these four categories. Based on our experience with data gathered under the nine different mobile broadband technologies that the form specifies and on commenters' support for limiting the number of technologies, we modify the requirement to limit the required submission to four categories of technology—''5G–NR (New Radio),'' ''LTE (Long Term Evolution),'' ''CDMA-based,'' and ''GSM-based.''

47. For broadband data submissions going forward, 5G–NR reported technology should comply with industry standards for 5G as adopted by 3GPP. Similarly, we adopt the LTE standards developed by 3GPP in Release 8 through Release 14, and deployment reported under LTE should be consistent with such standards. The ''CDMA-based'' category aggregates the CDMA and EVDO/EVDO Rev A categories in the current form, and the ''GSM-based'' category combines the GSM, WCDMA/UMTS/HSPA, and HSPA+ categories. We will eliminate collection of deployment data under the Analog and WiMAX categories because both technologies are no longer in widespread use and have been decommissioned by several mobile providers. The categories we adopt today will more meaningfully reflect information that is useful to consumers.

48. Several commenters suggest modifications to the proposal in the *2017 Data Collection Improvement FNPRM.* We reject AT&T's suggestion that we require ''providers to file coverage maps for only three technology categories, 3G/4G, 4G LTE and 5G.'' As some commenters observe, modifying the requirement will fail to capture deployment of mobile technologies that predate LTE and 5G when parts of the country are still reliant on such technologies. To address in part the concerns of GCI, Connected Nation, and the CPUC, we do not adopt AT&T's proposal. Instead, we modify the proposal from the *2017 Data Collection Improvement FNPRM* to retain aggregated collection under the ''CDMA-based'' and ''GSM-based'' categories of mobile broadband deployment data under technologies that predate LTE and 5G–NR (with the exception of WiMAX and Analog) because important uses remain for such data. Aggregated collection under the ''CDMA-based'' and ''GSM-based'' categories, combined with collection of LTE and 5G–NR deployment, will ensure that areas of the country covered by at least 3G technology and entirely unserved areas of the country are captured, and will allow the Commission and other policymakers to evaluate those areas most in need.

49. Given the extent of LTE deployment across the country, the importance of capturing mobile broadband deployment data under nine technology codes has been significantly reduced. In 2017, ''approximately 92% of the U.S. population lived in census blocks with LTE coverage by at least four service providers,'' ''AT&T and Verizon each provided LTE coverage to census blocks containing approximately 98% of the population, T-Mobile provided LTE coverage to approximately 96% of the population, while Sprint provided LTE coverage to approximately 91% of the population.'' Thus, with providers' increased reliance on LTE to provide mobile broadband across the country, capturing mobile broadband deployment under nine technology codes has become outdated and unnecessary. The four codes that we adopt in this item will reduce burdens on filers while providing adequate information for the Commission to continue to ''assess the wireless marketplace to ensure that our spectrum and competition policies accommodate growing demand and evolving technologies in the provision of mobile broadband services.''

50. The new 5G–NR, LTE, CDMA-based, and GSM-based technology codes also lessen the likelihood that filers may adopt and file under their own definitions of technology deployments, leading to confusion and decreasing the usefulness of the data gathered. Given that there are industry standards for 5G technology and LTE, we find it unnecessary to continue to require individual submissions under each of the previous nine codes.

51. Finally, requiring deployment data to be submitted under four, instead of nine, technology codes will ease burdens on filers who must currently submit shapefiles for each technology. We find that the limited usefulness and practical application of the nine technology codes that Form 477 currently requires do not outweigh the burdens that they generate for filers.

52. *Simplifying Mobile Voice Deployment Data Collection.* We eliminate the requirement to submit mobile voice data by spectrum band for the same reasons that we eliminate this requirement for mobile broadband data: The Commission has yet to use this spectrum band information in its mobile voice coverage analysis and the requirement poses an additional burden on filers. We also streamline the technology filing requirement to four main voice-technology categories: 5G–NR, Voice-over-LTE (VoLTE), GSM-based, and CDMA-based. GSM-based voice technologies include GSM or a subsequent generation of GSM, such as the current technology codes GSM, WCDMA/UMTS/HSPA, and HSPA+. CDMA-based voice technologies include CDMA or a subsequent generation of CDMA, such as the current technology codes CDMA and EVDO/EVDO Rev A.

53. In filing nationwide voice-service coverage data, facilities-based mobile voice providers are required to submit shapefiles representing geographic coverage by technology (*e.g.,* LTE, CDMA, analog) and spectrum band of the service providers' voice coverage. In the *2017 Data Collection Improvement FNPRM,* the Commission, while noting the importance of tracking where mobile voice services are available to consumers, sought comment on how it might streamline this collection. Specifically, the Commission asked whether it should eliminate the submission of voice coverage by both technology and spectrum band and whether it should continue to collect data for VoLTE separately.

54. In the *2013 Form 477 Order,* the Commission stated that voice deployment data filed by spectrum band and technology type would (1) enable the Commission to analyze the extent of deployment in different spectrum bands; (2) help the Commission project market trends and adjust its spectrum and competition policies; and (3) assist in the Commission's efforts in the areas of emergency response and disaster relief by identifying the providers that typically serve an affected area. The Commission no longer finds it useful, however, to examine voice deployment data by spectrum band for the purpose of adjusting its spectrum and competition policies, because service providers currently deploy voice and

broadband technologies across multiple bands. We also address the Commission's need to determine which provider's networks are available during an emergency, by retaining the requirement to submit data for VoLTE deployment. For example, VoLTE data coverage information demonstrates comprehensive technological compatibility among providers and aids the Commission in identifying where networks are available during natural disasters.

55. Multiple commenters observe that several maps must be generated to meet this filing requirement, with little corresponding benefit. In balancing these interests, we find that more streamlined coverage maps depicting each provider's nationwide voice coverage area based on the technology categories outlined above allows consumers (and the Commission) to know where they can receive voice service from a given provider. We agree with the argument that continuing a separate collection for certain voice technologies is necessary because, for instance, consumers with a GSM-only phone may not be able to complete a call when roaming in an area where only CDMA is available. Providers have or will soon sunset their older voice technologies, replacing them with VoLTE networks. However, continuing to collect the voice technology deployment data we outline in this order is necessary for tracking where remaining legacy voice technologies are decommissioned, to ensure that coverage gaps in mobile calling do not arise.

56. While we are streamlining the filing of voice-deployment data, we find facilities-based mobile-voice providers should continue to submit VoLTE-deployment data and going forward submit 5G voice deployment data under the new 5G–NR category. These data are valuable because they represent potential universal technical compatibility among mobile-voice providers, which could significantly aid emergency response and other efforts facilitated by such compatibility. For example, VoLTE coverage could better facilitate a customer's ability to complete a 911 call while roaming, particularly in rural areas where other voice technologies are not available. VoLTE is not yet ubiquitous. The filing of 5G–NR and VoLTE coverage data will allow the Commission to monitor how these deployments fill-in and expand upon the current voice-coverage footprint. We direct OEA, in consultation with WCB and WTB to change which mobile voice service technology data are collected going forward, as they evolve.

57. *Collect Mobile Broadband and Voice Subscription Data at the Census Tract Level.* Facilities-based mobile-broadband and voice providers are currently required to submit their subscriber numbers by state. Providers must include their own prepaid and postpaid customers in addition to those of resellers. Currently, providers are instructed to assign a subscriber to a particular state based on the area code of the device's phone number or ''by using some other method that best reflects the subscriber's locations, such as billing address or place of primary use address.''

58. To provide more granular data, the *2017 Data Collection Improvement FNPRM* proposed changing the subscribership data by requiring service providers to submit subscriber data at the census-tract level, attributed to the subscriber's billing address. Based on the record and the Commission's need for more granular data, we now require mobile providers to submit broadband and voice subscriber data at the census-tract level based on the subscriber's place of primary use for postpaid subscribers and based on the subscriber's telephone number for prepaid and resold subscribers. We find that state-level aggregation of subscription data significantly limits the data's usefulness, and that census-tract level data would substantially improve our ability to conduct more accurate mobile competition analysis, particularly in secondary market transactions. For instance, the Commission analyzes competition by Cellular Market Area to determine the impact of removing a competitor in a proposed license transfer. While the Commission receives subscriber data from service providers to assess competition in relevant market areas in a pending transaction, it does not contain information about the other competitors in the market. Having the same census-tract level subscribership data from all providers facilitates the Commission's ability to conduct comparative analysis in license transfer proceedings.

59. The Commission today relies on the telephone number-based Number Resource Utilization/Forecast information as a proxy for filer-submitted subscriber numbers when conducting competitive market analyses because of shortcomings in state-level subscriber data. Number Resource Utilization/Forecast subscriber data indicate the number of assigned phone numbers that a service provider has in a particular rate center, out of the 18,000 rate centers across the country. All service providers must report to the Commission the quantity of their phone numbers assigned to end users, which permits the Commission to calculate the total number of mobile wireless subscribers. When a geographical analysis is required, rate center data can be associated with a geographic point within a county boundary.

60. Number Resource Utilization/Forecast data, however, have limitations, like providing only the quantity of mobile wireless connections that have a telephone number, rather than the number of consumers subscribed to mobile broadband or voice service. If a mobile broadband or voice subscriber uses a device that does not have a telephone number assigned to it (*e.g.,* a tablet), then that subscriber will not be recorded in Number Resource Utilization/Forecast data. These data also do not reflect when consumers move to a different state and retain the same telephone number.

61. We find that both the Commission's need for more precise data for competitive analyses and the limitations of Number Resource Utilization/Forecast data outweigh industry concerns about the burden of the collection. We believe that filer-supplied data at the census-tract level are superior to Number Resource Utilization/Forecast data because they are generated by the operators and based on the operator-determined location of its subscribers. Use of Number Resource Utilization/Forecast data require the Commission to estimate the location of subscribers based on the rate centers associated with telephone numbers, and this can cause problems. Mobile subscriber data at the census-tract level provides a dataset needed for our analyses, instead of introducing error by relying on Number Resource Utilization/Forecast data in a manner that it was not intended to be used.

62. Census-tract level reporting of mobile subscription data strikes the proper balance between more useful, granular data, while reducing artificial precision that could be introduced by getting too granular with mobile service use. Some commenters support the requirement to file subscriber data by census block. OTI states that census-block level data would help digital literacy programs better target their efforts, because many households subscribing to these programs rely on mobile broadband as their primary means of accessing the internet. Using census tracts is consistent with our previous finding that this level of granularity corresponds to actual locations and can be correlated with

valuable demographic census data. Moreover, subscription data at the census-tract level would be useful for analyzing competition by market and would be more useful than rate-center based Number Resource Utilization/ Forecast data. While customers are attributed to a particular address for their place of primary use, unlike fixed, the mobile nature of the service inherently makes such attribution to too small an area artificial. The census-tract level maintains the balance of being useful for our analyses while reducing any artificial granularity.

63. We are not convinced that the burdens on reporting entities are so high that the Commission should continue to rely on Number Resource Utilization/ Forecast data. We disagree with commenters who contend that we should continue to rely on Number Resource Utilization/Forecast data as the primary source of mobile broadband connections and voice service subscriptions. The Commission must move forward with a more accurate mobile subscription collection to meet its goals and track subscribership data. Nothing in the record indicates that a census-tract collection is any more burdensome for mobile filers than for fixed filers, whom were already required to provide subscriber data at the census-tract level.

64. To ensure consistency among submissions, we require providers to submit census tract postpaid subscribership data by ''place of primary use,'' which is defined in the United States Code as ''the street address representative of where the customer's use of the mobile telecommunications service primarily occurs,'' and must be the ''the residential street address or the primary business street address of the customer'' and ''within the licensed service area of the home service provider.'' We find, however, that we should seek further comment on applying the place of primary use methodology to prepaid and reseller subscribers. As explained by CTIA, many prepaid mobile providers neither collect nor use place of primary use. Once prepaid subscribers purchase mobile services at point-of-sale, the service provider may not communicate with or track the subscriber. It would be a significant change if retailers and service providers are required to collect subscriber billing address at point-of-sale, or if providers are required to obtain customer billing address by some other means, such as by directly contacting the subscriber via text message or telephone call. To ensure the Commission receives prepaid and reseller subscriber data using a consistent methodology, we find it is necessary on an interim basis to require providers to submit data that assigns those subscribers to a census tract using the subscriber's telephone number.

65. We find persuasive the concerns expressed by commenters that the use of billing address does not reflect where subscribers primarily use their mobile broadband and voice services. Certain subscriber groups, such as seasonal workers, college students, business accounts, and prepaid subscribers, could be misreported if billing address is used to represent where they primarily use their service. The ''place of primary use'' best addresses all of these concerns. This definition focuses on where the service is primarily used, not billed, and allows for inclusion of prepaid subscribers. Facilities-based mobile service providers must also obtain and maintain this information for tax purposes, thus decreasing the burden of collecting and storing these subscriber data. To the extent that providers do not currently have a system that associates a place of primary use with a census tract, providers should obtain and keep this information in the normal course of business going forward. While the place of primary use may not reflect all locations that subscribers may use their service, we believe it is the best proxy given the benefits and burdens commenters identified.

66. *Eliminating Collection of Mobile Retail Availability.* We conclude it is appropriate to no longer collect census-tract level mobile retail availability data. The current form requires facilities-based mobile broadband providers to submit a list of census tracts in which the provider advertises its mobile wireless broadband service and in which the service is available to actual and potential subscribers. These retail availability data were used as a proxy for mobile broadband deployment data before the Commission required submission of such data. When the Commission began collecting deployment data, it decided to retain the retail availability collection, on the basis that such data are necessary to indicate where, within a service provider's coverage area, the provider actually has a local retail presence. The Commission concluded that collection of retail availability data would complement the deployment data by allowing the Commission to better understand where service is ''advertised and available'' to subscribers within the provider's deployment footprint.

67. The *2017 Data Collection Improvement FNPRM* proposed to eliminate the collection of retail availability data, given that, as time passed, the data did not in actuality provide useful, additional information about where service providers have a local retail presence. Based on the record, we now eliminate the mobile retail availability collection. We agree with commenters that this collection creates an additional filing burden but does not yield useful data.

68. We are not persuaded by those commenters that support retention or improvement of the retail availability filing requirement. The California PUC argues that we should continue collecting this information, but does not explain how it is useful beyond what is also collected for deployment data. The West Virginia Office of the GIS State Coordinator states that we should revise the collection and require providers to submit their local retail presence, which would aid in determining how to serve consumers not located in retail service areas. However, most (if not all) consumers can still subscribe to service despite the lack of a retail presence in a location, if a provider's network covers that location. We find that deployment information, which service providers must continue to submit, is much more useful to consumers and policymakers than retail availability information, and accordingly we eliminate the mobile retail availability collection.

69. *Eliminating the Committed Information Rate Collection for Fixed-Broadband Deployment.* Form 477 currently requires fixed providers offering business/enterprise/government services to report the maximum downstream and upstream contractual or guaranteed data throughput rate (committed information rate) available in each reported census block. However, the record in this proceeding supports discontinuing the collection of committed information rate data. We agree with commenters such as Alaska Communications that committed information rate data is ''not a useful category of data'' and ''imposes significant burdens'', and with ACA, who argues that any rationale there was to adopt the requirement no longer exists because ''small- and medium-sized end-users increasingly do not distinguish'' between best-efforts or committed information rate ''as broadband service performance for best-efforts is enhanced.'' Verizon also agrees with eliminating the committed information rate requirement because ''relying on the maximum upload and download speed should sufficiently describe the services that are available to business customers in an area.'' AT&T supports elimination and asks

that the Commission ''limit the collection to the maximum best efforts speed offered, and maintain the indicators for consumer and business data.'' Other commenters also are in agreement with eliminating the committed information rate reporting requirement.

70. Only Windstream supports keeping the collection of committed information rate data, arguing that such data ''enable the Commission to evaluate trends in the competitive landscape for the provision of Business Data Services. . . .'' Windstream, in fact, urges the Commission not only to keep but also to expand the collection and require reporting of the following CIR ranges at the census-block level: (1) 10 Mbps and below; (2) 11 to 50 Mbps; (3) 51 to 100 Mbps; (4) 101 Mbps to 1 GB; and (5) above 1GB. Windstream contends that these data ''are crucial for the Commission to evaluate whether its predictions prove accurate or whether different action is necessary to ensure competitive [business data service] markets.''

71. We disagree. Specific measures of a committed information rate are not required to evaluate the business data services market per the competitive market test that the Commission adopted in 2017 for price cap areas (prior to the *2017 Data Collection Improvement FNPRM*) and in 2018 for certain rate-of-return areas. Accordingly, discontinuing the committed information rate collection lacks any relationship to our ability to ''evaluate trends in the competitive landscape for the provision of [business data services],'' as Windstream claims. The competitive market test depends on reported service speeds (specifically, a minimum of 10/1 Mbps). As long as we collect service speeds for upload and download, all the information necessary for an analysis using the competitive market test remains available. Therefore, we disagree with Windstream and decline to expand the collection of committed information rate data as requested.

72. Permitting Company-Specific Fixed-Voice-Subscription Data at the Study-Area Level for Incumbent Local Exchange Companies. In the 2017 Data Collection Improvement FNPRM, the Commission proposed to use the Form 477 fixed voice subscription data, in conjunction with Study Area Boundary data, to develop and publish aggregated voice line counts for every rate-of-return carrier study area. The Commission's proposal stemmed from the fact that, at the time, rate-of-return carriers switching to the Alternative Connect America Cost Model and Alaska Plan carriers were no longer required to report such data to USAC for its legacy study area boundaries. However, in the December 2018 Rate-of-Return Reform Order, the Commission reinstated the requirement so the Commission can once again collect the line count information (through FCC Form 507), thereby maintaining a frequently-used data set. Consequently, we decline to adopt the proposal to replace the FCC Form 507 data with the Form 477 fixed voice subscription data (plus Study Area Boundary data) because the underlying rationale for the Commission's proposal no longer exists (*i.e.,* the proposal is moot).

73. *Non-Substantive Clarifying Rule Amendments.* Finally, we adopt amendments to clarify our rules, correct inaccurate references, and delete superfluous text, without changing the substantive requirements. First, we modify the rules to more clearly identify the categories of service providers required to submit data. The Commission has required facilities-based providers of broadband service to submit Form 477 since 2000, but the existing rules do not define the key term ''broadband.'' We remedy this gap by incorporating the form Instructions' definition of ''broadband connection'' into the rule. Moreover, facilities-based providers of mobile voice service have been required to file since the form's inception; but the rules do not make clear that mobile voice service providers can be defined as ''facilities-based providers'' or that only those that qualify as ''facilities-based'' must file. We correct these anomalies by broadening the definition of ''facilities-based providers'' to encompass mobile voice service providers as well as broadband connections.

74. We also consolidate the separate rule sections that establish Form 477 filing requirements for broadband service providers (Sections 1.7000 *et seq.*) and local voice service providers (Section 43.11) into a single set of rules. It is no longer necessary to retain two separate sets of rules regarding submission of the same form, particularly because any given entity may provide both types of services and thus is subject to both rules. Furthermore, we revise text in Section 1.7001(a) that inaptly refers to facilities-based providers' rights to use spectrum in terms of ownership rather than licensing. Instead, we use the more precise and accurate text of the Form 477 Instructions to make clear that fixed wireless and mobile voice and broadband service providers are ''facilities-based,'' for these purposes, if they: (1) Use spectrum for which they have a license; (2) manage or lease spectrum from another licensee pursuant to our rules; or (3) operate over unlicensed spectrum that is lawfully available for its use. We also delete unnecessary text.

75. Finally, we direct WCB, together with IB, WTB, and OEA, to modify Form 477 and the Instructions to the form to reflect changes in technologies over time and to update coverage resolution, network or transmission technologies, and related matters reported on Form 477 as necessary.

IV. Final Regulatory Flexibility Analysis

76. As required by the Regulatory Flexibility Act of 1980, as amended (RFA), an Initial Regulatory Flexibility Analysis (IRFA) was incorporated in the 2017 Data Collection Improvement FNPRM released in August 2017 in this proceeding. The Commission sought written public comment on the proposals in the FNPRM, including comments on the IRFA. No comments were filed specifically in response to the IRFA. One commenter in the proceeding referenced the IRFA in its general comments, and we address those comments below in Section B. This Final Regulatory Flexibility Analysis (FRFA) conforms to the RFA.

A. Need for, and Objectives of, the Proposed Rules

77. The Form 477 collection has evolved into the primary data source for many Commission actions, including reporting to Congress and the public about the availability of broadband services, informing merger reviews, and supporting our universal service policies. With the *Report and Order,* the Commission takes steps to improve the Form 477 data collection to reduce filing burdens and provide more useful information to consumers. Specifically, we make targeted changes to streamline the filing process and eliminate the collection of certain information that we believe is not sufficiently useful when compared with the burden imposed on filers in providing such information. In addition, we make targeted changes such as clarifying parts of the instructions and modifying the collection of certain data to aid in more accurate broadband data and the maps based on that data to improve the overall quality and accuracy of the data that we collect on fixed and mobile voice and broadband service. We also streamline the nine mobile broadband technology codes currently listed on the Form 477 down to four categories of technology; require collection of facilities-based mobile broadband and

voice subscription data at the census tract level; and make publicly available speed data that mobile broadband service providers submit on all subsequent Form 477 filings.

78. It also has become clear to the Commission that the fixed-broadband deployment data collected on Form 477 are no longer sufficient to use for targeting our universal service funds. Therefore, we direct the Universal Service Administrative Company (USAC), under the oversight of the Commission's Office of Economics and Analytics (OEA), the Wireline Competition Bureau (WCB), Wireless Telecommunications Bureau (WTB), and the International Bureau (IB), to initiate a new data collection (the Digital Opportunity Data Collection) for fixed providers based on geospatial broadband service availability data that represent the actual service area where fixed broadband is available. At the same time, to complement this granular broadband availability data, we adopt a process to have USAC begin collecting public input, sometimes known as ''crowdsourcing,'' on the accuracy of service providers' broadband deployment data. Through this new tool, State, local, and Tribal governmental entities, and members of the public, will be able to submit fixed broadband availability data, leveraging their experience concerning service availability. We believe these actions in the *Report and Order* will increase the usefulness of fixed broadband deployment data to the Commission, Congress, the industry, and the public.

B. Summary of Significant Issues Raised by Public Comments in Response to the IRFA

79. The Wireless Internet Service Providers Association (WISPA) in its general comments to the *FNPRM* contends that that IRFA does not meet the requirements of the Regulatory Flexibility Act (RFA) because the Commission failed ''to estimate how many small broadband providers use unlicensed spectrum.'' Section 603 of the RFA requires the Commission to include in the IRFA ''a description of and, where feasible, an estimate of the number of small entities to which the proposed rule will apply.'' WISPA argues that it is feasible for the Commission to estimate the number of small fixed wireless internet providers by using the information from its data collection on Form 477.

80. When we prepared the IRFA in 2017, it was not feasible for us to provide an accurate estimate of the number of small wireless internet service providers (WISPs) that would be affected by the proposed rule. Our action in Section III.B. of this *Report and Order* clarifies that WISPs that operate over unlicensed spectrum are required to file Form 477. We recognize the possibility that such entities might not have filed in prior data collections because of the ambiguity in Section 1.7001(a) of the Commission's rules. Thus, at the time, it was not feasible for us to estimate the number of small WISPs that would be affected by the proposed rule. However, we specifically considered the potential impact of the proposed rule on small WISPs in the IRFA for the *2017 Data Collection Improvement FNPRM* by including such entities in the ''Broadband Internet Access Service Providers'' category.

C. Response to Comments by the Chief Counsel for Advocacy of the Small Business Administration

81. Pursuant to the Small Business Jobs Act of 2010, which amended the RFA, the Commission is required to respond to any comments filed by the Chief Counsel for Advocacy of the Small Business Administration (SBA) and to provide a detailed statement of any change made to the proposed rules as a result of those comments.

82. The Chief Counsel did not file comments in response to the proposed rules in this proceeding.

D. Description and Estimate of the Number of Small Entities to Which the Proposed Rules Will Apply

83. The RFA directs agencies to provide a description of and, where feasible, an estimate of the number of small entities that may be affected by the rules adopted herein. The RFA generally defines the term ''small entity'' as having the same meaning as the terms ''small business,'' ''small organization,'' and ''small governmental jurisdiction.'' In addition, the term ''small business'' has the same meaning as the term ''small business concern'' under the Small Business Act.'' A ''small business concern'' is one which: (1) Is independently owned and operated; (2) is not dominant in its field of operation; and (3) satisfies any additional criteria established by the SBA.

84. *Small Businesses, Small Organizations, Small Governmental Jurisdictions.* Our actions, over time, may affect small entities that are not easily categorized at present. We therefore describe here, at the outset, three comprehensive small entity size standards that could be directly affected herein. First, while there are industry-specific size standards for small businesses that are used in the regulatory flexibility analysis, according to data from the SBA's Office of Advocacy, in general a small business is an independent business having fewer than 500 employees. These types of small businesses represent 99.9% of all businesses in the United States which translates to 28.8 million businesses.

85. Next, the type of small entity described as a ''small organization'' is generally ''any not-for-profit enterprise which is independently owned and operated and is not dominant in its field.'' Nationwide, as of August 2016, there were approximately 356,494 small organizations based on registration and tax data filed by nonprofits with the Internal Revenue Service (IRS).

86. Finally, the small entity described as a ''small governmental jurisdiction'' is defined generally as ''governments of cities, towns, townships, villages, school districts, or special districts, with a population of less than fifty thousand.'' U.S. Census Bureau data published in 2012 indicate that there were 89,476 local governmental jurisdictions in the United States. We estimate that, of this total, as many as 88,761 entities may qualify as ''small governmental jurisdictions.'' Thus, we estimate that most governmental jurisdictions are small.

i. Broadband Internet Access Service Providers

87. The broadband internet access service provider industry has changed since the definition was introduced in 2007. The data cited below may therefore include entities that no longer provide broadband internet access service and may exclude entities that now provide such service. To ensure that this FRFA describes the universe of small entities that our action might affect, we discuss in turn several different types of entities that might be providing broadband internet access service. We note that, although we have no specific information on the number of small entities that provide broadband internet access service over unlicensed spectrum, we included these entities in our Initial Regulatory Flexibility Analysis.

88. *Internet Service Providers (Broadband).* Broadband internet service providers include wired (*e.g.,* cable, DSL) and VoIP service providers using their own operated wired telecommunications infrastructure and fall in the category of Wired Telecommunication Carriers. Wired Telecommunications Carriers are comprised of establishments primarily engaged in operating and/or providing access to transmission facilities and infrastructure that they own and/or

lease for the transmission of voice, data, text, sound, and video using wired telecommunications networks. Transmission facilities may be based on a single technology or a combination of technologies. The SBA size standard for this category classifies a business as small if it has 1,500 or fewer employees. U.S. Census data for 2012 show that there were 3,117 firms that operated that year. Of this total, 3,083 operated with fewer than 1,000 employees. Consequently, under this size standard the majority of firms in this industry can be considered small.

89. *Internet Service Providers (Non-Broadband).* Internet access service providers such as Dial-up internet service providers, VoIP service providers using client-supplied telecommunications connections, and internet service providers using client-supplied telecommunications connections (*e.g.,* dial-up ISPs) fall in the category of All Other Telecommunications. The SBA has developed a small business size standard for All Other Telecommunications, which consists of all such firms with gross annual receipts of $32.5 million or less. For this category, U.S. Census data for 2012 shows that there were 1,442 firms that operated for the entire year. Of these firms, a total of 1,400 had gross annual receipts of less than $25 million. Consequently, under this size standard a majority of ''All Other Telecommunications'' firms can be considered small.

2. Wireline Providers

90. *Wired Telecommunications Carriers.* The U.S. Census Bureau defines this industry as ''establishments primarily engaged in operating and/or providing access to transmission facilities and infrastructure that they own and/or lease for the transmission of voice, data, text, sound, and video using wired communications networks. Transmission facilities may be based on a single technology or a combination of technologies. Establishments in this industry use the wired telecommunications network facilities that they operate to provide a variety of services, such as wired telephony services, including VoIP services, wired (cable) audio and video programming distribution, and wired broadband internet services. By exception, establishments providing satellite television distribution services using facilities and infrastructure that they operate are included in this industry.'' The SBA has developed a small business size standard for Wired Telecommunications Carriers, which consists of all such companies having 1,500 or fewer employees. U.S. Census Bureau data for 2012 show that there were 3,117 firms that operated that year. Of this total, 3,083 operated with fewer than 1,000 employees. Thus, under this size standard, the majority of firms in this industry can be considered small.

91. *Local Exchange Carriers (LECs).* Neither the Commission nor the SBA has developed a size standard for small businesses specifically applicable to local exchange services. The closest applicable NAICS Code category is Wired Telecommunications Carriers. Under the applicable SBA size standard, such a business is small if it has 1,500 or fewer employees. According to Commission data, U.S. Census data for 2012 show that there were 3,117 firms that operated that year. Of this total, 3,083 operated with fewer than 1,000 employees. Thus under this category and the associated size standard, the Commission estimates that the majority of local exchange carriers are small entities.

92. *Incumbent Local Exchange Carriers* (*Incumbent LECs*). Neither the Commission nor the SBA has developed a small business size standard specifically for incumbent local exchange services. The closest applicable NAICS Code category is Wired Telecommunications Carriers. Under the applicable SBA size standard, such a business is small if it has 1,500 or fewer employees. According to U.S. Census Bureau data for 2012, 3,117 firms operated in that year. Of this total, 3,083 operated with fewer than 1,000 employees. Consequently, the Commission estimates that most providers of incumbent local exchange service are small businesses that may be affected by our actions. According to Commission data, 1,307 Incumbent LECs reported that they were incumbent local exchange service providers. Of this total, an estimated 1,006 have 1,500 or fewer employees. Thus, using the SBA's size standard, the majority of Incumbent LECs can be considered small entities.

93. *Competitive Local Exchange Carriers (Competitive LECs), Competitive Access Providers (CAPs), Shared-Tenant Service Providers, and Other Local Service Providers.* Neither the Commission nor the SBA has developed a small business size standard specifically for these service providers. The appropriate NAICS Code category is Wired Telecommunications Carriers and under that size standard, such a business is small if it has 1,500 or fewer employees. U.S. Census Bureau data for 2012 indicate that 3,117 firms operated during that year. Of that number, 3,083 operated with fewer than 1,000 employees. Based on these data, the Commission concludes that the majority of Competitive LECS, CAPs, Shared-Tenant Service Providers, and Other Local Service Providers, are small entities. According to Commission data, 1,442 carriers reported that they were engaged in the provision of either competitive local exchange services or competitive access provider services. Of these 1,442 carriers, an estimated 1,256 have 1,500 or fewer employees. In addition, 17 carriers have reported that they are Shared-Tenant Service Providers, and all 17 are estimated to have 1,500 or fewer employees. Also, 72 carriers have reported that they are Other Local Service Providers. Of this total, 70 have 1,500 or fewer employees. Consequently, based on internally researched FCC data, the Commission estimates that most providers of competitive local exchange service, competitive access providers, Shared-Tenant Service Providers, and Other Local Service Providers are small entities.

94. *Interexchange Carriers (IXCs).* Neither the Commission nor the SBA has developed a definition for Interexchange Carriers. The closest NAICS Code category is Wired Telecommunications Carriers. The applicable size standard under SBA rules consists of all such companies having 1,500 or fewer employees. U.S. Census Bureau data for 2012 indicate that 3,117 firms operated during that year. Of that number, 3,083 operated with fewer than 1,000 employees. According to internally developed Commission data, 359 companies reported that their primary telecommunications service activity was the provision of interexchange services. Of this total, an estimated 317 have 1,500 or fewer employees. Consequently, the Commission estimates that the majority of interexchange service providers are small entities.

95. *Operator Service Providers* (*OSPs*). Neither the Commission nor the SBA has developed a small business size standard specifically for operator service providers. The closest applicable size standard under SBA rules is the category of Wired Telecommunications Carriers. Under the size standard for Wired Telecommunications Carriers, such a business is small if it has 1,500 or fewer employees. U.S. Census Bureau data for 2012 show that there were 3,117 firms that operated that year. Of this total, 3,083 operated with fewer than 1,000 employees. Thus, under this size standard, the majority of firms in this industry can be considered small.

96. According to Commission data, 33 carriers have reported that they are engaged in the provision of operator services. Of these, an estimated 31 have 1,500 or fewer employees and two have more than 1,500 employees. Consequently, the Commission estimates that the majority of OSPs are small entities.

97. *Other Toll Carriers.* Neither the Commission nor the SBA has developed a definition for small businesses specifically applicable to Other Toll Carriers. This category includes toll carriers that do not fall within the categories of interexchange carriers, operator service providers, prepaid calling card providers, satellite service carriers, or toll resellers. The closest applicable size standard under SBA rules is for Wired Telecommunications Carriers and the applicable small business size standard under SBA rules consists of all such companies having 1,500 or fewer employees. U.S. Census data for 2012 indicate that 3,117 firms operated during that year. Of that number, 3,083 operated with fewer than 1,000 employees. According to Commission data, 284 companies reported that their primary telecommunications service activity was the provision of other toll carriage. Of these, an estimated 279 have 1,500 or fewer employees. Consequently, the Commission estimates that most Other Toll Carriers are small entities.

3. Wireless Providers—Fixed and Mobile

98. The broadband internet access service provider category covered by these new rules may cover multiple wireless firms and categories of regulated wireless services. Thus, to the extent the wireless services listed below are used by wireless firms for broadband internet access service, the actions may have an impact on those small businesses as set forth above and further below. In addition, for those services subject to auctions, we note that, as a general matter, the number of winning bidders that claim to qualify as small businesses at the close of an auction does not necessarily represent the number of small businesses currently in service. Also, the Commission does not generally track subsequent business size unless, in the context of assignments and transfers or reportable eligibility events, unjust enrichment issues are implicated.

99. *Wireless Telecommunications Carriers (except Satellite).* This industry comprises establishments engaged in operating and maintaining switching and transmission facilities to provide communications via the airwaves. Establishments in this industry have spectrum licenses and provide services using that spectrum, such as cellular services, paging services, wireless internet access, and wireless video services. The appropriate size standard under SBA rules is that such a business is small if it has 1,500 or fewer employees. For this industry, U.S. Census data for 2012 show that there were 967 firms that operated for the entire year. Of this total, 955 firms had employment of 999 or fewer employees and 12 had employment of 1,000 employees or more. Thus, under this category and the associated size standard, the Commission estimates that the majority of wireless telecommunications carriers (except satellite) are small entities.

100. The Commission's own data—available in its Universal Licensing System—indicate that, as of August 31, 2018, there are 265 Cellular licensees that will be affected by our actions. The Commission does not know how many of these licensees are small, as the Commission does not collect that information for these types of entities. Similarly, according to internally-developed Commission data, 413 carriers reported that they were engaged in the provision of wireless telephony, including cellular service, Personal Communications Service (PCS), and Specialized Mobile Radio (SMR) Telephony services. Of this total, an estimated 261 have 1,500 or fewer employees, and 152 have more than 1,500 employees. Thus, using available data, we estimate that the majority of wireless firms can be considered small.

101. *Wireless Communications Services.* This service can be used for fixed, mobile, radiolocation, and digital audio broadcasting satellite uses. The Commission defined ''small business'' for the wireless communications services (WCS) auction as an entity with average gross revenues of $40 million for each of the three preceding years, and a ''very small business'' as an entity with average gross revenues of $15 million for each of the three preceding years. The SBA has approved these small business size standards. In the Commission's auction for geographic area licenses in the WCS, there were seven winning bidders that qualified as ''very small business'' entities and one that qualified as a ''small business'' entity.

102. *1670–1675 MHz Services.* This service can be used for fixed and mobile uses, except aeronautical mobile. An auction for one license in the 1670–1675 MHz band was conducted in 2003. One license was awarded. The winning bidder was not a small entity.

103. *Wireless Telephony.* Wireless telephony includes cellular, personal communications services, and specialized mobile radio telephony carriers. The closest applicable SBA category is Wireless Telecommunications Carriers (except Satellite). Under the SBA small business size standard, a business is small if it has 1,500 or fewer employees. For this industry, U.S. Census Bureau data for 2012 show that there were 967 firms that operated for the entire year. Of this total, 955 firms had fewer than 1,000 employees and 12 firms had 1,000 employees or more. Thus, under this category and the associated size standard, the Commission estimates that a majority of these entities can be considered small. According to Commission data, 413 carriers reported that they were engaged in wireless telephony. Of these, an estimated 261 have 1,500 or fewer employees and 152 have more than 1,500 employees. Therefore, more than half of these entities can be considered small.

104. *Broadband Personal Communications Service.* The broadband personal communications services (PCS) spectrum is divided into six frequency blocks designated A through F, and the Commission has held auctions for each block. The Commission initially defined a ''small business'' for C- and F-Block licenses as an entity that has average gross revenues of $40 million or less in the three previous calendar years. For F-Block licenses, an additional small business size standard for ''very small business'' was added and is defined as an entity that, together with its affiliates, has average gross revenues of not more than $15 million for the preceding three calendar years. These standards, defining ''small entity'' in the context of broadband PCS auctions, have been approved by the SBA. No small businesses within the SBA-approved small business size standards bid successfully for licenses in Blocks A and B. There were 90 winning bidders that claimed small business status in the first two C-Block auctions. A total of 93 bidders that claimed small business status won approximately 40 percent of the 1,479 licenses in the first auction for the D, E, and F Blocks. On April 15, 1999, the Commission completed the reauction of 347 C-, D-, E-, and F-Block licenses in Auction No. 22. Of the 57 winning bidders in that auction, 48 claimed small business status and won 277 licenses.

105. On January 26, 2001, the Commission completed the auction of 422 C and F Block Broadband PCS licenses in Auction No. 35. Of the 35

winning bidders in that auction, 29 claimed small business status. Subsequent events concerning Auction 35, including judicial and agency determinations, resulted in a total of 163 C and F Block licenses being available for grant. On February 15, 2005, the Commission completed an auction of 242 C-, D-, E-, and F-Block licenses in Auction No. 58. Of the 24 winning bidders in that auction, 16 claimed small business status and won 156 licenses. On May 21, 2007, the Commission completed an auction of 33 licenses in the A, C, and F Blocks in Auction No. 71. Of the 12 winning bidders in that auction, five claimed small business status and won 18 licenses. On August 20, 2008, the Commission completed the auction of 20 C-, D-, E-, and F-Block Broadband PCS licenses in Auction No. 78. Of the eight winning bidders for Broadband PCS licenses in that auction, six claimed small business status and won 14 licenses.

106. *Specialized Mobile Radio Licenses.* The Commission awards ''small entity'' bidding credits in auctions for Specialized Mobile Radio (SMR) geographic area licenses in the 800 MHz and 900 MHz bands to firms that had revenues of no more than $15 million in each of the three previous calendar years. The Commission awards ''very small entity'' bidding credits to firms that had revenues of no more than $3 million in each of the three previous calendar years. The SBA has approved these small business size standards for the 900 MHz Service. The Commission has held auctions for geographic area licenses in the 800 MHz and 900 MHz bands. The 900 MHz SMR auction began on December 5, 1995, and closed on April 15, 1996. Sixty bidders claiming that they qualified as small businesses under the $15 million size standard won 263 geographic area licenses in the 900 MHz SMR band. The 800 MHz SMR auction for the upper 200 channels began on October 28, 1997, and was completed on December 8, 1997. Ten bidders claiming that they qualified as small businesses under the $15 million size standard won 38 geographic area licenses for the upper 200 channels in the 800 MHz SMR band. A second auction for the 800 MHz band conducted in 2002 and included 23 BEA licenses. One bidder claiming small business status won five licenses.

107. The auction of the 1,053 800 MHz SMR geographic area licenses for the General Category channels was conducted in 2000. Eleven bidders won 108 geographic area licenses for the General Category channels in the 800 MHz SMR band and qualified as small businesses under the $15 million size standard. In an auction completed in 2000, a total of 2,800 Economic Area licenses in the lower 80 channels of the 800 MHz SMR service were awarded. Of the 22 winning bidders, 19 claimed small business status and won 129 licenses. Thus, combining all four auctions, 41 winning bidders for geographic licenses in the 800 MHz SMR band claimed status as small businesses.

108. In addition, there are numerous incumbent site-by-site SMR licenses and licensees with extended implementation authorizations in the 800 and 900 MHz bands. We do not know how many firms provide 800 MHz or 900 MHz geographic area SMR service pursuant to extended implementation authorizations, nor how many of these providers have annual revenues of no more than $15 million. One firm has over $15 million in revenues. In addition, we do not know how many of these firms have 1,500 or fewer employees, which is the SBA-determined size standard. We assume, for purposes of this analysis, that all of the remaining extended implementation authorizations are held by small entities, as defined by the SBA.

109. *Lower 700 MHz Band Licenses.* The Commission previously adopted criteria for defining three groups of small businesses for purposes of determining their eligibility for special provisions such as bidding credits. The Commission defined a ''small business'' as an entity that, together with its affiliates and controlling principals, has average gross revenues not exceeding $40 million for the preceding three years. A ''very small business'' is defined as an entity that, together with its affiliates and controlling principals, has average gross revenues that are not more than $15 million for the preceding three years. Additionally, the lower 700 MHz Service had a third category of small business status for Metropolitan/Rural Service Area (MSA/RSA) licenses—''entrepreneur''—which is defined as an entity that, together with its affiliates and controlling principals, has average gross revenues that are not more than $3 million for the preceding three years. The SBA approved these small size standards. An auction of 740 licenses (one license in each of the 734 MSAs/RSAs and one license in each of the six Economic Area Groupings (EAGs)) commenced on August 27, 2002, and closed on September 18, 2002. Of the 740 licenses available for auction, 484 licenses were won by 102 winning bidders. Seventy-two of the winning bidders claimed small business, very small business, or entrepreneur status and won a total of 329 licenses. A second auction commenced on May 28, 2003, closed on June 13, 2003, and included 256 licenses: 5 EAG licenses and 476 Cellular Market Area licenses. Seventeen winning bidders claimed small or very small business status and won 60 licenses, and nine winning bidders claimed entrepreneur status and won 154 licenses. On July 26, 2005, the Commission completed an auction of 5 licenses in the Lower 700 MHz band (Auction No. 60). There were three winning bidders for five licenses. All three winning bidders claimed small business status.

110. In 2007, the Commission reexamined its rules governing the 700 MHz band in the *700 MHz Second Report and Order.* An auction of 700 MHz licenses commenced January 24, 2008 and closed on March 18, 2008, which included, 176 Economic Area licenses in the A Block, 734 Cellular Market Area licenses in the B Block, and 176 EA licenses in the E Block. Twenty winning bidders, claiming small business status (those with attributable average annual gross revenues that exceed $15 million and do not exceed $40 million for the preceding three years) won 49 licenses. Thirty-three winning bidders claiming very small business status (those with attributable average annual gross revenues that do not exceed $15 million for the preceding three years) won 325 licenses.

111. *Upper 700 MHz Band Licenses.* In the *700 MHz Second Report and Order,* the Commission revised its rules regarding Upper 700 MHz licenses. On January 24, 2008, the Commission commenced Auction 73 in which several licenses in the Upper 700 MHz band were available for licensing: 12 Regional Economic Area Grouping licenses in the C Block and one nationwide license in the D Block. The auction concluded on March 18, 2008, with three winning bidders claiming very small business status (those with attributable average annual gross revenues that do not exceed $15 million for the preceding three years) and winning five licenses.

112. *700 MHz Guard Band Licensees.* In 2000, in the *700 MHz Guard Band Order,* the Commission adopted size standards for ''small businesses'' and ''very small businesses'' for purposes of determining their eligibility for special provisions such as bidding credits and installment payments. A small business in this service is an entity that, together with its affiliates and controlling principals, has average gross revenues not exceeding $40 million for the preceding three years. Additionally, a

very small business is an entity that, together with its affiliates and controlling principals, has average gross revenues that are not more than $15 million for the preceding three years. SBA approval of these definitions is not required. An auction of 52 Major Economic Area licenses commenced on September 6, 2000, and closed on September 21, 2000. Of the 104 licenses auctioned, 96 licenses were sold to nine bidders. Five of these bidders were small businesses that won a total of 26 licenses. A second auction of 700 MHz Guard Band licenses commenced on February 13, 2001, and closed on February 21, 2001. All eight of the licenses auctioned were sold to three bidders. One of these bidders was a small business that won a total of two licenses.

113. *Air-Ground Radiotelephone Service.* The Commission has previously used the SBA's small business size standard applicable to Wireless Telecommunications Carriers (except Satellite). The appropriate size standard under SBA rules is that such a business is small if it has 1,500 or fewer employees. For this industry, U.S. Census Bureau data for 2012 show that there were 967 firms that operated for the entire year. Of this total, 955 firms had fewer than 1,000 employees and 12 had employment of 1,000 employees or more. There are approximately 100 licensees in the Air-Ground Radiotelephone Service, and we estimate that almost all of them qualify as small entities under the SBA definition.

114. For purposes of assigning Air-Ground Radiotelephone Service licenses through competitive bidding, the Commission has defined ''small business'' as an entity that, together with controlling interests and affiliates, has average annual gross revenues for the preceding three years not exceeding $40 million. A ''very small business'' is defined as an entity that, together with controlling interests and affiliates, has average annual gross revenues for the preceding three years not exceeding $15 million. These definitions were approved by the SBA. In May 2006, the Commission completed an auction of nationwide commercial Air-Ground Radiotelephone Service licenses in the 800 MHz band (Auction No. 65). On June 2, 2006, the auction closed with two winning bidders winning two Air-Ground Radiotelephone Services licenses. Neither of the winning bidders claimed small business status.

115. *AWS Services (1710–1755 MHz and 2110–2155 MHz bands (AWS–1); 1915–1920 MHz, 1995–2000 MHz, 2020–2025 MHz and 2175–2180 MHz bands (AWS–2); 2155–2175 MHz band (AWS–3)).* For the AWS–1 bands, the Commission has defined a ''small business'' as an entity with average annual gross revenues for the preceding three years not exceeding $40 million, and a ''very small business'' as an entity with average annual gross revenues for the preceding three years not exceeding $15 million. For AWS–2 and AWS–3, although we do not know for certain which entities are likely to apply for these frequencies, we note that the AWS–1 bands are comparable to those used for cellular service and personal communications service. The Commission has not yet adopted size standards for the AWS–2 or AWS–3 bands but proposes to treat both AWS–2 and AWS–3 similarly to broadband PCS service and AWS–1 service due to the comparable capital requirements and other factors, such as issues involved in relocating incumbents and developing markets, technologies, and services.

116. *3650–3700 MHz band.* In March 2005, the Commission released a *Report and Order and Memorandum Opinion and Order* that provides for nationwide, non-exclusive licensing of terrestrial operations, using contention-based technologies, in the 3650 MHz band (*i.e.,* 3650–3700 MHz). As of April 2010, more than 1,270 licenses have been granted and more than 7,433 sites have been registered. The Commission has not developed a definition of small entities applicable to 3650–3700 MHz band nationwide, non-exclusive licenses. However, we estimate that the majority of these licensees are Internet Access Service Providers (ISPs) and that most of those licensees are small businesses.

117. *Fixed Microwave Services.* Microwave services include common carrier, private-operational fixed, and broadcast auxiliary radio services. They also include the Local Multipoint Distribution Service (LMDS), the Digital Electronic Message Service (DEMS), and the 24 GHz Service, where licensees can choose between common carrier and non-common carrier status. At present, there are approximately 36,708 common carrier fixed licensees and 59,291 private operational-fixed licensees and broadcast auxiliary radio licensees in the microwave services. There are approximately 135 LMDS licensees, three DEMS licensees, and three 24 GHz licensees. The Commission has not yet defined a small business with respect to microwave services. The closest applicable SBA category is Wireless Telecommunications Carriers (except Satellite) and the appropriate size standard for this category under SBA rules is that such a business is small if it has 1,500 or fewer employees. For this industry, U.S. Census Bureau data for 2012 show that there were 967 firms that operated for the entire year. Of this total, 955 firms had fewer than 1,000 employees and 12 had employment of 1,000 employees or more. Thus, under this SBA category and the associated size standard, the Commission estimates that a majority of fixed microwave service licensees can be considered small.

118. The Commission does not have data specifying the number of these licensees that have more than 1,500 employees, and thus is unable at this time to estimate with greater precision the number of fixed microwave service licensees that would qualify as small business concerns under the SBA's small business size standard. Consequently, the Commission estimates that there are up to 36,708 common carrier fixed licensees and up to 59,291 private operational-fixed licensees and broadcast auxiliary radio licensees in the microwave services that may be small and may be affected by the rules and policies adopted herein. We note, however, that the common carrier microwave fixed licensee category does include some large entities.

119. *Broadband Radio Service and Educational Broadband Service.* Broadband Radio Service systems, previously referred to as Multipoint Distribution Service (MDS) and Multichannel Multipoint Distribution Service (MMDS) systems and ''wireless cable,'' transmit video programming to subscribers and provide two-way high-speed data operations using the microwave frequencies of the Broadband Radio Service (BRS) and Educational Broadband Service (EBS) (previously referred to as the Instructional Television Fixed Service (ITFS)).

120. *BRS* — In connection with the 1996 BRS auction, the Commission established a small business size standard as an entity that had annual average gross revenues of no more than $40 million in the previous three calendar years. The BRS auctions resulted in 67 successful bidders obtaining licensing opportunities for 493 Basic Trading Areas (BTAs). Of the 67 auction winners, 61 met the definition of a small business. BRS also includes licensees of stations authorized prior to the auction. At this time, we estimate that of the 61 small business BRS auction winners, 48 remain small business licensees. In addition to the 48 small businesses that hold BTA authorizations, there are approximately 392 incumbent BRS licensees that are

considered small entities. After adding the number of small business auction licensees to the number of incumbent licensees not already counted, we find that there are currently approximately 440 BRS licensees that are defined as small businesses under either the SBA or the Commission's rules.

121. In 2009, the Commission conducted Auction 86, the sale of 78 licenses in the BRS areas. The Commission offered three levels of bidding credits: (1) A bidder with attributed average annual gross revenues that exceed $15 million and do not exceed $40 million for the preceding three years (small business) received a 15 percent discount on its winning bid; (2) a bidder with attributed average annual gross revenues that exceed $3 million and do not exceed $15 million for the preceding three years (very small business) received a 25 percent discount on its winning bid; and (3) a bidder with attributed average annual gross revenues that do not exceed $3 million for the preceding three years (entrepreneur) received a 35 percent discount on its winning bid. Auction 86 concluded in 2009 with the sale of 61 licenses. Of the ten winning bidders, two bidders that claimed small business status won four licenses; one bidder that claimed very small business status won three licenses; and two bidders that claimed entrepreneur status won six licenses.

122. *EBS*—The SBA's Cable Television Distribution Services small business size standard is applicable to EBS. There are presently 2,436 EBS licensees. All but 100 of these licenses are held by educational institutions. Educational institutions are included in this analysis as small entities. Thus, we estimate that at least 2,336 licensees are small businesses. Since 2007, Cable Television Distribution Services have been defined within the broad economic census category of Wired Telecommunications Carriers. Wired Telecommunications Carriers are comprised of establishments primarily engaged in operating and/or providing access to transmission facilities and infrastructure that they own and/or lease for the transmission of voice, data, text, sound, and video using wired telecommunications networks. Transmission facilities may be based on a single technology or a combination of technologies.'' The SBA's small business size standard for this category is all such firms having 1,500 or fewer employees. U.S. Census data for 2012 show that there were 3,117 firms that operated that year. Of this total, 3,083 operated with fewer than 1,000 employees. Thus, under this size standard, the majority of firms in this industry can be considered small.

4. Satellite Service Providers

123. *Satellite Telecommunications.* This category comprises firms ''primarily engaged in providing telecommunications services to other establishments in the telecommunications and broadcasting industries by forwarding and receiving communications signals via a system of satellites or reselling satellite telecommunications.'' Satellite telecommunications service providers include satellite and earth station operators. The category has a small business size standard of $32.5 million or less in average annual receipts, under SBA rules. For this category, U.S. Census Bureau data for 2012 show that a total of 333 firms operated for the entire year. Of this total, 299 firms had annual receipts of less than $25 million. Consequently, we estimate that the majority of satellite telecommunications providers are small entities.

124. *All Other Telecommunications.* The ''All Other Telecommunications'' category is comprised of establishments that are primarily engaged in providing specialized telecommunications services, such as satellite tracking, communications telemetry, and radar station operation. This industry also includes establishments primarily engaged in providing satellite terminal stations and associated facilities connected with one or more terrestrial systems and capable of transmitting telecommunications to, and receiving telecommunications from, satellite systems. Establishments providing internet services or voice over internet protocol (VoIP) services via client-supplied telecommunications connections are also included in this industry. The SBA has developed a small business size standard for ''All Other Telecommunications,'' which consists of all such firms with gross annual receipts of $32.5 million or less. For this category, U.S. Census Bureau data for 2012 show that there were 1,442 firms that operated for the entire year. Of these firms, a total of 1,400 had gross annual receipts of less than $25 million. Consequently, a majority of ''All Other Telecommunications'' firms potentially affected by our action can be considered small.

5. Cable Service Providers

125. *Cable and Other Subscription Programming.* This industry comprises establishments primarily engaged in operating studios and facilities for the broadcasting of programs on a subscription or fee basis. The broadcast programming is typically narrowcast in nature (*e.g.,* limited format, such as news, sports, education, or youth-oriented). These establishments produce programming in their own facilities or acquire programming from external sources. The programming material is usually delivered to a third party, such as cable systems or direct-to-home satellite systems, for transmission to viewers. The SBA size standard for this industry establishes as small, any company in this category that has annual receipts of $38.5 million or less. According to 2012 U.S. Census Bureau data, 367 firms operated for the entire year. Of that number, 319 operated with annual receipts of less than $25 million a year and 48 firms operated with annual receipts of $25 million or more. Based on this data, the Commission estimates that the majority of firms operating in this industry are small.

126. *Cable Companies and Systems (Rate Regulation).* The Commission has developed its own small business size standards for the purpose of cable rate regulation. Under the Commission's rules, a ''small cable company'' is one serving 400,000 or fewer subscribers nationwide. Industry data indicate that there are currently 4,600 active cable systems in the United States. Of this total, all but eleven cable operators nationwide are small under the 400,000-subscriber size standard. In addition, under the Commission's rate regulation rules, a ''small system'' is a cable system serving 15,000 or fewer subscribers. Current Commission records show 4,600 cable systems nationwide. Of this total, 3,900 cable systems have fewer than 15,000 subscribers, and 700 systems have 15,000 or more subscribers, based on the same records. Thus, under this standard as well, we estimate that most cable systems are small entities.

127. *Cable System Operators (Telecom Act Standard).* The Communications Act of 1934, as amended, also contains a size standard for small cable system operators, which is ''a cable operator that, directly or through an affiliate, serves in the aggregate fewer than 1 percent of all subscribers in the United States and is not affiliated with any entity or entities whose gross annual revenues in the aggregate exceed $250,000,000.'' There are approximately 52,403,705 cable video subscribers in the United States today. Accordingly, an operator serving fewer than 524,037 subscribers shall be deemed a small operator if its annual revenues, when combined with the total annual revenues of all its affiliates, do not exceed $250 million in the aggregate. Based on available data, we find that all but nine incumbent cable

operators are small entities under this size standard. We note that the Commission neither requests nor collects information on whether cable system operators are affiliated with entities whose gross annual revenues exceed $250 million. Although it seems certain that some of these cable system operators are affiliated with entities whose gross annual revenues exceed $250 million, we are unable at this time to estimate with greater precision the number of cable system operators that would qualify as small cable operators under the definition in the Communications Act.

6. All Other Telecommunications

128. *Electric Power Generators, Transmitters, and Distributors.* This U.S. industry is comprised of establishments that are primarily engaged in providing specialized telecommunications services, such as satellite tracking, communications telemetry, and radar station operation. This industry also includes establishments primarily engaged in providing satellite terminal stations and associated facilities connected with one or more terrestrial systems and capable of transmitting telecommunications to, and receiving telecommunications from, satellite systems. Establishments providing internet services or voice over internet protocol (VoIP) services via client-supplied telecommunications connections are also included in this industry. The closest applicable SBA category is ''All Other Telecommunications.'' The SBA's small business size standard for ''All Other Telecommunications'' consists of all such firms with gross annual receipts of $32.5 million or less. For this category, U.S. Census data for 2012 show that there were 1,442 firms that operated for the entire year. Of these firms, a total of 1,400 had gross annual receipts of less than $25 million. Consequently, we estimate that under this category and the associated size standard the majority of these firms can be considered small entities.

E. Description of Projected Reporting, Recordkeeping, and Other Compliance Requirements for Small Entities

129. We expect the rules adopted in the *Report and Order* will impose new or additional reporting, recordkeeping, and/or other compliance obligations on small entities. In an effort to develop better quality, more useful, and more granular broadband deployment data to advance our statutory universal service obligations, we conclude it is necessary to create a new data collection, calculated to produce broadband deployment maps that will allow the Commission to precisely target scarce universal service dollars to where broadband service is lacking. The Commission also modifies aspects of the Form 477 collection to increase the accuracy of the information collected and to streamline the current reporting requirements to reduce the burdens on filers. We are cognizant of the need to ensure that the benefits resulting from use of the data outweigh the reporting burdens imposed on filers and believe the new collection requirement for fixed providers to submit broadband coverage polygons depicting the areas where they actually have broadband-capable networks and make fixed broadband service available to end-user locations will benefit small entities as well as other providers. WISPA, for example, supports the reporting of broadband coverage polygons because it is less burdensome for its members, who are primarily small fixed wireless providers, and because it is a more accurate means of collecting deployment data.

130. We find that any additional burdens imposed by our new reporting approach will be relatively light for fixed providers in comparison to the significant benefit to be gained from more precise broadband deployment data. For example, many fixed providers are already familiar with GIS files because the Commission and other federal and state agencies use these files in other contexts. Further, some fixed providers already have internal GIS capabilities and/or vendor relationships for the production of GIS files, which should lessen the cost of compliance for small entities. The record suggests that several online resources and software options are available that can help fixed providers create their own polygons of service availability to comply with this requirement, which may lessen the need for small entities to hire professionals. Thus, we find that any additional burdens imposed by our new collection will be relatively light for fixed providers in comparison to the significant benefit to be gained from more accurate and precise broadband deployment data. Although the Commission cannot quantify the cost of compliance with the requirements in the *Report and Order,* we believe the streamlining and removal of certain reporting requirements should reduce the compliance burdens for small entities that are required to complete Form 477.

F. Steps Taken To Minimize the Significant Economic Impact on Small Entities, and Significant Alternatives Considered

131. The RFA requires an agency to describe any significant, specifically small business, alternatives that it has considered in reaching its approach, which may include the following four alternatives (among others): (1) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance or reporting requirements under the rule for small entities; (3) the use of performance, rather than design, standards; and (4) an exemption from coverage of the rule, or any part thereof, for small entities.

132. The Commission's actions to modernize and streamline the Form 477 collection and reduce the compliance burdens for filers include measures that should benefit small entities. In considering the comments in the record, we were mindful of the time, money, and resources that some small entities incur to complete the current Form 477. Our actions adopting the filing of broadband coverage polygons should provide some economic relief to small entities when compared to the burdens imposed by the current census-block reporting requirement. We also direct WCB, in coordination with OEA, WTB, and IB, to determine whether any category of very small fixed providers (*e.g.,* those with less than 250 subscribers (or 1,500 or some other small set number of subscribers) and who are not eligible telecommunications carriers (ETCs) under the USF program) should have additional time in filing their initial reports. In addition, to lessen the burdens on small fixed providers, the Commission and USAC intend to have service-desk help available, as well as clear instructions on the form for the new collection, to aid filers in preparing their broadband coverage polygons. We also believe our actions to streamline the filing process and eliminate certain filing requirements will benefit small entities by reducing the administrative costs they incur to file Form 477.

133. The Commission considered but declined to adopt a requirement to collect fixed broadband deployment data at the street segment level. With a street-level approach, smaller providers would encounter much greater burdens to report deployment data with more precision. For the reasons discussed in the *Report and Order,* we agree with

WISPA that a street-level approach is not appropriate for fixed wireless providers. In addition, we declined to establish technical standards for fixed providers to follow in determining whether fixed broadband is available in an area. Imposing fixed standards could result in increased costs and burdens for small entities and could risk undermining the expertise and on-the-ground knowledge of fixed providers, possibly resulting in less accurate maps. The unique knowledge of fixed broadband providers about their networks puts them in the best position to determine where broadband is available in their service areas.

V. Procedural Matters

134. *Paperwork Reduction Act.* The *Report and Order* contains new and modified information collection requirements subject to the Paperwork Reduction Act of 1995 (PRA), Public Law 104–13. It will be submitted to the Office of Management and Budget (OMB) for review under section 3507(d) of the PRA. The Commission, as part of its continuing effort to reduce paperwork burdens, will invite the general public and the Office of Management and Budget to comment on the information collection requirements contained in the *Report and Order,* as required by the PRA. In addition, pursuant to the Small Business Paperwork Relief Act of 2002, Public Law 107–198 (44 U.S.C. 3506(c)(4)), we seek specific comment on how we might further reduce the information collection burden for small business concerns with fewer than 25 employees.

135. *Congressional Review Act.* The Commission will send a copy of this Report & Order to Congress and the Government Accountability Office pursuant to the Congressional Review Act, *See* 5 U.S.C. 801(a)(1)(A).

136. *People With Disabilities:* To request materials in accessible formats for people with disabilities (braille, large print, electronic files, audio format), send an email to *fcc504@fcc.gov* or call the Consumer & Governmental Affairs Bureau at 202–418–0530 (voice), 202–418–0432 (TTY).

VI. Clauses

137. Accordingly, *it is ordered* that, pursuant to Sections 1–4, 7, 201, 254, 301, 303, 309, 319, and 332 of the Communications Act of 1934, as amended, 47 U.S.C. 151–154, 157, 201, 254, 301, 303, 309, 319, and 332, this *Report and Order and Second Further Notice of Proposed Rulemaking is adopted.*

138. *It is further ordered* that Parts 1, 43, and 54 of the Commission's rules *are amended* as set forth in Appendix A.

139. *It is further ordered* that the *Report and Order shall be* effective 30 days after publication in the **Federal Register**, except for rules and portions of the *Report and Order* that have new or modified information collection requirements that must be approved by the Office of Management and Budget (OMB), which will be effective 30 days after the announcement in the **Federal Register** of OMB approval of those requirements. OMB approval is necessary for the information collection requirements in 47 CFR 54.1401, 54.1402(b), (c), (d)(2), and (e), plus paragraphs 44–51 and 57–65 of the *Report and Order.*

140. *It is further ordered* that the Commission's Consumer & Governmental Affairs Bureau, Reference Information Center, *shall send* a copy of the *Report and Order* to Congress and the Government Accountability Office pursuant to the Congressional Review Act, *see* 5 U.S.C. 801(a)(1)(A).

141. *It is further ordered* that the Commission's Consumer & Governmental Affairs Bureau, Reference Information Center, *shall send* a copy of this *Report and Order and Second Further Notice of Proposed Rulemaking,* including the Final Regulatory Flexibility Analysis, to the Chief Counsel for Advocacy of the Small Business Administration.

List of Subjects

47 CFR Part 1

Administrative practice and procedure, Broadband, Reporting and recordkeeping requirements, Telecommunications.

47 CFR Part 43

Communications common carriers, Reporting and recordkeeping requirements.

47 CFR Part 54

Broadband, Reporting and recordkeeping requirements, Universal service fund.

Federal Communications Commission.

Marlene Dortch,

Secretary.

Final Rules

For the reasons discussed in the preamble, the Federal Communications Commission amends 47 CFR part 1 as follows:

PART 1—PRACTICE AND PROCEDURE

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

Authority: 47 U.S.C. 151, 154(i) and (j), 155, 157, 225, 227, 303(r), 309, 1403, 1404, 1451, and 1452.

Subpart V—Commission Collection of Advanced Telecommunications Capability Data and Local Exchange Competition Data

■ 2. Revise the subpart V heading to read as set forth above.

■ 3. Revise § 1.7000 to read as follows:

§ 1.7000 Purpose.

The purposes of this subpart are to set out the terms by which certain commercial and government-controlled entities report data to the Commission concerning (a) the provision of wired and wireless local telephone services and interconnected Voice over internet Protocol services, and (b) the deployment of advanced telecommunications capability, as defined in 47 U.S.C. 1302, and services that are competitive with advanced telecommunications capability.

■ 4. Amend § 1.7001 by revising paragraphs (a), (b), and (d) to read as follows:

§ 1.7001 Scope and content of filed reports.

(a) *Definitions.* Terms used in this subpart have the following meanings:

(1) *Broadband connection.* A wired line, wireless channel, or satellite service that terminates at an end user location or mobile device and enables the end user to receive information from and/or send information to the internet at information transfer rates exceeding 200 kilobits per second (kbps) in at least one direction.

(2) *Facilities-based provider.* An entity is a *facilities-based provider* of a service if it supplies such service using facilities that satisfy any of the following criteria:

(i) Physical facilities that the entity owns and that terminate at the end-user premises;

(ii) Facilities that the entity has obtained the right to use from other entities, such as dark fiber or satellite transponder capacity as part of its own network, or has obtained;

(iii) Unbundled network element (UNE) loops, special access lines, or other leased facilities that the entity uses to complete terminations to the end-user premises;

(iv) Wireless service for which the entity holds a license or that the entity manages or has obtained the right to use via a spectrum leasing arrangement or comparable arrangement pursuant to subpart X of this Part (§§ 1.9001–1.9080); or

(v) Unlicensed spectrum.

(3) *End user.* A residential, business, institutional, or government entity that subscribes to a service, uses that service for its own purposes, and does not resell that service to other entities.

(4) *Local telephone service.* Telephone exchange or exchange access service (as defined in 47 U.S.C. 153(20 and (54)) provided by a common carrier or its affiliate (as defined in 47 U.S.C. 153(2)).

(5) *Mobile telephony service.* Mobile telephony (as defined in § 20.15 of this chapter) provided to end users by a commercial mobile radio service (CMRS) provider.

(b) The following entities shall file with the Commission a completed FCC Form 477, in accordance with the Commission's rules and the instructions to the FCC Form 477:

(1) Facilities-based providers of broadband service;

(2) Providers of local telephone service;

(3) Facilities-based providers of mobile telephony service; and

(4) Providers of Interconnected Voice over internet Protocol (VoIP) service (as defined in § 9.3 of this chapter) to end users.

* * * * *

(d) Disclosure of data contained in FCC Form 477 will be addressed as follows:

(1) Emergency operations contact information contained in FCC Form 477 is information that should not be routinely available for public inspection pursuant to section 0.457 of this chapter, in addition to other information that should not be routinely available for public inspection pursuant to § 0.457.

(2)(i) Respondents may request that provider-specific subscription information in FCC Form 477 filings be treated as confidential and be withheld from public inspection by so indicating on Form 477 at the time that they submit such data.

(ii) The Commission will release the following information in FCC Form 477 filings to the public, and respondents may not request confidential treatment of such information:

(A) Provider-specific mobile deployment data;

(B) Data regarding minimum advertised or expected speed for mobile broadband services; and

(C) Location information that is necessary to permit accurate broadband mapping, including crowdsourcing or challenge processes.

(3) Respondents seeking confidential treatment of any other data contained in FCC Form 477 must submit a request that the data be treated as confidential with the submission of their Form 477 filing, along with their reasons for withholding the information from the public, pursuant to § 0.459 of this chapter.

(4) The Commission shall make all decisions regarding non-disclosure of provider-specific information, except that the Chiefs of the International Bureau, Wireless Telecommunications Bureau, Wireline Competition Bureau, or Office of Economics and Analytics may release provider-specific information to:

(i) A state commission, provided that the state commission has protections in place that would preclude disclosure of any confidential information,

(ii) ''Eligible entities,'' as those entities are defined in the Broadband Data Improvement Act, in an aggregated format and pursuant to confidentiality conditions prescribed by the Commission, and

(iii) Others, to the extent that access to such data can be accomplished in a manner that addresses concerns about the competitive sensitivity of the data and precludes public disclosure of any confidential information.

* * * * *

■ 5. Add § 1.7003 to subpart V to read as follows:

§ 1.7003 Authority to update FCC Form 477.

The International Bureau, Wireless Telecommunications Bureau, Wireline Competition Bureau, and Office of Economics and Analytics may update the specific content of data to be submitted on FCC Form 477 as necessary to reflect changes over time in transmission technologies, spectrum usage, Geographical Information Systems (GIS) and other data storage and processing functionalities, and other related matters; and may implement any technical improvements or other clarifications to the filing mechanism and forms.

PART 43—REPORTS OF COMMUNICATIONS COMMON CARRIERS, PROVIDERS OF INTERNATIONAL SERVICES AND CERTAIN AFFILIATES

■ 6. The authority citation for part 43 continues to read as follows:

Authority: 47 U.S.C. 35–39, 154, 211, 219, 220; sec. 402(b)(2)(B), (c), Pub. L. 104–104, 110 Stat. 129.

§ 43.11 [Removed]

■ 7. Remove § 43.11.

PART 54—UNIVERSAL SERVICE

■ 8. The authority citation for part 54 continues to read as follows:

Authority: 47 U.S.C. 151, 154(i), 155, 201, 205, 214, 219, 220, 254, 303(r), 403, and 1302, unless otherwise noted.

■ 9. Add subpart N, consisting of §§ 54.1400 through 54.1403, to read as follows:

Subpart N—The Digital Opportunity Data Collection

Sec.

Subpart N—The Digital Opportunity Data Collection

§ 54.1400 Purpose.

The purpose of this subpart is to set out the terms by which facilities-based providers report data to the Universal Service Administrative Company concerning the deployment of fixed broadband connections for use in administration of the Universal Service program and related matters.

§ 54.1401 Frequency of reports.

Entities subject to the provisions of this subpart shall file initial reports pursuant to the Digital Opportunity Data Collection within six months after the Office of Economics and Analytics issues a public notice announcing the availability of the new Digital Opportunity Data Collection platform. Thereafter, Digital Opportunity Data Collection filers must submit updates within six months of completing any new, or discontinuing existing, fixed broadband deployments; acquiring new, or selling existing, network facilities that have fixed broadband connections; or changing existing offerings that change the data submitted on their current Digital Opportunity Data Collection filing. Entities that become subject to the provisions of this subpart for the first time after the initial filing deadline shall file their initial reports within six months after they become eligible and shall report data for that initial period. All eligible entities must file a certification once per year on or before June 30th that as of December 31st of the previous year all of the filers' data continues to be accurate, subject to any updates made by the filer through June 30th of that calendar year.

§ 54.1402 Scope and content of filed reports.

(a)(1) *Definitions.* The definitions in § 1.7001(a) of this chapter apply to terms used in this subpart.

(2) *Fixed broadband connection.* A broadband connection that cannot be used to provide a mobile service (as defined in 47 U.S.C. 153(33)) and does not terminate to mobile stations (as defined in 47 U.S.C. 153(34)).

(b) All facilities-based providers of fixed broadband connections shall file with USAC, pursuant to the timetable in § 54.1401 of this subpart, a completed filing as part of the Digital Opportunity Data Collection in accordance with the rules of the Commission and the instructions to the Digital Opportunity Data Collection.

(c) All filers in the Digital Opportunity Data Collection shall include in each report a certification signed by an appropriate official of the filer (as specified in the Digital Opportunity Data Collection's instructions) and shall report the title of their certifying official.

(d)(1) All data contained in Digital Opportunity Data Collection filings will be routinely available for public disclosure, except for emergency operations contact information and other information that should not be routinely available for public inspection pursuant to § 0.457 of this chapter.

(2) Filers seeking confidential treatment of any data contained in the Digital Opportunity Data Collection must submit a request that the data be treated as confidential with the submission of their filing, along with their reasons for withholding the information from the public, pursuant to § 0.459 of this chapter.

(3) The Commission shall make all decisions regarding non-disclosure of confidential information.

(e) Filers shall file a revised version of their Digital Opportunity Data Collection filing if they discover a significant reporting error in their data.

(f) Failure to file in the Digital Opportunity Data Collection in accordance with the Commission's rules and the instructions to the Digital Opportunity Data Collection may lead to enforcement action pursuant to the Act and any other applicable law.

§ 54.1403 Authority to update the Digital Opportunity Data Collection.

The Office of Economics and Analytics, in consultation with the Wireline Competition Bureau, the Wireless Telecommunications Bureau, and the International Bureau, may update the fixed broadband technologies reported in the Digital Opportunity Data Collection as necessary to reflect changes over time in technology, and the Office may implement any technical improvements, changes to the format and type of data submitted, or other clarifications to the Digital Opportunity Data Collection and its instructions.

[FR Doc. 2019–18063 Filed 8–21–19; 8:45 am]

BILLING CODE 6712–01–P

DEPARTMENT OF COMMERCE

National Oceanic and Atmospheric Administration

50 CFR Part 622

[Docket No. 121004518–3398–01]

RIN 0648–XG974

Reef Fish Fishery of the Gulf of Mexico; 2019 Commercial Accountability Measures; Annual Catch Limit & Annual Catch Target Reductions

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

ACTION: Temporary rule.

SUMMARY: Through this temporary rule, NMFS implements accountability measures (AMs) for the gray triggerfish commercial sector in the exclusive economic zone (EEZ) of the Gulf of Mexico (Gulf) for the 2019 fishing year. NMFS has determined that the 2018 commercial annual catch limit (ACL) for Gulf gray triggerfish was exceeded. Therefore, NMFS reduces the ACL and annual catch target (ACT) for the commercial sector for Gulf gray triggerfish on August 24, 2019, and these reductions will remain in effect through the end of the fishing year on December 31, 2019. These reductions are necessary to protect the Gulf gray triggerfish resource.

DATES: This temporary rule is effective from 12:01 a.m., local time, on August 24, 2019, until 12:01 a.m., local time, on January 1, 2020.

FOR FURTHER INFORMATION CONTACT: Kelli O'Donnell, NMFS Southeast Regional Office, telephone: 727–824–5305, email: *kelli.odonnell@noaa.gov.*

SUPPLEMENTARY INFORMATION: NMFS manages the Gulf reef fish fishery, which includes gray triggerfish, under the Fishery Management Plan for the Reef Fish Resources of the Gulf of Mexico (FMP). The FMP was prepared by the Gulf of Mexico Fishery Management Council (Council) and is implemented by NMFS under the authority of the Magnuson-Stevens Fishery Conservation and Management Act (Magnuson-Stevens Act) through regulations at 50 CFR part 622. All gray triggerfish weights discussed in this temporary rule are in round weight.

The commercial ACL for Gulf gray triggerfish is 64,100 lb (29,075 kg) (50 CFR 622.41(b)(1)), and the commercial ACT (quota) is 60,900 lb (27,624 kg) (50 CFR 622.39(a)(1)(vi)). The regulations at 50 CFR 622.41(b)(1) require an overage of the commercial ACL be subtracted from the following year's ACL and ACT. Landings of gray triggerfish for the commercial sector in 2018 totaled 64,702 lb (29,348 kg); 602 lb (273 kg), which is 602 lb greater than the 2018 ACL of 64,100 lb (29,075 kg). Accordingly, this temporary rule reduces both the ACL and ACT for the commercial sector for Gulf gray triggerfish by the overage amount of 602 lb (273 kg). The revised commercial ACT (commercial quota) for gray triggerfish is 60,298 lb (27,351 kg), and the revised commercial ACL for gray triggerfish is 63,498 lb (28,802 kg). Both reductions in the ACL and ACT for the commercial sector for gray triggerfish are effective at 12:01 a.m., local time, on August 24, 2019, and they will remain in effect through the end of the fishing year on December 31, 2019.

Classification

The Regional Administrator for the NMFS Southeast Region has determined this temporary rule is necessary for the conservation and management of Gulf gray triggerfish and is consistent with the Magnuson-Stevens Act and other applicable laws.

This action is taken under 50 CFR 622.41(b)(1) and is exempt from review under Executive Order 12866.

These measures are exempt from the procedures of the Regulatory Flexibility Act because the temporary rule is issued without opportunity for prior notice and comment.

This action responds to the best scientific information available. The Assistant Administrator for NOAA Fisheries (AA) finds that the need to immediately implement this action to reduce the commercial ACL and ACT for gray triggerfish constitutes good cause to waive the requirements to provide prior notice and opportunity for public comment on this temporary rule pursuant to the authority set forth in 5 U.S.C. 553(b)(B), because such procedures are unnecessary and contrary to the public interest. Such procedures are unnecessary because the rule establishing the ACL and ACT revision provisions was subject to notice and comment, and all that remains is to notify the public of the reductions. Such procedures are contrary to the public interest because of the need to immediately implement this action to protect gray triggerfish and to provide advance notice of the reductions in ACL and ACT for the commercial sector.

For the aforementioned reasons, the AA also finds good cause to waive the 30-day delay in the effectiveness of this action under 5 U.S.C. 553(d)(3).

Authority: 16 U.S.C. 1801 *et seq.*

Dated: August 19, 2019.

Alan D. Risenhoover,

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

[FR Doc. 2019–18129 Filed 8–19–19; 4:15 pm]

BILLING CODE 3510–22–P

DEPARTMENT OF COMMERCE

National Oceanic and Atmospheric Administration

50 CFR Part 622

[Docket No. 140722613–4908–02]

RIN 0648–XS007

Coastal Migratory Pelagic Resources of the Gulf of Mexico and Atlantic Region; Commercial Closure for Atlantic Spanish Mackerel in the Northern Zone

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

ACTION: Temporary rule; closure.

SUMMARY: NMFS implements an accountability measure (AM) for commercial Spanish mackerel in the northern zone of the Atlantic exclusive economic zone (EEZ) through this temporary rule. NMFS has determined that the commercial quota for Spanish mackerel in the northern zone of the Atlantic EEZ will be reached by August 24, 2019. Therefore, NMFS closes the northern zone of the Atlantic EEZ to commercial harvest of Spanish mackerel on August 24, 2019. This closure is necessary to protect the Spanish mackerel resource in the Atlantic.

DATES: The closure is effective at 12:01 a.m., local time, on August 24, 2019, until 12:01 a.m., local time, on March 1, 2020.

FOR FURTHER INFORMATION CONTACT: Mary Vara, NMFS Southeast Regional Office, telephone: 727–824–5305, or email: *mary.vara@noaa.gov.*

SUPPLEMENTARY INFORMATION: The fishery for coastal migratory pelagic fish in the Atlantic includes king mackerel, Spanish mackerel, and cobia on the east coast of Florida, and is managed under the Fishery Management Plan for the Coastal Migratory Pelagic Resources of the Gulf of Mexico and Atlantic Region (FMP). The FMP was prepared by the Gulf of Mexico and South Atlantic Fishery Management Councils and is implemented by NMFS under the authority of the Magnuson-Stevens Fishery Conservation and Management Act (Magnuson-Stevens Act) by regulations at 50 CFR part 622. All weights described for Spanish mackerel in the Atlantic EEZ apply as either round or gutted weight.

On November 20, 2014, NMFS published a final rule in the **Federal Register** to implement Framework Amendment 1 to the FMP (79 FR 69058). That final rule implemented a commercial annual catch limit (equal to the commercial quota) of 3.33 million lb (1.51 million kg) for the Atlantic migratory group of Spanish mackerel (Atlantic Spanish mackerel). Atlantic Spanish mackerel are divided into northern and southern zones for management purposes. The northern zone commercial quota for Atlantic Spanish mackerel is 662,670 lb (300,582 kg) for the current fishing year, which is March 1, 2019, through February 29, 2020 (50 CFR 622.384(c)(2)(i)).

The northern zone for Atlantic Spanish mackerel extends in Federal waters from New York through North Carolina. The northern boundary of the northern zone extends from an intersection point off New York, Connecticut, and Rhode Island at 41°18′16.249″ N Lat., 71°54′28.477″ W long. and proceeds southeast to 37°22′32.75″ N Lat. and the intersection point with the outward boundary of the EEZ. The southern boundary of the northern zone extends from the North Carolina and South Carolina state border, along a line extending in a direction of 135°34′55″ from true north beginning at 33°51′07.9″ N Lat., 78°32′32.6″ W long. to the intersection point with the outward boundary of the EEZ.

Regulations at 50 CFR 622.388(d)(1)(i) require NMFS to close the commercial sector for Atlantic Spanish mackerel in the northern zone when the commercial quota for that zone is reached, or is projected to be reached, by filing a notification to that effect with the Office of the Federal Register. NMFS has determined that the commercial quota of 662,670 lb (300,582 kg) for Atlantic Spanish mackerel in the northern zone will be reached by August 24, 2019. Accordingly, the commercial sector for Atlantic Spanish mackerel in the northern zone is closed effective at 12:01 a.m., local time, on August 24, 2019, through February 29, 2020, the end of the current fishing year.

During the commercial closure, a person on board a vessel that has been issued a valid Federal permit to harvest Atlantic Spanish mackerel may continue to retain this species in the northern zone under the recreational bag and possession limits specified in 50 CFR 622.382(a)(1)(iii) and (a)(2), as long as the recreational sector for Atlantic Spanish mackerel is open (50 CFR 622.384(e)(1)).

Also during the closure, Atlantic Spanish mackerel from the closed zone, including those harvested under the recreational bag and possession limits, may not be purchased or sold. This prohibition does not apply to Atlantic Spanish mackerel from the closed zone that were harvested, landed ashore, and sold prior to the closure and were held in cold storage by a dealer or processor (50 CFR 622.384(e)(2)).

Classification

The RA for the NMFS Southeast Region has determined this temporary rule is necessary for the conservation and management of Atlantic Spanish mackerel and is consistent with the Magnuson-Stevens Act and other applicable laws.

This action is taken under 50 CFR 622.8(b), 622.384(e)(2), and 622.388(d)(1)(i) and is exempt from review under Executive Order 12866.

These measures are exempt from the procedures of the Regulatory Flexibility Act, because the temporary rule is issued without opportunity for prior notice and opportunity for comment.

This action responds to the best scientific information available. The Assistant Administrator for NOAA Fisheries (AA) finds good cause to waive the requirements to provide prior notice and opportunity for public comment pursuant to the authority set forth at 5 U.S.C. 553(b)(B) as such procedures are unnecessary and contrary to the public interest. Such procedures are unnecessary because the rule implementing the commercial quota and the associated AM has already been subject to notice and public comment, and all that remains is to notify the public of the closure. Additionally, allowing prior notice and opportunity for public comment is contrary to the public interest because of the need to immediately implement this action to protect the Atlantic Spanish mackerel stock, because the capacity of the fishing fleet allows for rapid harvest of the commercial quota. Prior notice and opportunity for public comment would require time and could potentially result in a harvest well in excess of the established commercial quota.

For the aforementioned reasons, the AA also finds good cause to waive the 30-day delay in effectiveness of this action under 5 U.S.C. 553(d)(3).

Authority: 16 U.S.C. 1801 *et seq.*

Dated: August 19, 2019.

Alan D. Risenhoover,

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

[FR Doc. 2019–18128 Filed 8–19–19; 4:15 pm]

BILLING CODE 3510–22–P

DEPARTMENT OF COMMERCE

National Oceanic and Atmospheric Administration

50 CFR Part 679

[Docket No. 180713633–9174–02]

RIN 0648–XY006

Fisheries of the Exclusive Economic Zone Off Alaska; Reallocation of Pacific Cod in the Bering Sea and Aleutian Islands Management Area

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

ACTION: Temporary rule; reallocation.

SUMMARY: NMFS is reallocating the projected unused amount of Pacific cod total allowable catch (TAC) from trawl catcher vessels, vessels using jig gear, and catcher vessels greater than or equal to 60 feet (18.3 m) length overall (LOA) using hook-and-line gear to catcher vessels less than 60 feet (18.3 meters) LOA using hook-and-line or pot gear in the Bering Sea and Aleutian Islands management area. This action is necessary to allow the 2019 TAC of Pacific cod to be harvested.

DATES: Effective August 21, 2019, through 2400 hours, Alaska local time (A.l.t.), December 31, 2019.

FOR FURTHER INFORMATION CONTACT: Obren Davis, 907–586–7228.

SUPPLEMENTARY INFORMATION: NMFS manages the groundfish fishery in the Bering Sea and Aleutian Islands (BSAI) according to the Fishery Management Plan for Groundfish of the Bering Sea and Aleutian Islands Management Area (FMP) prepared by the North Pacific Fishery Management Council under authority of the Magnuson-Stevens Fishery Conservation and Management Act. Regulations governing fishing by U.S. vessels in accordance with the FMP appear at subpart H of 50 CFR part 600 and 50 CFR part 679.

The 2019 Pacific cod TAC specified for catcher vessels using trawl gear in the BSAI is 35,660 metric tons (mt) as established by the final 2019 and 2020 harvest specifications for groundfish in the BSAI (84 FR 9000, March 13, 2019),

The 2019 Pacific cod TAC specified for vessels using jig gear in the BSAI is 1,059 mt as established by the final 2019 and 2020 harvest specifications for groundfish in the BSAI (84 FR 9000, March 13, 2019), and one reallocation (84 FR 2068, February 6, 2019).

The 2019 Pacific cod TAC specified for catcher vessels greater than or equal to 60 feet (18.3 m) LOA using hook-and-line gear in the BSAI is 321 mt as established by the final 2019 and 2020 harvest specifications for groundfish in the BSAI (84 FR 9000, March 13, 2019).

The 2019 Pacific cod TAC allocated to catcher vessels less than 60 feet (18.3 meters (m)) length overall (LOA) using hook-and-line or pot gear in the BSAI is 4,414 mt as established by the final 2019 and 2020 harvest specifications for groundfish in the BSAI (84 FR 9000, March 13, 2019) and one reallocation (84 FR 2068, February 6, 2019).

The Administrator, Alaska Region, NMFS, (Regional Administrator) has determined that catcher vessels using trawl gear will not be able to harvest 1,000 mt of the 2019 Pacific cod TAC allocated to those vessels under § 679.20(a)(7)(ii)(A)(*9*), jig vessels will not be able to harvest 500 mt of the 2019 Pacific cod TAC allocated to those vessels under § 679.20(a)(7)(ii)(A)(*1*), and catcher vessels greater than or equal to 60 feet (18.3 m) LOA using hook-and-line gear will not be able to harvest 321 mt of the 2018 Pacific cod TAC allocated to those vessels under § 679.20(a)(7)(ii)(A)(*3*).

Therefore, in accordance with § 679.20(a)(7)(iii)(A), NMFS reallocates 1,000 mt from the trawl catcher vessel apportionment and 321 mt from the catcher vessels greater than or equal to 60 feet (18.3 m) LOA using hook-and-line gear apportionment to the annual amount specified for catcher vessels less than 60 feet (18.3 m) LOA using hook-and-line or pot gear. Also, in accordance with § 679.20(a)(7)(iv)(C), NMFS reallocates 500 mt of Pacific cod from the jig gear apportionment to the annual amount specified for catcher vessels less than 60 feet (18.3 m) LOA using hook-and-line or pot gear.

The harvest specifications for Pacific cod included in final 2019 and 2020 harvest specifications for groundfish in the BSAI (84 FR 9000, March 13, 2019) and one reallocation (84 FR 2068, February 6, 2019 are revised as follows: 34,660 mt to catcher vessels using trawl gear, 559 mt to vessels using jig gear, 0 mt to catcher vessels greater than or equal to 60 feet (18.3 m) LOA using hook-and-line gear, and 6,235 mt to catcher vessels less than 60 feet (18.3 m) LOA using hook-and-line or pot gear.

Classification

This action responds to the best available information recently obtained from the fishery. The Assistant Administrator for Fisheries, NOAA (AA), finds good cause to waive the requirement to provide prior notice and opportunity for public comment pursuant to the authority set forth at 5 U.S.C. 553(b)(B) as such requirement is impracticable and contrary to the public interest. This requirement is impracticable and contrary to the public interest as it would prevent NMFS from responding to the most recent fisheries data in a timely fashion and would delay the reallocations of Pacific cod to catcher vessels less than 60 feet (18.3 m) LOA using hook-and-line or pot gear. Since the fishery is currently open, it is important to immediately inform the industry as to the revised allocations. Immediate notification is necessary to allow for the orderly conduct and efficient operation of this fishery, to allow the industry to plan for the fishing season, and to avoid potential disruption to the fishing fleet as well as processors. NMFS was unable to publish a notice providing time for public comment because the most recent, relevant data only became available as of August 16, 2019.

The AA also finds good cause to waive the 30-day delay in the effective date of this action under 5 U.S.C. 553(d)(3). This finding is based upon the reasons provided above for waiver of prior notice and opportunity for public comment.

This action is required by § 679.20 and is exempt from review under Executive Order 12866.

Authority: 16 U.S.C. 1801 *et seq.*

Dated: August 19, 2019.

Alan D. Risenhoover,

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

[FR Doc. 2019–18121 Filed 8–21–19; 8:45 am]

BILLING CODE 3510–22–P

DEPARTMENT OF COMMERCE

National Oceanic and Atmospheric Administration

50 CFR Part 679

[Docket No. 180713633–9174–02]

RIN 0648–XY010

Fisheries of the Exclusive Economic Zone Off Alaska; Atka Mackerel in the Bering Sea and Aleutian Islands Management Area

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

ACTION: Temporary rule; closure.

SUMMARY: NMFS is prohibiting directed fishing for Atka mackerel in the Central Aleutian district (CAI) of the Bering Sea and Aleutian Islands management area (BSAI) by vessels participating in the BSAI trawl limited access sector fishery. This action is necessary to prevent exceeding the 2019 total allowable catch (TAC) of Atka mackerel in the CAI allocated to vessels participating in the BSAI trawl limited access sector fishery.

DATES: Effective 1200 hrs, Alaska local time (A.l.t.), August 19, 2019, through 2400 hrs, A.l.t., December 31, 2019.

FOR FURTHER INFORMATION CONTACT: Steve Whitney, 907–586–7228.

SUPPLEMENTARY INFORMATION: NMFS manages the groundfish fishery in the BSAI exclusive economic zone according to the Fishery Management Plan for Groundfish of the Bering Sea and Aleutian Islands Management Area (FMP) prepared by the North Pacific Fishery Management Council under authority of the Magnuson-Stevens Fishery Conservation and Management Act. Regulations governing fishing by U.S. vessels in accordance with the FMP appear at subpart H of 50 CFR part 600 and 50 CFR part 679.

The 2019 TAC of Atka mackerel, in the CAI, allocated to vessels participating in the BSAI trawl limited access sector fishery was established as a directed fishing allowance of 1,278 metric tons by the final 2019 and 2020 harvest specifications for groundfish in the BSAI (84 FR 9000, March 13, 2019).

In accordance with § 679.20(d)(1)(iii), the Regional Administrator finds that this directed fishing allowance has been reached. Consequently, NMFS is prohibiting directed fishing for Atka mackerel in the CAI by vessels participating in the BSAI trawl limited access sector fishery. While this closure is effective, the maximum retainable amounts at § 679.20(e) and (f) apply at any time during a trip.

Classification

This action responds to the best available information recently obtained from the fishery. The Assistant Administrator for Fisheries, NOAA, (AA) finds good cause to waive the requirement to provide prior notice and opportunity for public comment pursuant to the authority set forth at 5 U.S.C. 553(b)(B) as such a requirement is impracticable and contrary to the public interest. This requirement is impracticable and contrary to the public interest as it would prevent NMFS from responding to the most recent fisheries data in a timely fashion and would delay the closure of the Atka mackerel directed fishing in the CAI for vessels participating in the BSAI trawl limited access sector fishery. NMFS was unable to publish a notice providing time for public comment because the most recent, relevant data only became available as of August 16, 2019.

The AA also finds good cause to waive the 30-day delay in the effective date of this action under 5 U.S.C. 553(d)(3). This finding is based upon the reasons provided above for waiver of prior notice and opportunity for public comment.

This action is required by § 679.20 and is exempt from review under Executive Order 12866.

Authority: 16 U.S.C. 1801 *et seq.*

Dated: August 19, 2019.

Alan D. Risenhoover,

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

[FR Doc. 2019–18103 Filed 8–19–19; 4:15 pm]

BILLING CODE 3510–22–P

Proposed Rules

Federal Register

Vol. 84, No. 163

Thursday, August 22, 2019

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

10 CFR Part 72

[NRC–2019–0126]

RIN 3150–AK35

List of Approved Spent Fuel Storage Casks: Holtec International Storage, Transport and Repository (HI–STAR) 100 Storage System, Certificate of Compliance No. 1008, Amendment No. 3

AGENCY: Nuclear Regulatory Commission.

ACTION: Proposed rule.

SUMMARY: The U.S. Nuclear Regulatory Commission (NRC) is proposing to amend its spent fuel storage regulations by revising the Holtec International Storage, Transport and Repository 100 Storage System listing within the ''List of approved spent fuel storage casks'' to include Amendment No. 3 to Certificate of Compliance No. 1008. Amendment No. 3 revises the technical specifications to: Include multipurpose canister (MPC)-32 for storage of pressurized-water reactor spent fuel in the Holtec International HI–STAR 100 Storage System; include the Metamic neutron absorber for MPC–32, MPC–24, and MPC–68; credit the soluble boron in criticality analyses for both MPC–32 and MPC–24; incorporate standard system features and ancillaries such as the forced helium dehydration; allow for horizontal storage of the casks; provide updated drawings; and revise the MPC design pressure for accident condition to 200 pounds per square inch gauge. Amendment No. 3 also makes other administrative changes to the technical specifications.

DATES: Submit comments by September 23, 2019. Comments received after this date will be considered if it is practical to do so, but the NRC is able to ensure consideration only for comments received on or before this date.

ADDRESSES: You may submit comments by any of the following methods:

- *Federal Rulemaking Website:* Go to *http://www.regulations.gov* and search for Docket ID NRC–2019–0126. Address questions about NRC dockets to Carol Gallagher; telephone: 301–415–3463; email: *Carol.Gallagher@nrc.gov.* For technical questions contact the individuals listed in the **FOR FURTHER INFORMATION CONTACT** section of this document.
- *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 obtaining information and submitting comments, see ''Obtaining Information and Submitting Comments'' in the **SUPPLEMENTARY INFORMATION** section of this document.

FOR FURTHER INFORMATION CONTACT: Bernard H. White, Office of Nuclear Material Safety and Safeguards; telephone: 301–415–6577; email: *Bernard.White@nrc.gov* or Solomon Sahle, Office of Nuclear Material Safety and Safeguards; telephone: 301–415–3781; email: *Solomon.Sahle@nrc.gov.* Both are staff of the U.S. Nuclear Regulatory Commission, Washington, DC 20555–0001.

SUPPLEMENTARY INFORMATION:

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I. Obtaining Information and Submitting Comments

A. Obtaining Information

Please refer to Docket ID NRC–2019–0126 when contacting the NRC about the availability of information for this action. You may obtain publicly-available information related to this action by any of the following methods:

- *Federal Rulemaking Website:* Go to *http://www.regulations.gov* and search for Docket ID NRC–2019–0126.
- *NRC's Agencywide Documents Access and Management System (ADAMS):* You may obtain publicly-available documents online in the ADAMS Public Documents collection at *http://www.nrc.gov/reading-rm/adams.html.* To begin the search, 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.* For the convenience of the reader, instructions about obtaining materials referenced in this document are provided in the ''Availability of Documents'' section.
- *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–2019–0126 in your comment submission.

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 routinely 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 does not routinely edit comment submissions to remove such information before making the comment submissions available to the public or entering the comment into ADAMS.

II. Rulemaking Procedure

Because the NRC considers this action to be non-controversial, the NRC is publishing this proposed rule concurrently with a direct final rule in the Rules and Regulations section of this issue of the **Federal Register**. The direct final rule will become effective on November 5, 2019. However, if the NRC receives significant adverse comments on this proposed rule by September 23, 2019, then the NRC will publish a document that withdraws the direct final rule. If the direct final rule is withdrawn, the NRC will address the comments received in response to these proposed revisions in a subsequent final rule. Absent significant modifications to the proposed revisions requiring republication, the NRC will not initiate a second comment period on this action in the event the direct final rule is withdrawn.

A significant adverse comment is a comment where the commenter explains why the rule would be inappropriate, including challenges to the rule's underlying premise or approach, or would be ineffective or unacceptable without a change. A comment is adverse and significant if:

(1) The comment opposes the rule and provides a reason sufficient to require a substantive response in a notice-and-comment process. For example, a substantive response is required when:

(a) The comment causes the NRC to reevaluate (or reconsider) its position or conduct additional analysis;

(b) The comment raises an issue serious enough to warrant a substantive response to clarify or complete the record; or

(c) The comment raises a relevant issue that was not previously addressed or considered by the NRC.

(2) The comment proposes a change or an addition to the rule, and it is apparent that the rule would be ineffective or unacceptable without incorporation of the change or addition.

(3) The comment causes the NRC to make a change (other than editorial) to the rule.

For procedural information and the regulatory analysis, see the direct final rule published in the Rules and Regulations section of this issue of the **Federal Register**.

III. Background

Section 218(a) of the Nuclear Waste Policy Act of 1982, as amended, requires that ''the Secretary [of the Department of Energy] shall establish a demonstration program, in cooperation with the private sector, for the dry storage of spent nuclear fuel at civilian nuclear power reactor sites, with the objective of establishing one or more technologies that the [Nuclear Regulatory] Commission may, by rule, approve for use at the sites of civilian nuclear power reactors without, to the maximum extent practicable, the need for additional site-specific approvals by the Commission.'' Section 133 of the Nuclear Waste Policy Act states, in part, that ''[the Commission] shall, by rule, establish procedures for the licensing of any technology approved by the Commission under section [218(a)] for use at the site of any civilian nuclear power reactor.''

To implement this mandate, the Commission approved dry storage of spent nuclear fuel in NRC-approved casks under a general license by publishing a final rule which added a new subpart K in part 72 of title 10 of the *Code of Federal Regulations* (10 CFR) entitled ''General License for Storage of Spent Fuel at Power Reactor Sites'' (55 FR 29181; July 18, 1990). This rule also established a new subpart L in 10 CFR part 72 entitled ''Approval of Spent Fuel Storage Casks,'' which contains procedures and criteria for obtaining NRC approval of spent fuel storage cask designs. The NRC subsequently issued a final rule on September 3, 1999, that approved the Holtec International Storage, Transport and Repository (HI–STAR) 100 Storage System design and added it to the list of NRC-approved cask designs provided in § 72.214 as Certificate of Compliance No. 1008 (64 FR 48259).

IV. Plain Writing

The Plain Writing Act of 2010 (Pub. L. 111–274) requires Federal agencies to write documents in a clear, concise, well-organized manner. The NRC has written this document to be consistent with the Plain Writing Act as well as the Presidential Memorandum, ''Plain Language in Government Writing,'' published June 10, 1998 (63 FR 31885). The NRC requests comment on the proposed rule with respect to clarity and effectiveness of the language used.

V. Availability of Documents

The documents identified in the following table are available to interested persons through one or more of the following methods, as indicated.

Document	ADAMS accession No.
Holtec International, Submittal of Certificate of Compliance Amendment Request (1008–3), dated September 25, 2015	ML15280A182.
Holtec International, Certificate of Compliance Amendment 1008–3—Summary of Proposed Changes, dated September 25, 2015.	ML15280A219.
Holtec International, Certificate of Compliance Amendment 1008–3—Revision 4 of the HI–STAR Final Safety Analysis Report, dated September 25, 2015.	ML15280A220.
Holtec International, Certificate of Compliance Amendment 1008–3—Final Safety Analysis Report on HI–STAR 100 MPC Storage System, dated September 25, 2015.	ML15280A223.
Certificate of Compliance for Spent Fuel Storage Casks, NRC Form 561, dated September 25, 2015	ML15280A224.
Certificate of Compliance No. 1008, Appendix A, Technical Specifications for the HI–STAR 100 Cask System, Amendment 3, dated September 25, 2015.	ML15280A225.
Certificate of Compliance No. 1008, Appendix B, Approved Contents and Design Features for the HI–STAR 100 Cask System, Amendment 3, dated September 25, 2015.	ML15280A222.
Holtec International—Supplemental Information for HI–STAR 100 System, Amendment Request (1008–3), dated January 15, 2016.	ML16041A041.
Submittal of Response to Request for Additional Information for Revision Request (1008–3) to HI–STAR 100 Certificate of Compliance, dated April 29, 2016.	ML16133A503.
Submittal of Response to Request for Additional Information for Revision Request (1008–3) to HI–STAR 100 Certificate of Compliance, Attachment 1—Request for Additional Information Responses on HI–STAR 100—Nonproprietary, dated April 29, 2016.	ML16133A509.
Submittal of Response to Request for Additional Information for Revision Request (1008–3) to HI–STAR 100 Certificate of Compliance, Attachment 3—HI–STAR 100 Certificate of Compliance Appendix A Request for Additional Information Mark-up, dated April 29, 2016.	ML16133A511.
Submittal of Response to Request for Additional Information for Revision Request (1008–3) to HI–STAR 100 Certificate of Compliance, Attachment 4—HI–STAR 100 Certificate of Compliance Appendix B Request for Additional Information Mark-up, dated April 29, 2016.	ML16133A512.
Submittal of Response to Request for Additional Information for Revision Request (1008–3) to HI–STAR 100 Certificate of Compliance, Attachment 5—Final Safety Analysis Report Changed Pages, dated April 29, 2016.	ML16133A513.

Document	ADAMS accession No.
Holtec International Submittal of Responses to NRC's 2nd Round Requests for Additional Information for HI–STAR 100 Amendment Number 3, dated December 15, 2017.	ML17360A162.
Holtec International—Submittal of Supplemental Changes for HI–STAR 100 Certificate of Compliance Amendment Request 1008–3, dated July 2, 2018.	ML18183A448.
Holtec International—Supplemental Changes for HI–STAR 100 Certificate of Compliance Amendment Request 1008–3, dated July 2, 2018.	ML18183A449.
Holtec International—HI–STAR 100 Amendment Request (1008–3), Removal of Preferential Fuel Loading Requirement from Certificate of Compliance, dated February 6, 2019.	ML19037A152.
User Need for Rulemaking for Amendment No. 3 to the Holtec International Storage, Transport and Repository (HI–STAR) 100 Storage System, Enclosure 1: Proposed Certificate of Compliance No. 1008, Amendment No. 3.	ML19137A303.
User Need for Rulemaking for Amendment No. 3 to the Holtec International Storage, Transport and Repository (HI–STAR) 100 Storage System, Enclosure 2: Proposed Technical Specifications Appendix A.	ML19137A300.
User Need for Rulemaking for Amendment No. 3 to the Holtec International Storage, Transport and Repository (HI–STAR) 100 Storage System, Enclosure 3: Proposed Technical Specifications Appendix B.	ML19137A301.
User Need for Rulemaking for Amendment No. 3 to the Holtec International Storage, Transport and Repository (HI–STAR) 100 Storage System, Enclosure 4: Preliminary Safety Evaluation Report.	ML19137A302.

The NRC may post materials related to this document, including public comments, on the Federal Rulemaking website at *http://www.regulations.gov* under Docket ID NRC–2019–0126. The Federal Rulemaking website allows you to receive alerts when changes or additions occur in a docket folder. To subscribe: (1) Navigate to the docket folder (NRC–2019–0126); (2) click the ''Sign up for Email Alerts'' link; and (3) enter your email address and select how frequently you would like to receive emails (daily, weekly, or monthly).

List of Subjects in 10 CFR Part 72

Administrative practice and procedure, Hazardous waste, Indians, Intergovernmental relations, Nuclear energy, Penalties, Radiation protection, Reporting and recordkeeping requirements, Security measures, Spent fuel, Whistleblowing.

Dated at Rockville, Maryland, this 9th day of August, 2019.

For the Nuclear Regulatory Commission.

Margaret M. Doane,

Executive Director for Operations.

[FR Doc. 2019–18108 Filed 8–21–19; 8:45 am]

BILLING CODE 7590–01–P

DEPARTMENT OF ENERGY

10 CFR Part 431

[EERE–2018–BT–STD–0003]

Appliance Standards and Rulemaking Federal Advisory Committee: Notice of Public Meetings for the Variable Refrigerant Flow Multi-Split Air Conditioners and Heat Pumps Working Group To Negotiate a Notice of Proposed Rulemaking for Test Procedures and Energy Conservation Standards

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

ACTION: Notice of public meetings and webinars.

SUMMARY: The U.S. Department of Energy (DOE or the Department) announces public meetings and webinars for the variable refrigerant flow multi-split air conditioners and heat pumps (VRF multi-split systems) working group. The Federal Advisory Committee Act (FACA) requires that agencies publish notice of an advisory committee meeting in the **Federal Register**.

DATES: See the **SUPPLEMENTARY INFORMATION** section for meeting dates.

ADDRESSES: The next several rounds of public meetings will be held at multiple locations. Please see the **SUPPLEMENTARY INFORMATION** section to find the address for each date. Please see the Public Participation section of this notice for additional information on attending the public meeting, including webinar registration information, participant instructions, and information about the capabilities available to webinar participants.

FOR FURTHER INFORMATION CONTACT: Mr. John Cymbalsky, U.S. Department of Energy, Office of Building Technologies (EE–5B), 950 L'Enfant Plaza SW, Washington, DC 20024. Telephone: 202–287–1692. Email: *ASRAC@ee.doe.gov.*

SUPPLEMENTARY INFORMATION: On January 10, 2018, the Appliance Standards and Rulemaking Federal Advisory Committee (ASRAC) met and passed the recommendation to form a VRF multi-split systems working group to meet and discuss and, if possible, reach a consensus on proposed Federal test procedures and standards for VRF multi-split systems. On April 11, 2018, DOE published a notice of intent to establish a working group for VRF multi-split systems to negotiate a notice of proposed rulemaking for test procedures and energy conservations standards. The notice also solicited nominations for membership to the working group. 83 FR 15514. This notice announces the next series of meetings for this working group.

DOE will host a public meeting and webinar on the following dates:

- Thursday, September 19, 2019 from 9:00 a.m. to 5:00 p.m. at National Renewable Energy Laboratory, 901 D Street SW, Suite 930, Washington, DC 20024.
- Friday, September 20, 2019 from 9:00 a.m. to 1:00 p.m. at National Renewable Energy Laboratory, 901 D Street SW, Suite 930, Washington, DC 20024.
- Wednesday, October 9, 2019 from 9:00 a.m. to 5:00 p.m. at National Renewable Energy Laboratory, 901 D Street SW, Suite 930, Washington, DC 20024.
- Thursday, October 10, 2019 from 9:00 a.m. to 3:00 p.m. at National Renewable Energy Laboratory, 901 D Street SW, Suite 930, Washington, DC 20024.
- Wednesday, October 23, 2019 from 9:00 a.m. to 5:00 p.m. at U.S.

Department of Energy, Forrestal Building, Room 8E–089, 1000 Independence Avenue SW, Washington, DC 20585–0121.

• Thursday, October 24, 2019 from 9:00 a.m. to 3:00 p.m. at U.S. Department of Energy, Forrestal Building, Room 8E–089, 1000 Independence Avenue SW, Washington, DC 20585–0121.

• Wednesday, November 6, 2019 from 9:00 a.m. to 5:00 p.m. at Federal Mediation & Conciliation Services, Room 7008, 250 E Street SW, Washington, DC 20427.

• Thursday, November 7, 2019 from 9:00 a.m. to 3:00 p.m. at Federal Mediation & Conciliation Services, Room 7008, 250 E Street SW, Washington, DC 20427.

• Wednesday, November 20, 2019 from 9:00 a.m. to 5:00 p.m. at U.S. Department of Energy, Forrestal Building, Room 8E–089, 1000 Independence Avenue SW, Washington, DC 20585–0121.

• Thursday, November 21, 2019 from 9:00 a.m. to 3:00 p.m. at U.S. Department of Energy, Forrestal Building, Room 8E–089, 1000 Independence Avenue SW, Washington, DC 20585–0121.

The purpose of these meetings will be to negotiate in an attempt to reach consensus on proposed Federal test procedures and energy conservation standards for VRF multi-split systems.

Public Participation

Attendance at Public Meeting

The times, dates, and locations of the public meetings are listed in the **SUPPLEMENTARY INFORMATION** section of this document. If you plan to attend the public meeting, please notify the ASRAC staff at *asrac@ee.doe.gov.*

Please note that foreign nationals participating in the public meeting or webinar are subject to advance security screening procedures which require advance notice prior to attendance at the public meeting. If a foreign national wishes to participate in the public meeting or webinar, please inform DOE as soon as possible by contacting Ms. Regina Washington at (202) 586–1214 or by email: *Regina.Washington@ee.doe.gov* so that the necessary procedures can be completed.

DOE requires visitors to have laptops and other devices, such as tablets, checked upon entry into the building. Any person wishing to bring these devices into the Forrestal Building will be required to obtain a property pass. Visitors should avoid bringing these devices, or allow an extra 45 minutes to check in. Please report to the visitor's desk to have devices checked before proceeding through security.

Due to the REAL ID Act implemented by the Department of Homeland Security (DHS), there have been recent changes regarding ID requirements for individuals wishing to enter Federal buildings from specific States and U.S. territories. DHS maintains an updated website identifying the State and territory driver's licenses that currently are acceptable for entry into DOE facilities at *https://www.dhs.gov/real-id-enforcement-brief.* A driver's license from a State or territory identified as not compliant by DHS will not be accepted for building entry and one of the alternate forms of ID listed below will be required. Acceptable alternate forms of Photo-ID include: A U.S. Passport or Passport Card; an Enhanced Driver's License or Enhanced ID-Card issued by States and territories as identified on the DHS website (Enhanced licenses issued by these States and territories are clearly marked Enhanced or Enhanced Driver's License); a military ID or other Federal government-issued Photo-ID card.

In addition, you can attend the public meeting via webinar. Webinar registration information, participant instructions, and information about the capabilities available to webinar participants will be published on DOE's website: *https://energy.gov/eere/buildings/appliance-standards-and-rulemaking-federal-advisory-committee.* Participants are responsible for ensuring their systems are compatible with the webinar software.

Procedure for Submitting Prepared General Statements for Distribution

Any person who has plans to present a prepared general statement may request that copies of his or her statement be made available at the public meeting. Such persons may submit requests, along with an advance electronic copy of their statement in PDF (preferred), Microsoft Word or Excel, WordPerfect, or text (ASCII) file format, to the appropriate address shown in the **FOR FURTHER INFORMATION CONTACT** section of this notice. The request and advance copy of statements must be received at least one week before the public meeting and may be emailed, hand-delivered, or sent by postal mail. DOE prefers to receive requests and advance copies via email. Please include a telephone number to enable DOE staff to make a follow-up contact, if needed.

Conduct of the Public Meetings

ASRAC's Designated Federal Officer will preside at the public meetings and may also use a professional facilitator to aid discussion. The meetings will not be judicial or evidentiary-type public hearings, but DOE will conduct them in accordance with section 336 of EPCA (42 U.S.C. 6306). A court reporter will be present to record the proceedings and prepare a transcript. A transcript of each public meeting will be included on DOE's website: *https://energy.gov/eere/buildings/appliance-standards-and-rulemaking-federal-advisory-committee.* In addition, any person may buy a copy of each transcript from the transcribing reporter. Public comment and statements will be allowed prior to the close of each meeting.

Docket

The docket is available for review at: *https://www.regulations.gov/docket?D=EERE-2018-BT-STD-0003,* including **Federal Register** notices, public meeting attendee lists and transcripts, comments, and other supporting documents/materials. All documents in the docket are listed in the *http://www.regulations.gov* index. However, not all documents listed in the index may be publically available, such as information that is exempt from public disclosure.

Signed in Washington, DC, on August 14, 2019.

Alexander N. Fitzsimmons,

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

[FR Doc. 2019–18162 Filed 8–21–19; 8:45 am]

BILLING CODE 6450–01–P

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 360

RIN 3064–AF09

Securitization Safe Harbor Rule

AGENCY: Federal Deposit Insurance Corporation (FDIC).

ACTION: Notice of proposed rulemaking.

SUMMARY: The FDIC is proposing a rule (the proposed rule) that would revise certain provisions of its securitization safe harbor rule, which relates to the treatment of financial assets transferred in connection with a securitization or participation transaction, in order to eliminate a requirement that the securitization documents require compliance with Regulation AB of the Securities and Exchange Commission in circumstances where Regulation AB by its terms would not apply to the issuance of obligations backed by such financial assets.

DATES: Comments on the proposed rule must be received by October 21, 2019.

ADDRESSES: You may submit comments, identified by RIN 3064–AF09, by any of the following methods:

• *Agency Website: https://www.fdic.gov/regulations/laws/federal/.* Follow instructions for submitting comments on the agency website.

• *Email: Comments@FDIC.gov.* Include RIN 3064–AF09 in the subject line of the message.

• *Mail:* Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street NW, Washington, DC 20429.

• *Hand Delivery/Courier:* Guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7:00 a.m. and 5:00 p.m.

• *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the instructions for submitting comments.

Instructions: All comments will be posted without change to *https://www.fdic.gov/regulations/laws/federal/,* including any personal information provided.

FOR FURTHER INFORMATION CONTACT: Phillip E. Sloan, Counsel, Legal Division, (703) 562–6137, *psloan@FDIC.gov;* George H. Williamson, Manager, Division of Resolutions and Receiverships, (571) 858–8199, *GeWilliamson@FDIC.gov.*

SUPPLEMENTARY INFORMATION:

I. Policy Objectives

The FDIC is proposing to revise the Securitization Safe Harbor Rule by removing a disclosure requirement that was established by the Rule when it was amended and restated in 2010. As used in this notice of proposed rulemaking (NPR), ''Securitization Safe Harbor Rule'' and ''Rule'' refer to the FDIC's securitization safe harbor rule titled ''Treatment of financial assets transferred in connection with a securitization or participation'' and codified at 12 CFR 360.6.

The Rule addresses circumstances that may arise if the FDIC is appointed receiver or conservator for an insured depository institution (IDI) which has sponsored one or more securitization transactions.[1] If a securitization satisfies one of the sets of conditions established by the Rule, the Rule provides that, depending on which set of conditions is satisfied, either (i) in the exercise of its authority to repudiate or disclaim contracts, the FDIC shall not reclaim, recover or recharacterize as property of the institution or receivership the financial assets transferred as part of the securitization transaction, or (ii) if the FDIC repudiates the securitization agreement pursuant to which financial assets were transferred and does not pay damages within a specified period, or if the FDIC is in monetary default under a securitization for a specified period due to its failure to pay or apply collections received by it under the securitization documents, certain remedies will be available to investors on an expedited basis.

The FDIC is proposing to remove the requirement of the Rule that the documents governing securitization transactions require compliance with Regulation AB of the Securities and Exchange Commission, 17 CFR part 229, subpart 229.1100 (Regulation AB), which imposes significant asset-level disclosure requirements in circumstances where, under the terms of Regulation AB itself, Regulation AB is not applicable to the transaction. This would mean that, unlike under the Rule as currently in effect, the documents governing a private placement or an issuance not otherwise required to be registered would not be required to mandate compliance with Regulation AB (as currently in effect). This proposal is made in response to feedback that it is difficult for institutions to comply with Regulation AB as applied to certain types of securitization transactions, in particular residential mortgage securitizations. While the SEC has not applied the Regulation AB disclosure requirements to private placement transactions, the Rule has required (except for certain grandfathered transactions) that these disclosures be required as a condition for eligibility for the Rule's benefits. The net effect appears to have been a disincentive for IDIs to sponsor securitizations of residential mortgages that are compliant with the Rule.

The FDIC's rationale for establishing the disclosure requirements in 2010 was to reduce the likelihood of a buildup of structurally opaque and potentially risky mortgage securitizations or other securitizations that could pose risks to IDIs. In the ensuing years, a number of other regulatory changes have been implemented that have also contributed to the same objective. As a result, it is no longer clear that compliance with the public disclosure requirements of Regulation AB in a private placement or in an issuance not otherwise required to be registered is needed to achieve the policy objective of preventing a buildup of opaque and potentially risky securitizations such as occurred during the pre-crisis years, particularly where the imposition of such a requirement may serve to restrict overall liquidity.

Accordingly, the policy objective of the proposed rule is to remove unnecessary barriers to securitization transactions, in particular the securitization of residential mortgages, without adverse effects on the safety and soundness of insured institutions.

II. Background

The FDIC, in the Securitization Safe Harbor Rule, set forth criteria under which in its capacity as receiver or conservator of an IDI the FDIC will not, in the exercise of its authority to repudiate contracts, recover or reclaim financial assets transferred in connection with securitization transactions. Asset transfers that, under the Securitization Safe Harbor Rule, are not subject to recovery or reclamation through the exercise of the FDIC's repudiation authority include those that pertain to certain grandfathered transactions, such as, for example, asset transfers made prior to December 31, 2010, which satisfied the conditions (except for the legal isolation condition addressed by the Securitization Safe Harbor Rule) for sale accounting treatment under generally accepted accounting principles (GAAP) in effect for reporting periods prior to November 15, 2009, and which pertain to a securitization transaction that satisfied certain other requirements. In addition, the Securitization Safe Harbor Rule provides that asset transfers that are not grandfathered, but that satisfy the conditions (except for the legal isolation condition addressed by the Securitization Safe Harbor Rule) for sale accounting treatment under GAAP in effect for reporting periods after November 15, 2009, and that pertain to a securitization transaction that satisfies all other conditions of the Securitization Safe Harbor Rule (such asset transfers, together with grandfathered asset transfers, are referred to collectively as Safe Harbor Transfers) will not be subject to FDIC recovery or reclamation actions through the exercise of the FDIC's repudiation authority. For any securitization transaction in respect of which transfers of financial assets do not qualify as Safe Harbor Transfers but which transaction satisfies all of its other requirements, the Securitization Safe Harbor Rule provides that, in the event the FDIC as receiver or conservator remains in monetary default for a specified period under a securitization due to its failure to pay or apply collections, or repudiates the securitization asset transfer agreement

[1] The Rule also addresses transfers of assets in connection with participation transactions. Since the revision included in the proposed rule does not address participations, this NPR does not include further reference to participations.

and does not pay damages within a specified period, certain remedies can be exercised by investors on an expedited basis.

Paragraph (b)(2) of the Securitization Safe Harbor Rule sets forth conditions relating to the disclosure of information. Under paragraph (b)(2)(i)(A), the documents governing the securitization must require disclosure of information as to the securitized financial assets on a financial asset or pool level and on a security level that, at a minimum, complies with the requirements of Regulation AB, even if the securities issued in the securitization are issued in private placement or are not otherwise required to be registered.

The SEC first adopted Regulation AB in 2004 as a new, principles–based set of disclosure items specifically tailored to asset–backed securities. The regulation was intended to form the basis of disclosure for both Securities Act registration statements and Exchange Act reports relating to asset-backed securities. In April 2010, the SEC proposed significant revisions to Regulation AB and other rules regarding the offering process, disclosure and reporting for asset-backed securities (Proposed Regulation AB). Among such revisions were the adoption of specified asset-level disclosures for particular asset classes and the extension of the Regulation AB disclosure requirements to exempt offerings and exempt resale transactions for asset backed securities. As adopted in 2014, Regulation AB retained the majority of the proposed asset-specific disclosure requirements but declined to require issuers to provide the same disclosure for exempt offerings as is required for registered offerings. The disclosure requirements of Regulation AB vary, depending on the type of securitization issuance. The most extensive disclosure requirements relate to residential mortgage securitizations. These requirements became effective in November 2016.

FDIC staff has been told that potential IDI sponsors of residential mortgage securitizations have found that it is difficult to provide certain information required by Regulation AB, either because the information is not readily available to them or because there is uncertainty as to the information requested to be disclosed and, thus, uncertainty as to whether the disclosure would be deemed accurate. FDIC staff was also advised that due to the provision of paragraph (b)(2)(i)(A) that requires that the securitization documents require compliance with Regulation AB in private transactions, private offerings of residential mortgage backed securitization obligations that are compliant with the Rule are similarly challenging for sponsors, and that the net effect has been to discourage IDIs from participating in the securitization of residential mortgages, apart from selling the mortgages to, or with a guarantee from, the government-sponsored housing enterprises.

III. Discussion

In adopting the Securitization Safe Harbor Rule, the FDIC stated that the conditions of the Rule were designed to ''provide greater clarity and transparency to allow a better ongoing evaluation of the quality of lending by banks and reduce the risks to the DIF from opaque securitization structures and the poorly underwritten loans that led to onset of the financial crisis.'' [2] As part of its effort to achieve this goal, the FDIC included paragraph (b)(2) in the Rule, which imposes extensive disclosure requirements relating to securitizations. These requirements include paragraph (b)(2)(i)(A), which mandates that the documents governing a securitization require disclosure of information as to the securitized financial assets on a financial asset or pool level and on a security level that, at a minimum, complies with the requirements of Regulation AB, whether or not the transaction is a registered issuance otherwise subject to Regulation AB.

While the requirement of the Rule that documents governing a private securitization require compliance with the disclosure requirements of Regulation AB differs from the requirements of Regulation AB as adopted by the SEC in 2014, the requirement was consistent with Proposed Regulation AB, which was pending when the FDIC adopted the Rule and proposed that investors in ''structured finance products'' (which term included private placements of securitization transactions) be entitled to request and receive the information that would be required by Regulation AB in a public transaction. This consistency was emphasized in the preamble to the Final Rule (published on September 30, 2010), which states that the Rule ''is also consistent with the amendments to Regulation AB proposed by the Securities and Exchange Commission (''SEC'') on April 7, 2010 (as so proposed to be amended, ''New Regulation AB'').'' [3] After noting that Proposed Regulation AB would establish extensive new requirements for both SEC registered publicly offered securitizations and many private placements, the preamble states ''[t]he disclosure and retention requirements of New Regulation AB are consistent with and support the approach of the Rule.'' [4] A later paragraph of the preamble addresses the same point, and states that, as Proposed Regulation AB governs disclosure for private transactions as well as other issuances, ''the Rule and the SEC's proposed regulations are fully consistent.'' [5]

Subsequently, the SEC finalized Regulation AB to apply only to public issuances. The FDIC is now proposing to modify paragraph (b)(2)(i)(A) of the Rule such that its disclosure requirements are consistent with Regulation AB and are applicable only when disclosure is required by Regulation AB.

The reasons underlying the requirement that private transactions include Regulation AB disclosures have diminished. While the requirement applies to all securitizations, the preamble to the Rule makes clear that the FDIC was focused mostly on residential mortgage securitizations. The preamble states that ''securitization as a viable liquidity tool in mortgage finance will not return without greater transparency and clarity . . . [G]reater transparency . . . will serve to more closely tie the origination of loans to their long-term performance by requiring disclosures of performance.'' [6] In a different paragraph, the preamble refers to defects in many of the subprime and other mortgages originated and sold into securitizations, and states that such originations require attention by the FDIC to fulfill its responsibilities as deposit insurer and that the defects and misalignment of incentives in the securitization process for residential mortgages constituted a ''significant contributor to the erosion of underwriting standards throughout the mortgage finance system.'' [7]

The FDIC believes that if, in the midst of the financial crisis, it was appropriate, in crafting an FDIC rule governing when securitization investors are eligible for safe harbor protection, to make applicable to certain transactions SEC disclosure requirements that do not otherwise apply to those transactions, such a requirement is no longer necessary in view of regulatory developments relating to residential mortgages since 2010.

In addition, the specific requirements in paragraph (b)(2), other than paragraph (b)(2)(i)(A), address goals set

[2] 75 FR 60287 at 60291(Sept. 30, 2010).

[3] *Id.* at 60290.

[4] *Id.*

[5] *Id.*

[6] *Id.* at 60291.

[7] *Id.* at 60289.

out in the preamble to the Rule. Paragraph (b)(2)(i)(B) mandates that the documents governing the securitization require disclosure of numerous matters, including (among others), the capital or tranche structure of the securitization, priority of payments and subordination features, and representations and warranties made with respect to the financial assets. The documents must also require that while the securities are outstanding, the issuer provide information as to the credit performance of the securities and the underlying financial assets, substitutions and removal of financial assets, servicer advances and losses allocated tranches. The documents must also disclose the nature and amount of compensation paid to originators, the sponsor, rating agencies, and certain other parties. In the case of securitizations backed by any residential mortgage, the documents must require disclosure of certain loan level information, such as loan type, loan structure, maturity and interest rate, as well as disclosure of certain interests by servicers, and a requirement that the sponsors affirm compliance with applicable statutory and regulatory standards for the origination of mortgage loans. These additional requirements are not affected by the proposed rule and would remain in effect if the proposed rule is adopted.

IV. Expected Effects

The proposed rule could increase the willingness of IDIs to sponsor the issuance of asset backed securities (ABS) that are exempt from registration with the SEC. Feedback from market participants suggests that the proposed rule may be most likely to affect incentives to issue residential mortgage backed securities (RMBS) that are exempt from registration (henceforth, privately issued RMBS, or private RMBS), since the disclosure requirements of Regulation AB are most extensive for residential mortgages.

If these market perceptions are correct, the proposed rule could result in an increase in the dollar volume of privately issued RMBS, presumably increasing the total flow of credit available to finance residential mortgages in the United States. For context, total issuance of RMBS secured by 1–4 family residential mortgages was approximately $1.3 trillion in 2018.[8] About $1.2 trillion of this total were agency issuances, issued through the government sponsored housing enterprises, or GSEs: the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Government National Mortgage Association (Ginnie Mae). About $100 billion of RMBS were non-agency issuances. The $100 billion of non-agency issuances would include both securities registered with the SEC (public issuances), if any, and private issuances.

The FDIC cannot readily identify the set of FDIC-insured banks that have sponsored private RMBS. Moreover, for any bank that has sponsored private RMBS, some may have chosen to make the Regulation AB disclosures necessary for the safe harbor, and some may have chosen not to make such disclosures, but instead may have chosen to disclose to investors the risks associated with the exercise of the FDIC's receivership authorities. Information about such disclosure choices made by private RMBS issuers also is not readily available to the FDIC.

The FDIC believes, however, that the number of insured banks sponsoring private RMBS, or any type of private ABS, and thereby directly affected by this proposed rule, is extremely small. In its most recent Information Collection Resubmission request for § 360.6 of the FDIC regulations, the FDIC identified fewer than 20 distinct private ABS issuances of any type sponsored by FDIC insured institutions based on a sample of issuances in 2017, some of which were different issuances by the same banks.[9] For most of the transactions, the sponsoring banks were very large institutions.

This information appears generally consistent with market participants' observations that current private RMBS activity by insured banks is muted. This would suggest that removing the disclosures might be expected to encourage banks engaging in sponsoring private RMBS issuances to expand their activities. It also is possible that other institutions not currently involved in issuing private RMBS could begin doing so. While the proposed rule could be expected to result in an increase in the dollar volume of private RMBS issuances, the disclosures are only one among many factors affecting the demand and supply of RMBS. Levels of RMBS outstanding suggest that demand for non-agency RMBS is still weak in the aftermath of the crisis.[10] For all these reasons, the FDIC does not have a basis for quantifying the amount of any increase in RMBS that might result from the proposed rule.

Increased issuance sponsored by insured banks of private RMBS, to the extent it is not offset by corresponding reductions in the amount of mortgages they hold in portfolio, would result in an increase in the supply of credit available to fund residential mortgages. An increase in the supply of mortgage credit would be expected to benefit borrowers by increasing mortgage availability and decreasing mortgage costs. While problematical or predatory mortgage practices can harm borrowers, a significant body of regulation exists to prevent such practices. Given this, it is more likely that any increase in mortgage credit resulting from the proposed rule would be beneficial to borrowers.

Some associated increase in measured U.S. economic output would be expected to accompany an increased volume of mortgage credit. This is in part because the imputed value of the credit services banks provide is a component of measured GDP. The purchase of a new home also may be accompanied by the purchase of other household goods and services that contribute to an increase in overall economic activity.

Institutions affected by the proposed rule would incur reduced compliance costs as a result of not having to make the otherwise required disclosures. Based on the Information Collection Resubmission cited earlier, the reduction in compliance costs associated with the proposed change to part 360 across the FDIC-insured institutions identified as having been involved in private ABS issuances in 2017 would have been about $9.7 million.

To the extent private ABS is being issued now in conformance with the disclosure requirements that would be removed under the proposal, a potential cost of the proposal is that the information available to investors about the credit quality of the assets underlying these ABS could be reduced. As a general matter, a reduction in information available to investors can result in a less efficient allocation of credit and increased risk of potential losses to investors, including banks. A related potential cost is that if privately placed securitization products were to become more widespread and risky as a result of the proposed rule, the vulnerability of the mortgage market to a period of financial stress could increase. In this respect, a significant part of the problems experienced with RMBS during the crisis were attributable to the proliferation of

[8] Inside Mortgage Finance, 2019 Mortgage Market Statistical Annual.

[9] 82 FR 56240 (Nov. 28, 2017).

[10] Annual non-agency single family RMBS issuance reached a high of about $1.2 trillion in 2005, and as previously noted, was about $100 billion in 2018. Inside Mortgage Finance, 2019 Mortgage Market Statistical Annual.

subprime and so-called alternative mortgages as underlying assets for those RMBS. The FDIC believes that a number of post-crisis regulatory changes make it unlikely that substantial growth of similar types of RMBS would occur again.

V. Request for Comment

The FDIC invites comment from all members of the public on all aspects of the proposed rule. Comments are specifically requested on whether the proposed rule is consistent with the purposes of section 360.6 and whether the results intended to be achieved by the proposed rule will be and should be achieved as set forth in the proposed rule or by way of different modifications to the Securitization Safe Harbor Rule. The FDIC will carefully consider all comments that relate to the proposed rule.

VI. Administrative Law Matters

A. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act (44 U.S.C. 3501, *et seq.*) (PRA) the FDIC may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid Office of Management and Budget (OMB) control number.

As discussed above, the FDIC proposes to revise certain provisions of its securitization safe harbor rule, which relates to the treatment of financial assets transferred in connection with a securitization or participation transaction, in order to eliminate a requirement that the securitization documents require compliance with Regulation AB of the Securities and Exchange Commission in circumstances where Regulation AB by its terms would not apply to the issuance of obligations backed by such financial assets.

The FDIC has determined that this proposed rule would revise an existing collection of information (3064–0177). The information collection requirements contained in this proposed rulemaking will be submitted by the FDIC to OMB for review and approval under section 3507(d) of the PRA (44 U.S.C. 3507(d)) and § 1320.11 of the OMB's implementing regulations (5 CFR 1320.11).

The FDIC proposes to revise this information collection as follows:

Title of Information Collection: Conservator or Receiver of Financial Assets Transferred by an Insured Depository Institution in Connection with a Securitization or Participation After September 30, 2010.

OMB Control Number: 3064–0177

Affected Public: Insured Depository Institutions.

Burden Estimate:

ANNUAL BURDEN

	Type of burden	Estimated number of respondents	Estimated number of responses (average number)	Estimated time per response	Estimated frequency	Frequency of response	Total annual estimated burden (hours)
Disclosures:							
360.6(b)(2)(i)(A), (D)—On-going.							
Private Transactions—Non Reg AB Compliant.	Disclosure	0	1.895	37	12.0	Monthly	0
360.6(b)(2)(i)(D)	Disclosure	35	1.971	3	1.0	On Occasion	207
360.6(b)(2)(ii)(B)—Initial/One-Time.	Disclosure	1	6.000	1	1.0	On Occasion	6
360.6(b)(2)(ii)(C)	Disclosure	1	6.000	1	1.0	On Occasion	6
Total Disclosure Burden.							219
Recordkeeping:							
360.6(c)(7)	Recordkeeping	35	1.971	1	1.0	On Occasion	69
Total Recordkeeping Burden.							69
Total burden							288

Comments are invited on: (a) Whether the collection of information is necessary for the proper performance of the FDIC's functions, including whether the information has practical utility; (b) the accuracy of the estimates of the burden of the information collection, including the validity of the methodology and assumptions used; (c) ways to enhance the quality, utility, and clarity of the information to be collected; (d) ways to minimize the burden of the information collection on respondents, including through the use of automated collection techniques or other forms of information technology; and (e) estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information. All comments will become a matter of public record.

B. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) generally requires that, in connection with a proposed rule, an agency prepare and make available for public comment an initial regulatory flexibility analysis describing the impact of the rulemaking on small entities.[11] A regulatory flexibility analysis is not required, however, if the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. The Small Business Administration (SBA) has defined "small entities" to include banking organizations with total assets less than or equal to $550 million.[12] Generally, the FDIC considers a significant effect to be a quantified effect in excess of 5 percent of total annual salaries and benefits per institution, or

[11] 5 U.S.C. 601 *et seq.*

[12] The SBA defines a small banking organization as having $550 million or less in assets, where an organization's "assets are determined by averaging the assets reported on its four quarterly financial statements for the preceding year." See 13 CFR 121.201 (as amended, effective December 2, 2014). In its determination, the "SBA counts the receipts, employees, or other measure of size of the concern whose size is at issue and all of its domestic and foreign affiliates." See 13 CFR 121.103. Following these regulations, the FDIC uses a covered entity's affiliated and acquired assets, averaged over the preceding four quarters, to determine whether the covered entity is "small" for the purposes of RFA.

2.5 percent of total non-interest expenses. The FDIC believes that effects in excess of these thresholds typically represent significant effects for FDIC-supervised institutions. For the reasons described below and under section 605(b) of the RFA, the FDIC certifies that this proposed rule will not have a significant economic effect on a substantial number of small entities.

The FDIC supervises 3,489 depository institutions,[13] of which 2,674 are considered small entities for the purposes of RFA.[14] The proposed rule will only affect institutions currently engaged in arranging, issuing or acting as servicer for privately placed securitizations of asset-backed securities, or likely to do so as a result of the proposed rule. The FDIC knows of no small FDIC-insured institution that is currently acting in this capacity. The FDIC believes that acting as arranger, issuer or servicer for privately placed ABS requires a level of resources and capital markets expertise that would preclude a substantial number of small FDIC-insured institutions from becoming involved in these activities.

Accordingly, the FDIC concludes that the proposed rule will not have a significant impact on a substantial number of small entities. For the reasons described above and pursuant to 5 U.S.C. 605(b), the FDIC certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities. The FDIC invites comments on all aspects of the supporting information provided in this RFA section. In particular, would this rule have any significant effects on small entities that the FDIC has not identified?

C. Plain Language

Section 722 of the Gramm-Leach-Bliley Act[15] requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The FDIC has sought to present the proposed rule in a simple and straightforward manner, and invites comment on the use of plain language. For example:

- Has the FDIC organized the material to suit your needs? If not, how could this material be better organized?
- Are the requirements in the proposed rule clearly stated? If not, how could the rule be stated more clearly?
- Does the proposed rule contain language or jargon that is unclear? If so, which language requires clarification?
- What else could the FDIC do to make the proposed rule easier to understand?

D. Riegle Community Development and Regulatory Improvement Act of 1994

Pursuant to section 302(a) of the Riegle Community Development and Regulatory Improvement Act (RCDRIA), in determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions, each federal banking agency must consider, consistent with principles of safety and soundness and the public interest, any administrative burdens that such regulations would place on insured depository institutions, including small depository institutions, and customers of depository institutions, as well as the benefits of such regulations.[16] In addition, section 302(b) of RCDRIA requires new regulations and amendments to regulations that impose additional reporting, disclosures, or other new requirements on insured depository institutions generally to take effect on the first day of a calendar quarter that begins on or after the date on which the regulations are published in final form.[17]

The FDIC has determined that the proposed rule would not impose additional reporting, disclosure, or other requirements; therefore the requirements of RCDRIA do not apply. However, the FDIC invites any comments that will inform its consideration of RCDRIA.

List of Subjects in 12 CFR Part 360

Banks, Banking, Bank deposit insurance, Holding companies, National banks, Participations, Reporting and recordkeeping requirements, Savings associations, Securitizations.

Authority and Issuance

For the reasons set forth in the preamble, the Federal Deposit Insurance Corporation proposes to amend 12 CFR part 360 as follows:

PART 360—RESOLUTION AND RECEIVERSHIP RULES

■ 1. The authority citation for part 360 continues to read as follows:

Authority: 12 U.S.C. 1821(d)(1),1821(d)(10)(C), 1821(d)(11), 1821(e)(1), 1821(e)(8)(D)(i), 1823(c)(4), 1823(e)(2); Sec. 401(h), Public Law 101–73, 103 Stat. 357.

■ 2. Revise § 360.6(b)(2)(i)(A) to read as follows:

§ 360.6 Treatment of financial assets transferred in connection with a securitization or participation.

* * * * *

(b) * * *

(2) * * *

(i) * * *

(A) In the case of an issuance of obligations that is subject to 17 CFR part 229, subpart 229.1100 (Regulation AB of the Securities and Exchange Commission (Regulation AB)), the documents shall require that, on or prior to issuance of obligations and at the time of delivery of any periodic distribution report and, in any event, at least once per calendar quarter, while obligations are outstanding, information about the obligations and the securitized financial assets shall be disclosed to all potential investors at the financial asset or pool level, as appropriate for the financial assets, and security-level to enable evaluation and analysis of the credit risk and performance of the obligations and financial assets. The documents shall require that such information and its disclosure, at a minimum, shall comply with the requirements of Regulation AB. Information that is unknown or not available to the sponsor or the issuer after reasonable investigation may be omitted if the issuer includes a statement in the offering documents disclosing that the specific information is otherwise unavailable;

* * * * *

Federal Deposit Insurance Corporation.

By order of the Board of Directors.

Dated at Washington, DC, on July 16, 2019.

Robert E. Feldman,

Executive Secretary.

[FR Doc. 2019–15536 Filed 8–21–19; 8:45 am]

BILLING CODE 6714–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration

21 CFR Part 15

[Docket No. FDA–2019–N–2514]

Standards for Future Opioid Analgesic Approvals and Incentives for New Therapeutics To Treat Pain and Addiction; Public Hearing; Correction

AGENCY: Food and Drug Administration, HHS.

ACTION: Notification of public hearing; request for comments; correction.

[13] FDIC-supervised institutions are set forth in 12 U.S.C. 1813(q)(2).

[14] FDIC Call Report, December 31, 2018.

[15] Public Law 106–102, sec. 722, 113 Stat. 1338, 1471 (1999).

[16] 12 U.S.C. 4802(a).

[17] 12 U.S.C. 4802(b).

SUMMARY: The Food and Drug Administration (FDA) is correcting a notice entitled ''Standards for Future Opioid Analgesic Approvals and Incentives for New Therapeutics To Treat Pain and Addiction; Public Hearing'' that appeared in the **Federal Register** of June 21, 2019. The document was published with incorrect presenter registration and slide deck submission deadlines. This document corrects those deadlines.

FOR FURTHER INFORMATION CONTACT: Nicole Zelenak, Center for Drug Evaluation and Research, Food and Drug Administration, 10903 New Hampshire Ave., Bldg. 22, Rm. 6429, Silver Spring, MD 20993–0002, 301–796–9030.

SUPPLEMENTARY INFORMATION: In the **Federal Register** of Friday, June 21, 2019 (84 FR 29112), in FR Doc. 2019–13219, on page 29114, the following correction is made:

On page 29114, in the first column, in the ''Presenter'' bulleted paragraph, the fourth and fifth sentences ''Presenters must register no later than August 9, 2019. Slide decks are due to *CDER-PublicMeeting@fda.hh.gov* in PDF or PowerPoint format no later than August 23, 2019.'' are corrected to read ''Presenters must register no later than September 6, 2019. Slide decks are due to *CDER-PublicMeeting@fda.hh.gov* in PDF or PowerPoint format no later than September 6, 2019.''

Dated: August 16, 2019.

Lowell J. Schiller,

Principal Associate Commissioner for Policy.

[FR Doc. 2019–18090 Filed 8–21–19; 8:45 am]

BILLING CODE 4164–01–P

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 52

[EPA–R09–OAR–2018–0713: FRL–9998–36–Region 9]

Revisions to California State Implementation Plan; Antelope Valley Air Quality Management District and Ventura County Air Pollution Control District; Nonattainment New Source Review Requirements for the 2008 8-Hour Ozone Standard

AGENCY: Environmental Protection Agency (EPA).

ACTION: Proposed rule.

SUMMARY: The Environmental Protection Agency (EPA) is proposing to approve two state implementation plan (SIP) revisions submitted by the State of California addressing the nonattainment new source review (NNSR) requirements for the 2008 8-hour ozone National Ambient Air Quality Standards (NAAQS) and one SIP revision regarding a permit rule. These SIP revisions address the Antelope Valley Air Quality Management District (AVAQMD or District) and Ventura County Air Pollution Control District (VCAPCD or District) portions of the California SIP. This action is being taken pursuant to the Clean Air Act (CAA or ''Act'') and its implementing regulations.

DATES: Any comments must arrive by September 23, 2019.

ADDRESSES: Submit your comments, identified by Docket ID No. EPA–R09–OAR–2018–0713 at *https://www.regulations.gov,* or via email to *R9AirPermits@epa.gov.* For comments submitted at *Regulations.gov*, follow the online instructions for submitting comments. Once submitted, comments cannot be removed or edited from *Regulations.gov*. For either manner of submission, the EPA may publish any comment received to its public docket. Do not submit electronically any information you consider to be Confidential Business Information (CBI) or other information whose disclosure is restricted by statute. Multimedia submissions (audio, video, etc.) must be accompanied by a written comment. The written comment is considered the official comment and should include discussion of all points you wish to make. The EPA will generally not consider comments or comment contents located outside of the primary submission (*i.e.,* on the web, cloud, or other file sharing system). For additional submission methods, please contact the person identified in the **FOR FURTHER INFORMATION CONTACT** section. For the full EPA public comment policy, information about CBI or multimedia submissions, and general guidance on making effective comments, please visit *https://www2.epa.gov/dockets/commenting-epa-dockets.*

FOR FURTHER INFORMATION CONTACT: Manny Aquitania, EPA Region IX, 75 Hawthorne St., San Francisco, CA 94105; (415) 972–3977, *aquitania.manny@epa.gov.*

SUPPLEMENTARY INFORMATION: Throughout this document, the terms ''we,'' ''us,'' and ''our'' refer to EPA.

Table of Contents

I. Background and Purpose

On May 10, 2019, EPA published a notice of proposed rulemaking regarding the NNSR requirements for the 2008 8-hour ozone NAAQS and one SIP revision regarding a permit rule. The EPA received one comment, stating that Section V, Incorporation by Reference of the proposed rule, contained a minor administrative error regarding what provisions were to be incorporated by reference. In response, Section V of today's **Federal Register** notice now clearly states we are proposing to incorporate into the SIP Ventura County Rule 10, ''Required Permits''.

On March 12, 2008, the EPA promulgated a revised 8-hour ozone NAAQS of 0.075 parts per million (ppm).[1] Upon promulgation of a new or revised NAAQS, the CAA requires the EPA to designate as nonattainment any area that is violating the NAAQS based on the three most recent years of ambient air quality data. The two California air districts that are subject to this action were designated nonattainment for the 2008 8-hour ozone NAAQS on April 30, 2012, using years 2009–2011 ambient air quality data.[2] At the time of designation, the AVAQMD was classified as a severe ozone nonattainment area as part of the Mojave Desert Air Basin and VCAPCD was classified as a serious ozone nonattainment area as part of the South Central Coast Air Basin.

[1] 73 FR 16436 (March 27, 2008).

[2] 77 FR 30088 (May 21, 2012).

On March 6, 2015, the EPA issued a final rule entitled, ''Implementation of the 2008 National Ambient Air Quality Standards for Ozone: State Implementation Plan Requirements'' (''SIP Requirements Rule''), which establishes the requirements and deadlines that state, tribal, and local air quality management agencies must meet as they develop implementation plans for areas where ozone concentrations exceed the 2008 8-hour ozone NAAQS.[3] Based on the initial nonattainment designations for the 2008 8-hour ozone standard, each District was required to make a SIP revision addressing NNSR no later than July 20, 2015.[4] This requirement may be met by submitting a SIP revision consisting of a new or revised NNSR permit program, or an analysis demonstrating that the existing SIP-approved NNSR permit program meets the applicable 2008 ozone requirements and a letter certifying the analysis.

On February 3, 2017, the EPA issued a final rule entitled, ''Findings of Failure to Submit State Implementation Plan Submittals for the 2008 Ozone National Ambient Air Quality Standards'' (''FFS Rule''). The rule found that certain state and local air agencies, including the AVAQMD and VCAPCD, had failed to submit a SIP revision in a timely manner to satisfy specific New Source Review requirements that apply to nonattainment areas. The rule established certain deadlines for the imposition of sanctions, if a state does not submit a timely SIP revision addressing the requirements for which the finding was made, and for the EPA to promulgate a federal implementation plan (FIP) to address any outstanding SIP requirements.

II. The State's Submittal

A. What did the State submit?

Table 1 lists the dates the submitted 2008 Ozone Certification letters and permit rule addressed by this proposal were adopted by each air District and submitted by the California Air Resources Board (CARB), the agency responsible for California SIP submittals.

TABLE 1—SIP SUBMITTALS

District	Rule No.	Rule title	Adoption/ amend date	Submittal date
AVAQMD	N/A	2008 Ozone Certification	7/17/2018	8/31/2018
VCAPCD	N/A	2008 Ozone Certification	7/31/2018	8/31/2018
VCAPCD	10	Permits Required	4/13/2004	7/19/2004

On August 10, 2004, CARB's July 19, 2004 submittal of VCAPCD's Rule 10 was deemed to meet the completeness criteria in 40 CFR part 51, appendix V, which must be met before formal EPA review. On September 6, 2018, CARB's August 31, 2018 submittal of AVAQMD's and VCAPCD's 2008 Certification letters were also deemed to meet the completeness criteria in 40 CFR part 51, appendix V.

B. What is the purpose of the submitted certification letters?

The submittal from each District is intended to satisfy the SIP Requirement Rule that requires states to make a SIP revision addressing NNSR and the FFS Rule that requires each District to make a SIP submittal by September 6, 2018. The SIP for each District currently contains approved NNSR permit programs based on their nonattainment classification for the 1997 8-hour ozone NAAQS. The submitted certification letters provide a mechanism for each District to satisfy the 40 CFR 51.1114 submittal requirements based on their 2008 8-hr ozone nonattainment designations. EPA's analysis of how these SIP revisions address the NNSR requirements for the 2008 8-hour ozone NAAQS is provided below.

C. What is the purpose of the submitted permit rule?

The submittal of Rule 10 by the VCAPCD is intended to clarify the expiration date of a Part 70 permit. The District revised Section 3 of Rule 10, pertaining to the expiration of a ''Permit to Operate'' to clarify that a Part 70 permit does not expire annually. This revision clarifies that a Part 70 permit expires only if not renewed in accordance with the requirements of VCAPCD's Rule 30, ''Permit Renewal''.

III. Analysis of Nonattainment New Source Review Requirements

The minimum SIP requirements for NNSR permitting programs for the 2008 8-hour ozone NAAQS are contained in 40 CFR 51.165. These NNSR program requirements include those promulgated in the ''Phase 2 Rule'' implementing the 1997 8-hour ozone NAAQS[5] and the SIP Requirements Rule implementing the 2008 8-hour ozone NAAQS. Under the Phase 2 Rule, the SIP for each ozone nonattainment area must contain NNSR provisions that: (1) Set major source thresholds for nitrogen oxides (NO_X) and volatile organic compounds (VOC) pursuant to 40 CFR 51.165(a)(1)(iv)(A)(*1*)(*i*)–(*iv*) and (*2*); (2) classify physical changes at a major source if the change would constitute a major source by itself pursuant to 40 CFR 51.165(a)(1)(iv)(A)(*3*); (3) consider any significant net emissions increase of NO_X as a significant net emissions increase for ozone pursuant to 40 CFR 51.165(a)(1)(v)(E); (4) consider any increase of VOC emissions in extreme ozone nonattainment areas as significant net emissions increases and major modifications for ozone pursuant to 40 CFR 51.165(a)(1)(v)(F); (5) set significant emissions rates for VOC and NO_X as ozone precursors pursuant to 40 CFR 51.165(a)(1)(x)(A)–(C) and (E); (6) contain provisions for emissions reductions credits pursuant to 40 CFR 51.165(a)(3)(ii)(C)(*1*)–(*2*); (7) provide that the requirements applicable to VOC also apply to NO_X pursuant to 40 CFR 51.165(a)(8); and (8) set offset ratios for VOC and NO_X pursuant to 40 CFR 51.165(a)(9)(ii)–(iv). Under the SIP Requirements Rule, the SIP for each ozone nonattainment area designated nonattainment for the 2008 8-hour ozone NAAQS and designated nonattainment for the 1997 ozone NAAQS as of April 6, 2015, must also contain NNSR provisions that include the anti-backsliding requirements at 40 CFR 51.1105.

[3] 80 FR 12263 (March 6, 2015). The SIP Requirements Rule addresses a range of nonattainment area SIP requirements for the 2008 ozone NAAQS, including requirements pertaining to attainment demonstrations, reasonable further progress (RFP), reasonably available control technology, reasonably available control measures, major new source review, emission inventories, and the timing of SIP submissions and of compliance with emission control measures in the SIP. The rule also revokes the 1997 ozone NAAQS and establishes anti-backsliding requirements.

[4] 40 CFR 51.1114.

[5] 70 FR 71612 (November 29, 2005).

A. Antelope Valley Air Quality Management District (AVAQMD)

The AVAQMD's longstanding SIP-approved NNSR program,[6] established in Regulation XIII, ''New Source Review,'' of the AVAQMD's Rules and Regulations, applies to the construction and modification of stationary sources, including major stationary sources in nonattainment areas under its jurisdiction. In addition, the District has submitted revisions to their NSR program that update and clarify certain provisions.[7] The AVAQMD's submitted SIP revision includes a demonstration, consisting of a table listing each of the Phase 2 Rule and SIP Requirements Rule NNSR program requirements, and a citation to the specific provision of the SIP-approved or SIP-submitted rule satisfying the requirement. The submittal also includes a certification by the AVAQMD that the cited rules meet the federal NNSR requirements for the applicable ozone nonattainment designation. These documents are available in the docket for this action. EPA has reviewed the demonstration and cited program elements intended to meet the federal NNSR requirements and is proposing to approve the AVAQMD's submittal because the current SIP-approved or SIP-submitted NSR program contains all the Phase 2 Rule and SIP Requirements Rule NNSR program requirements for a severe ozone nonattainment area.

B. Ventura County Air Pollution Control District (VCAPCD)

The VCAPCD's longstanding SIP-approved NNSR program,[8] established in Rules 26–26.11, applies to the construction and modification of stationary sources, including major stationary sources in nonattainment areas under its jurisdiction. The VCAPCD's submitted SIP revision includes a demonstration, consisting of a table listing each of the Phase 2 Rule and SIP Requirements Rule NNSR program requirements, and a citation to the specific provision of the rule satisfying the requirement. The submittal also includes a certification by the VCAPCD that the cited rules meet the federal NNSR requirements for the applicable ozone nonattainment designation. These documents are available in the docket for this action. The EPA has reviewed the demonstration and cited program elements intended to meet the federal NNSR requirements and is proposing to approve the VCAPCD's submittal because the current SIP-approved NSR program contains all the Phase 2 Rule and SIP Requirements Rule NNSR program requirements for a serious ozone nonattainment area.

The EPA has determined that the revision to Rule 10 provides clarity pertaining to the expiration of permits issued by the District. Therefore, we find this revision acceptable for incorporation into the SIP by reference.

IV. Proposed Action and Public Comment

The EPA is proposing to approve SIP revisions addressing the NNSR requirements for the 2008 8-hour ozone NAAQS for the AVAQMD and VCAPCD, as well as VCAPCD Rule 10. In support of this proposed action, we have concluded that our approval would comply with section 110(l) of the Act because the submittals will not interfere with continued attainment of the NAAQS in each District. The EPA has concluded that the State's submission fulfills the 40 CFR 51.1114 revision requirement and meets the requirements of CAA section 110 and the minimum SIP requirements of 40 CFR 51.165. The intended effect of our proposed action is to approve the submitted certifications as meeting the applicable Phase 2 Rule requirements. If we finalize this action as proposed, our action would incorporate these certifications and Rule 10 into the federally-enforceable SIP and be codified through revisions to 40 CFR 52.220 (Identification of plan—in part).

We will accept comments from the public on this proposal until September 23, 2019.

In addition, the FFS Rule issued by the EPA on February 3, 2017, started an 18-month sanctions clock and a 24-month FIP clock.[9] The 18-month sanctions clock was stopped upon receipt of California's SIP revisions and our determination that the submittals were complete. We determined the submittals for AVAQMD and VCAPCD were complete on September 6, 2018. The 24-month FIP clock will stop upon the effective date of our final approval.

V. Incorporation by Reference

In this rule, the EPA is proposing to include in a final EPA rule regulatory text that includes incorporation by reference. In accordance with requirements of 1 CFR 51.5, the EPA is proposing to incorporate by reference the VCAPCD rule listed in Table 1 of this preamble. The EPA has made, and will continue to make, this material available electronically through *https://www.regulations.gov* and at the EPA Region IX Office (please contact the person identified in the **FOR FURTHER INFORMATION CONTACT** section of this preamble for more information).

VI. Statutory and Executive Order Reviews

Under the Clean Air Act, the Administrator is required to approve a SIP submission that complies with the provisions of the Act and applicable Federal regulations. 42 U.S.C. 7410(k); 40 CFR 52.02(a). Thus, in reviewing SIP submissions, The EPA's role is to approve state choices, provided that they meet the criteria of the Clean Air Act. Accordingly, this action merely approves state law as meeting Federal requirements and does not impose additional requirements beyond those imposed by state law. For that reason, this action:

- Is not a significant regulatory action subject to review by the Office of Management and Budget under Executive Orders 12866 (58 FR 51735, October 4, 1993) and 13563 (76 FR 3821, January 21, 2011);
- Does not impose an information collection burden under the provisions of the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*);
- Is certified as not having a significant economic impact on a substantial number of small entities under the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*);
- Does not contain any unfunded mandate or significantly or uniquely affect small governments, as described in the Unfunded Mandates Reform Act of 1995 (Pub. L. 104–4);
- Does not have Federalism implications as specified in Executive Order 13132 (64 FR 43255, August 10, 1999);
- Is not an economically significant regulatory action based on health or safety risks subject to Executive Order 13045 (62 FR 19885, April 23, 1997);
- Is not a significant regulatory action subject to Executive Order 13211 (66 FR 28355, May 22, 2001);
- Is not subject to requirements of Section 12(d) of the National Technology Transfer and Advancement Act of 1995 (15 U.S.C. 272 note) because application of those requirements would be inconsistent with the Clean Air Act; and
- Does not provide the EPA with the discretionary authority to address, as appropriate, disproportionate human health or environmental effects, using

[6] 61 FR 64291 (December 4, 1996).

[7] New Rule 1305—Emission Offsets was submitted to the EPA by CARB on October 30, 2001 and rule revisions were submitted on December 29, 2006.

[8] 65 FR 76567 (December 7, 2000), 68 FR 9561 (February 28, 2003), 75 FR 1284 (January 11, 2010).

[9] 82 FR 9158, (February 3, 2017).

practicable and legally permissible methods, under Executive Order 12898 (59 FR 7629, February 16, 1994).

- In addition, the SIP is not approved to apply on any Indian reservation land or in any other area where the EPA or an Indian tribe has demonstrated that a tribe has jurisdiction. In those areas of Indian country, the rule does not have tribal implications and will not impose substantial direct costs on tribal governments or preempt tribal law as specified by Executive Order 13175 (65 FR 67249, November 9, 2000).

List of Subjects in 40 CFR Part 52

Environmental protection, Air pollution control, Incorporation by reference, Intergovernmental relations, Nitrogen dioxide, Ozone, Reporting and recordkeeping requirements, Volatile organic compounds.

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

Dated: August 6, 2019.

Michael Stoker,

Regional Administrator, Region IX.

[FR Doc. 2019–17804 Filed 8–21–19; 8:45 am]

BILLING CODE 6560–50–P

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 52

[EPA–R07–OAR–2019–0468; FRL–9998–40–Region 7]

Air Plan Approval; Iowa; Revisions to Regional Haze Plan and Visibility Requirements in Infrastructure State Implementation Plans for the 2006 $PM_{2.5}$, 2012 $PM_{2.5}$, 2010 NO_2, 2010 SO_2, 2008 Ozone, and 2015 Ozone NAAQS

AGENCY: Environmental Protection Agency (EPA).

ACTION: Proposed rule.

SUMMARY: The Environmental Protection Agency (EPA) is proposing to approve Iowa's request on four actions regarding the Iowa State Implementation Plan (SIP). The four SIP actions relate to Iowa's Regional Haze Plan and infrastructure SIPs for the 2006 Fine Particulate Matter ($PM_{2.5}$), 2012 $PM_{2.5}$, 2010 Nitrogen Dioxide (NO_2), 2010 Sulfur Dioxide (SO_2), 2008 Ozone, and 2015 Ozone National Ambient Air Quality Standards (NAAQS).

DATES: Comments must be received on or before September 23, 2019.

ADDRESSES: You may send comments, identified by Docket ID No. EPA–R07–OAR–2019–0468 to *https://www.regulations.gov.* Follow the online instructions for submitting comments.

Instructions: All submissions received must include the Docket ID No. for this rulemaking. Comments received will be posted without change to *https://www.regulations.gov/,* including any personal information provided. For detailed instructions on sending comments and additional information on the rulemaking process, see the "Written Comments" heading of the **SUPPLEMENTARY INFORMATION** section of this document.

FOR FURTHER INFORMATION CONTACT: Jed D. Wolkins, Environmental Protection Agency, Region 7 Office, Air Quality Planning Branch, 11201 Renner Boulevard, Lenexa, Kansas 66219 at telephone number (913) 551–7588; email address *wolkins.jed@epa.gov.*

SUPPLEMENTARY INFORMATION: Throughout this document "we," "us," and "our" refer to EPA.

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I. Written Comments

Submit your comments, identified by Docket ID No. EPA–R07–OAR–2019–0468, at *https://www.regulations.gov.* Once submitted, comments cannot be edited or removed from *Regulations.gov*. The EPA may publish any comment received to its public docket. Do not submit electronically any information you consider to be Confidential Business Information (CBI) or other information whose disclosure is restricted by statute. Multimedia submissions (audio, video, etc.) must be accompanied by a written comment. The written comment is considered the official comment and should include discussion of all points you wish to make. The EPA will generally not consider comments or comment contents located outside of the primary submission (*i.e.* on the web, cloud, or other file sharing system). For additional submission methods, the full EPA public comment policy, information about CBI or multimedia submissions, and general guidance on making effective comments, please visit *https://www.epa.gov/dockets/commenting-epa-dockets.*

II. What is being addressed in this document?

On May 14, 2019, the State of Iowa submitted a request to revise the State of Iowa's Regional Haze Plan, changing from reliance on the Clean Air Interstate Rule (CAIR) to reliance on the Cross State Air Pollution Rule (CSAPR) for certain regional haze requirements; removing EPA's Federal Implementation Plan (FIP) for reliance on CSAPR for certain regional haze requirements, converting EPA's limited approval/limited disapproval of Iowa's Regional Haze Plan for the first regional haze planning period to a full approval; and approving the states' submissions addressing the Clean Air Act (CAA or the Act) section 110(a)(2)(D)(i)(II) provision (prong 4) that prohibits emissions activity in one state from interfering with measures to protect visibility in another state of Iowa's infrastructure SIP submittals for the 2006 $PM_{2.5}$, 2012 $PM_{2.5}$, 2010 NO_2, 2010 SO_2, 2008 Ozone, and 2015 Ozone NAAQS. The EPA is proposing approve these requests.

A. Regional Haze SIPs and Their Relationship With CAIR and CSAPR

Section 169A(b)(2)(A) of the CAA requires states to submit Regional Haze SIPs that contain such measures as may be necessary to make reasonable progress towards the natural visibility goal at Class I areas, including a requirement that certain categories of existing major stationary sources built between 1962 and 1977 procure, install, and operate Best Available Retrofit Technology (BART) as determined by the state. Under the Regional Haze Rule (RHR), adopted in 1999, states are directed to conduct BART determinations for such "BART-eligible" sources that may be anticipated to cause or contribute to visibility impairment in a Class I area.[1] Rather than requiring source-specific BART controls, states also have the flexibility to adopt an emissions trading program or other alternative program as long as the alternative provides greater reasonable progress towards improving visibility than BART.[2] The EPA provided states with this flexibility in the 1999 RHR, and further refined the criteria for assessing whether an alternative program provides for greater reasonable progress in two subsequent rulemakings.[3]

The EPA demonstrated that CAIR would achieve greater reasonable

[1] *See* 64 FR 35714 (July 1, 1999).

[2] *See* 40 CFR 51.308(e)(2).

[3] See 70 FR 39104 (July 6, 2005) and 71 FR 60612 (October 13, 2006).

progress than BART in revisions to the RHR made in 2005.[4] In those revisions, the EPA amended its regulations to provide that states participating in the CAIR cap-and-trade programs pursuant to an EPA-approved CAIR SIP or states that remain subject to a CAIR FIP need not require affected BART-eligible electric generating units (EGUs) to install, operate, and maintain BART for emissions of SO_2 and nitrogen oxides (NO_X). As a result of the EPA's determination that CAIR was ''better-than-BART,'' a number of states in the CAIR region, including Iowa, relied on the CAIR cap-and-trade programs as an alternative to BART for EGU emissions of SO_2 and NO_X in designing their Regional Haze SIPs. These states also relied on CAIR as an element of a long-term strategy (LTS) for achieving reasonable progress. However, in 2008, the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit) remanded CAIR to the EPA, which it did without vacatur to preserve the environmental benefits provided by CAIR.[5] On August 8, 2011, acting on the D.C. Circuit's remand, the EPA promulgated CSAPR to replace CAIR and issued FIPs to implement the rule in CSAPR-subject states.[6] Implementation of CSAPR was scheduled to begin on January 1, 2012, when CSAPR would have superseded the CAIR program.

Due to the D.C. Circuit's 2008 ruling that CAIR was ''fatally flawed'' and its resulting status as a temporary measure following that ruling, the EPA could not fully approve Regional Haze SIPs to the extent that they relied on CAIR to satisfy the EGU BART requirement. On these grounds, the EPA published in the **Federal Register** a limited disapproval of Iowa's Regional Haze SIP on June 7, 2012, and promulgated a FIP relying on CSAPR rather than CAIR, pending Iowa's submission, and EPA approval of, a SIP revision that corrected the deficiency.[7] The EPA finalized a limited approval of Iowa's Regional Haze SIP on June 26, 2012, as meeting the remaining applicable Regional Haze requirements set forth in the CAA and the RHR.[8]

In the June 7, 2012 limited disapproval action, the EPA also amended the RHR to provide that participation by a state's EGUs in a CSAPR trading program for a given pollutant—either a CSAPR Federal trading program implemented through a CSAPR FIP or an integrated CSAPR state trading program implemented through an approved CSAPR SIP revision—qualifies as a BART alternative for those EGUs for that pollutant.[9] Since the EPA promulgated this amendment, numerous states covered by CSAPR have come to rely on the provision through either SIPs or FIPs.[10] Iowa is currently relying on the FIP published in the **Federal Register** on June 7, 2012 to rely on CSAPR as a BART-alternative for the covered BART-eligible sources.

Numerous parties filed petitions for review of CSAPR in the D.C. Circuit, and on August 21, 2012, the court issued its ruling, vacating and remanding CSAPR to the EPA and ordering continued implementation of CAIR.[11] The D.C. Circuit's vacatur of CSAPR was reversed by the United States Supreme Court on April 29, 2014, and the case was remanded to the D.C. Circuit to resolve remaining issues in accordance with the high court's ruling.[12] On remand, the D.C. Circuit affirmed CSAPR in most respects, but invalidated without vacating some of the CSAPR budgets as to a number of states.[13] The remanded budgets include the Phase 2 SO_2 emissions budgets for Alabama, Georgia, South Carolina, and Texas and the Phase 2 ozone-season NO_X budgets for eleven states. This litigation ultimately delayed implementation of CSAPR for three years, from January 1, 2012, when CSAPR's cap-and-trade programs were originally scheduled to replace the CAIR cap-and-trade programs, to January 1, 2015. Thus, the rule's Phase 2 budgets that were originally promulgated to begin on January 1, 2014, began on January 1, 2017.

Recognizing that changes to the scope of CSAPR's coverage could potentially affect its 2012 determination that CSAPR is ''better than BART,'' on November 10, 2016,[14] the EPA published in the **Federal Register** a notice of proposed rulemaking (NPRM) explaining the Agency's belief that the potentially material changes to the scope of CSAPR coverage resulting from the D.C. Circuit's remand would not have altered EPA's 2012 conclusion that CSAPR is ''better-than-BART,'' that is, that participation in CSAPR remains available as an alternative to BART for EGUs covered by the trading programs on a pollutant-specific basis. On September 21, 2017, the Administrator signed the final action, ''Interstate Transport of Fine Particulate Matter: Revision of Federal Implementation Plan Requirements for Texas.'' [15] In this action, the agency removed Texas from the CSAPR annual NO_X and SO_2 trading programs and affirmed the continued validity of the Agency's 2012 determination that participation in CSAPR meets the Regional Haze Rule's criteria for an alternative to the application of source-specific BART.

On May 14, 2019, the State of Iowa submitted request to revise its Regional Haze SIP to rely on its participation in the CSAPR annual trading programs for NO_X and SO_2 to satisfy the requirements of 40 CFR 51.308(d)(3) and 51.308(e) with respect to emissions of NO_X and SO_2 from electric generating units, pursuant to the option provided in 40 CFR 51.308(e)(4) (the ''CSAPR-better-than-BART'' provision).

We are proposing to approve Iowa's submission as satisfying the SO_2 and NO_X requirements in 40 CFR 51.308(d)(3) and (e) for BART-eligible EGUs subject to the CSAPR SO_2 trading program and the annual CSAPR NO_X trading program. We are also proposing to convert the limited approval/limited disapproval of Iowa's Regional Haze plan to a full approval. Finally, the EPA is proposing to withdraw the FIP relying on CSAPR as a BART-alternative for these sources.

[4] CAIR created regional cap-and-trade programs to reduce SO_2 and NO_X emissions in 27 eastern states (and the District of Columbia), including Iowa, that contributed to downwind nonattainment or interfered with maintenance of the 1997 8-hour ozone NAAQS or the 1997 $PM_{2.5}$ NAAQS. See 70 FR 39104 (July 6, 2005).

[5] *North Carolina* v. *EPA,* 550 F.3d 1176, 1178 (D.C. Cir. 2008).

[6] CSAPR requires 28 eastern states to limit their statewide emissions of SO_2 and/or NO_X in order to mitigate transported air pollution unlawfully impacting other states' ability to attain or maintain four NAAQS: the 1997 ozone NAAQS, the 1997 annual $PM_{2.5}$ NAAQS, the 2006 24-hour $PM_{2.5}$ NAAQS, and the 2008 8-hour ozone NAAQS. The CSAPR emissions limitations are defined in terms of maximum statewide ''budgets'' for emissions of annual SO_2, annual NO_X, and/or ozone-season NO_X by each covered state's large EGUs. The CSAPR state budgets are implemented in two phases of generally increasing stringency, with the Phase 1 budgets applying to emissions in 2015 and 2016 and the Phase 2 budgets applying to emissions in 2017 and later years. See 76 FR 48208 (August 8, 2011).

[7] *See* 77 FR 33642, 77 FR 33653–77 FR 336554 (June 7, 2012). EPA finalized limited disapprovals of fourteen states' regional haze SIP submissions that relied on CAIR in this action, including Iowa's.

[8] *See* 77 FR 38006. (June 26, 2012)

[9] *See* 40 CFR 51.308(e)(4).

[10] EPA has promulgated FIPs relying on CSAPR participation for BART purposes for Georgia, Indiana, Iowa, Kentucky, Michigan, Missouri, Ohio, Pennsylvania, South Carolina, Tennessee, Virginia, and West Virginia, 77 FR at 33654, and Nebraska, 77 FR 40150, 40151 (July 6, 2012). EPA has approved Minnesota's and Wisconsin's SIPs relying on CSAPR participation for BART purposes. *See* 77 FR 34801, 34806 (June 12, 2012) for Minnesota and 77 FR 46952, 46959 (August 7, 2012) for Wisconsin.

[11] *EME Homer City Generation, L.P.* v. *EPA,* 696 F.3d 7, 38 (D.C. Cir. 2012).

[12] *EPA* v. *EME Homer City Generation, L.P.,* 134 S. Ct. 1584 (2014).

[13] *EME Homer City Generation, L.P.* v. *EPA,* 795 F.3d 118 (D.C. Cir. 2015).

[14] See 81 FR 78954 (November 10, 2016)

[15] Legal challenges to this rule are pending. *Nat'l Parks Conservation Ass'n* v. *EPA,* No. 17–1253 (D.C. Cir. filed November 28, 2017).

B. Infrastructure SIPs

By statute, SIPs meeting the requirements of sections 110(a)(1) and (2) of the CAA are to be submitted by states within three years (or less, if the Administrator so prescribes) after promulgation of a new or revised NAAQS to provide for the implementation, maintenance, and enforcement of the new or revised NAAQS. The EPA has historically referred to these SIP submissions, which are made for satisfying the requirements of sections 110(a)(1) and 110(a)(2), as ''infrastructure SIP'' submissions. Sections 110(a)(1) and (2) require states to address basic SIP elements such as for monitoring, basic program requirements, and legal authority that are designed to assure attainment and maintenance of the newly established or revised NAAQS. More specifically, section 110(a)(1) provides the procedural and timing requirements for infrastructure SIPs. Section 110(a)(2) lists specific elements that states must meet for the infrastructure SIP requirements related to a newly established or revised NAAQS. The contents of an infrastructure SIP submission may vary depending upon the specific NAAQS in question, as well as the provisions already contained in the state's implementation plan at the time at which the state develops and submits the submission for a new or revised NAAQS.

Section 110(a)(2)(D)(i) includes four distinct components, commonly referred to as ''prongs,'' that must be addressed in infrastructure SIP submissions. The first two prongs, which are codified in section 110(a)(2)(D)(i)(I), are provisions that prohibit any source or other type of emissions activity in one state from contributing significantly to nonattainment of the NAAQS in another state (prong 1) and from interfering with maintenance of the NAAQS in another state (prong 2). The third and fourth prongs, which are codified in section 110(a)(2)(D)(i)(II), are provisions that prohibit emissions activity in one state from interfering with measures required to prevent significant deterioration of air quality in another state (prong 3) or from interfering with measures to protect visibility in another state (prong 4).

Through this action, the EPA is proposing to approve the prong 4 portion of Iowa's infrastructure SIP submissions for the 2006 $PM_{2.5}$, 2012 $PM_{2.5}$, 2010 1-hour NO_2, 2010 1-hour SO_2, 2008 Ozone, and 2015 Ozone NAAQS. All other applicable infrastructure SIP requirements for these SIP submissions have been or will be addressed in separate rulemakings. A brief background regarding the NAAQS relevant to this proposal is provided below. For comprehensive information on these NAAQS, please refer to the **Federal Register** notices cited in the following subsections.

1. 2006 $PM_{2.5}$ NAAQS

On October 17, 2006, the EPA revised the 24 hour primary $PM_{2.5}$ NAAQS to 35 micrograms per cubic meter ($\mu g/m^3$).[16] States were required to submit infrastructure SIP submissions for the 2006 $PM_{2.5}$ NAAQS to the EPA no later than September 21, 2009. Iowa submitted an infrastructure SIP submission for the 2006 $PM_{2.5}$ NAAQS on July 29, 2013. This proposed action only addresses the prong 4 element of that submission.

2. 2012 $PM_{2.5}$ NAAQS

On December 14, 2012, the EPA revised the annual primary $PM_{2.5}$ NAAQS to 12 micrograms per cubic meter ($\mu g/m^3$).[17] States were required to submit infrastructure SIP submissions for the 2012 $PM_{2.5}$ NAAQS to the EPA no later than December 14, 2015. Iowa submitted an infrastructure SIP submission for the 2012 $PM_{2.5}$ NAAQS on December 22, 2015. This proposed action only addresses the prong 4 element of that submission.

3. 2010 1-Hour SO_2 NAAQS

On June 2, 2010, the EPA revised the 1-hour primary SO_2 NAAQS to an hourly standard of 75 parts per billion (ppb) based on a 3-year average of the annual 99th percentile of 1-hour daily maximum concentrations.[18] States were required to submit infrastructure SIP submissions for the 2010 1-hour SO_2 NAAQS to the EPA no later than June 2, 2013. Iowa submitted an infrastructure SIP submission for the 2010 1-hour SO_2 NAAQS on July 28, 2013. This proposed action only addresses the prong 4 element of that submission.

4. 2010 1-Hour NO_2 NAAQS

On January 22, 2010, the EPA promulgated a new 1-hour primary NAAQS for NO_2 at a level of 100 ppb, based on a 3-year average of the 98th percentile of the yearly distribution of 1-hour daily maximum concentrations.[19] States were required to submit infrastructure SIP submissions for the 2010 1-hour NO_2 NAAQS to the EPA no later than January 22, 2013. Iowa submitted infrastructure SIP submissions for the 2010 1-hour NO_2 NAAQS on July 29, 2013. This proposed action only addresses the prong 4 element of those submissions.

5. 2008 8-Hour Ozone NAAQS

On March 12, 2008, the EPA revised the 8-hour Ozone NAAQS to 0.075 parts per million.[20] States were required to submit infrastructure SIP submissions for the 2008 8-hour Ozone NAAQS to the EPA no later than March 12, 2011. Iowa submitted an infrastructure SIP for the 2008 8-hour Ozone NAAQS on January 17, 2013. This proposed action only addresses the prong 4 element of that submission.

6. 2015 8-Hour Ozone NAAQS

On October 1, 2015, the EPA revised the 8-hour Ozone NAAQS to 0.070 parts per million.[21] States were required to submit infrastructure SIP submissions for the 2015 8-hour Ozone NAAQS to the EPA no later than October 1, 2018. Iowa submitted an infrastructure SIP for the 2015 8-hour Ozone NAAQS on November 30, 2018. This proposed action only addresses the prong 4 element of that submission.

C. What are the prong 4 requirements?

The prong 4 requirement of CAA section 110(a)(2)(D)(i)(II) requires a state's implementation plan to contain provisions prohibiting any source or other type of emissions activity within the State from emitting any air pollutant in amounts which will interfere with measures required to be included in the applicable implementation plan for any other State under part C of this subchapter to protect visibility (which includes sections 169A and 169B). On September 13, 2013, the EPA issued *Guidance on the Infrastructure State Implementation Plan (SIP) Elements Under Clean Air Act Sections 110(a)(1) and 110(a)(2)* (''2013 Guidance'').[22] The EPA developed this document to provide states with guidance for infrastructure SIPs for any new or revised NAAQS. The 2013 Guidance states that the prong 4 requirement may be satisfied by an approved SIP provision that the EPA has found to adequately address contribution of that state's sources that impacts the visibility program requirements in other states. The 2013 Guidance also states that the

[16] *See* 71 FR 200 (October 17, 2006).

[17] *See* 78 FR 3086 (January 15, 2013).

[18] *See* 75 FR 35520 (June 22, 2010).

[19] *See* 75 FR 6474 (February 9, 2010).

[20] *See* 73 FR 16436 (March 27, 2008).

[21] *See* 80 FR 65292 (October 26, 2015).

[22] ''Guidance on the Infrastructure State Implementation Plan (SIP) Elements Under Clean Air Act Sections 110(a)(1) and 110(a)(2)''; Memorandum from Stephen D. Page, September 13, 2013.

EPA interprets this prong to be pollutant-specific, such that the infrastructure SIP submission need only address the potential for interference with protection of visibility caused by the pollutant (including precursors) to which the new or revised NAAQS applies.

The 2013 Guidance lays out how a state's infrastructure SIP may satisfy prong 4. One way that a state can meet the requirements is via confirmation in its infrastructure SIP submission that the state has an approved Regional Haze SIP that fully meets the requirements of 40 CFR 51.308 or 51.309. 40 CFR 51.308 and 51.309 specifically require that a state participating in a regional planning process include all measures needed to achieve its apportionment of emission reduction obligations agreed upon through that process. A fully approved Regional Haze SIP will ensure that emissions from sources under an air agency's jurisdiction are not interfering with measures required to be included in other air agencies' plans to protect visibility.

D. What is the EPA's analysis of how Iowa addressed prong 4 and regional haze?

Each of Iowa's infrastructure SIP submittals (2008 8-hour Ozone, 2015 8-hour Ozone, 2010 1-hour NO_2, 2010 1-hour SO_2, 2006 24-hour $PM_{2.5,}$ and 2012 annual $PM_{2.5}$) relied on the State having a fully approved Regional Haze SIP to satisfy its prong 4 requirements. However, at the time of those submittals, the EPA had not fully approved Iowa's Regional Haze SIP, as the Agency issued a limited disapproval of the State's original Regional Haze plan on June 7, 2012. As detailed earlier in this proposed action, the EPA is proposing to convert EPA's limited approval/limited disapproval of Iowa's Regional Haze plan to a full approval because final approval of Iowa's SIP revision relying on CSAPR pursuant to 40 CFR 51.308(e)(4) would correct the deficiencies that led to EPA's limited approval/limited disapproval of the State's Regional Haze SIP. With this proposed action, the EPA would then fully approve Iowa's Regional Haze SIP for the first planning period. Because a state may satisfy prong 4 requirements through a fully approved Regional Haze SIP, the EPA is therefore also proposing to approve the prong 4 portion of Iowa's 2010 1-hour NO_2, 2010 1-hour SO_2, 2006 24-hour $PM_{2.5}$, 2012 annual $PM_{2.5,}$ 2008 8-hour Ozone, and 2015 8-hour Ozone infrastructure SIP submissions.

III. Have the requirements for approval of a SIP revision been met?

The state submission has met the public notice requirements for SIP submissions in accordance with 40 CFR 51.102. The submission also satisfied the completeness criteria of 40 CFR part 51, appendix V. The state provided the Federal Land Managers the draft rule on Febuarary 28, 2019, providing until April 28, 2019, to receive comments and received no comments. The state provided public notice of this SIP revision on March 29, 2019, providing until April 29, 2019 to receive comments and received no comments. The state held a public hearing on April 29, 2019 and received no comments. In addition, as explained above, the revision meets the substantive SIP requirements of the CAA, including section 110 and implementing regulations.

IV. What action is the the EPA taking?

The EPA is proposing to take the following actions: approve Iowa's SIP submittal relying on CSAPR for certain Regional Haze requirements in accordance with the CAA and the Regional Haze Rule (40 CFR 51.308(e)(4)); withdraw the FIP relying on CSAPR to satisfy those requirements; fully approve Iowa's Regional Haze SIP for the first planning period; and approve the prong 4 portions for each of the six NAAQS identified above. We are soliciting comments on this proposed action. Final rulemaking will occur after consideration of any comments.

V. Statutory and Executive Order Reviews

Under the CAA, the Administrator is required to approve a SIP submission that complies with the provisions of the Act and applicable Federal regulations. 42 U.S.C. 7410(k); 40 CFR 52.02(a). Thus, in reviewing SIP submissions, EPA's role is to approve state choices, provided that they meet the criteria of the CAA. Accordingly, this action merely approves state law as meeting Federal requirements and does not impose additional requirements beyond those imposed by state law. For that reason, this action:

- Is not a significant regulatory action subject to review by the Office of Management and Budget under Executive Orders 12866 (58 FR 51735, October 4, 1993) and 13563 (76 FR 3821, January 21, 2011);
- Is not an Executive Order 13771 (82 FR 9339, February 2, 2017) regulatory action because SIP approvals are exempted under Executive Order 12866.
- Does not impose an information collection burden under the provisions of the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*);
- Is certified as not having a significant economic impact on a substantial number of small entities under the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*);
- Does not contain any unfunded mandate or significantly or uniquely affect small governments, as described in the Unfunded Mandates Reform Act of 1995 (Pub. L. 104–4);
- Does not have Federalism implications as specified in Executive Order 13132 (64 FR 43255, August 10, 1999);
- Is not an economically significant regulatory action based on health or safety risks subject to Executive Order 13045 (62 FR 19885, April 23, 1997);
- Is not a significant regulatory action subject to Executive Order 13211 (66 FR 28355, May 22, 2001);
- Is not subject to requirements of section 12(d) of the National Technology Transfer and Advancement Act of 1995 (15 U.S.C. 272 note) because application of those requirements would be inconsistent with the CAA; and
- Does not provide EPA with the discretionary authority to address, as appropriate, disproportionate human health or environmental effects, using practicable and legally permissible methods, under Executive Order 12898 (59 FR 7629, February 16, 1994).

The SIP is not approved to apply on any Indian reservation land or in any other area where EPA or an Indian tribe has demonstrated that a tribe has jurisdiction. In those areas of Indian country, the rule does not have tribal implications and will not impose substantial direct costs on tribal governments or preempt tribal law as specified by Executive Order 13175 (65 FR 67249, November 9, 2000).

List of Subjects in 40 CFR Part 52

Environmental protection, Administrative practice and procedure, Air pollution control, Incorporation by reference, Intergovernmental relations, Nitrogen dioxide, Ozone, Particulate Matter, Reporting and recordkeeping requirements, Sulfur oxides.

Dated: August 13, 2019.

James B. Gulliford,

Regional Administrator, Region 7.

For the reasons stated in the preamble, the EPA proposes to amend 40 CFR part 52 as set forth below:

PART 52—APPROVAL AND PROMULGATION OF IMPLEMENTATION PLANS

■ 1. The authority citation for part 52 continues to read as follows:

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

Subpart Q—Iowa

■ 2. In § 52.820, the table in paragraph (e) is amended by adding the entry "(51)" in numerical order to read as follows:

§ 52.820 Identification of plan.

* * * * *

(e) * * *

EPA-APPROVED IOWA NONREGULATORY PROVISIONS

Name of nonregulatory SIP revision	Applicable geographic or non-attainment area	State submittal date	EPA Approval date	Explanation
* *	*	*	*	* *
(51) Sections 110(a)(2) Infrastructure Prong 4 Requirements for the 2006 Fine Particulate Matter, 2012 Fine Particulate Matter, 2010 Nitrogen Dioxide, 2010 Sulfur Dioxide, 2008 Ozone, and 2015 Ozone NAAQS.	Statewide	1/17/2013; 7/28/2013; 7/29/2013; 7/29/2013; 12/22/2015; 11/30/2018; 5/14/2019.	[Date of publication of the final rule in the **Federal Register**], [**Federal Register** citation of the final rule].	This action approves the following CAA elements: 110(a)(2)(D)(i)(II)—prong 4. [EPA–R07–OAR–2019–0468; FRL–9998–40–Region 7].

■ 3. Revise § 52.842 to read as follows:

§ 52.842 Visibility protection.

The requirements of section 169A of the Clean Air Act are met because the Regional Haze plan submitted by Iowa on March 25, 2008 and supplemented on May 14, 2019, includes fully approvable measures for meeting the requirements of the Regional Haze Rule including 40 CFR 51.308(d)(3) and 51.308(e) with respect to emissions of NO_X and SO_2 from electric generating units.

[FR Doc. 2019–18137 Filed 8–21–19; 8:45 am]

BILLING CODE 6560–50–P

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 62

[EPA–HQ–OAR–2019–0338; FRL–9998–62–OAR]

RIN 2060–AU52

Federal Plan Requirements for Municipal Solid Waste Landfills That Commenced Construction On or Before July 17, 2014, and Have Not Been Modified or Reconstructed Since July 17, 2014

AGENCY: Environmental Protection Agency (EPA).

ACTION: Proposed rule.

SUMMARY: In this action, the U.S. Environmental Protection Agency (EPA) proposes a federal plan to implement the Emission Guidelines and Compliance Times for Municipal Solid Waste Landfills (2016 MSW Landfills EG) for existing MSW landfills located in states and Indian country where state plans or tribal plans are not in effect. This proposed MSW Landfills Federal Plan includes the same elements as required for a state plan: Identification of legal authority and mechanisms for implementation; inventory of designated facilities; emissions inventory; emission limits; compliance schedules; a process for the EPA or state review of design plans for site-specific gas collection and control systems (GCCS); testing, monitoring, reporting and record keeping requirements; public hearing requirements; and progress reporting requirements. Additionally, this action summarizes implementation and delegation of authority of the MSW Landfills Federal Plan.

DATES: *Comments.* Comments must be received on or before October 7, 2019.

Public Hearing. We will hold a public hearing on September 6, 2019 from 1:00 p.m. to 5:00 p.m. (Eastern Daylight Time) in Research Triangle Park, North Carolina as specified in the **ADDRESSES** section of this preamble. If no one contacts the EPA requesting to speak at the public hearing to be held concerning this action by August 27, 2019, the public hearing will not take place. Information regarding whether or not a hearing will be held will be posted on the rule's website located at *https://www.epa.gov/stationary-sources-air-pollution/municipal-solid-waste-landfills-new-source-performance-standards.* EPA does not intend to publish any future documents in the **Federal Register** regarding a public hearing on this proposed action and directs all inquiries regarding a hearing to the website and contact person. See **SUPPLEMENTARY INFORMATION** for information on registering and attending a public hearing.

ADDRESSES: *Comments.* You may send comments, identified by Docket ID No. EPA–HQ–OAR–2019–0338, by any of the following methods:

- *Federal eRulemaking Portal: https://www.regulations.gov/* (our preferred method). Follow the online instrucations for submitting comments.
- *Email: a-and-r-docket@epa.gov.* Include Docket ID No. EPA–HQ–OAR–2019–0338 in the subject line of the message.
- *Fax:* (202) 566–9744. Attention Docket ID No. EPA–HQ–OAR–2019–0338.
- *Mail:* U.S. Environmental Protection Agency, EPA Docket Center, Docket ID No. EPA–HQ–OAR–2019–0338, Mail Code 28221T, 1200 Pennsylvania Avenue NW, Washington, DC 20460.
- *Hand/Courier Delivery:* EPA Docket Center, WJC West Building, Room 3334, 1301 Constitution Avenue NW, Washington, DC 20004. The Docket Center's hours of operation are 8:30 a.m.–4:30 p.m., Monday–Friday (except federal holidays).
- *Public Hearing:* A public hearing will be held at the U.S. EPA's North Carolina campus located at 109 T.W. Alexander Drive, Research Triangle Park, NC 27711.

Instructions: All submisison received must include the Docket ID No. for this rulemaking. Comments received may be posted without change to *https://www.regulations.gov/* including any personal information provided. For detailed instructions on sending comments and additional information on the rulemaking process, see the **SUPPLEMENTARY INFORMATION** section of this document.

FOR FURTHER INFORMATION CONTACT: For questions about this proposed action, contact Andrew Sheppard, Sector Policies and Programs Division (E143–03), Office of Air Quality Planning and Standards, U.S. Environmental Protection Agency, Research Triangle Park, North Carolina 27711; telephone number: (919) 541–4161; fax number: (919) 541–0516; and email address: *sheppard.andrew@epa.gov.*

SUPPLEMENTARY INFORMATION:

Public hearing. Please contact Virginia Hunt at (919) 541–0832 or by email at *hunt.virginia@epa.gov* to register to speak at the public hearing, or to inquire as to whether a public hearing will be held.

Docket. The EPA has established a docket for this action under Docket ID No. EPA–HQ–OAR–2019–0338. All documents in the docket are listed on *Regulations.gov.* Although listed, some information is not publicly available, *e.g.,* Confidential Business Information (CBI) or other information whose disclosure is restricted by statute. Certain other material, such as copyrighted material, is not placed on the internet and will be publicly available only in hard copy. Publicly available docket materials are available either electronically in *Regulations.gov* or in hard copy at the EPA Docket Center, Room 3334, WJC West Building, 1301 Constitution Avenue NW, Washington, DC. The Public Reading Room is open from 8:30 a.m. to 4:30 p.m., Monday through Friday, excluding legal holidays. The telephone number for the Public Reading Room is (202) 566–1744, and the telephone number for the EPA Docket Center is (202) 566–1742.

Instructions. Direct your comments to Docket ID No. EPA–HQ–OAR–2019–0338. The EPA's policy is that all comments received will be included in the public docket without change and may be made available online at *https://www.regulations.gov/,* including any personal information provided, unless the comment includes information claimed to be CBI or other information whose disclosure is restricted by statute. Do not submit information that you consider to be CBI or otherwise protected through *https://www.regulations.gov/* or email. This type of information should be submitted by mail as discussed below.

The EPA may publish any comment received to its public docket. Multimedia submissions (audio, video, etc.) must be accompanied by a written comment. The written comment is considered the official comment and should include discussion of all points you wish to make. The EPA will generally not consider comments or comment contents located outside of the primary submission (*i.e.,* on the Web, cloud, or other file sharing system). For additional submission methods, the full EPA public comment policy, information about CBI or multimedia submissions, and general guidance on making effective comments, please visit *https://www.epa.gov/dockets/commenting-epa-dockets.*

The *https://www.regulations.gov/* website allows you to submit your comment anonymously, which means the EPA will not know your identity or contact information unless you provide it in the body of your comment. If you send an email comment directly to the EPA without going through *https://www.regulations.gov/,* your email address will be automatically captured and included as part of the comment that is placed in the public docket and made available on the internet. If you submit an electronic comment, the EPA recommends that you include your name and other contact information in the body of your comment and with any digital storage media you submit. If the EPA cannot read your comment due to technical difficulties and cannot contact you for clarification, the EPA may not be able to consider your comment. Electronic files should not include special characters or any form of encryption and be free of any defects or viruses. For additional information about the EPA's public docket, visit the EPA Docket Center homepage at *https://www.epa.gov/dockets.*

Submitting CBI. Do not submit information containing CBI to the EPA through *https://www.regulations.gov/* or email. Clearly mark the part or all of the information that you claim to be CBI. For CBI information on any digital storage media that you mail to the EPA, mark the outside of the digital storage media as CBI and then identify electronically within the digital storage media the specific information that is claimed as CBI. In addition to one complete version of the comments that includes information claimed as CBI, you must submit a copy of the comments that does not contain the information claimed as CBI directly to the public docket through the procedures outlined in *Instructions* above. If you submit any digital storage media that does not contain CBI, mark the outside of the digital storage media clearly that it does not contain CBI. Information not marked as CBI will be included in the public docket and the EPA's electronic public docket without prior notice. Information marked as CBI will not be disclosed except in accordance with procedures set forth in 40 Code of Federal Regulations (CFR) part 2. Send or deliver information identified as CBI only to the following address: OAQPS Document Control Officer (C404–02), OAQPS, U.S. Environmental Protection Agency, Research Triangle Park, North Carolina 27711, Attention Docket ID No. EPA–HQ–OAR–2019–0338.

Preamble acronyms and abbreviations. We use multiple acronyms and terms in this preamble. While this list may not be exhaustive, to ease the reading of this preamble and for reference purposes, the EPA defines the following terms and acronyms here:

CAA Clean Air Act
CBI Confidential Business Information
CDX Central Data Exchange
CEDRI Compliance and Emissions Data Reporting Interface
CFR Code of Federal Regulations
CHIEF Clearinghouse for Inventories and Emissions Factors
EG Emission Guidelines
EPA Environmental Protection Agency
ERT Electronic Reporting Tool
GCCS Gas Collection and Control System
LFG Landfill Gas
LFGCost Landfill Gas Energy Cost Model
m^3 Cubic Meter
Mg Megagram
MSW Municipal Solid Waste
NAICS North American Industry Classification System
NESHAP National Emission Standards for Hazardous Air Pollutants
NMOC Nonmethane Organic Compounds
NSPS New Source Performance Standards
NTTAA National Technology Transfer and Advancement Act of 1995
OAQPS Office of Air Quality Planning and Standards
OMB Office of Management and Budget
ppm Parts Per Million
PRA Paperwork Reduction Act
RFA Regulatory Flexible Act
RIN Regulatory Information Number
SBAR Small Business Advocacy Review
SEM Surface Emissions Monitoring
TTN Technology Transfer Network
UMRA Unfunded Mandate Reform Act
U.S.C. United States Code
VCS Voluntary Consensus Standards

Organization of this document. The information in this preamble is organized as follows:

I. General Information

A. Does this action apply to me?

This proposed action addresses existing MSW landfills and associated solid waste management programs. For the purpose of this regulation, existing MSW landfills are those that accepted waste after November 8, 1987, and commenced construction on or before July 17, 2014. Table 1 of this preamble lists the associated regulated industrial source categories that are the subject of this action. Table 1 of this preamble is not intended to be exhaustive, but rather provides a guide for readers regarding the entities that this proposed action is likely to affect. The proposed standards, once promulgated, will be directly applicable to the designated facilities.

TABLE 1—REGULATED ENTITIES

Source category	Examples of potentially regulated entities	NAICS [1]
Industry: Air and water resource and solid waste management	Solid waste landfills	924110
Industry: Refuse systems—solid waste landfills	Solid waste landfills	562212
State, local, and tribal government agencies	Administration of air and water resource and solid waste management programs.	924110

[1] North American Industry Classification System.

B. Where can I get a copy of this document and other related information?

In addition to being available in the docket, an electronic copy of this action is available on the internet. Following signature by the EPA Administrator, the EPA will post a copy of this proposed action at *https://www.epa.gov/stationary-sources-air-pollution/municipal-solid-waste-landfills-new-source-performance-standards.* Following publication in the **Federal Register**, the EPA will post the **Federal Register** version of this proposed action and key technical documents at this same website.

As provided by the Administrative Procedure Act (5 U.S.C. 553(b)(3)), the EPA has generally described the proposed changes to part 62 rather than setting out the specific changes. For the convenience of the reader, the EPA is also providing regulatory text as it would look with the proposed changes in redline in the docket rather than in this **Federal Register** document. See *Proposed Regulatory Text for MSW Landfills Federal Plan (40 CFR part 62, subpart OOO),* in Docket ID No. EPA–HQ–OAR–2019–0338. Submit public comments using the same mechanisms described in the **DATES** and **ADDRESSES** sections of this preamble.

II. Background

A. What is the regulatory development background and legal authority for this action?

Under authority of the Clean Air Act (CAA), the EPA has promulgated several regulations that apply to MSW landfills. In 1996, under CAA section 111, the EPA promulgated the original standards of performance for new MSW landfills (*i.e.,* new source performance standards or NSPS) at 40 CFR part 60, subpart WWW, and EG for existing MSW landfills at 40 CFR part 60, subpart Cc (61 FR 9905; March 12, 1996). The NSPS and EG are based on the Administrator's determination that MSW landfills cause, or contribute significantly to, air pollution that may reasonably be anticipated to endanger public health or welfare. In 1999, the EPA promulgated a federal plan under CAA section 111 to implement the 1996 EG for landfills located in states that did not have approved and effective state plans (40 CFR part 62, subpart GGG) (64 FR 60689, November 8, 1999). The federal plan was necessary to implement the 1996 EG for MSW landfills located in states and Indian country where state plans or tribal plans were not in effect. In 2003, the EPA promulgated national emission standards for hazardous air pollutants (NESHAP) under CAA section 112 to regulate hazardous air pollutant (HAP) emissions from MSW landfills (40 CFR part 63, subpart AAAA) (68 FR 2227, January 16, 2003). The 2003 NESHAP fulfills the requirements of CAA section 112(d), which requires the EPA to regulate HAP listed in CAA section 112(b) and helps implement the Urban Air Toxics Strategy under CAA section 112(k). To control emissions of HAP from area sources in urban areas, the

EPA developed a strategy identifying 33 HAP that present the greatest threat to public health in the largest number of urban areas as the result of emissions from area sources. MSW landfills were listed on July 19, 1999, as an area source category to be regulated pursuant to CAA section 112(k) because 13 of the listed HAP are emitted from MSW landfills.

In 2016, the EPA reviewed and revised the MSW Landfills NSPS at 40 CFR part 60, subpart XXX, and the EG for existing MSW landfills at 40 CFR part 60, subpart Cf (81 FR 59276 and 59332, August 29, 2016). For the 2016 rulemaking, the EPA reviewed the NSPS and EG based on changes in the landfills industry since the rules were first promulgated in 1996, including changes to the size and number of existing landfills, industry practices, and gas control methods and technologies. Based on its review, the EPA made several revisions to further reduce emissions of landfill gas and its components. The major changes included reducing the emissions threshold at which an MSW landfill must install controls from 50 megagrams (Mg) per year of nonmethane organic compounds (NMOC) to 34 Mg per year NMOC. Additionally, the EPA developed a subcategory for closed landfills because closed landfills do not produce as much landfill gas (LFG) as an active landfill. Landfills in this subcategory remain subject to an NMOC emission threshold of 50 Mg per year for determining when controls must be installed or can be removed. The EPA is now proposing a federal plan for the 2016 MSW Landfills EG.

B. What is the purpose of this action?

On August 29, 2016, the EPA promulgated revisions to the 2016 MSW Landfills EG. The CAA regulations implementing EG require states with existing MSW landfills subject to the EG to submit to the EPA state plans to implement and enforce the EG. The state plans to implement the 2016 MSW Landfills EG were due on May 30, 2017. For states that did not submit an approvable plan by that deadline, CAA section 111 and 40 CFR 60.27(c) and (d) require the EPA to develop, implement, and enforce a federal plan for existing MSW landfills located in any state (*i.e.,* state, territory, or protectorate) or Indian country that does not have an approved state plan that implements the 2016 MSW Landfills EG. This action proposes an MSW Landfills Federal Plan to implement the 2016 MSW Landfills EG for those areas without an approved state plan. For the purposes of this preamble and the proposed MSW Landfills Federal Plan, the word ''state'' means any of the 50 United States and the protectorates of the United States. The word ''protectorate'' means American Samoa, the Commonwealth of Puerto Rico, the District of Columbia, Guam, the Northern Mariana Islands, and the Virgin Islands.

C. What is the status of state plan submittals?

The EPA has received eight plans to implement the 2016 MSW Landfills EG, which includes submittals form the following: Arizona (one plan covering Maricopa County, one covering Pinal County, and another covering the remainder of the state), California, Delaware, New Mexico (one plan covering Albuquerque–Bernalillo County and another covering the rest of the state), and West Virginia. The EPA has proposed action on these state plans, but the actions have not been finalized. See *e.g.,* 84 FR 32363 (July 8, 2019) (Arizona); 84 FR 32365 (July 8, 2019) (Pinal County, Arizona); 84 FR 31278 (July 1, 2019) (West Virginia); 84 FR 31279 (July 1, 2019) (Delaware); 84 FR 29138 (June 21, 2019) (New Mexico and Albuquerque–Bernalillo County); and 84 FR 36863 (July 30, 2019) (California). The plan from Maricopa County, Arizona, was withdrawn on July 3, 2019. The EPA is not aware of any tribes that have developed plans to implement the 2016 MSW Landfills EG or submitted negative declaration letters. The EPA is proposing this MSW Landfills Federal Plan to implement the 2016 MSW Landfills EG in states, territories, protectorates, and Indian country, that do not have an approved and effective state or tribal plan.

The MSW landfills covered by the state plans submitted to date would not be subject to the MSW Landfills Federal Plan once the state plan that includes those MSW landfills has been approved and becomes effective. However, MSW landfills located in those states would be subject to the federal plan (or portions of the federal plan) in the event that the state plan is subsequently disapproved, in whole or in part. Table 2 of this preamble summarizes the status of state plans and negative declarations as of July 15, 2019.

TABLE 2—STATUS OF STATE PLANS

Status	States
I. EPA-Approved State Plans	None.
II. Negative Declaration Submitted to the EPA	None.
III. Final State Plans Submitted to the EPA	Arizona (one plan covering Pinal County, and another covering the remainder of the state), California, Delaware, New Mexico (one plan covering Albuquerque and Bernalillo County and another covering the rest of the state), and West Virginia.
IV. EPA Has Not Received a Final State Plan or Negative Declaration.	Alabama, Alaska, Arkansas, Colorado, Connecticut, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Puerto Rico, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, Virgin Islands, Washington, Wisconsin, Wyoming.

As the EPA Regional offices approve implementation plans, they will also, in the same action, amend the appropriate subpart of 40 CFR part 62 to codify their approvals. MSW landfill owners or operators can also contact the EPA Regional office for the state in which their MSW landfill is located to determine whether there is an approved and effective state plan in place.

Table 3 of this preamble lists the addresses for the EPA Regional offices and the states and Indian countries that they cover.

TABLE 3—EPA REGIONAL OFFICES

Region	Address	States and territories
Region I	5 Post Office Square—Suite 100, Boston, MA 02109–3912	Connecticut, Massachusetts, Maine, New Hampshire, Rhode Island, Vermont.
Region II	290 Broadway, New York, NY 10007–1866	New York, New Jersey, Puerto Rico, Virgin Islands.
Region III	Air Protection Division, Mail Code 3AP00, 1650 Arch Street, Philadelphia, PA 19103–1129.	Virginia, Delaware, District of Columbia, Maryland, Pennsylvania, West Virginia.
Region IV	61 Forsyth Street SW, Atlanta, GA 30303–3104	Florida, Georgia, North Carolina, Alabama, Kentucky, Mississippi, South Carolina, Tennessee.
Region V	Mail Code A–17J, 77 West Jackson Blvd., Chicago, Il 60604–3590.	Minnesota, Wisconsin, Illinois, Indiana, Michigan, Ohio.
Region VI	1st International Building, 1201 Elm St., Dallas, TX 75270	Arkansas, Louisiana, New Mexico, Oklahoma, Texas.
Region VII	Air and Waste Management Division, 11201 Renner Boulevard, Lenexa, Kansas 66219.	Iowa, Kansas, Missouri, Nebraska.
Region VIII	Director, Air Program, Office of Partnerships and Regulatory Assistance, Mail Code 8P–AR, 1595 Wynkoop Street, Denver, CO 80202–1129.	Colorado, Montana, North Dakota, South Dakota, Utah, Wyoming.
Region IX	75 Hawthorne Street, San Francisco, CA 94105	Arizona, California, Hawaii, Nevada, American Samoa, Guam, Northern Mariana Islands.
Region X	1200 6th Avenue, Suite 155, Seattle, WA 98101	Washington, Alaska, Idaho, Oregon.

III. What are the designated facilities?

A. What is a designated MSW landfill?

The designated facility for this MSW Landfills Federal Plan is each MSW landfill that (1) commenced construction, reconstruction, or modification prior to July 17, 2014, and has not been modified or reconstructed since then, and (2) has accepted waste since November 8, 1987, or has capacity for future waste deposition.

This MSW Landfills Federal Plan will apply to existing MSW landfills located in: (1) Any state or portion of Indian country for which a state or tribal plan that implements the 2016 MSW Landfills EG has not become effective in whole or in part; (2) any state or portion of Indian country for which the state or tribe submitted a negative declaration; (3) any state or portion of Indian country with an effective state or tribal plan that subsequently is vacated in whole or in part; or (4) any state or portion of Indian country with an effective plan that subsequently revises any component of the plan (*e.g.,* the underlying legal authority or enforceable mechanism) such that the state or tribal plan no longer meets the requirements of the 2016 MSW Landfill EG. An MSW landfill that meets any of these criteria is covered by the MSW Landfills Federal Plan until a state or tribal plan to implement and enforce the 2016 MSW Landfills EG is approved according to the requirements in 40 CFR part 60, subpart B, and becomes effective. If a state or tribal plan is approved in part, portions of the federal plan will apply to the designated MSW landfills in lieu of the disapproved portions of the plan until the state or tribe addresses the deficiencies in the plan and the revised plan is approved by the EPA.

If an existing MSW landfill subject to the federal plan increases its permitted volume design capacity through vertical or horizontal expansion (*i.e.,* is modified) on or after July 17, 2014, it would be subject to the MSW Landfills NSPS (40 CFR part 60, subpart XXX) (see 81 FR 59332, August 29, 2016) and would no longer be subject to the federal plan. An existing MSW landfill that makes operational changes without increasing the horizontal or vertical dimensions of the landfill would continue to be subject to the federal or state plan that implements the 2016 MSW Landfills EG, rather than the NSPS.

B. How do I determine if my MSW landfill is covered by an approved and effective state plan?

An approved state or tribal plan is a plan that the EPA has reviewed and approved in whole or in part based on the requirements in 40 CFR part 60, subpart B, to implement and enforce the 2016 MSW Landfills EG. Throughout this preamble, references to approved state plans apply to both whole state plans and portions of state plans. The state plan becomes effective on the date specified in the notice published in the **Federal Register** announcing the EPA's approval. The effective date of this action will be 30 days after the final federal plan is published in the **Federal Register.**

The 2016 MSW Landfills Federal Plan will not apply to landfills appropriately covered by an approved and effective state or tribal plan. If a state or tribal plan becomes effective before promulgation of the federal plan, the promulgated MSW Landfills Federal Plan will not apply to landfills appropriately covered by that plan. Promulgation of this MSW Landfills Federal Plan does not preclude a state or tribe from submitting a plan later. If a state or tribe submits a plan after promulgation of the MSW Landfills Federal Plan, the EPA will review and approve or disapprove the plan. Upon the effective date of the approved state or tribal plan, the federal plan will no longer apply. States and tribes are, therefore, encouraged to continue their efforts to develop and submit state and tribal plans to the EPA for approval.

MSW landfill owners or operators can contact the EPA Regional office for the state or Indian country in which their MSW landfill is located to determine whether there is an approved and effective state plan in place. Table 3 of this preamble lists the addresses of the EPA Regional offices and the states and Indian countries that they cover.

IV. Elements of the MSW Landfills Federal Plan

Section 111(d) of the CAA, as amended, 42 U.S.C. 7411(d), requires states to develop and implement state plans for MSW landfills to implement and enforce the 2016 MSW Landfills EG. This proposed federal plan will establish standards in the absence of an approved and effective state plan. Because this proposed federal plan will establish standards in the absence of an approved and effective state plan, this action includes the same elements as a state plan: (1) Identification of legal authority and mechanisms for implementation; (2) inventory of designated facilities; (3) inventory of emissions; (4) emission limits; (5) compliance schedules; (6) process for the EPA or state review of site-specific design plans for GCCS; (7) testing, monitoring, reporting, and recordkeeping requirements; (8) public hearing requirements; and (9) progress reporting requirements. This section of the preamble explains the proposed federal plan elements. Additionally, Table 4 of this preamble identifies each element and indicates where it is located or codified.

TABLE 4—LOCATION OF MSW LANDFILLS FEDERAL PLAN ELEMENTS

Element of the MSW landfills federal plan	Where located or codified
a. Identification of legal authority and mechanisms for implementation	Section 111(d)(2) of the CAA and section IV.A of this preamble.
b. Inventory of designated facilities	EPA–HQ–OAR–2019–0338.
c. Inventory of emissions	EPA–HQ–OAR–2019–0338.
d. Emission limits	40 CFR 62.714 of proposed subpart OOO.
e. Compliance schedules	40 CFR 62.712 of proposed subpart OOO.
f. Process for review and approval of site-specific design plans for GCCS.	Section IV.F of this preamble.
g. Testing, monitoring, reporting, and recordkeeping requirements	40 CFR 62.718, 62.722, 62.724, and 62.726 of proposed subpart OOO and section IV.G of this preamble.
h. Public hearing requirements	Section IV.H of this preamble.
i. Progress reports	Section IV.I of this preamble.

A. Legal Authority and Enforcement Mechanism

Section 111(d) of the CAA directs the EPA to develop a federal plan for states that do not submit approvable state plans. Section 111 of the CAA provides the EPA with the authority to implement and enforce the federal plan in cases where the state fails to submit a fully satisfactory state plan.

B. Inventory of Designated MSW Landfills

The docket for this action includes an inventory of the MSW landfills that may potentially be covered by this proposed federal plan in the absence of approved state or tribal plans. There are an estimated 1,913 landfills potentially covered by this proposed federal plan. These landfills exist in all 50 states and the U.S. territories of Puerto Rico and the Virgin Islands. Additionally, one tribal entity, the Salt River Pima Maricopa Indian Community, would be covered by this proposed federal plan. The EPA developed the inventory of landfills by identifying existing landfills that are expected to be covered by the federal plan as of July 15, 2019, using the databases developed for the 2016 MSW Landfills EG and NSPS. For a discussion of the sources, their locations, and information used to develop the source list, see the memorandum, *Developing a Federal Plan Source and Emission Inventory,* which is available in the docket for this action. Any MSW landfill that meets the applicability criteria in this action will be subject to the federal plan, regardless of whether it is listed in the inventory in Docket ID No. EPA–HQ–OAR–2019–0338. The EPA requests that states or owners or operators identify additional sources for inclusion on the list during the comment period for this action.

C. Inventory of Emissions

The EPA estimated the emissions from the inventory of existing MSW landfills that are expected to be covered by the federal plan as of July 15, 2019. Pollutant emissions are expressed in Mg NMOC per year in calendar year 2019. Table 5 of this preamble summarizes the results of the inventory. Although the EPA has proposed to approve some state plans in whole or in part, to date none of the actions on the proposed state plans have been finalized. Therefore, the inventory includes all existing MSW landfills in the U.S. that meet the applicable criteria. The inventory will be updated before promulgation of the federal plan to exclude sources and emissions that are located in states for which an approved state plan is subsequently promulgated.

The EPA estimated emissions from MSW landfills by first estimating the LFG generation rates of landfills identified in the source inventory, using a first-order decay equation. The decay equation uses default values from *Compilation of Air Pollutant Emission Factors (AP–42)* for the methane generation potential (L_0), the methane generation rate (k), and the NMOC concentration.[1] Next, the EPA estimated when the MSW landfills in the source inventory would control emissions under the previous regulatory level (NMOC emissions of 50 Mg per year). To determine the timing of these controls, the EPA modeled emissions using Tier 1 default values from 40 CFR part 60, subpart WWW for the L_0 and k, but applied the NMOC concentration in AP–42 for determining when MSW landfills would meet the regulatory NMOC emissions threshold. The Tier 1 default values in subpart WWW for L_0 and k are conservatively high for the purpose of estimating actual emissions; therefore, they are used only for estimating uncontrolled emissions to determine when MSW landfills could exceed the threshold and be required to install a GCCS. The EPA also factored in lag times to account for the initial 30-month time period between when the MSW landfill exceeds the emission rate threshold until the MSW landfill must install and operate controls, and the periodic expansion of the GCCS into new areas of waste placement (5 years for active areas and 2 years for areas that are closed or at final grade). After determining the timing of controls required by the regulation, the actual amount of collected gas was estimated using AP–42 defaults for L_0, k, and NMOC, and an assumed collection efficiency of 85 percent and an assumed destruction efficiency of 98 percent. The remaining emissions, after considering controls, represent the modeled NMOC emissions based on LFG generation and AP–42 default parameters minus the emission reductions. See the memorandum, *Developing a Federal Plan Source and Emission Inventory,* which is available in the docket for this action, for the complete emissions inventory, including detailed emissions from MSW landfills in each state, and details on the calculations used to determine those emissions. These estimates are based solely on the modeled emissions remaining after considering controls required by 40 CFR part 60, subparts WWW and Cc, and do not include any additional emissions reductions from voluntary actions, such as early installation of the GCCS.

[1] U.S. EPA, AP–42, Fifth Edition, *Compilation of Air Pollutant Emission Factors, Volume 1: Stationary Point and Area Sources.* 1995. *http://www.epa.gov/ttnchie1/ap42/.*

TABLE 5—SUMMARY OF ESTIMATED NMOC EMISSIONS FROM EXISTING MSW LANDFILLS EXPECTED TO BE COVERED BY THE FEDERAL PLAN

Region/state	2019 NMOC emissions (Mg per year)
Region 1	
Connecticut	118
Maine	85
Massachusetts	429
New Hampshire	77
Rhode Island	47
Vermont	47
Region 2	
New Jersey	387
New York	970
Puerto Rico	230
Virgin Islands	14
Region 3	
Delaware	44
Maryland	462
Pennsylvania	1,313
Virginia	916
West Virginia	199
Region 4	
Alabama	437
Florida	1,157
Georgia	1,035
Kentucky	574
Mississippi	213
North Carolina	993
South Carolina	430
Tennessee	860
Region 5	
Illinois	1,361
Indiana	837
Michigan	1,219
Minnesota	263
Ohio	1,251
Wisconsin	547
Region 6	
Arkansas	346
Louisiana	563
New Mexico	201
Oklahoma	324
Texas	2,045
Region 7	
Iowa	380
Kansas	354
Missouri	485
Nebraska	265
Region 8	
Colorado	742
Montana	86
North Dakota	51
South Dakota	78
Utah	287
Wyoming	48
Region 9	
Arizona	597
California	3,018
Hawaii	111
Nevada	38
Region 10	
Alaska	94
Idaho	138
Oregon	376
Washington	404

D. Emission Limits and Operating Limits

This proposed federal plan contains emission limits that correspond to the 2016 MSW Landfills EG, which are summarized in section V.C of this preamble. In accordance with 40 CFR 60.27(e), this action does not propose to revise the final limits. Instead, it proposes to implement the emission limits as promulgated in the 2016 MSW Landfills EG for existing sources in states that do not have an approved state plan.

E. Compliance Schedule

According to 40 CFR 60.24(e)(1), increments of progress are required for any compliance schedule that is longer than 12 months. The proposed federal plan would require owners or operators of existing MSW landfills with design capacities equal to or greater than 2.5 million Mg and 2.5 million cubic meters (m^3) to install GCCS within 30 months of reaching or exceeding 34 Mg per year NMOC. This proposed federal plan would require owners or operators of existing closed MSW landfills—those that have submitted a closure report as specified in 40 CFR 62.724(f) with design capacities equal to or greater than 2.5 million Mg and 2.5 million m^3—to install GCCS within 30 months of reaching or exceeding 50 Mg per year NMOC. This proposed federal plan includes increments of progress, which are the primary mechanisms for ensuring progress toward final compliance with the emission guidelines. Each increment of progress has a specified date for achievement described in section V.B of this preamble.

F. Process for Review and Approval of Site-Specific Design Plans

The 2016 MSW Landfills EG requires plans to include a process for review and approval of site-specific design plans for required GCCS (see 40 CFR 60.38f(d)). As previously discussed, if the existing MSW landfill has (1) a design capacity equal to or greater than 2.5 million Mg and 2.5 million m^3 and (2) NMOC emissions equal to or exceeding 34 Mg per year (50 Mg per year for the closed landfill subcategory), the landfill owner or operator must submit the cover page containing the engineer's seal of the site-specific design plan. The EPA Regional office will make a decision within 90 days about whether the entire plan should be submitted for review. In cases where the state or tribe has been delegated authority to implement this aspect of the federal plan, the state or tribe would review the design plans. See section VI of this preamble for a discussion of federal plan delegation.

When the EPA opts to review the entire plan, the EPA intends to review design plans as expeditiously as possible to allow sufficient time after approval of the plans for the landfills to install controls prior to the compliance date. The EPA will initially review the design plans for completeness and the source will be notified if any items are missing. The EPA will then review the plans for acceptability, and, once that review is completed, the EPA will notify the source and the state or tribe in writing of the acceptability of the plan. If the plan is not acceptable, the source will be given an appropriate amount of time to make the necessary changes. However, the date by which a GCCS must be completed and in compliance remains unchanged, *i.e.,* 30 months after the emission rate report first shows NMOC emissions greater than or equal to 34 Mg per year (50 Mg per year for the closed landfill subcategory).

G. Testing, Monitoring, Recordkeeping, and Reporting Requirements

The proposed federal plan includes testing, monitoring, recordkeeping, and reporting requirements, as described in sections V.D and E of this preamble. These proposed requirements correspond with the 2016 MSW Landfills EG. Testing, monitoring, recordkeeping, and reporting requirements will assure initial and ongoing compliance.

H. Requirement for Public Hearing

According to 40 CFR 60.27(f), the EPA must provide the opportunity for a public hearing prior to promulgation of a federal plan. For this MSW Landfills Federal Plan, the EPA will offer the opportunity for a public hearing in Research Triangle Park, North Carolina, as specified in the **ADDRESSES** and **DATES** sections of this preamble.

V. Summary of Proposed MSW Landfills Federal Plan Requirements

A. What are the proposed applicability requirements?

The proposed federal plan applicability criteria (40 CFR 62.711) reflect the 2016 MSW Landfills EG (40 CFR 60.31f). The designated facility for this MSW Landfills Federal Plan is described in section III.A of this preamble.

B. What are the proposed compliance schedules?

Owners or operators of MSW landfills subject to the federal plan will be required to submit a design capacity report within 90 days after the effective date of the federal plan (40 CFR 62.724(a)). If the design capacity indicates a capacity equal to or greater than 2.5 million Mg and 2.5 million m^3 of solid waste a landfill can accept, an annual NMOC emission rate report must also be submitted within 90 days after the effective date of the federal plan and then every 12 months until the landfill installs a GCCS (40 CFR 62.724(c)).

If the first NMOC emission rate report shows emissions less than 34 Mg per year NMOC (50 Mg per year for the closed landfill subcategory), then the owner or operator must recalculate NMOC emissions annually and submit annual NMOC emission rate reports unless the MSW landfill is closed. (See 40 CFR 62.718 for conditions under which 5-year reports rather than annual reports may be submitted.) If an emission rate report shows that NMOC emissions equal or exceed 34 Mg per year, the owner or operator must begin following enforceable increments of progress to install a GCCS within 30 months of reaching or exceeding 34 Mg per year NMOC (40 CFR 62.712). Therefore, the generic schedule for the increments of progress starts with the date of the first annual emission rate report that shows NMOC emissions equal or exceed 34 Mg per year (50 Mg per year for the closed landfill subcategory) (40 CFR 62.712(c)). Alternatively, a landfill may follow Tier 4 as discussed later in this section (40 CFR 62.718(a)(6)). For the closed landfill subcategory, if an emission rate report shows that NMOC emissions equal or exceed 50 Mg per year, the owner or operator must begin following enforceable increments of progress to install a GCCS within 30 months of reaching or exceeding 50 Mg per year NMOC.

This proposed MSW Landfills Federal Plan includes the five increments of progress and provides flexibility to establish the increment dates (40 CFR 62.712). The proposed MSW Landfills Federal Plan contains a generic compliance schedule (Table 1 to 40 CFR part 62, subpart OOO) that applies to designated MSW landfills unless the EPA approves an alternative schedule according to the criteria in 40 CFR 60.27(e)(2).

The five mandatory increments of progress are as follows:

1. Submit final control plan (design plan)—1 year after the first annual emission rate report showing NMOC emissions ≥34 Mg per year (≥50 Mg per year for the closed landfill subcategory).
2. Award contracts for control systems or orders for purchase of components—20 months after the first annual emission rate report showing NMOC emissions ≥34 Mg per year (≥50 Mg per year for the closed landfill subcategory).
3. Begin on-site construction or installation of the GCCS—24 months after the first annual emission rate report showing NMOC emissions ≥34 Mg per year (≥50 Mg per year for the closed landfill subcategory).
4. Complete on-site construction or installation of the GCCS—30 months after the first annual emission rate report showing NMOC emissions ≥34 Mg per year (≥50 Mg per year for the closed landfill subcategory).
5. Achieve final compliance—30 months after the first annual emission rate report showing NMOC emissions ≥34 Mg per year (≥50 Mg per year for the closed landfill subcategory). Note that the initial performance test to demonstrate compliance must be conducted within 180 days after the date the landfill is required to achieve final compliance.

The date for the first, fourth, and fifth increments is established in the 2016 MSW Landfill EG. According to 40 CFR 60.27(e)(1), federal plan compliance times may be no less stringent than those established in the EG.

The EPA selected the proposed dates for the middle two increments (awarding contract and initiating on-site construction) to allow a reasonable period of time for MSW landfills to complete these activities. These increments of progress are required by 40 CFR 60.24, but dates are not specified in the 2016 MSW Landfills EG. The EPA established these dates to match the dates included in the previous federal plan for MSW landfills (40 CFR part 62, subpart GGG) because the two plans require the same increments of progress to achieve compliance. The proposed date for awarding contracts is 20 months after the first annual NMOC emission rate report showing NMOC emissions greater than or equal to 34 Mg per year (50 Mg per year for the closed landfill subcategory), which is 8 months after the proposed date that the design plan is due. This 8-month time frame would allow adequate time for the regulatory agency to review and approve the design plan and for the MSW landfill owner or operator to solicit bids based on the design plan and award the contract(s).

The proposed date for initiating on-site construction is 24 months after the first annual emission report showing NMOC emissions greater than or equal to 34 Mg per year (50 Mg per year for the closed landfill subcategory) is due (4 months after contract award). This 4-month period would allow time for the contractor to mobilize and obtain materials necessary to begin construction. A later date would not be practical because the date for completing on-site construction and final compliance is 30 months after the first annual emission rate report showing NMOC emissions greater than or equal to 34 Mg per year (50 Mg per year for the closed landfill subcategory). If construction is not initiated by 24 months after the first annual emission rate report showing NMOC emissions greater than or equal to 34 Mg per year (50 Mg per year for the closed landfill subcategory), it is unlikely that the construction could be completed by the final compliance date. Some MSW landfills may want to initiate on-site construction earlier to assure that they can meet the final compliance date. The fourth increment, completion of on-site construction, would need to be completed by the final compliance date (increment 5) in order for the landfill to achieve compliance.

Owners and operators employing Tier 4 would follow the generic compliance schedule for Tier 4 landfills in Table 1 to 40 CFR part 62, subpart OOO. Increment 1 is triggered by the first measured concentration of methane of 500 parts per million (ppm) or greater, rather than the initial NMOC emission rate report showing NMOC emissions 34 Mg per year or greater. Landfills employing Tier 4 would continue to submit an annual NMOC emission rate report (40 CFR 62.724(c)). Timing of increments 2 through 5 for Tier 4 landfills are based on the *most recent* NMOC emission rate report showing NMOC emissions 34 Mg per year or greater.

For all landfills, the EPA recognizes that flexibility may be needed for increment 2 (award contract) and increment 3 (begin construction) given facility-specific GCCS considerations and constraints. Therefore, the EPA will accept facility-specific compliance schedules from MSW landfill owners or operators, as allowed under 40 CFR 60.27(e)(2).

The MSW landfill owner or operator would submit alternative dates for increments 2 and 3 and a justification to the EPA at the time the final control plan is due (40 CFR 62.724(p)). If the MSW landfill owner or operator is submitting the alternative dates for these increments, the owner or operator should also send a copy to the appropriate state or tribe. The EPA is allowing alternative dates for increments 2 and 3 to provide flexibility to MSW landfill owners or operators. However, owners or operators using alternate dates for increments 2 and 3 must continue to meet the required dates for increments 1, 4, and 5. The EPA would review the schedule and coordinate with the owner or operator.

C. What emissions and operating limits is the EPA proposing to incorporate into the federal plan?

The EPA is proposing that an MSW landfill subject to the federal plan must install and operate a GCCS that meets specified emissions and operating limits (40 CFR 62.714 and 40 CFR 62.716), if the NMOC emissions rate is 34 Mg per year or more (50 Mg per year or more for the closed landfill subcategory). The standards would require owners or operators to operate the GCCS at a negative pressure at each wellhead (except during certain specified conditions), operate the interior wellhead at a temperature less than 55 degrees Celsius (131 degrees Fahrenheit), and operate the collection system so that the methane concentration is less than 500 ppm above background at the surface of the landfill (40 CFR 62.716(b–(d)). The owner or operator of a landfill must control the collected gas by routing it to either: (1) A non-enclosed flare designed and operated according to the requirements of 40 CFR 60.18, (2) an enclosed control device achieving 98-percent NMOC reduction or an outlet concentration of 20 ppm NMOC by volume or less, or (3) a gas treatment system that processes the collected gas for subsequent sale or beneficial use (40 CFR 62.714(c)).

The proposed requirements of the federal plan are the same as the requirements of the 2016 MSW Landfills EG as published on August 29, 2016 (81 FR 59276). However, this proposed federal plan applies a technical correction to the compliance provisions section and the corresponding reporting requirement in the reporting section. Those corrections appear in this proposed federal plan at 40 CFR 62.720(a)(3)(ii) and 40 CFR 62.724(h)(7) and would ensure that the owner or operator conducts a corrective action analysis, develops an implementation schedule, and reports corrective action(s) to address not only positive pressure, but also elevated temperature.

D. What are the proposed performance testing and monitoring requirements?

1. NMOC Emissions Rate

The EPA proposes that, to determine if a GCCS is required, the owner or operator must determine NMOC emissions using one or both of the two emission rate equations in the rule and one of four optional methods to determine the model inputs (referred to as tier methods in the rule) (40 CFR 62.718(a)). Tier 1 uses default assumptions for methane generation rate and NMOC concentration in the emissions model (40 CFR 62.718(a)(2)). Tier 2 requires testing to determine a site-specific NMOC concentration. Tier 3 requires testing to determine a site-specific NMOC concentration and methane generation rate (40 CFR 62.718(a)(4)). Any MSW landfill that exceeds the NMOC emissions threshold using Tier 2 or 3 would install a GCCS, unless the owner or operator chooses to use Tier 4 (40 CFR 62.718(a)(6)).

Tier 4 is based on surface emissions monitoring (SEM) to demonstrate that surface emissions are low (40 CFR 62.718(a)(6)). An owner or operator can use Tier 4 only if the MSW landfill owner or operator can demonstrate that NMOC emissions are greater than or equal to 34 Mg per year but less than 50 Mg per year using Tier 1 or Tier 2. An MSW landfill employing Tier 4 that can demonstrate that surface emissions are below 500 ppm for four consecutive quarters would not trigger the requirement to install a GCCS even if Tier 1, 2, or 3 calculations indicate that the 34 Mg per year threshold has been exceeded. However, once SEM demonstrates emissions exceeding 500 ppm (40 CFR 62.718(a)(6)(v)), the MSW landfill would be required to install a GCCS according to the schedule in section V.B. of this preamble and Table 1 to subpart OOO of part 62.

2. Gas Collection System Monitoring

The EPA proposes that the landfill gas collection system must be equipped with a sampling or access port and the owner or operator must periodically monitor gauge pressure in the gas collection header, monitor nitrogen or oxygen content in the landfill gas, and monitor temperature of the landfill gas (40 CFR 62.722(a)).

3. Flare Monitoring

The EPA proposes that, if a flare is used, the owner or operator must monitor the flare using a heat sensing device that indicates presence of a flame and a device that records flow to the flare and any bypass lines (40 CFR 62.722(c)).

4. Control Device Testing and Monitoring

The EPA proposes that, if an enclosed control device is used, the owner or operator must conduct an initial performance test (40 CFR 62.714(c)). The owner or operator must then operate the device as required by the manufacturer's specifications, install a temperature monitoring device, and install a device that records flow to the control device and any bypass lines (40 CFR 62.722(b)). A temperature monitoring device is not required for boilers or process heaters with a design heat capacity of 44 megawatts or greater (40 CFR 62.722(b)(1)).

E. What are the proposed recordkeeping and reporting requirements?

The EPA proposes that owners and operators must retain records of all required monitor readings (40 CFR 62.726). Owners or operators must submit certain required performance test reports, NMOC emission rate reports, and annual reports documenting compliance and any deviations from the operating standards in the federal plan (40 CFR 62.724). All required reports must be submitted through the EPA's Central Data Exchange (CDX) using the Compliance and Emissions Data Reporting Interface (CEDRI) (40 CFR 62.724(j)). Owners or operators are allowed to maintain electronic copies of the records in lieu of hardcopies to satisfy federal recordkeeping requirements.

The requirement to submit performance test data electronically to the EPA would apply only to those performance tests conducted using test methods that are supported by the Electronic Reporting Tool (ERT). A listing of the pollutants and test methods supported by the ERT is available at: *https://www3.epa.gov/ttn/chief/ert/ert_info.html.* When the EPA adds new methods to the ERT, a notice will be sent out through the Clearinghouse for Inventories and Emissions Factors (CHIEF) Listserv (*https://www.epa.gov/airemissions-inventories/emissionsinventory-listservs*) and a notice of availability will be added to the ERT website. You are encouraged to check the ERT website regularly for up-to-date information on methods supported by the ERT.

VI. Implementation of the Federal Plan and Delegation

A. Background of Authority

Under section 111(d) of the CAA, the EPA is required to adopt EG that are applicable to existing MSW landfills. These EG are implemented when the EPA approves a state or tribal plan or adopts a federal plan that implements and enforces the EG. As discussed above, this action would regulate existing MSW landfills in states or Indian country that do not have approved plans in effect to implement the EG.

Congress has determined that the primary responsibility for air pollution prevention and control rests with state, tribal and local agencies. See CAA section 101(a)(3). Consistent with that overall determination, Congress established CAA section 111(d) with the intent that state, tribal and local agencies take the primary responsibility for ensuring that the standards of performance and other requirements in the EG are achieved. Also, Congress explicitly required that the EPA establish procedures that are like those under CAA section 110 for state implementation plans. Although Congress required the EPA to propose and promulgate a federal plan for states and tribes that fail to submit approvable state plans on time, states may submit plans after promulgation of this federal plan. The EPA strongly encourages states and tribes that are unable to submit approvable plans to request delegation of the federal plan so that they can have primary responsibility for implementing the 2016 MSW Landfills EG, consistent with the intent of Congress.

The preferred outcome under the statute and the regulations results when the state, tribal, and local agencies implement an EPA-approved state or tribal plan because state, tribal, and local agencies not only have the responsibility to implement the 2016 MSW Landfills EG, but also have the practical knowledge and enforcement resources critical to achieving the highest rate of compliance. In cases where states are unable to develop and submit approvable state or tribal plans, it is still preferable for the state, tribal and local agencies to be the implementing agency. For these reasons, the EPA will do all that it can to expedite delegation of the federal plan to state, tribal, and local agencies, whenever possible, in cases where states or tribes are unable to develop and submit approvable state or tribal plans. The EPA will also continue to review and approve state or tribal plans after promulgation of this federal plan.

B. Mechanisms for Transferring Authority

There are two mechanisms for transferring implementation authority to state, tribal, and local agencies: (1) The EPA's approval of a state plan after the federal plan is in effect; and (2) if a state does not submit or obtain approval of its own plan, the EPA's delegation to a state, tribe, or local agency is transferred with the authority to implement certain portions of this federal plan to the extent appropriate and if allowed by state law. Both options are described in more detail below.

1. Federal Plan Becomes Effective Prior to Approval of a State Plan

After MSW landfills in a state become subject to the federal plan, the state or tribal agency may still adopt and submit a state or tribal plan to the EPA. If the EPA determines that the state or tribal plan meets the requirements of the 2016 MSW Landfills EG, the EPA will approve the state or tribal plan. If the EPA determines that the plan does not meet the requirements of the 2016 MSW Landfills EG, the EPA will approve the portions of the plan that are consistent with the 2016 MSW Landfills EG. If a state or tribal plan is approved in part, portions of the federal plan will apply to the designated MSW landfills in lieu of the disapproved portions of the state or tribal plan until the state or tribe addresses the deficiencies in the state or tribal plan and the revised plan is approved by the EPA. Prior to any disapproval, the EPA will work with states and tribes in an attempt to reconcile areas of the plan that remain inconsistent with the EG.

Upon the effective date of a state or tribal plan, the federal plan will no longer apply to MSW landfills covered by such a plan. The state, tribe, territory, or local agency would implement and enforce the state plan in lieu of the federal plan. When an EPA Regional office approves a state or tribal plan, it will amend the appropriate subpart of 40 CFR part 62 to indicate such approval.

2. State, Tribe, Territory, or Local Agency Taking Delegation of the Federal Plan

The EPA, in its discretion, may delegate to state, tribe, territorial, or local agencies the authority to implement this proposed federal plan. As discussed above, the EPA has concluded that it is advantageous and the best use of resources for states, tribes, territories, or local agencies to agree to undertake, on the EPA's behalf, administrative and substantive roles in implementing the federal plan to the extent appropriate and where authorized by federal, state, tribal, territorial, or local law. If a state, tribe, territory, or local agency requests delegation, the EPA will generally delegate the entire federal plan to the state, tribe, territory, or local agency. These functions include administration and oversight of compliance, reporting and recordkeeping requirements, MSW landfill inspections, and preparation of draft notices of violation, but will not include any authorities retained by the EPA. Agencies that have taken delegation, as well as the EPA, will have responsibility for bringing enforcement actions against sources violating federal plan provisions.

C. Implementing Authority

The EPA Regional Administrators have been delegated the authority for implementing the MSW Landfills Federal Plan. All reports required by the federal plan should be submitted to the appropriate Regional Administrator. Table 3 of this preamble lists the addresses for the EPA Regional offices and the states they cover.

D. Delegation of the Federal Plan and Retained Authorities

If a state, tribe, territory, or local agency intends to take delegation of the federal plan, the state, tribe, territory, or local agency should submit a written request for delegation of authority to the appropriate EPA regional office. The state, tribe, territory, or local agency should explain how it meets the criteria for delegation. See *Good Practices Manual for Delegation of NSPS and NESHAP* (U.S. EPA, February 1983). The letter requesting delegation of authority to implement the federal plan should: (1) Demonstrate that the state, tribe, territory, or local agency has adequate resources, as well as the legal authority to administer and enforce the program; (2) include an inventory of designated MSW landfills, which includes those that have ceased operation, but have not been dismantled or rendered inoperable, and an inventory of the designated units' air emissions and a provision for progress reports to the EPA; (3) certify that a public hearing was held on the state, tribe, territory, or local agency delegation request; and (4) include a memorandum of agreement between the state, tribe, territory, or local agency and the EPA that sets forth the terms and conditions of the delegation, the effective date of the agreement, and the mechanism to transfer authority. Upon signature of the agreement, the appropriate EPA regional office would publish an approval notice in the **Federal Register**, thereby incorporating the delegation of authority into the appropriate subpart of 40 CFR part 62.

If authority is not delegated to a state, tribe, territory, or local agency, the EPA will implement the federal plan. Also, if a state, tribe, territory, or local agency fails to properly implement a delegated portion of the federal plan, the EPA will assume direct implementation and enforcement of that portion. The EPA will continue to hold enforcement authority along with the state, tribe, territory, or local agency even when the agency has received delegation of the federal plan. In all cases where the federal plan is delegated, the EPA will retain and will not transfer authority to a state, tribe, or local agency to approve the following items promulgated in 40 CFR 62.710(b)): (1) Approval of alternative methods to determine the site-specific NMOC concentration or a site-specific methane generation rate constant (k); (2) alternative emission standards; (3) major alternatives to test methods (Major alternatives to test methods or to monitoring are modifications made to a federally enforceable test method or to a federal monitoring requirement. These changes would involve the use of unproven technology or procedures or an entirely new method, which is sometimes necessary when the required test method or monitoring requirement is unsuitable.); and (4) waivers of recordkeeping.

Any MSW landfill owners or operators who wish to petition the agency for an alternative requirement to those in 40 CFR 62.710(b) should submit a request to the appropriate Regional Administrator with a copy sent to the appropriate state.

VII. Title V Operating Permits

Existing landfills with design capacities less than 2.5 million Mg or 2.5 million m^3 are not required to have a title V operating permit, unless they are a major source or are subject to title V (part 70 or part 71) for some other reason (*e.g.,* subject to a CAA section 112 NESHAP or to another CAA section 111 NSPS). All existing MSW landfills with design capacities equal to or greater than 2.5 million Mg and 2.5 million m^3 must have a title V operating permit. Existing MSW landfills that are not currently subject to title V permitting because their design capacity is less than 2.5 million Mg or 2.5 million m^3 may trigger the requirement to apply for a title V permit in the future if the landfill's design capacity increases to equal or exceed 2.5 million Mg and 2.5 million m^3. Such sources, newly subject to the requirement to obtain a title V permit for operating the MSW landfill at or above the 2.5 million Mg or 2.5 million m^3 capacity, become subject to the title V program 90 days after the effective date of this federal plan, even if the design capacity report is submitted prior to that date. This date that triggers title V applicability is consistent with the published EG. The requirements of a federal plan are applicable requirements for title V sources covered by a federal plan. Additional information for filing a timely title V application should be obtained at the permitting authority. See 40 CFR 70.5(a)(1)(i) or 71.5(a)(1)(i).

An MSW landfill that is closed and is no longer subject to title V as a result of this federal plan, once finalized, may remain subject to title V permitting requirements for another reason or reasons. See 40 CFR 62.711(e) and 40 CFR 70.3 or 71.3. In such circumstances, the landfill would be required to continue operating in compliance with a title V permit.

VIII. Statutory and Executive Order Reviews

Additional information about these statutes and Executive Orders can be found at *https://www.epa.gov/laws-regulations/laws-and-executive-orders.*

A. Executive Order 12866: Regulatory Planning and Review and Executive Order 13563: Improving Regulation and Regulatory Review

This action is not a significant regulatory action and was, therefore, not submitted to the Office of Management and Budget (OMB) for review.

B. Executive Order 13771: Reducing Regulation and Controlling Regulatory Costs

This action is not expected to be an Executive Order 13771 regulatory action because this action is not significant under Executive Order 12866.

C. Paperwork Reduction Act (PRA)

This action does not impose any new information collection burden under the PRA. This action simply proposes the MSW Landfills Federal Plan to implement the 2016 MSW Landfills EG for those states that do not have a state plan implementing the EG. OMB has previously reviewed the information collection activities contained in the 2016 MSW Landfills EG and has assigned OMB control number 2060–0720.

D. Regulatory Flexibility Act (RFA)

I certify that this action will not have a significant economic impact on a substantial number of small entities under the RFA. The small entities subject to the requirements of this action are small MSW landfills. The Agency has determined that up to 15 small entities, representing approximately 13 percent of the total number of small entities subject to the proposal, may experience an impact of greater than 3 percent of sales or revenues. A summary of this analysis is available in the memorandum, *Small Entity Screening Assessment for Proposed Federal Plan for Emission Guidelines and Compliance Times for Municipal Solid Waste Landfills,* which is available in the docket for this action. More details of the general economic analysis of the EG, which this action implements, are available in the docket for the 2016 MSW Landfills EG (Docket ID Item No. EPA–HQ–OAR–2014–0451–0225).

Although not required by the RFA to convene a Small Business Advocacy Review (SBAR) Panel because the EPA has now determined that this proposal would not have a significant economic impact on a substantial number of small entities, there was substantial interest in the revision of the EG among small entities. Thus, during development of the 2016 MSW Landfills EG, the EPA conducted stakeholder outreach as detailed in sections XI.C and XI.E of the preamble to the proposed Standards of Performance for MSW Landfills (79 FR 41828–41829; July 17, 2014) and in sections VIII.C and VIII.E of the preamble to the 2016 MSW Landfills EG (81 FR 59309–59310; August 29, 2016). The EPA convened an SBAR Panel in 2013 for the MSW Landfills NSPS and EG rulemakings. The EPA originally planned a review of the EG and NSPS in one action, but the actions were subsequently divided into separate rulemakings. The SBAR Panel evaluated the assembled materials and small entity comments on issues related to the rule's potential effects and significant alternative regulatory approaches. A copy of the *Summary of Small Entity Outreach* is available in the docket for the 2016 MSW Landfills EG (Docket ID

Item No. EPA–HQ–OAR–2014–0451–0012). While formulating the provisions of the EG, the EPA considered the input provided over the course of the stakeholder outreach as well as the input provided in the many public comments and incorporated many of the suggestions in the 2016 MSW Landfills EG.

E. Unfunded Mandates Reform Act (UMRA)

This action does not contain any unfunded mandate as described in UMRA, 2 U.S.C. 1531–1538. This action implements mandates specifically and explicitly set forth in 40 CFR 60.27 without the exercise of any policy discretion by the EPA.

We note, however, that the EG may affect small governments because small governments operate landfills (80 FR 52146, August 27, 2015). This action implements the promulgated EG. In developing the final 2016 MSW Landfills EG, the EPA consulted with small governments pursuant to a plan established under section 203 of the UMRA to address impacts of regulatory requirements in the rule that might significantly or uniquely affect small governments. The EPA also held meetings as discussed in section VIII.F of this preamble.

F. Executive Order 13132: Federalism

The EPA has concluded that this action may have federalism implications, because the rule imposes substantial direct compliance costs on state or local governments, and the federal government will not provide the funds necessary to pay those costs. The EPA provided the following federalism summary impact statement for the 2016 MSW Landfills EG. The EPA consulted with state and local officials early in the process of developing the 2016 MSW Landfills EG to permit them to have meaningful and timely input into its development. In developing the regulatory options reflected in the proposed and final 2016 MSW Landfills EG, the EPA consulted with eight national organizations representing state and local elected officials. Additionally, the Environmental Council of the States, the National Association of Clean Air Agencies, and the Association of State and Territorial Solid Waste Management Officials participated in preproposal briefings. Finally, in addition to these associations, over 140 officials representing state and local governments across the nation participated in at least one of three preproposal briefings in the fall of 2013 (September 10, 2013, November 7, 2013, and November 14, 2013), which is summarized in the docket for the 2016 MSW Landfills EG (Docket ID Item No. EPA–HQ–OAR–2014–0451–0013). The EPA received comments from over 40 entities representing state and local governments. The EPA conducted an additional Federalism outreach meeting on April 15, 2015.

The principal intergovernmental concerns raised during the preproposal consultations, as well as during the proposed rule's public comment period, include: (1) Implementation concerns associated with shortening of GCCS installation and/or expansion timeframes; (2) concerns regarding significant lowering of the design capacity or emission thresholds; (3) the need for clarifications associated with wellhead operating parameters; and (4) the need for consistent, clear, and rigorous surface monitoring requirements. In response to these comments and based upon the available data, the EPA decided not to adjust the design capacity or significantly lower the emission threshold. The EPA also decided not to adjust the time allotted for installation of the GCCS or expansion of the wellfield. In the proposed MSW Landfills EG (80 FR 52121, August 27, 2015), the EPA highlighted specific concerns raised by commenters, which included state agencies as well as landfill owners and operators, about the interaction between shortened lag times and design plan approvals, costs, and safety concerns associated with reduced lag times, and the need for flexibility for lag time adjustments. The EPA adjusted wellhead operating parameters to limit corrective action requirements to negative pressure and temperature. The EPA also acknowledged concerns about wellhead operating parameters in 80 FR 52121 (August 27, 2015) and considered public comments in favor of and against retention of the parameters.

A complete list of the comments from state and local governments was provided to OMB and was placed in the docket for the 2016 MSW Landfills EG (Final Report of the Small Business Advocacy Review Panel on EPA's Planned Proposed Rules Standards of Performance for Municipal Solid Waste Landfills and Review of Emissions Guidelines for Municipal Solid Waste Landfills, Docket ID Item No. EPA–HQ–OAR–2014–0451–0139). In addition, the detailed response to comments from these entities is contained in the EPA's Response to Comments document for the 2016 MSW Landfills EG (Docket ID Item No. EPA–HQ–OAR–2014–0451–0229). As required by section 8(a) of Executive Order 13132, the EPA included a certification from its Federalism official stating that the EPA had met the Executive Order's requirements in a meaningful and timely manner when it sent the draft of the 2016 MSW Landfills EG to OMB for review pursuant to Executive Order 12866. A copy of the certification is included in the record for the 2016 MSW Landfills EG (Outreach under Executive Order 13132 for MSW Landfills, Docket ID Item Nos. EPA–HQ–OAR–2014–0451–0013 and EPA–HQ–OAR–2014–0451–0100).

G. Executive Order 13175: Consultation and Coordination With Indian Tribal Governments

This action has tribal implications as specified in Executive Order 13175. This action will neither impose substantial direct compliance costs on federally recognized tribal governments nor preempt tribal law. The database used to estimate impacts of the 2016 MSW Landfills EG, identified one tribe, the Salt River Pima-Maricopa Indian Community, which owns three landfills potentially subject to this federal plan. One of these landfills is open, the Salt River Landfill, and is already controlling emissions under the current NSPS/EG framework, so while subject to this subpart, the costs of this proposal are not substantial. The two other landfills are closed and anticipated to meet the definition of the closed landfill subcategory. One of the closed landfills, the Tri Cities Landfill, is already controlling emissions under the current NSPS/EG framework and will not incur substantial additional compliance costs under the federal plan. The other landfill, North Center Street Landfill, is not estimated to install controls under the federal plan. The EPA will consult with tribal officials under the EPA Policy on Consultation and Coordination with Indian Tribes in the process of developing this action to permit them to have meaningful and timely input into its development. A summary of that consultation will be provided in the docket for this action once completed.

H. Executive Order 13045: Protection of Children From Environmental Health Risks and Safety Risks

The EPA interprets Executive Order 13045 as applying only to those regulatory actions that concern environmental health or safety risks that the EPA has reason to believe may disproportionately affect children, per the definition of ''covered regulatory action'' in section 2–202 of the Executive Order. This action is not subject to Executive Order 13045 because it implements a previously promulgated federal standard.

I. Executive Order 13211: Actions Concerning Regulations That Significantly Affect Energy Supply, Distribution, or Use

This action is not subject to Executive Order 13211 because it is not a significant regulatory action under Executive Order 12866.

J. National Technology Transfer and Advancement Act (NTTAA) and 1 CFR Part 51

This action involves technical standards. The EPA proposes to use EPA Methods 2, 2E, 3, 3A, 3C, 18, 21, 25, 25A, and 25C of 40 CFR part 60, appendix A. The EPA identified 15 voluntary consensus standards (VCS) as being potentially applicable (ASTM D3154–00 (2006), ASTM D3464–96 (2007), ASTM D3796–90 (2001), ANSI/ASME PTC 19–10–1981 Part 10, ASME B133.9–1994 (2001), ISO 10396:1993 (2007), ISO 12039:2001, ISO 10780:1994, ASTM D5835–95 (2013), ASTM D6522–11, ASTM D6420–99 (2010), CAN/CSA Z223.2–M86 (1999), ASTM D6060–96 (2009), ISO 14965:2000(E), EN 12619(1999)). The EPA determined that 14 of the 15 candidate VCS identified for measuring emissions of pollutants or their surrogates subject to emission standards in the rule would not be practical due to lack of equivalency, documentation, validation data, and other important technical and policy considerations. The agency identified no equivalent standards for EPA Methods 2E, 21, and 25C. However, one VCS was identified as an acceptable alternative to EPA Method 3A.

The VCS ASTM D6522–11, ''Standard Test Method for the Determination of Nitrogen Oxides, Carbon Monoxide, and Oxygen Concentrations in Emissions from Natural Gas-Fired Reciprocating Engines, Combustion Turbines, Boilers, and Process Heaters Using Portable Analyzers,'' is an acceptable alternative to EPA Method 3A when used at the wellhead before combustion. It is advisable to know the flammability and check the lower explosive limit of the flue gas constituents, prior to sampling, in order to avoid undesired ignition of the gas. The results of ASTM D6522–11 may be used to determine nitrogen oxides and carbon monoxide emission concentrations from natural gas combustion at stationary sources. This test method may also be used to monitor emissions during short-term emission tests or periodically in order to optimize process operation for nitrogen oxides and carbon monoxide control. The EPA's review, including review of comments for these 15 methods, is documented in the memorandum, *Voluntary Consensus Standard Results for Emission Guidelines and Compliance Times for Municipal Solid Waste Landfills, 2016,* which is available in the docket for the 2016 MSW Landfills EG (Docket ID Item No. EPA–HQ–OAR–2014–0451–0206).

K. Executive Order 12898: Federal Actions To Address Environmental Justice in Minority Populations and Low-Income Populations

The EPA believes that this action does not have disproportionately high and adverse human health or environmental effects on minority populations, low-income populations, and/or indigenous peoples, as specified in Executive Order 12898 (59 FR 7629, February 16, 1994). The EPA has determined that because this action increases the level of environmental protection for all affected populations without having any disproportionately high and adverse human health or environmental effects on any population, including any minority, low-income, or indigenous populations. To the extent that any minority, low-income, or indigenous subpopulation is disproportionately impacted by landfill gas emissions due to the proximity of their homes to sources of these emissions, that subpopulation also stands to see increased environmental and health benefit from the emission reductions called for by this action. The results of the demographic analysis are presented in the *EJ Screening Report for Municipal Solid Waste Landfills,* July 2016, a copy of which is available in the 2016 MSW Landfills EG docket (Docket ID Item No. EPA–HQ–OAR–2014–0451–0223).

Dated: August 14, 2019.

Andrew R. Wheeler,

Administrator.

[FR Doc. 2019–17822 Filed 8–21–19; 8:45 am]

BILLING CODE 6560–50–P

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 81

[EPA–HQ–OAR–2014–0464; FRL–9998–54–OAR]

Error Correction of the Area Designations for the 2010 1-Hour Sulfur Dioxide (SO_2) Primary National Ambient Air Quality Standard (NAAQS) in Freestone and Anderson Counties, Rusk and Panola Counties, and Titus County in Texas

AGENCY: Environmental Protection Agency (EPA).

ACTION: Proposed rule.

SUMMARY: The Environmental Protection Agency (EPA) is proposing to correct an error in the designations for three areas in Texas: Freestone and Anderson Counties, Rusk and Panola Counties, and Titus County. On December 13, 2016, portions of Freestone and Anderson Counties, Rusk and Panola Counties, and Titus County were designated as nonattainment for the 2010 primary sulfur dioxide (SO_2) National Ambient Air Quality Standard (NAAQS). Under our Clean Air Act (CAA or Act) authority to correct errors, the EPA is proposing that we erred in not giving greater weight to Texas' preference to characterize air quality through monitoring, and steps undertaken by Texas to begin monitoring in these three areas, when considering all available information; in relying on available air quality analyses in making the initial designations that the EPA recognizes included certain limitations; or a combination of these two issues. Therefore, to correct these errors, the EPA is proposing that the previously designated nonattainment areas in Freestone and Anderson Counties, Rusk and Panola Counties, and Titus County in Texas each be revised to be designated as unclassifiable.

DATES: Comments must be received on or before September 23, 2019. Please refer to **SUPPLEMENTARY INFORMATION** for additional information on the comment period.

ADDRESSES: Submit your comments, identified by Docket ID No. EPA–HQ–OAR–2014–0464, at *http://www.regulations.gov.* Follow the online instructions for submitting comments. Once submitted, comments cannot be edited or removed from regulations.gov. The EPA may publish any comment received to our public docket. Do not submit electronically any information you consider to be Confidential

Business Information (CBI) or other information whose disclosure is restricted by statute. Multimedia submissions (audio, video, etc.) must be accompanied by a written comment. The written comment is considered the official comment and should include discussion of all points you wish to make. The EPA will generally not consider comments or comment contents located outside of the primary submission (*i.e.,* on the Web, Cloud, or other file sharing system). For additional submission methods, the full EPA public comment policy, information about CBI or multimedia submissions, and general guidance on making effective comments, please visit *https://www2.epa.gov/dockets/commenting-epa-dockets.*

FOR FURTHER INFORMATION CONTACT: For further information concerning this action, please contact Corey Mocka, U.S. EPA, Office of Air Quality Planning and Standards, Air Quality Policy Division, Mail Code C539–01, 109 T.W. Alexander Drive, Research Triangle Park, NC 27709; by telephone at (919) 541–5142 or by email at *mocka.corey@epa.gov.*

SUPPLEMENTARY INFORMATION:

Throughout this document wherever ''we,'' ''us,'' or ''our'' is used, we mean the EPA.

Table of Contents

I. What is the purpose of this action?

A. CAA Legal Authority

Section 110(k)(6) of the CAA, 42 U.S.C. 7410(k)(6), as amended in 1990, provides: ''Whenever the Administrator determines that the Administrator's action approving, disapproving, or promulgating any plan or plan revision (or part thereof), *area designation,* redesignation, classification or reclassification was in error, the Administrator may in the same manner as the approval, disapproval, or promulgation revise such action as appropriate without requiring any further submission from the state. Such determination and the basis thereof shall be provided to the state and the public.'' (Emphasis added.)

We interpret this provision to authorize the agency to make corrections to a promulgated area designation when it is shown to our satisfaction (or we discover) that (1) we clearly erred by failing to consider or by inappropriately considering information made available to the EPA at the time of the promulgation, or the information made available at the time of promulgation is subsequently demonstrated to have been clearly inadequate, and (2) other information persuasively supports a change in the action. *See, e.g.,* 57 FR 56762, 56763 (November 30, 1992) (correcting certain designations, boundaries, or classifications for a variety of NAAQS promulgated in agency actions shortly after the 1990 Clean Air Act amendments).

B. Background on the Designations of Freestone and Anderson Counties, Rusk and Panola Counties, and Titus County in Texas

On June 2, 2010, the EPA Administrator signed a notice of final rulemaking that revised the primary SO_2 NAAQS (75 FR 35520 (June 22, 2010)) after review of the existing primary SO_2 standards promulgated on April 30, 1971 (36 FR 8187). The EPA established the revised primary SO_2 NAAQS at 75 parts per billion (ppb), which is attained when the 3-year average of the annual 99th percentile of daily maximum 1-hour average concentrations does not exceed 75 ppb. 40 CFR 50.17(a)–(b).

The process for designating areas following promulgation of a new or revised NAAQS is contained in the CAA section 107(d) (42 U.S.C. 7407(d)). After promulgation of a new or revised NAAQS, each governor or tribal leader has an opportunity to recommend air quality designations, including the appropriate boundaries for nonattainment areas, to the EPA (42 U.S.C. 7407(d)(1)(A)). The EPA considers these recommendations when fulfilling its duty to promulgate the formal area designations and boundaries for the new or revised NAAQS. By no later than 120 days prior to promulgating designations, the EPA is required to notify states, territories, and tribes, as appropriate, of any intended modifications to an area designation or boundary recommendation that the EPA deems necessary (42 U.S.C. 7407(d)(1)(B)).

After invoking a 1-year extension of the deadlines to designate areas, as provided for in section 107(d)(1)(B) of the Act, the EPA published an initial round of SO_2 designations for certain areas of the country on August 5, 2013 (referred to as ''Round 1'') (78 FR 47191). Following the initial designations, three lawsuits were filed against the EPA in different U.S. District Courts, alleging the agency had failed to perform a nondiscretionary duty under the CAA by not designating all portions of the country by the June 2, 2013, statutory deadline. The state of Texas was a plaintiff or plaintiff-intervenor in two of those cases. In one of those cases (*Sierra Club and NRDC* v. *McCarthy,* No. 13–cv–3953), the U.S. District Court for the Northern District of California on March 2, 2015, entered an enforceable order for the EPA to complete the area designations by three specific deadlines according to the court-ordered schedule. The court order required the EPA to designate areas containing sources meeting certain criteria no later than July 2, 2016. The three Texas areas the EPA designated that are the subject of this proposed action contained sources meeting those criteria.

To meet the first court-ordered deadline for the next set of SO_2 designations, known as ''Round 2,'' the final action designating 61 additional areas was signed on June 30, 2016, and a supplemental final action including the designations for portions of Freestone and Anderson Counties, Rusk and Panola Counties, and Titus County, was signed on November 29, 2016 [1]

[1] By a series of stipulations of the parties in *Sierra Club and NRDC* v. *McCarthy* and orders of the Court, the deadline for the three areas in Texas that are the subject of this proposed action, and a fourth

(''Round 2 Supplement'') and published at 81 FR 45039 (July 12, 2016) and 81 FR 89870 (December 13, 2016), respectively. To meet the second court-ordered deadline, all remaining undesignated areas, except those where a state has installed and begun timely operating a new SO_2 monitoring network meeting the EPA specifications referenced in the EPA's SO_2 Data Requirements Rule, were designated on December 21, 2017, with a supplemental amendment on March 28, 2018 (referred to as ''Round 3'') and published at 83 FR 1098 (January 9, 2018) and 83 FR 14597 (April 14, 2018), respectively.[2] Pursuant to the court-ordered schedule, the EPA must complete SO_2 designations for the remaining areas of the country by December 31, 2020 (referred to as ''Round 4'').

On August 21, 2015 (80 FR 51052), the EPA separately promulgated an SO_2 air quality data rule. The Data Requirements Rule (DRR) requires state air agencies to provide additional monitoring or modeling information to characterize SO_2 air quality in areas containing SO_2 emissions sources either meeting certain criteria or that have otherwise been listed under the DRR by the EPA or state air agencies. In lieu of the SO_2 air quality characterization required under the DRR, air agencies could demonstrate that the listed sources restricted their annual SO_2 emissions to less than 2,000 tons per year (tpy) through federally enforceable and in effect emission limits, or provide documentation that the sources had been shut down, by January 13, 2017. Thus, for the purpose of meeting the DRR obligations, states were provided options on how to characterize their air quality, including setting up and beginning operation of new SO_2 monitoring networks by January 1, 2017. States were required to notify the EPA by July 1, 2016, of which characterization option they had selected for each listed DRR source. Since states were not required under the DRR to complete characterization of air quality in subject areas for purposes of that rule before the Round 2 deadline for the EPA to issue area designations, for those areas—including the three Round 2 Texas areas that are the subject of this proposed action—the EPA did not expect to have the results of the DRR implementation in time for those areas' designations.

In Freestone County, Big Brown Steam Electric Station (''Big Brown'') was the largest source of SO_2 emissions in the area, but recently and permanently suspended operations as of January 2018, and the majority of its New Source Review (NSR) permits were voided on March 29, 2018, and it's operating permit was voided August 3, 2018.[3] In Titus County, Monticello Steam Electric Station (''Monticello'') was the largest source of SO_2 emissions in the area, but recently and permanently suspended operations as of February 2018 and the majority of its NSR permits were voided on February 14, 2018 and its operating permit was voided on August 3, 2018.[4][5] In Rusk County, Martin Lake Electric Station is the largest source of SO_2 emissions in the area and continues to operate. All three facilities are owned by Vistra Energy Corp and its subsidiary Luminant (''Vistra Energy'').

In 2011, following the promulgation of the revised NAAQS, the state of Texas initially recommended an unclassifiable designation for Freestone and Anderson Counties, Rusk and Panola Counties, and Titus County since, at the time, there were not any SO_2 monitors in these counties. In September 2015, Texas updated its recommendation to unclassifiable/attainment for areas of the state where there were no monitors, including the above counties. Texas stated its position that ambient air monitoring data were the appropriate information for use in the designation process. In December 2015, prior to the EPA's notification to the Governor of our intended designations, we received air quality modeling from the Sierra Club for these three areas, but we did not receive any other monitoring, modeling, or technical information from Texas or Vistra Energy. In February 2016, the EPA notified Texas of our intended designations of nonattainment for three separate areas covering portions of Freestone and Anderson Counties, Rusk and Panola Counties, and Titus County, based on the modeling submitted by Sierra Club.[6]

During the public comment period in March 2016, the EPA received substantive comments from citizens, Sierra Club, Vistra Energy, the Texas Commission on Environmental Quality (TCEQ), and the Governor of the state of Texas regarding our intended nonattainment designations for these three areas. Summaries of the comments received can be found in the Responses to Significant Comments on the Designation Recommendations for the 2010 Sulfur Dioxide National Ambient Air Quality Standards (NAAQS)—Supplement for Four Areas in Texas Not Addressed in June 30, 2016, Version.[7] Vistra Energy submitted air dispersion modeling for all three areas, and the Sierra Club submitted updated versions of the modeling previously submitted. The EPA determined that the modeling submitted by Vistra Energy was not representative of current air quality in these areas for several reasons. For example, Vistra Energy's modeling used a non-EPA preprocessor model, AERLIFT, to increase the observed temperatures and velocities of the plumes exiting from the stacks, which the EPA determined was not adequately justified, and, thus, could not be relied upon in the designations decision-making process. The Sierra Club's updated modeling used the latest model version available at the time, in accordance with the general recommendations on modeling provided by the EPA.[8] Texas did not submit modeling but maintained its position that monitoring of air quality was the proper basis for designating these areas. Concerning the Sierra Club modeling, Texas claimed that this modeling ''has errors and clearly overestimates actual SO_2 concentrations.'' [9] Full reviews of the modeling received can be found in the

area, Milam County, which is not part of this proposed action, was extended to November 29, 2016.

[2] The remaining undesignated portions of the five Texas counties that are the subject of this notice were designated attainment/unclassifiable in Round 3.

[3] *See* docket item number EPA–HQ–OAR–2014–0464–0455 for a list of Big Brown's voided NSR permits. Big Brown's voided operating permit is also located in Docket EPA–HQ–OAR–2014–0464.

[4] For Monticello, *see* docket item number EPA–HQ–OAR–2014–0464–0456 for a list of voided NSR permits, and docket item number EPA–HQ–OAR–2014–0464–0457 for the voided operating permit.

[5] Any remaining NSR or material handling permits for Big Brown and Monticello will only be maintained while the facilities complete closure activities related to coal piles, silos, conveyors, and other shutdown tasks.

[6] *See* the 120-day letter from the EPA to Texas: *https://www.epa.gov/sites/production/files/2016-03/documents/il-epa-resp-r2.pdf* and the Technical Support Document (TSD) for the intended designations for Texas: *https://www.epa.gov/sites/production/files/2016-03/documents/tx-epa-tsd-r2.pdf* (''Intended TSD'').

[7] *https://www.epa.gov/sites/production/files/2016-11/documents/rtc_so2_comments_received_document_4_tx_sources_final_0.pdf.*

[8] *See* the SO_2 NAAQS Designations Source-Oriented Monitoring Technical Assistance Document at *https://www.epa.gov/sites/production/files/2016-06/documents/so2monitoringtad.pdf,* and the SO_2 NAAQS Designations Modeling Technical Assistance Document at *https://www.epa.gov/sites/production/files/2016-06/documents/so2modelingtad.pdf.*

[9] Comment submitted on March 31, 2016 by Richard A. Hyde, Executive Director, Texas Commission on Environmental Quality. Docket ID# EPA–HQ–OAR–2014–0464–0294.

Texas Intended TSD [10] and Texas Final TSD [11] from Round 2. The final nonattainment designations were based on EPA's analysis of all the air quality modeling submitted by Vistra Energy and Sierra Club, as well as consideration of comments submitted by Texas.

On June 29, 2016, timely meeting its DRR option selection deadline, Texas separately communicated to the EPA that it had chosen the monitoring pathway for these areas to meet its obligations under that rule to characterize air quality for the sources in these areas that were listed under the DRR. In Texas' annual monitoring network plan for 2016, the state indicated that it intended to site new SO_2 monitors in any Round 2 area that the EPA designated as nonattainment. Following up on this intention, in its 2017 annual monitoring network plan, Texas included new proposed SO_2 monitoring sites in Freestone, Titus, and Rusk Counties to assess air quality in the three new SO_2 nonattainment areas involving Vistra Energy sources. Texas referred to the 2016 Sierra Club modeling analysis, among other information, to inform their proposed siting of the new monitors, but stated: ''The use of the 2016 Sierra Club modeling analysis for possible monitor placement decisions does not infer TCEQ's concurrence with the use of this modeling analysis for any other purpose.'' [12] The EPA approved the three monitor siting proposals in an August 10, 2017, letter to TCEQ.[13]

On February 13, 2017, the state of Texas, TCEQ, and Vistra Energy and its subsidiary companies filed petitions for judicial review of the Round 2 Supplement in the Fifth Circuit Court of Appeals.[14] On that same day, Vistra Energy sent the EPA a petition for reconsideration and administrative stay of EPA's nonattainment designations for Freestone and Anderson Counties, Rusk and Panola Counties, and Titus County. On March 15, 2017, TCEQ also submitted a request for an administrative stay of the Round 2 Supplement. On September 21, 2017, the EPA responded to Vistra Energy's February 2017 petition for reconsideration by indicating an intent to undertake an administrative action with notice and comment to revisit the nonattainment designations for the three areas. On October 12, 2017, the Fifth Circuit Court of Appeals granted EPA's motion to place the consolidated challenges to the Round 2 Supplement in abeyance on this basis. In December 2017, TCEQ submitted a new petition for reconsideration and Vistra Energy submitted additional information to support their February 2017 petition for reconsideration. Both submissions in December 2017 provided information regarding the planned retirements of the Big Brown (Freestone/Anderson Counties) and Monticello (Titus County) facilities. Since December 2017, both the Big Brown and Monticello power plants have ceased operations and surrendered their operating permits.

In November 2017, Texas sited an SO_2 monitor at the Martin Lake (Rusk/Panola Counties) power plant. Texas also sited and began operating a monitor around the Big Brown power plant (Freestone/Anderson Counties) on October 30, 2017. The Big Brown power plant shut down in February 2018; however, Texas is currently continuing to operate the monitor. The EPA anticipates that these monitors will not have 3 years of monitoring data necessary to fully evaluate compliance with the SO_2 NAAQS until the end of calendar year 2020. Texas also planned to site a monitor around the Monticello power plant (Titus County), but once the retirement of the facility had been announced, the monitor was not installed.

C. Purpose of This Action

In this document, the EPA is proposing that we erred in failing to give greater weight to the state of Texas' preference to use ambient air monitors to characterize SO_2 air quality in their state for purposes of the designation, when we considered all available information at the time of designation. The EPA has consistently recognized appropriately sited ambient air monitoring data as relevant information for determining an area's designation for the 2010 1-hour SO_2 NAAQS.[15] [16] The EPA's DRR gave states the ability to choose whether to characterize areas around listed sources through modeling or monitoring. It was also the EPA's stated intention in developing the overall implementation strategy for the 2010 SO_2 NAAQS to use the air quality characterizations required under the DRR to inform area designations, where those characterizations were conducted in time to inform the EPA's designations rounds.[17] However, areas required to be designated in Round 2 by the first court-ordered deadline of July 2, 2016, generally were designated before the air quality characterization information required under the DRR became available, and were required to be designated regardless of the state's choice of air quality characterization, including those states that planned to begin operating a new monitoring network in such an area in 2017 in accordance with the DRR.

Since 2011, the state of Texas has consistently communicated to the EPA their support of ambient air monitoring data as the appropriate information for use in the designations decisions process for areas in Texas.[18] Because the

[10] *https://www.epa.gov/sites/production/files/2016-03/documents/tx-epa-tsd-r2.pdf.*

[11] *https://www.epa.gov/sites/production/files/2016-11/documents/texas_4_deferred_luminant_tsd_final_docket.pdf.*

[12] Appendix E: Sulfur Dioxide Data Requirements Rule Monitor Placement Evaluations, from 2017 TCEQ Annual Monitoring Network Plan.

[13] TCEQ subsequently deployed SO_2 monitors near Big Brown on October 30, 2017, and near Martin Lake on November 1, 2017. No monitors where deployed in the area around Monticello as the source was retired on February 8, 2018 (*see* 2018 TCEQ Annual Monitoring Network Plan).

[14] Sierra Club additionally filed a petition for judicial review of this action in the D.C. Circuit Court of Appeals, which was transferred to the Fifth Circuit on November 2, 2017, and consolidated with the pending petitions.

[15] *See* ''Updated Guidance for Area Designations for the 2010 Primary Sulfur Dioxide National Ambient Air Quality Standard,'' memorandum to Regional Air Division Directors, Regions I–X, from Stephen D. Page, dated March 20, 2015, available at *https://www.epa.gov/sites/production/files/2016-04/documents/20150320so2designations.pdf.* The EPA supplemented this guidance with documents first made available to states and other interested parties in 2013 and updated in 2016. See SO_2 NAAQS Designations Source-Oriented Monitoring Technical Assistance Document (February 2016), available at *https://www.epa.gov/sites/production/files/2016-06/documents/so2monitoringtad.pdf,* and SO_2 NAAQS Designations Modeling Technical Assistance Document (August 2016), available at *https://www.epa.gov/sites/production/files/2016-06/documents/so2modelingtad.pdf.*

[16] The EPA has relied on monitors, where appropriate, to determine that areas were affirmatively attaining or not attaining the 2010 SO_2 NAAQS in all three rounds of designations. *See, e.g.,* any Round 1 designations (all areas were designated based on monitored data), Round 2 designation for the Gibson County Area in Indiana (*https://www.epa.gov/sites/production/files/2016-03/documents/in-epa-tsd-r2.pdf* and *https://www.epa.gov/sites/production/files/2016-07/documents/r5_in_final_designation_tsd_06302016.pdf*), and Round 3 designation for the North Denver Area in Colorado (*https://www.epa.gov/sites/production/files/2017-08/documents/7_co_so2_rd3-final.pdf*).

[17] *See* ''Next Steps on Designating Areas and Implementing the 1-Hour SO_2 Standard—EPA Webinar for State, Local, and Tribal Air Agencies,'' February 13, 2013, page 2, *https://archive.epa.gov/apti/video/web/pdf/presentation-7.pdf;* Data Requirements Rule for the 1-Hour Sulfur Dioxide Primary NAAQS—Proposed Rule, 79 FR 27446 (May 13, 2014) (''[t]he air quality data developed by the states in accordance with this rulemaking would be used by the EPA in future rounds of area designations for the 1-hour SO_2 NAAQS'').

[18] Examples of these communications include: TCEQ's 2011 Comments on Guidance for 1-Hour SO_2 NAAQS SIP Submissions at *https://www.regulations.gov/document?D=EPA-HQ-OAR-2010-1059-0034,* TCEQ's 2014 comments regarding Data Requirements for the 1-Hour SO_2 NAAQS at *https://www.regulations.gov/document?D=EPA-HQ-OAR-2013-0711-0051,* Texas' 2016 Round 2 recommendations at *https://www.epa.gov/sites/*

areas around SO_2 emissions sources in Freestone and Anderson Counties, Rusk and Panola Counties, and Titus County were subject to the Round 2 deadline of July 2, 2016, these areas were required to be designated at that time, regardless of the state of Texas' preference to characterize the areas based on monitoring data and its intention to monitor these areas, given additional time.

However, the EPA is proposing that we erred in failing to give greater weight to the preference of the state to monitor air quality in these areas when considering all available information at the time of designation. Accordingly, in light of the lack of monitoring data available at that time, and Texas' expressed preference at that time for designations of these areas to be based on monitoring data, we are proposing to correct this error by designating the areas as unclassifiable.

The EPA is also proposing a second, independent grounds for error, that we erred in relying on available air quality modeling, in particular modeling submitted by Sierra Club, in making the initial nonattainment designations for these three areas. As noted earlier, the modeling submitted by Vistra Energy, which purported to show attainment, used a non-EPA preprocessor which constitutes an alternative model for which the state did not secure approval from the EPA per Appendix W to 40 CFR part 51—Guideline on Air Quality Models. Also, as noted earlier, the modeling submitted by Sierra Club, which purported to show nonattainment, while developed in accordance with the general recommendations on modeling provided by the EPA, contained key limitations and uncertainties. On one hand, we noted in the Texas Intended TSD and Texas Final TSD from Round 2 that individually these key limitations and uncertainties would not significantly change modeled results or, in many cases, could result in underestimation of SO_2 concentrations.[19] On the other hand, given the possible collective significance of these issues and, in the case of the areas around the Martin Lake and Monticello power plants, given that the maximum modeled concentrations are within about 10% of the primary SO_2 NAAQS, we are less confident in our prior statements that potential adjustments to the Sierra Club modeling would not result in modeled values near or below the NAAQS.[20] We, therefore, propose that our error in relying on the Sierra Club modeling represents an insufficient basis for the EPA's initial nonattainment designations. Accordingly, we are proposing to correct this error by designating the areas as unclassifiable.

One of the most significant limitations and uncertainties with Sierra Club's modeling is the absence of variable stack conditions and representation of 100 percent load stack parameters. As commenters on the EPA's proposed designations noted, this issue is particularly pronounced as the Electric Reliability Council of Texas (ERCOT) market is competitive ''with plant dispatch based on variable cost'' and falling natural gas prices and renewable capacity resulting in these units running in variable operations.[21] The EPA noted in the technical support document for the 2016 designations in Indiana that ''use of hourly stack parameters more accurately characterize plume characteristics, which will provide greater reliability both in the estimated concentration and in the geographical distribution of concentrations.'' [22] Other limitations and uncertainties with the Sierra Club modeling identified in the Texas Intended TSD and the Texas Final TSD for the 2016 SO_2 designations include: Use of an older version of AERMOD; representation of recent emissions, including controls after the 2011 National Emissions Inventory; inappropriate elevation of flagpole receptors; use of a larger receptor grid than recommended; treatment of building downwash, surface meteorology, hourly wind inputs, potential to emit/allowable emissions, variable stack temperature, and velocity; approach to estimation of background concentrations; and failure to include building downwash and fenceline, or source contribution in the modeling analysis. While individually these deficiencies are not dispositive, collectively they are a sufficient basis for the EPA to propose that we erred in relying on the Sierra Club modeling in making the initial nonattainment designations for the three Texas areas.

This proposed rationale is consistent with related statements by the EPA. The EPA's March 2011 Guidance explained that given the currently limited network of SO_2 monitors and our expectation that states will not yet have completed appropriate modeling of all significant SO_2 sources, we anticipated that most areas of the country will be designated ''unclassifiable.'' [23] The EPA's updated designations guidance in March 2015 indicated that: ''In the absence of information clearly demonstrating a designation of 'attainment' or 'nonattainment,' the EPA intends to designate areas as 'unclassifiable' when it takes action pursuant to the court order.'' [24] In promulgating revisions to the SO_2 NAAQS in 2010, the EPA stated that where informational records ''are insufficient to support initial designations of either 'attainment' or 'nonattainment' * * * EPA is required to issue a designation for the area of 'unclassifiable.' '' [25] The EPA also stated that designations would be determined ''based on 3 years of complete, quality assured, certified monitoring data'' [26] and that the EPA would allow for modeling in addition to monitoring (where monitoring was insufficient).[27] The Northern District Court of California also stated in regards to the consent decree that the appropriate remedy was to ''. . . require the EPA to issue designations pursuant to a schedule, not to mandate that EPA issue any particular designation.'' [28]

Furthermore, the EPA recognizes that its potential future reliance on properly sited monitors rather than dispersion modeling—as could be the case in a future redesignation of the Martin Lake power plant in Rusk/Panola Counties

production/files/2016-03/documents/tx-rec-r2.pdf, TCEQ's 2016 Annual Monitoring Network Plan at *https://www.tceq.texas.gov/assets/public/compliance/monops/air/annual_review/historical/2016-AMNP.pdf,* and TCEQ's 2017 Annual Monitoring Network Plan at *https://www.tceq.texas.gov/assets/public/compliance/monops/air/annual_review/historical/2017-AMNP.pdf.*

[19] *See* the Technical Support Document (TSD) for the intended designations for Texas: *https://www.epa.gov/sites/production/files/2016-11/documents/texas_4_deferred_luminant_tsd_final_docket.pdf* (''Final TSD'').

[20] The maximum predicted 99th percentile 1-hour SO_2 concentrations are 224 μg/m³ for the modeling domain that includes the Martin Lake power plant, and 212 μg/m³ for the modeling domain that includes the Monticello power plant. (The 1-hour SO_2 NAAQS is achieved at 196.4 μg/m³.) The prior TSDs erred in stating that the modeling for Monticello showed concentrations ''almost double the standard.''

[21] Comment submitted on March 31, 206 from Kim Mireles, Luminant Generation Company, LLC. Docket ID# EPA–HQ–OAR–2014–0464–0328. ERCOT is the independent system operator responsible for dispatching electricity to the majority of Texas consumers.

[22] Technical Support Document for EPA's Intended Round 2 Area Designations for the 2010 SO_2 NAAQS in Indiana (page 46) at *https://www.epa.gov/sites/production/files/2016-03/documents/in-epa-tsd-r2.pdf.*

[23] Memorandum dated March 24, 2011, titled ''Area Designations for the 2010 Revised Primary Sulfur Dioxide National Ambient Air Quality Standards,'' from Stephen D. Page, Director of EPA's Office of Air Quality Planning and Standards, to Regional Air Division Directors.

[24] *https://www.epa.gov/sites/production/files/2016-06/documents/20150320so2designations.pdf.*

[25] 75 FR 35571.

[26] 75 FR 35570–71.

[27] 75 FR 35569.

[28] Sierra Club, et al. v. McCarthy, 2015 WL 889142 at 11.

area and the Big Brown power plant in Freestone/Anderson Counties area—would be consistent with the approach the agency took in 2016 in designating the area around the Gibson power plant in Gibson County, Indiana. The EPA has also recognized in other areas that, where conflicting sets of model results exist, the appropriate designation may be ''unclassifiable,'' depending on the facts of that area.'' [29] [30]

Additionally, the EPA is proposing that our error in relying on the Sierra Club modeling along with our error in failing to give greater weight to Texas' preference for monitoring, represents an insufficient basis for the EPA's initial nonattainment designations. Accordingly, we are proposing to correct this error by designating the areas as unclassifiable.

The proposed revised designation of unclassifiable indicates that the EPA could not determine based on available information at the time of issuing the designation whether the three Texas areas that are the subject of this proposed action were meeting or not meeting the 2010 SO_2 NAAQS. The EPA is initiating this notice-and-comment process for the public to comment on the EPA's proposed errors and approach to correct the initial designation for Freestone and Anderson Counties, Rusk and Panola Counties, and Titus County to unclassifiable, rather than nonattainment.

Furthermore, independent from correcting these initial designations, the EPA is proposing to remove the portion of Titus County that was erroneously listed as attainment/unclassifiable on the Texas Part 81 attainment status designations table. As part the Round 3 final designations rule published on January 9, 2018 (83 FR 1098), the EPA inadvertently listed a portion of Titus County (*i.e.,* the portion that is not being designated as part of this proposed action nor the previous Round 2 final action) as attainment/unclassifiable. Consistent with the rulemaking records, the remaining portion of Titus County should not have been listed as attainment/unclassifiable in the part 81 table.[31] EPA will designate the remaining Titus County area by December 31, 2020 during the Round 4 designations process.

II. Instructions for Submitting Public Comments and Internet Website for Rulemaking Information

A. Invitation To Comment

The purpose of this document is to solicit input from the public on EPA's error in designating portions of Freestone and Anderson Counties, Rusk and Panola Counties, and Titus County as nonattainment, and the corrected designations of unclassifiable.

Please be as specific as possible in supporting your views.

- Describe any assumptions and provide any technical information and/or data that you used.
- Provide specific examples to illustrate your concerns, and suggest alternatives.
- Explain your views as clearly as possible.
- Provide your input by the comment period deadline identified.

Previous submissions and supporting technical analyses utilized for the initial Round 2 designations can be found at *https://www.epa.gov/sulfur-dioxide-designations* and, also, in the public docket for these SO_2 designations at Docket ID No. EPA–HQ–OAR–2014–0464. Air dispersion modeling input and output files are too large to post in the docket or on the website and must be requested from the EPA Docket Office or from the contact listed in the **FOR FURTHER INFORMATION CONTACT** section. The EPA Docket Office can be contacted at (202) 566–1744, and is located at EPA Docket Center Reading Room, WJC West Building, Room 3334, 1301 Constitution Avenue NW, Washington, DC 20004. The hours of operation at the EPA Docket Center are 8:30 a.m.–4:30 p.m., Monday–Friday.

The EPA invites public input on this proposed action regarding error correction of the designations of the Freestone and Anderson Counties, Rusk and Panola Counties, and Titus County areas during the 30-day comment period provided in this document. In order to receive full consideration, input from the public must be submitted to the docket by September 23, 2019. At this time, the EPA is not asking for public comment on areas beyond the three areas that are the subject of this proposed action. In addition, in finalizing this action the EPA will not revisit comments relating to the designations for these three areas in Texas received in previous public comment periods. (The agency has already responded to these comments in the previous designations actions.) This opportunity for public comment does not affect any rights or obligations of any state, territory, or tribe, or of the EPA, which might otherwise exist pursuant to the CAA section 107(d).

Please refer to the **FOR FURTHER INFORMATION CONTACT** section in this document for specific instructions on submitting comments and locating relevant public documents.

B. What should I consider as I prepare my comments for the EPA?

1. *Submitting CBI.* Do not submit CBI information to the EPA through *https://www.regulations.gov* or email. Clearly mark the part or all of the information that you claim to be CBI. For CBI in any digital storage media that you mail to the EPA, mark the outside of the digital storage media as CBI and then identify electronically within the digital storage media the specific information that is claimed as CBI. In addition to one complete version of the comment that includes information claimed as CBI, a copy of the comment that does not contain the information claimed as CBI must be submitted for inclusion in the public docket. Information so marked will not be disclosed except in accordance with procedures set forth in 40 Code of Federal Regulations (CFR) part 2. Send or deliver information identified as CBI only to the following address: Tiffany Purifoy, OAQPS CBI Officer, U.S. EPA, Office of Air Quality Planning and Standards, Mail Code C404–02, Research Triangle Park, NC 27711, telephone (919) 541–0878, email at *purifoy.tiffany@epa.gov,* Attention Docket ID No. EPA–HQ–OAR–2014–0464.

2. *Tips for Preparing Your Comments.* When submitting comments, remember to:

- Identify the rulemaking by docket number and other identifying information (subject heading, **Federal Register** date and page number).
- Follow directions.
- Explain why you agree or disagree; suggest alternatives and substitute language for your requested changes.

[29] *See* ''Technical Analysis for the Sheldon Station, Nebraska Area'' in the Technical Support Document for EPA's Intended Round 2 Area Designations for the 2010 SO_2 NAAQS in Nebraska (page 33) at *https://www.epa.gov/sites/production/files/2016-03/documents/ne-epa-tsd-r2.pdf,* and in the Final Technical Support Document for EPA's Round 2 Area Designations for the 2010 SO_2 NAAQS in Nebraska (page 11) at *https://www.epa.gov/sites/production/files/2016-07/documents/r7_ne_final_designation_tsd_06302016.pdf.*

[30] *See* ''Technical Analysis for Gallia County, Ohio'' in the Technical Support Document for the EPA's Intended Round 2 Area Designations for the 2010 SO_2 NAAQS in Ohio (page 19) at *https://www.epa.gov/sites/production/files/2016-03/documents/oh-epa-tsd-r2.pdf,* and in the Technical Support Document for EPA's Final Round 2 Area Designations for the 2010 SO_2 NAAQS in Ohio (page 8) at *https://www.epa.gov/sites/production/files/2016-07/documents/r5_oh_final_designation_tsd_06302016.pdf.*

[31] For examples, see Table 2 in the Round 3 final designations TSD for Texas at *https://www.epa.gov/sites/production/files/2017-12/documents/39-tx-so2-rd3-final.pdf* and footnote #3 of the Texas Part 81 table.

C. Where can I find additional information for this rulemaking?

All documents in the docket are listed in the *www.regulations.gov* index, identified by Docket ID No. EPA–HQ–OAR–2014–0464, and on the agency's SO_2 Designations website at *https://www.epa.gov/sulfur-dioxide-designations.* Although listed in the index, some information is not publicly available, *e.g.,* CBI or other information whose disclosure is restricted by statute. Certain other material, such as copyrighted material, will be publicly available only in hard copy. Publicly available docket materials are available either electronically in *www.regulations.gov* or in hard copy at the EPA Docket Center. Air dispersion modeling input and output files are too large to post in the docket or on the website and must be requested from the contact listed in the **FOR FURTHER INFORMATION CONTACT** section. The EPA Docket Center can be contacted at (202) 566–1744, and is located at EPA Docket Center Reading Room, WJC West Building, Room 3334, 1301 Constitution Avenue NW, Washington, DC 20004. The hours of operation at the EPA Docket Center are 8:30 a.m.–4:30 p.m., Monday–Friday.

III. Environmental Justice Concerns

When the EPA establishes a new or revised NAAQS, the CAA requires the EPA to designate all areas of the United States as either nonattainment, attainment, or unclassifiable. This proposed action would correct an error in the nonattainment designations for Freestone and Anderson Counties, Rusk and Panola Counties, and Titus County in Texas for the 2010 SO_2 NAAQS. Area designations address environmental justice concerns by ensuring that the public is properly informed about the air quality in an area. In locations where air quality does not meet the NAAQS, the CAA requires relevant state authorities to initiate appropriate air quality management actions to ensure that all those residing, working, attending school, or otherwise present in those areas are protected, regardless of minority and economic status.

IV. Statutory and Executive Order Reviews

A. Executive Order 12866: Regulatory Planning and Review and Executive Order 13563: Improving Regulation and Regulatory Review

This action is exempt from review by the Office of Management and Budget because it is proposing to correct an error in previously promulgated designations for portions of Freestone and Anderson Counties, Rusk and Panola Counties, and Titus County in Texas for the 2010 1-hour SO_2 NAAQS.

B. Executive Order 13771: Reducing Regulations and Controlling Regulatory Costs

This action is not an Executive Order 13771 regulatory action because actions such as error corrections of air quality designations associated with a new revised NAAQS are exempt under Executive Order 12866.

C. Paperwork Reduction Act (PRA)

This action does not impose an information collection burden under the PRA. In this action, the EPA is correcting the SO_2 NAAQS designations for portions of Freestone and Anderson Counties, Rusk and Panola Counties, and Titus County in Texas promulgated previously on December 13, 2016, and does not contain any information collection activities.

D. Regulatory Flexibility Act (RFA)

This proposed error correction action under CAA section 110(k)(6) is not subject to the RFA. The RFA applies only to rules subject to notice-and-comment rulemaking requirements under the Administrative Procedure Act (APA), 5 U.S.C. 553, or any other statute. Section 107(d)(2)(B) of the CAA explicitly provides that designations are exempt from the notice-and-comment provisions of the APA. In addition, designations under CAA section 107(d) are not among the list of actions that are subject to the notice-and-comment rulemaking requirements of CAA section 307(d).

E. Unfunded Mandates Reform Act (UMRA)

This action does not contain any unfunded mandate as described in UMRA, 2 U.S.C. 1531–1538 and does not significantly or uniquely affect small governments. The action imposes no enforceable duty on any state, local, or tribal governments or the private sector.

F. Executive Order 13132: Federalism

This action does not have federalism implications. It will not have substantial direct effects 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. The division of responsibility between the federal government and the states for purposes of implementing the NAAQS is established under the CAA.

G. Executive Order 13175: Consultation and Coordination With Indian Tribal Government

This action does not have tribal implications, as specified in Executive Order 13175. This action concerns the designation of portions of Freestone and Anderson Counties, Rusk and Panola Counties, and Titus County in Texas for the 2010 SO_2 NAAQS. The CAA provides for states, territories, and eligible tribes to develop plans to regulate emissions of air pollutants within their areas, as necessary, based on the designations. The Tribal Authority Rule (TAR) provides tribes the opportunity to apply for eligibility to develop and implement CAA programs, such as programs to attain and maintain the SO_2 NAAQS, but it leaves to the discretion of the tribe the decision of whether to apply to develop these programs and which programs, or appropriate elements of a program, the tribe will seek to adopt. This rule does not have a substantial direct effect on one or more Indian tribes. It would not create any additional requirements beyond those of the SO_2 NAAQS. This rule, if finalized, would revise the designations for portions of Freestone and Anderson Counties, Rusk and Panola Counties, and Titus County in Texas for the SO_2 NAAQS, but no areas of Indian country are intended to be designated by this action. Furthermore, this rule does not affect the relationship or distribution of power and responsibilities between the federal government and Indian tribes. The CAA and the TAR establish the relationship of the federal government and tribes in developing plans to attain the NAAQS, and this rule does nothing to modify that relationship. Thus, Executive Order 13175 does not apply.

H. Executive Order 13045: Protection of Children From Environmental Health and Safety Risks

The EPA interprets Executive Order 13045 as applying to those regulatory actions that concern environmental health or safety risks that the EPA has reason to believe may disproportionately affect children, per the definition of ''covered regulatory action'' in section 2–202 of the Executive Order. This action is not subject to Executive Order 13045 because it does not establish an environmental standard intended to mitigate health or safety risks.

I. Executive Order 13211: Actions That Significantly Affect Energy Supply, Distribution or Use

This action is not subject to Executive Order 13211 because it is not a significant regulatory action under Executive Order 12866.

J. National Technology Transfer and Advancement Act (NTTAA)

This rulemaking does not involve technical standards.

K. Executive Order 12898: Federal Actions To Address Environmental Justice in Minority Populations and Low-Income Populations

The EPA believes that this action does not have disproportionately high and adverse human health or environmental effects on minority populations, low-income populations and/or indigenous peoples, as specified in Executive Order 12898 (59 FR 7629, February 16, 1994). The documentation for this determination is contained in Section IV of this preamble, ''Environmental Justice Concerns.''

List of Subjects in 40 CFR Part 81

Environmental protection, Air pollution control, National parks, Wilderness areas.

Dated: August 13, 2019.

Anne L. Idsal,

Acting Assistant Administrator.

[FR Doc. 2019–18048 Filed 8–21–19; 8:45 am]

BILLING CODE 6560–50–P

DEPARTMENT OF LABOR

Office of Federal Contract Compliance Programs

41 CFR Part 60–1

RIN 1250–AA09

Implementing Legal Requirements Regarding the Equal Opportunity Clause's Religious Exemption

AGENCY: Office of Federal Contract Compliance Programs; Labor.

ACTION: Notice of proposed rulemaking; correction.

SUMMARY: On August 15, 2019, the Office of Federal Contract Compliance Programs (OFCCP) published a proposed rule to clarify the scope and application of the religious exemption contained in section 204(c) of Executive Order 11246, as amended. That document included incorrect information for the quantifiable costs that appear in Table 2. This document corrects Table 2 in the proposed rule.

DATES: August 22, 2019.

FOR FURTHER INFORMATION CONTACT: Harvey D. Fort, Acting Director, Division of Policy and Program Development, Office of Federal Contract Compliance Programs, 200 Constitution Avenue NW, Room C–3325, Washington, DC 20210. Telephone: (202) 693–0104 (voice) or (202) 693–1337 (TTY).

SUPPLEMENTARY INFORMATION: The following correction is made to the document that published in the **Federal Register** on August 15, 2019:

On page 41687, the first line of Table 2. Quantifiable Costs ''First-Year Costs $24,197,500'' is corrected to read ''First-Year Costs $20,325,900''.

Craig E. Leen,

Director, OFCCP.

[FR Doc. 2019–18060 Filed 8–21–19; 8:45 am]

BILLING CODE 4510–45–P

FEDERAL COMMUNICATIONS COMMISSION

47 CFR Parts 1 and 54

[WC Docket Nos. 11–10 and 19–195, FCC No. 19–79]

Establishing the Digital Opportunity Data Collection and Modernizing the FCC Form 477 Data Program

AGENCY: Federal Communications Commission.

ACTION: Proposed rule.

SUMMARY: In this document, the Federal Communications Commission (Commission) adopts a Report and Order and Second Further Notice of Proposed Rulemaking (*Second FNPRM*). This document seeks comment on certain aspects of the Digital Opportunity Data Collection to enhance its accuracy and usefulness. The *Second FNPRM* seeks comment on ways to develop location-specific data that could be used in conjunction with the polygon-based data in the new collection to precisely identify the homes and small businesses that have and do not have access to broadband services. With respect to mobile wireless coverage, the *Second FNPRM* seeks comment on how to align the Digital Opportunity Data Collection with changes in mobile broadband deployment technology, markets, and policy needs. The *Second FNPRM* also seeks comment on how to improve satellite broadband deployment data given the unique characteristics of satellites.

DATES: For the *Second FNPRM* comments are due on or before September 23, 2019, and reply comments are due on or before October 7, 2019. Written comments on the Paperwork Reduction Act information collection requirements must be submitted by the public, OMB, and other interested parties on or before October 21, 2019.

ADDRESSES: In addition to filing comments with the Commission's Office of the Secretary, as set forth below, a copy of any comments on the Paperwork Reduction Act information collection requirements contained herein should be submitted to the Commission via email to *PRA@fcc.gov* and to Nicole Ongele, FCC, via email to *Nicole.Ongele@fcc.gov.*

FOR FURTHER INFORMATION CONTACT: Wireline Competition Bureau, Kirk Burgee, at (202) 418–1599, *Kirk.Burgee@fcc.gov,* or, Wireless Telecommunications Bureau, Garnet Hanly, at (202) 418–0995, *Garnet.Hanly@fcc.gov.* For additional information concerning the Paperwork Reduction Act information collection requirements contained in this document, send an email to *PRA@fcc.gov* or contact Nicole Ongele at (202) 418–2991.

SUPPLEMENTARY INFORMATION: This is a summary of the Commission's *Report and Order and Second Further Notice of Proposed Rulemaking* in WC Docket Nos. 11–10 and 19–195, FCC 19–79, adopted August 1, 2019 and released August 6, 2019. The full text of this document is available for public inspection during regular business hours in the FCC Reference Information Center, Portals II, 445 12th Street SW, Room CY–A257, Washington, DC 20554. It also is available on the Commission's website at *https://www.fcc.gov/document/fcc-improves-broadband-mapping-0.*

Pursuant to sections 1.415 and 1.419 of the Commission's rules, 47 CFR 1.415, 1.419, interested parties may file comments and reply comments in response to the *Second FNPRM* on or before the dates indicated on the first page of this document. Comments may be filed using the Commission's Electronic Filing System (ECFS). *See Electronic Filing of Documents in Rulemaking Proceedings,* 63 FR 24121 (1998).

- *Electronic Filers:* Comments may be filed electronically using the internet by accessing the ECFS: *https://www.fcc.gov/ecfs/.*
- *Paper Filers:* Parties who choose to file by paper must file an original and one copy of each filing. If more than one docket or rulemaking number appears in the caption of this proceeding, filers

must submit two additional copies for each additional docket or rulemaking number. Filings can be sent by hand or messenger delivery, by commercial overnight courier, or by first-class or overnight U.S. Postal Service mail. All filings must be addressed to the Commission's Secretary, Office of the Secretary, Federal Communications Commission. All hand-delivered or messenger-delivered paper filings for the Commission's Secretary must be delivered to FCC Headquarters at 445 12th St. SW, Room TW–A325, Washington, DC 20554. The filing hours are 8:00 a.m. to 7:00 p.m. All hand deliveries must be held together with rubber bands or fasteners. Any envelopes and boxes must be disposed of *before* entering the building. Commercial overnight mail (other than U.S. Postal Service Express Mail and Priority Mail) must be sent to 9050 Junction Drive, Annapolis Junction, MD 20701. U.S. Postal Service first-class, Express, and Priority mail must be addressed to 445 12th Street SW, Washington, DC 20554.

▪ *People With Disabilities:* To request materials in accessible formats for people with disabilities (Braille, large print, electronic files, audio format), send an email to *fcc504@fcc.gov* or call the Consumer & Governmental Affairs Bureau at 202–418–0530 (voice), 202–418–0432 (tty).

Synopsis

I. Introduction

1. Accurate broadband deployment data is critical to the Commission's efforts to bridge the digital divide. Effectively targeting federal and state spending efforts to bring broadband to those areas most in need of it means understanding where broadband is available and where it is not. The census-block level fixed broadband service availability reporting the Commission currently requires has been an effective tool for helping the Commission target universal service support to the least-served areas of the country, but has made it difficult for the Commission to direct funding to the ''gaps'' in broadband coverage—those areas where some, but not all, homes and businesses have access to modern communications services.

2. We therefore initiate a new data collection, the Digital Opportunity Data Collection, that is distinct from the existing Form 477 collection and that will gather geospatial broadband service availability data specifically targeted toward advancing our universal service goals. Pursuant to the Digital Opportunity Data Collection, we require all broadband service providers to submit granular maps of the areas where they have broadband-capable networks and make service available. Given the Commission's ongoing investigation into the coverage maps of one or more major mobile operators, we limit the new data collection obligations to fixed broadband providers at present and seek comment on how best to incorporate mobile wireless coverage data into the Digital Opportunity Data Collection.

3. Service providers—who are uniquely situated to know where their own networks are deployed—must determine in the first instance the availability of broadband in their service areas, taking into account their individual circumstances and their on-the-ground knowledge and experience. At the same time, to complement this granular broadband availability data, we adopt a process to begin collecting public input, sometimes known as ''crowdsourcing,'' on the accuracy of service providers' broadband deployment data. Through this new tool, State, local, and Tribal governmental entities and members of the public will be able to submit fixed broadband availability data, leveraging their experience concerning service availability. In addition, because we leave in place for now the existing Form 477 data collection, we make targeted changes to reduce reporting burdens for all providers by removing and clarifying certain requirements and modifying the collection.

4. In the *Second FNPRM,* we seek comment on certain aspects of the Digital Opportunity Data Collection to enhance the accuracy and usefulness of broadband deployment reporting. We also seek comment on ways that we can develop location-specific data that could be overlaid onto the polygon-based data in this new data collection to precisely identify the homes and small businesses that have and do not have access to broadband services. With respect to mobile wireless coverage, we seek comment on how to align the Digital Opportunity Data Collection with changes in mobile broadband deployment technology, markets, and policy needs. The questions asked, and proposals made, in the *Second FNPRM* build a framework for addressing these and other issues. Finally, the *Second FNPRM* seeks comment on how we can improve the satellite broadband deployment data given the unique characteristics of satellites.

II. Background

5. First established in 2000, the Commission's Form 477 began as a collection of subscription and connection data for local telephone and broadband services that helped the Commission to, among other things, meet statutory annual reporting obligations and monitor local voice competition. Over time, the Form 477 data collection has evolved into the primary data source for many Commission actions, including reporting to Congress and the public about the availability of broadband services, informing transaction reviews, and supporting our universal service policies. At the same time, it has become increasingly clear that the fixed and mobile broadband deployment data collected on the Form 477 are not sufficient to understanding where universal service support should be targeted and supporting the imperative of our broadband-deployment policy goals.

6. For purposes of broadband deployment reporting, the Commission currently requires fixed providers to report the census blocks in which their broadband service is available. Fixed broadband connections are available in a census block ''if the provider does, or could, within a service interval that is typical for that kind of connection—that is, without an extraordinary commitment of resources—provision two-way data transmission to and from the internet with *advertised* speeds exceeding 200 kbps in at least one direction to *end-user premises* in the census block.'' However, census-block based fixed deployment data have limitations—providers report whether or not fixed broadband service is available in at least some part of each census block, but not whether there is availability at all areas within a block.

7. Providers of fixed voice and broadband service report on their end-user subscriptions by submitting the total number of connections in each census tract in which they provide service. Providers of mobile voice and broadband service report their total subscribers for each state in which they provide service to customers. Facilities-based providers of mobile broadband service report on deployment by submitting, for each technology and frequency band employed, polygons in geographic information system (GIS) mapping files that digitally represent the geographic areas in which a customer could expect to receive the minimum speed the service provider advertises for that area. In addition, mobile service providers must report the census tracts in which their service is advertised and available to potential customers.

8. In establishing the Form 477 as its primary vehicle for collecting

information about the deployment of broadband services, the Commission predicted that the data from the Form 477 would ''materially improve'' its ability to develop, evaluate, and revise broadband policy, as well as provide valuable benchmarks for Congress, the Commission, other policymakers, and consumers. In its comments in this proceeding, the National Telecommunications and Information Administration (NTIA) states that its analysts ''routinely refer to the Commission's Form 477 data, including both deployment and subscription data, to help inform policymakers and enhance [its] technical support of broadband infrastructure investment.'' The Commission has used aggregate broadband data reported by providers on Form 477 to, among other things: (1) Meet our statutory obligation to annually report on the state of broadband availability; (2) update our universal service policies and monitor whether our universal service goals are being achieved in a cost-effective manner; (3) meet our public safety obligations; and (4) maintain coverage maps to inform stakeholders, including industry and the public.

9. In an effort to collect and develop better quality, more useful, and more granular broadband deployment data, the Commission adopted the *2017 Data Collection Improvement FNPRM* in August 2017. In the *2017 Data Collection Improvement FNPRM,* the Commission sought comment on: (1) Ways in which the Commission might increase the quality and accuracy of the broadband information we collect; and (2) ways in which the Commission might streamline its broadband reporting requirements and thereby reduce the burdens on filers. The Commission also noted that one of its primary objectives is to ensure that the data collected will be closely aligned with the uses to which they will be put, and sought comment on those uses to inform our analysis. In response, we received a voluminous amount of comments, reply comments, and ex parte presentations with specific recommendations on how best to improve our broadband reporting process.

III. Second Further Notice of Proposed Rulemaking

10. We take steps today in the *Report and Order* to improve our broadband data collection and reporting by directing USAC, under the supervision of OEA, to undertake establishing the online portal for the Digital Opportunity Data Collection, an entirely new collection targeted specifically at identifying unserved areas with greater precision in order to advance our universal service goals. In this *Second FNPRM,* we seek comment on additional issues to continue our ongoing efforts to ensure that the Digital Opportunity Data Collection will evolve to align with changes to technology, markets, and policy needs.

A. Improving Broadband Data

11. Even with public input to improve the quality of the Digital Opportunity Data Collection over time, it is essential that we receive reliable fixed broadband availability data from filers of this new collection at the outset. Although we are cognizant of the potential burdens that greater precision in reporting can entail, commenters have indicated in the record that the approach we adopt today—to collect coverage polygons of fixed-broadband service availability—will allow providers to submit more precise data with reasonable burdens. Nonetheless, we seek comment on steps the Commission can take to improve the quality of fixed broadband coverage polygons while minimizing the associated reporting burdens.

1. Additional Technical Standards for Fixed Broadband Reporting

12. As part of the Digital Opportunity Data Collection, the Commission is directing OEA to provide guidance to fixed providers regarding how to develop the polygons depicting fixed broadband coverage. Connected Nation expresses concern that small service providers in particular will struggle to comply with the new reporting requirements in the Digital Opportunity Data Collection unless they get assistance in creating their broadband coverage polygons. In the *Report and Order,* we identify help-desk support and clear instructions as ways we will assist fixed broadband providers with meeting the new filing obligations. We seek comment on what other steps the Commission and USAC can take to help fixed providers file accurate data as part of the new collection.

13. We seek comment on whether Commission staff should prescribe rules for reporting fixed wired broadband deployment that will provide consistently reliable results for similarly-situated filers? For example, should we establish fixed buffers around network facilities to define coverage for specific fixed technologies (*e.g.,* 200-meter buffers around the location of distribution or coaxial plant)? Would this promote consistency and reliability among submissions? We note that applying such buffers or other constraints may foreclose consideration of individual network characteristics. Are there ways to mitigate or address this risk? What other methodologies for developing polygons should we permit fixed providers to use? For example, would polygons based on homes passed or addresses served by the fixed provider produce equally reliable polygons? How much flexibility should we afford fixed providers in selecting a methodology to creating broadband coverage polygons? Would any globally-applied constraint be too likely to over- or under-state service availability? How should broadband coverage polygons account for transport capacity? That is, how should we ensure that fixed providers are capable of serving every location covered by a polygon? We recognize that determining the area served by a broadband network is highly idiosyncratic and determined by multiple factors. For example, different companies might take different approaches in the same circumstance, while a single company might take a different approach in different markets depending on the level of local government regulation (*e.g.,* local franchise agreements that include build-out requirements). In addition, coverage can depend on very local conditions like access to rights-of-way along one route and not another or the ability to serve the edge of franchise or service areas. With the end goal of creating a single cohesive dataset and map representation of where coverage is and is not located, what measures, methods, and mechanisms should be implemented to ensure the greatest interoperability and least post-processing of the submitted data?

14. We also seek comment on establishing standards for reporting coverage polygons for terrestrial fixed wireless broadband service. In the *2017 Data Collection Improvement FNPRM,* the Commission sought comment on setting standards for mobile coverage polygons. Separately, it adopted a set of standards for determining mobile coverage using a propagation model for the Mobility Fund Phase-II (MF–II) LTE data collection. If the Commission adopts standards for reporting mobile broadband deployment, should we require terrestrial-fixed wireless providers to report broadband deployment using similar standards? Are there fundamental differences between fixed wireless and mobile technologies that would caution against using mobile wireless standards for fixed wireless deployment reporting (*e.g.,* fixed wireless use of fixed, high-powered antennas that could result in a different link budget than for mobile

service, or the use of unlicensed spectrum by some fixed wireless providers)? If so, would it be appropriate to adopt different standards (*e.g.,* probability of cell-edge throughput) or parameters (*e.g.,* a different utilization rate for unlicensed spectrum) for fixed wireless? Further, what factors should Commission staff consider to independently validate the fixed wireless mapping methodology (*e.g.,* cell-site and receive-site engineering and technical details and locations, RF propagation characteristics, signal strength)?

15. We also seek comment on whether fixed broadband providers should include latency levels along with the other parameters in reporting their coverage polygons. Latency is the time it takes for a data packet to travel across a network from one point on the network to another. The Commission considers latency levels as relevant in the provision of universal service support. If latency is to be included in reporting fixed broadband coverage, how should it be included? For instance, how and at what point in the network should the provider measure latency? Would we need to be more specific than how we considered latency in the context of awarding Connect America Fund Phase II support or would the same approach be appropriate?

16. We seek comment on what steps the Commission can or should take to support the production of high-quality data and ways the Commission can provide incentives to improve the quality of the data filed. Are there steps that fixed providers can take to ensure better quality broadband deployment data and, if so, what will the cost of those steps likely be? Does the technology deployed or the size of the fixed provider matter? If so, how? Is there a size or type of fixed provider that will be able to file high-quality data without any additional support or added cost? Are there unique burdens on smaller fixed providers that would not be burdens for larger fixed providers? In general, what will the cost be on the fixed broadband industry to produce reliable deployment data? Also, is there anything that can be done to lessen reporting burdens on all filers as part of the new collection, especially ways to harmonize filing procedures and requirements from other collections to reduce duplication of efforts? In addition, are there other relevant data that we should gather as part of a new collection of broadband deployment data?

17. We emphasize that the introduction of crowdsourced data does not alleviate a fixed provider's obligation to conduct thorough assessments of service availability before submitting broadband deployment data. We propose to use a variety of methods, including audits and statistical analyses, to confirm that the fixed broadband deployment data submitted by providers are accurate. Put simply, if a location falls within the coverage polygon submitted by a fixed provider, then it must either already receive fixed broadband service or be capable of receiving such service within ten business days and without extraordinary expense. We seek comment on the best method (or mix of methods) to ensure the submission of accurate fixed broadband deployment data, including the plans that USAC must develop for corroborating and spot-checking data submitted by fixed providers. What penalties would be appropriate upon a finding of inaccurate data and should there be more severe penalties for chronic filers of bad data? Should the Commission treat differently those coverage polygons submitted by providers that have a certain number of public filings disputing their accuracy? Is there an appropriate threshold or methodology to identify unreliable filings that should be treated differently, and if so, how should the Commission treat those filings? ACA argues that providers should not be sanctioned for submitting inaccurate data ''unless there is clear evidence the provider intentionally and persistently did so.'' We seek comment on this approach, as well as how to handle situations in which the filer is negligent (but not intentional) in submitting inaccurate data.

18. The Digital Opportunity Data Collection will significantly improve our understanding of broadband deployment, and we want to ensure that its value is fully realized by the Commission, stakeholders, and ratepayers. We therefore seek comment on additional measures we can adopt to meet this objective. Can the maps and datasets derived from the Digital Opportunity Data Collection be used in connection with the other universal service programs, in particular E-Rate and Rural Health Care, to the extent they provide support for infrastructure build-out, to promote efficiency, minimize waste, and help avoid duplicative funding within the Fund? If so, how? Should we combine the Digital Opportunity Data Collection datasets with other datasets, for example, locations where funding has been committed in Commission and other federal agency programs, even where deployment may not have occurred? We believe that the Digital Opportunity Data Collection represents a unique opportunity for integrating related but distinct data resources to produce a unified picture of broadband data. What data would be appropriate to include in this effort and how can it be used most effectively? What other issues should we consider as we evaluate this possibility?

19. *Improving Satellite Broadband Data.* We seek comment on how, for purposes of the Digital Opportunity Data Collection, we can improve upon the existing satellite broadband data collection to reflect more accurately current satellite broadband service availability. The Commission has recognized there are issues with the quality of the satellite broadband data that are currently reported under the existing Form 477. For instance, according to currently reported data, satellite service offering 25 Mbps/3 Mbps speeds is available to all but 0.03% of the U.S. population. However, while satellite signal coverage may enable operators to offer services to wide swaths of the country, overall satellite capacity may limit the number of consumers that can actually subscribe to satellite service at any one time. Given that the coverage geographies reported by satellite providers based on satellite beams are likely to remain larger than those reported by terrestrial fixed providers based on their network facilities, we seek comment generally on how to improve the satellite broadband data reported in the new data collection. Geostationary orbit (GSO) satellites are unique in that they have the relatively large beam coverage area over which service is provided, have inherent flexibility in using wide-area beams and spot beams, and face relative difficulty in adding new capacity. For instance, given these characteristics of GSO satellite service, should the Commission require GSO satellite providers to report network capacity as well? Would additional information, including the number and location of satellite beams, the capacity used to provide service by individual satellite to consumers at various speeds, and the number of subscribers served at those levels, improve the quality and usefulness of the satellite broadband availability data?

20. We also seek comment on whether we could rely on other data to improve the reliability of the satellite broadband availability data reported in the new data collection. For example, would examining the presence of existing subscribers provide greater insight into where satellite broadband service is available than does satellite beam

coverage data alone? Could we meaningfully validate a satellite provider's availability data based on the presence of subscribers above a *de minimis* level in the census tract in which the census block is located? For instance, should we use an absolute number and/or percentage of households or subscribers in a census tract? We seek comment on these methods and any other analysis to obtain a more meaningful representation of the deployment of satellite capacity in a geographic area.

21. We also seek comment on whether there are any other limitations that we should place on the reporting of fixed satellite broadband service. Current fixed satellite broadband service relies on GSO satellites, and customers' satellite earth stations therefore need a clear view of the southern sky to connect to such services. Should satellite broadband providers that rely on GSO satellites exclude from their reported coverage polygons any area where terrain blocks a clear view of their satellites (*i.e.,* where it is not physically possible to deliver the service)? We note that the Commission has recently authorized several non-geostationary satellite constellations (NGSOs) that contemplate providing low-earth-orbit, low latency satellite broadband services in the future. What issues should be addressed for these satellite services in the new data collection as they begin to be offered?

2. Use of Crowdsourcing

22. In the *Report and Order,* the Commission directs USAC to begin collecting information from state governments, including state public utility commissions, and local and Tribal governmental entities, as well as members of the public, about the accuracy of the coverage polygons gathered from fixed providers and to make certain data publicly available. In this section, we seek comment about steps the Commission and USAC can take to make the best use of such data to improve the quality of the service-availability dataset going forward.

23. At a high level, we propose that USAC track coverage disputes, follow-up with providers to ascertain whether there is agreement that there is a problem with the data and ensure that providers refile updated and corrected data in a timely fashion. We propose that USAC create a system to track complaints about the accuracy of fixed broadband coverage polygons. This functionality could be similar to the Commission's existing consumer-complaints database. Having a tracking system would allow USAC to pass the complaints along to the appropriate provider and track whether the person filing the complaint received a response. In instances where the provider agrees that its original filing was in error, USAC could track the error and ensure that the provider corrects its data. Alternatively, USAC could simply publish the complaints it receives and require providers to periodically check complaints about their filings. Is this a reasonable burden to place on providers? How could USAC efficiently track which of the complaints should be and ultimately are addressed through data corrections?

24. We also seek comment on the appropriate time period (if any) for fixed providers to respond to a complaint. ACA argues that it would be ''onerous if a smaller provider had to respond immediately to each and every submission from an individual or government entity'' and recommends that small providers be allowed to account for any inaccurate data at its next Digital Opportunity Data Collection filing. Connected Nation recommends that there be ''a cyclical, scheduled feedback process in which there are defined windows for receiving feedback, analyzing and validating feedback, and updating the map after feedback has been adjudicated.'' We seek comment on the best approach to timing for the crowdsourcing process, not only for small providers but for all filers.

25. We propose to have USAC collect the following data from entities disputing coverage: The address of the location at which coverage is disputed and/or its coordinates (latitude and longitude); the fixed provider whose service coverage is in dispute; the download and upload speeds available for subscription; the technology reported at that location by the provider; and contact information from the submitting party (email address and/or phone number). Are these types of data appropriate for this collection and are there other types of data USAC should ask for to make this collection an effective tool for USAC, the Commission, industry, and the public? We also propose to require that individuals disputing coverage certify that they have requested service from the provider and that the provider either refused, or failed, to provide service within the applicable 10-business day period. Would this establish a reasonable threshold for disputing coverage? Are there other requirements we could establish to ensure that disputes raise a valid question about coverage in individual locations? How should we handle disputes that do not meet these criteria (such as those admitting availability but alleging that a service falls short of expectations based on service provider's reported coverage)? Would it be helpful to gather information about nearby areas where service is available (if the individual knows)?

26. The Commission has noted that overall broadband deployment in Indian country remains significantly behind deployment on non-Tribal lands due to several long-recognized barriers to broadband deployment on Tribal lands. Given these additional challenges, we recognize the importance of Tribal participation in the Digital Opportunity Data Collection's public feedback mechanism. We seek comment on how best to incorporate input of Tribal governments on broadband coverage maps, given the special importance of collecting accurate and complete broadband availability information for Tribal lands. For example, we propose to have USAC or Commission staff conduct outreach directly with Tribal governments to facilitate their involvement in the dispute process and to provide technical assistance to them as needed. We seek comment on these proposals and how we could implement them most effectively. We also seek comment on any additional issues specific to Tribal governments that we should take into account in connection with any disputes concerning coverage data. Finally, we seek comment on whether we should expand these proposals to include other Tribal entities, such as inter-Tribal organizations.

27. We seek comment about how quickly fixed providers should be required to correct any data where they do not refute the alleged lack of coverage. Should USAC require that fixed providers either establish coverage or file updated coverage polygons within a specific number of days following submission of an uncontested dispute? If so, what number of days would provide a reasonable balance between the burden placed on fixed providers and the need for policy-makers to have the most accurate data possible? On the other hand, would it be overly burdensome for fixed providers to re-file data addressing each individual error, particularly if the provider's coverage is the subject of multiple pending complaints? Should USAC allow for fixed providers to batch any corrections into weekly or monthly updates, as needed? How can USAC balance the need for corrected data against provider burden? We note that NCTA proposes that fixed providers would correct the data in the next filing opportunity, which could leave the

original data possibly in place for many months even after an agreement that the original filing was in error. Is that approach reasonable?

28. When the public files a complaint about the fixed broadband coverage polygons, there is a time lag between the date of the filing under the new collection and the date that the complaint is filed. We believe there are only very limited circumstances in which a provider would have previously had broadband service of a given quality (technology, upload speed and download speed) but removed it (*e.g.,* copper retirement). Thus, if there is a complaint that the fixed broadband coverage polygons are incorrect, we believe it is likely that the data are incorrect for earlier time periods as well. Is this a reasonable assumption and should we require providers to resubmit all earlier datasets for the affected areas to conform to any corrections? Doing so would provide a more accurate view on the evolution of service-availability coverage over time. On the other hand, it will also involve a greater burden for providers. In addition, it is unclear whether the time-series data would be useful in targeting USF support. We seek comment on the relative benefit (better time series data) compared to the provider burden.

29. We also seek comment on what standards and processes the Commission should establish to govern the resolution of cases in which providers and the stakeholders disagree about whether the broadband coverage polygons are correct—that is, whether service is actually available at a given location. NTCA argues that crowdsourced reports should not be treated the same as general consumer complaints, requiring a provider response in all cases. NTCA suggests that providers should be required to respond to reports or adjust their maps only in situations where ''material trends develop in vetted information that indicate a systemic problem with a provider's reporting in a given area.'' Are these reasonable approaches? What dispute resolution process would be appropriate? Providers should have a period of time within which to refute any complaint and, in the absence of a timely and compelling response, USAC could require the fixed provider to submit a coverage polygon that excludes the disputed location. What types of evidence would be appropriate for providers to submit? What framework should the Commission establish to ensure that USAC reliably and efficiently adjudicates conflicting claims in such circumstances? What evidentiary standard should the Commission establish to resolve such disputes: Preponderance of evidence, clear and convincing evidence, or another standard? In situations indicating pervasive reporting errors, bad faith, or a refusal to refile a coverage polygon that has been found to contain an inaccurate location, USAC could take additional steps, such as referring the matter to the FCC for enforcement action. What remedies would be appropriate in such an enforcement action? If one possibility were monetary forfeitures, what would be an appropriate base forfeiture amount and what would be appropriate increments in the case of repeated or more egregious violations? Are there other approaches the Commission should take to areas where there is disagreement?

30. We believe there could be instances of dispute between a member of the public filing a complaint and a fixed provider where both parties can credibly claim that they are correct. For example, a consumer may find a fixed provider is not available in its building because the building owner is not allowing that provider entry into the building. If the excluded provider could meet the service-reporting requirements (*e.g.,* with respect to time to service), should the Commission consider such a location as served by that provider or not? Would it be beneficial to identify, as part of any tracking process for public feedback on the data collection, instances where a provider is willing and able to provide service but is not able to do so due to circumstances beyond its control? Would USAC need to verify or validate such claims and, if so, how? Or, in the alternative, should the Commission require that providers remove from the coverage polygons they file small areas to represent those buildings in which they are prohibited from offering service for any reason?

31. Finally, we seek comment on whether the Commission should direct USAC to accept the upload of bulk complaints data. We want to avoid bad-faith or malicious challenges to coverage data, such as a dispute to every address in a fixed provider's footprint via an automated tool or bot. In order for this tool to be effective, it is essential that we safeguard the integrity of the data submitted through it. On the other hand, we can see there could be value in allowing Tribal, local, or state governments to provide data in bulk where they have already investigated and so want to consider whether and how to permit USAC to allow for the collection of bulk data. Would establishing a certification requirement, similar to what we have proposed for individuals, help to ensure the validity of bulk challenge data?

32. To address these issues, should the Commission limit permissible bulk filings to certain authenticated users, such as states or state commissions, local governments, and Tribal entities? If so, how should it approach authentication? What entities should be entitled to become authenticated users—for example, should the Commission limit it to just state government entities? Are there parts of state governments, like public-utility commissions, or mapping or broadband offices, that would be more likely to provide meaningful input? Should USAC track and resolve disputes involving bulk complaints in the same manner as individual complaints? Or, in the alternative, should USAC accept complaints as accurate and shift the burden of proof onto providers to submit convincing data to refute the crowdsourced data? We seek comment on these issues.

3. Incorporating Location Information Into the Digital Opportunity Data Collection

33. In the accompanying *Report and Order,* we adopt the reporting of coverage polygons for fixed-broadband services, a step that will result in more precise deployment data. Parties have correctly pointed out, however, that simply knowing what parts of a census block lack broadband service does not provide enough information by itself to identify the specific locations within that census block that lack fixed broadband availability. We agree that there are likely benefits to incorporating nationwide location data into the Digital Opportunity Data Collection and we propose to adopt such an approach, informed by comments on how USAC can collect and incorporate such data. What data does USAC need and how could it get access to them? We believe that broadband coverage polygons submitted by service providers could be overlaid on nationwide location data in order to precisely identify the homes and small businesses that have and do not have access to broadband services, and seek comment on this view.

34. We note that the first step in incorporating location data is to establish a process where all broadband-serviceable locations (*e.g.,* houses, businesses, structures) are mapped using a single methodology, providing a harmonized reference point for fixed broadband reporting. Toward that end, the Broadband Mapping Coalition is in the process of testing a ''Broadband Serviceable Location Fabric'' to demonstrate the viability of a location-

based proposal. The Broadband Mapping Coalition's testing represents a concrete effort to identify the issues facing USAC in moving to a location-based collection.

35. We propose to create and integrate a broadband-serviceable location tool into the Digital Opportunity Data Collection. As an initial matter, we seek comment on Alexicon's claim that a broad definition of location lowers both the reporting burden for providers and the underlying cost of identifying locations. We also seek comment on what kinds of locations we should include as broadband-serviceable. For example, we could designate a parcel as the definition of a location on the theory that a fixed provider that offers service to one part of the parcel would be willing to serve anywhere on that parcel. We seek comment on how to define the location of a parcel (*e.g.,* as the centroid of a parcel or as the location of a building on a parcel). Alternatively, we could determine that a broadband addressable location should be defined as a building. The Broadband Mapping Coalition work has shown that it is generally possible to identify individual buildings as locations. We note, however, that there can be multiple buildings on a parcel and question whether it would be advisable to treat each of those buildings as a distinct location. We believe a provider is likely to run a single connection (drop) from its network to, for example, a farm, rather than individual connections to all of the structures on the parcel (*e.g.,* the farmhouse and each garage, barn, chicken coop, storage shed, etc.). We seek comment on alternatives for defining a broadband-serviceable location.

36. Should we decide that, for residential users, the location would be the individual housing unit? For residential Multi-Tenant Environments (*e.g.,* apartment buildings), this could mean treating each individual apartment or unit as a separate broadband-serviceable location. We do not believe this approach is appropriate for determining fixed broadband coverage in a Multi-Tenant Environment—fixed providers likely would not offer service only to some units in a Multi-Tenant Environment. Additionally, we are concerned that the added complexity—far more locations and the need to differentiate not just latitude and longitude, but also potentially altitude—would outweigh any benefits. We seek comment on this assumption.

37. With regard to defining a location, we propose to have the database record a single point, defined by latitude and longitude, for that location. We anticipate that this would be the coordinates of a building on a parcel. We believe that recording each location as a single point has an advantage over reporting the outlines of each building (*i.e.,* a polygon for each location), the latter of which will increase the difficulty of creating the database and the amount of data required, without meaningfully improving the quality of the database. We seek comment on this approach.

38. We also seek comment on how we would approach the quality of such a broadband-serviceable location database. We note that there are different types of errors possible in such a database, for example incorrectly counting a structure that does not need a broadband connection as a broadband-serviceable location, such as an abandoned house or a shed. Including such locations might lead us to mistakenly direct USF support to a location that does not need broadband service. Another type of error could be to exclude locations that should be included, such as a home in a heavily forested area that does not appear on satellite imagery. Such missed locations would not appear in the data collection at all and could be excluded from any USF support. Finally, there also could be errors about the characteristics of a location, for example, designating a residential location as a business or identifying the wrong building from among several on a given property. We seek comment on how best to account for these and other possible challenges in building an accurate location-based database.

39. We note that there are a limited number of data sources against which USAC could check such a dataset. The U.S. Census Bureau publishes block-level data, including the number of housing units, but only every ten years and Census data do not generally include business locations. We seek comment on whether the less granular county-level housing estimates the Census publishes yearly could be used as a data source for dataset verification. Furthermore, if we define a location as a parcel or building (rather than a housing unit), we would not expect the counts to match the Census data. The National Address Database and Open Address Database each provide a list of addresses and point locations for areas where they have coverage. Neither is a complete nationwide dataset, though they could be useful for checking areas where they have data. Each of these datasets has challenges, however. For example, the data in the National Address Database do not appear to be updated on a regular schedule and often have multiple points for a given address (*e.g.,* from state, county and local government), making it hard to get a count of points in a given area. We seek comment on whether or how we can make use of such data sources. We also seek input on whether there are other sources we should be aware of that could be useful as a check of a broadband-addressable location database.

40. As an alternative, we could take a statistically valid sample of the data points as a way to keep the database updated and accurate. We seek comment on how to stratify such a sample (are there distinct categories in the data—urban, suburban, rural, residential, business, Tribal, non-Tribal—that warrant distinct samples?). We also seek comment about how to evaluate the quality of the sampled data. Is it sufficient to look at satellite imagery or would we need to inspect locations in person?

41. In addition, the Commission must consider the level of quality that it seeks to attain in using any database. How should the Commission consider the trade-off between the time to improve the database's accuracy against the risks posed by any inaccuracies in the data? Would any of these approaches or sources identified above, or others, be helpful in determining particular types of errors in the location database? Should we incorporate public feedback, as we are doing with regard to broadband service availability polygons, in order to improve the accuracy of such a broadband-serviceable location database? And if so, how should we incorporate that data effectively?

42. With regard to the Broadband Mapping Coalition's proposal to integrate location data into the Digital Opportunity Data Collection, we seek comment on the use of two distinct data products used by the Broadband Mapping Coalition: a database of broadband-serviceable locations and a ''lookup'' tool for integrating provider addresses data into the locations database. We seek comment on whether the lookup tool would be necessary given our adoption of availability-map reporting in the accompanying *Report and Order.* In other words, if fixed providers have invested the resources to create accurate polygons that depict the areas where their service is available, is an address-based lookup necessary at all? In the event such a lookup is necessary, should USAC be responsible for creating that lookup? And if USAC does develop a lookup, how can it ensure its accuracy? The Broadband

Mapping Coalition has noted that there are reliability problems with geocoders, particularly in rural areas. What steps can USAC take to ensure that this lookup avoids some of the pitfalls the Broadband Mapping Coalition has observed? For example, matching a provider's address data to the Broadband Mapping Coalition's address data might require matching several data fields, such as the street number and name, any prefix or suffix, the city or town, state, and zip code, each with substantial possible variations. Should USAC accept only strict matches in order to avoid making mistakes, such as suggesting that a provider offers service in a location where it does not because of a too-loose matching approach? Is the risk greater of accepting low-quality matches, that is, identifying that service is available when it is not, or in rejecting too many matches for failing to meet quality criteria, potentially understating providers' reach? If USAC is matching only a relatively small fraction of provider addresses to the Broadband Mapping Coalition's database, should it be USAC's responsibility to improve the lookup or the providers' responsibility to improve their source data?

43. The Broadband Mapping Coalition pilot also raises several methodological and technical questions. For example, the Broadband Mapping Coalition chose which data sources to use, including negotiating the data rights associated with those sources; the fields from those data sources used to help make determinations about what constitutes a location in the database; and the logic used. For purposes of its pilot program, the Broadband Mapping Coalition also established, for example, a method for determining if a single structure that spans multiple parcels is a row house that should be split into multiple locations and how to choose which building location to use as part of the database, when there are multiple buildings on a parcel, or whether there are certain circumstances when one might have more than one building, such as in a trailer park. Are there determinations made by the Broadband Mapping Coalition as part of its pilot that the Commission should approach differently?

44. We also seek comment on whether, when, and how, after establishing a location-based fabric, USAC should implement incorporating the fabric into the Digital Opportunity Data Collection. We seek comment on USTelecom's proposal that the creation of a location-based fabric run in parallel with the establishment of the online portal for our polygon-based approach. Is this a reasonable approach or would it be more reasonable to adopt a different transition time for implementation? Will collecting locations for use as part of the Digital Opportunity Data Collection impose additional burdens on filers, especially smaller providers, and (if so) would such burdens be outweighed by the benefits of using locations as part of the new collection? In addition, ACA argues that fixed providers not accepting Universal Service support should not be required to ''publicly disclose individual location information since such information is considered to be competitively-sensitive.'' We seek comment on ACA's proposal.

45. In addition, we seek comment on the extent to which any location-based database should be fully accessible by the public. Should the full dataset be made available to the public or just the aggregate results from the filings? To what extent should such location information be shared with all providers? Would full disclosure aid the Commission and USAC in gathering location-specific information from the public? Would securing such rights lead to higher costs for the Commission than for the Broadband Mapping Coalition? Are there some data sources or fields that should not be made public? Should members of the public be granted access to the actual database? Should there be restrictions on who should be granted such access (*e.g.,* governmental entities, other providers)? We seek comment on these issues.

B. Improving Mobile Broadband and Voice Data

46. We seek comment on incorporating mobile wireless voice and broadband coverage into the Digital Opportunity Data Collection and what additional steps the Commission should take to obtain more accurate and reliable mobile broadband deployment data. Obtaining accurate mobile broadband deployment data is challenging because measuring performance on mobile broadband networks is inherently variable even though coverage is generally reliable. Mobile network speed at a particular location and the coverage area of any specific cell site can vary depending on a wide variety of factors, including: (1) The spectrum band employed; (2) cell traffic loading and network capacity in different locations; (3) the availability and quality of cell site backhaul; (4) the capability of consumers' devices; (5) whether a consumer is using a device indoors or outdoors; (6) terrain and the presence of obstacles between a consumer's device and the provider's nearest cell site (*e.g.,* buildings, trees, and other local structures); and (7) weather conditions. This inherent variability has two dimensions—temporal and spatial. For example, a consumer's handset may not receive a strong enough signal at a given location to maintain a reliable broadband speed, or the network may be overloaded at one moment, and then suddenly acquire a signal strong enough, or the network traffic load lightens enough, to maintain a connection at speeds of 5 Mbps or more. This makes the measurement of mobile broadband service at any specific location complex, as many factors can affect a user's experience, making it difficult to develop a coverage map that provides the exact mobile coverage and speed that a consumer experiences. Although no mobile broadband map will consistently reflect consumer experience with complete accuracy, wireless service providers must improve the quality of the data they submit.

47. *Standardized Predictive Propagation Maps.* In the *2017 Data Collection Improvement FNPRM,* the Commission sought comment on requiring the submission of coverage maps generated by propagation modeling software using standardized parameters for 4G LTE and later-generation technologies. It also sought comment on whether to specify possible eligible models and to standardize to some extent the output of those models and certain input parameters, with the goal of allowing more meaningful comparisons among providers' mobile broadband deployment. The Commission asked, for instance, whether it should require deployment maps to represent coverage at median speeds as well as speeds at the cell edge and, if so, how it should determine those speeds. The Commission inquired about a range of potential input parameters, including: (1) The location of cells in decimal degrees latitude and longitude; (2) channel bandwidth in megahertz; (3) signal strength; (4) signal quality with signal to noise ratio; (5) cell loading factors; and (6) terrain provided at a minimum resolution of three arc-seconds.

48. In response to the *2017 Data Collection Improvement FNPRM,* several commenters expressed support for requiring providers to submit coverage maps based on standardized technical parameters. AT&T, for example, recommended requiring parameters ''with a standard cell edge probability of attaining specific download speeds for each technology (3G/4G, 4G LTE and 5G),'' and a ''standard cell loading factor based on the geographic service area (*e.g.,* 30% for rural areas; 50% for

urban/suburban areas).'' AT&T further argued that the reporting of other parameters, such as signal strength and clutter factors, was unnecessary. The City of New York supported standardized parameters for median and edge speeds and stated that a median download speed of 10 Mbps with an edge speed of 3 Mbps ''may be sufficient for current 4G LTE deployments, but is unlikely to be sufficient for future-generation deployments.'' Deere & Company commented that propagation models should reflect ''a signal strength of −85 dBm RSSI (Relative Signal Strength Indicator),'' because a signal strength parameter would ''accurately [reveal] where service quality is insufficient.'' Other commenters urged the Commission to adopt the same parameters that it adopted for data collected in the Mobility Fund Phase II (MF–II) proceeding.

49. In 2017, in the MF–II proceeding, the Commission separately instituted a new, one-time collection of data to determine the deployment of 4G LTE for purposes of establishing the areas eligible for universal service support in the MF–II auction. Broadly consistent with an industry consensus proposal, the Commission standardized a number of technical parameters for the data collection to be used for MF–II. In December 2018, the Commission suspended the subsequent phase of the MF–II challenge process, in which providers that filed coverage maps and data regarding their 4G LTE coverage could respond to challenges, and launched an investigation into potential violations of MF–II challenge process rules by one or more major providers. The investigation remains ongoing.

50. We ask commenters to refresh the record on the potential use of RF signal prediction, including the mutual use (by the Commission and stakeholders) of a standardized RF propagation prediction model, and standardized coverage maps for mobile services. We observe that at least one other national regulator is considering a standardized RF propagation prediction method as a basis for verifying geographic coverage. Commenters should specifically discuss their experience in the MF–II proceeding. Do commenters believe that requiring the submission of coverage maps using standardized RF propagation model(s) and parameters was or would be useful in demonstrating mobile broadband coverage? What insights should the Commission draw from the standardized parameters it established in that proceeding? Do commenters view standardized RF signal strength prediction and technical parameters regarding download speed, cell loading, probability of coverage or confidence intervals as sufficient to demonstrate coverage? If not, what additional parameters would generate better data that will allow meaningful comparisons of coverage between providers? Should the Commission, for example, specify an upload speed parameter? Should it specify a standardized signal strength level? Alternatively, should the Commission establish fewer or different parameters? Would 5G technology require different standardized parameters? Given that cell traffic loading and network capacity varies with time and in different locations, how representative of loading do commenters view the 30% loading factor for rural areas established in the context of the MF–II proceeding as compared to standard network loading conditions at various locations? Should we adopt a higher standard loading factor for urban areas? Should we instead require mobile wireless service providers to maintain and report historical cell loading over a given reporting period?

51. Coverage models predict speed and coverage using assumptions that are based on a combination of geographical and network information, including the location of network infrastructure and the power and capacity of network equipment. Although providers continually refine models by adding additional data, the inherent variability of mobile broadband performance will always affect their ability to predict an individual consumer's experience at a particular time and location. We seek commenters' views on how best to specify technical parameters that would account for the variability of mobile broadband performance. Do commenters agree that all parameters must be subject to a specified probability standard or confidence interval? Assuming a probability factor is necessary for describing coverage, do commenters view the 80% probability factor at the cell edge established in the context of the MF–II proceeding as reasonable or would a higher probability parameter such as 90% be more appropriate?

52. *GIS Data Format.* We ask commenters to refresh the record on whether providers should submit coverage maps as vector-formatted or raster-formatted GIS data. In the *2017 Data Collection Improvement FNPRM,* the Commission sought comment on requiring the submission of raster data, noting that because deployment maps are typically developed in raster format and then converted into vector-formatted GIS data, the submission of raster data would appear to be less burdensome for filers than the submission of vector data. The Commission also stated that, unlike vector data, raster data would allow the Commission to ''check the resolution of the submissions and to apply standard parameters, including simplified outputs and smoothing, when converting the rasters to shapefiles for analysis.'' Some commenters supporting such an approach argued that allowing the submission of raster data instead of vector data would help reduce the burdens associated with broadband data collection by allowing providers to skip the step of converting deployment data into vector format. We seek additional comment on whether requiring the submission of raster-formatted rather than vector-formatted data would improve the ability to verify the accuracy of deployment data, and what file format is the least burdensome. Would raster-formatted or vector-formatted data be preferable if the Commission decides to require providers to submit standardized coverage maps? Should the Commission require, or in the alternative, permit filers to submit data using another file format, such as ESRI Geodatabase? Additionally, we seek comment as to what GIS standards, file formats, and technical specifications should be used to facilitate the most efficient and effective collection of data.

53. *Infrastructure Information.* We propose to require that, upon the Commission's request, providers submit infrastructure information sufficient to allow for verification of the accuracy of providers' broadband data. A growing number of parties have suggested that mobile broadband coverage maps are inaccurate and have urged the Commission to implement mechanisms to verify provider data. To date, however, the Commission has not had the information necessary to examine the methodologies used by providers in generating coverage data, or whether these propagation models reflect actual consumer experience. In light of issues raised about the accuracy of coverage maps even after the Commission standardized some technical parameters in the MF–II proceeding, we anticipate that collecting accurate and recent network infrastructure information would be necessary to independently verify providers' data. Therefore, we propose to require that the provider submit, upon Commission request, the following information: (1) The geographic location of cell sites; (2) the height (above ground and sea level), type, and directional orientation of all transmit antennas at each cell site; (3)

operating radiated transmit power of the radio equipment at each cell site; (4) the capacity and type of backhaul used at each cell site; (5) all deployed spectrum bands and channel bandwidth in megahertz; (6) throughput and associated required signal strength and signal to noise ratio; (7) cell loading factors; (8) deployed technologies (*e.g.,* LTE Release 13) and (9) any terrain and land use information used in deriving clutter factors or other losses associated with each cell site. We propose to require that a provider submit its infrastructure information within 30 days of receiving a request from the Commission. We ask for commenters' views on our proposal.

54. At the outset, we recognize that providers may view the infrastructure information we propose to collect as commercially sensitive information and we agree that such information should be treated as highly confidential. We seek comment on this view. Do commenters agree that collecting network infrastructure information would be necessary to verify the accuracy of provider coverage map filings? If not, without such data, what mechanisms are available to validate that providers' coverage maps reflect reasonable predictions of consumer experience? Do commenters view the infrastructure information included in our proposal as sufficient to evaluate providers' mobile coverage and speed claims? If not, we ask commenters to discuss any additional infrastructure information we should require. Alternatively, does our proposal include any information that is not necessary? We seek comment on the potential burden associated with requiring such information, particularly for small providers, and on steps we could take to minimize the potential burden.

55. *Supplement Data Collections with On-The-Ground Data.* In addition to seeking comment on whether to require the submission of coverage maps based on standardized parameters, the *2017 Data Collection Improvement FNPRM* sought comment on whether to require the submission of ''on-the-ground'' data as part of the broadband data collection. The Commission asked whether collecting on-the-ground data from providers, such as drive test data or tests taken from stationary points, would allow it to better evaluate consumer experience. It noted that collection of on-the-ground data could supplement the model-based data, improving the understanding of how the theoretical data relates to actual consumer experience. The Commission asked whether it should require speed test data, how it could impose such a requirement without being unduly burdensome to small providers, and whether providers generate data of this kind during their ordinary course of business.

56. We ask commenters to refresh the record on these questions. In their comments on the *2017 Data Collection Improvement FNPRM,* some commenters supported a requirement that providers supplement their current broadband data with on-the-ground data. Other providers opposed collecting on-the-ground data; they argued that such a requirement would impose unnecessary burdens on providers, especially since the Commission already had access to such information from third-party providers. Some also argued that speed test data generally had limited value given variations in providers' speed test methodologies. What steps could the Commission take to address concerns about the meaningfulness and statistical validity of providers' on-the-ground data? Should the Commission specify the methodology that providers must use to collect and provide on-the-ground mobile network performance data? If so, what parameters should the Commission establish for specific methodologies? Should the Commission consider requiring use of a specific set of measurement equipment or software applications enabling measurement of mobile broadband speeds? What measurement scenarios (*i.e.,* indoor, outdoor, in-vehicle, stationary, mobile, height, etc.) should the Commission specify? To what extent do providers already collect any such data in their ordinary course of business?

57. *Crowdsourced Data.* Consistent with the public feedback mechanism we adopt for fixed providers in the Digital Opportunity Data Collection, we propose to collect similar crowdsourced data for purposes of improving the quality of mobile broadband deployment data and seek comment on how to incorporate such data into data quality analysis. Crowdsourced data are generated by mobile broadband users who voluntarily download speed test apps on their mobile devices. The Commission has used crowdsourced data in assessing service availability and in various Commission reports. For example, in its most recent Broadband Deployment Report, the Commission supplemented Form 477 data with Ookla crowdsourced speed test data in assessing the deployment of advanced telecommunications capability for mobile services. Crowdsourced data can serve as an inexpensive tool to validate speed and coverage claims by providing independent measurements of actual consumer experience on a mobile network across a variety of times and locations. Crowdsourced data have certain limitations, however. For example, speed tests that consumers usually initiate manually and perform only at specific times or places may introduce bias into the data and provide a less accurate picture of overall broadband performance. More generally, the methods by which different speed test apps collect data vary and may not use techniques that control for geographic location, type of device, whether the test is performed indoors or outdoors, and traffic along the network path not controlled by the wireless provider. In addition, there may be a small sample problem with respect to some crowdsourced data, especially in rural areas where there may sometimes be very few speed tests. And, given the probabilistic nature of mobile wireless service in general, we note that crowdsourced data may not indicate an inaccuracy in the data from the coverage map as much as a difference in conditions.

58. We seek comment on developments in crowdsourcing applications and on ways in which the Commission can make greater use of third-party crowdsourced data to create more accurate and reliable mobile broadband maps. While we recognize the potential limitations, we nonetheless believe that crowdsourced data can serve as an important supplement to the information we collect from providers by independently measuring mobile broadband speed and availability. We ask parties to discuss potential sources of crowdsourced data as well as alternatives to crowdsourced data that can provide similar benefits. How should the Commission make greater use of third-party crowdsourced data? How should the Commission determine which data to use, what limitations affect the use of such data, and how can they be resolved? How can we best make use of the Commission's own crowdsourcing application—the Measuring Mobile Broadband speed test? Are there particular areas, such as rural areas, Tribal areas, or urban areas, or situations, such as hours of peak capacity, in which the Measuring Mobile Broadband speed test app would perform particularly well? How else can the FCC's own crowdsourcing application be better used? How can the Commission make greater use of crowdsourced data collected by local, state, or Tribal governmental entities? What steps should the Commission take to ensure that the crowdsourced data it uses are statistically valid and provide

accurate information? How should the Commission handle cases in which crowdsourced data show that service is unavailable in an area where a provider claims broadband availability?

59. *Sampling Methodologies.* We also seek comment on other potential approaches for verifying submitted mobile broadband deployment data. Should the Commission establish a structured sampling process to verify the information it collects from providers? The Commission has used third-party structured sample data to assess service availability in its analysis of the mobile wireless industry. Structured sample data help ensure statistical validity by controlling for the location and time of the tests as well as for the devices used in the test and may be collected using stationary indoor or outdoor tests or drive tests. But structured sample data can be expensive and involve judgments about when and where to run tests. Structured sample data may not include sufficient testing at indoor locations or in rural areas. We seek comment on whether the Commission should expand the use of structured sample data or even establish its own structured sample testing program to verify provider filings regarding mobile broadband coverage and speed? If so, then how can the Commission create a program that will produce a rich and useful dataset?

60. In response to the *2017 Data Collection Improvement FNPRM,* the California PUC supported the Commission's adoption of a structured sample approach. It argued that collecting drive test data at the state level provides ''the most effective measure of actual mobile broadband service speeds.'' It suggested that the Commission designate a defined set of points nationwide and contract with a third party to deliver speed test data from those locations. We seek commenters' views on such an approach. Assuming the Commission establishes its own testing process, how should it design a process that will produce a useful dataset? Should the Commission establish partnerships to collect drive test information? For example, should the Commission explore creating a pilot program with the United States Postal Service or other delivery organization with a nationwide fleet, to gather mobile performance data? Under such an approach, postal trucks could be equipped to collect mobile deployment and speed data as they travel on their routes in rural areas. We seek comment on the feasibility of creating such a program. What other partnerships should the Commission explore?

61. *Drones and Other Testing Technologies.* We seek comment on the use of aerial drone testing, and other technologies, such as satellites, to verify data accuracy, with a particular emphasis on using such technologies to conduct sample audits of provider-submitted mobile deployment data. For example, drone testing, like drive testing, measures signal strength and coverage using various software solutions (*e.g.,* crowdsourcing and network performance applications) loaded onto smartphones mounted to a testing platform. Service providers have begun using drones to measure coverage and signal strength of their networks, demonstrating that drones are a viable mobile network performance testing method. We note that both drive and drone testing have significant limitations due to the inherent probabilistic nature of mobile network performance testing.

62. We seek comment generally on the cost elements of drone and other types of testing technologies and the relative contribution of each element to overall cost. For instance, drones may need fuel or battery replacements more frequently than vehicles used in drive testing platforms. Are these costs significant? How do roadway density, population, weather and natural and man-made terrain features affect the cost of drone testing? How does flight duration affect costs? Are there cost-effective ways to mitigate survey time? What proportion of costs are attributable to the drone operator? What other costs are significant?

63. We also seek comment on unique barriers that may affect the usefulness and practicality of conducting network performance testing using drones and other technologies. USAC recently performed drone and drive tests to measure mobile wireless coverage and quality in Puerto Rico post-hurricanes. USAC's initial analysis shows that drone and drive-tests can provide a comparable picture of network coverage and service quality in a given area, although drone tests are subject to specific variables that the test design should take into account. What specific testing parameters should apply to drone data collection compared to drive testing, satellites, and crowdsourcing to ensure uniform results across methods? Are there any specific technical requirements (*e.g.,* antenna, on-board processing) necessary to ensure uniform results across testing methods? Are there places and/or terrain where specific technologies are either uniquely suited to surveying or, alternatively, currently unable to perform a valid network performance test, regardless of the cost?

64. We seek comment on future technological advances that may increase drone efficiency. Are advanced drone technologies ready and available today, at sufficiently low costs, to use widely? If not, what is a likely timeframe for their widespread adoption? Finally, we seek comment on whether there are other technologies in addition to drones that can be used to measure signal strength and data accuracy.

65. *Availability of Mobile Broadband Deployment Data.* Finally, we seek comment on ways we can make mobile broadband deployment data more available to the public. Currently, the Commission makes available on its website both coverage shapefiles, by provider and technology, as well as the deployment data represented in those shapefiles disaggregated to census blocks, based on two different methodologies. In addition, the Commission has created a limited number of visualizations of the mobile deployment data including a map of nationwide mobile wireless coverage and a map of LTE coverage by number of providers. As the Commission works to improve its data collection, we seek comment on whether we should provide additional visualizations of mobile broadband deployment data. Now that we have determined in the *Report and Order* that, going forward, we will publish nationwide provider-specific coverage maps that depict minimum advertised or expected speed data, what additional maps or other visualizations would help provide useful information to the public? Should we make this data available to the public in any other formats? We seek comment on how the proposals described in this *Second FNPRM* would affect the Commission's ability to provide additional visualizations of mobile broadband data.

66. *Changes to the Collection of Mobile Voice and Broadband Subscription Data.* We seek comment on other changes to improve the collection of subscription data. For example, should we combine the mobile voice and broadband subscription data filing requirements? Consolidating these data could provide a better understanding of the marketplace, as consumers increasingly subscribe to both broadband and voice service. In the current form, providers are required to include subscriptions to mobile broadband plans purchased ''on a standalone basis, as an add-on feature to a voice subscription, or bundled with a voice subscription.'' We propose to require providers to report whether

subscriptions are data only, voice only, or provided as a bundle. These data could provide us with a better understanding of whether and how consumers purchase and use mobile services, in addition to allowing us to continue to track those who only subscribe to voice service.

67. We propose to require facilities-based mobile broadband and/or voice service providers to report whether subscriptions are enterprise, government, wholesale, prepaid retail, or postpaid retail. These data serve an important purpose in understanding the marketplace for mobile services, that aid in competitive analysis, particularly in transaction review. Should we require providers to submit data about Internet of Things (IoT) or Machine-to-Machine (M2M) subscriptions? Do these subscriptions make up enough of the marketplace for mobile services that they should be tracked? Would a combined subscription filing—as opposed to the current separate filings—likely reduce or increase the burden on filers? We also propose to eliminate the requirement to report mobile broadband subscription data by minimum upload and download speed given that this information is already submitted with broadband deployment data.

68. We also seek comment on how best to assign prepaid and reseller subscribers to a particular census tract. CTIA observes that, while place of primary use address is technically feasible for postpaid-customer subscription data at the census-tract level, the primary place of use methodology is ''challenging for mobile providers when applied to prepaid customer and reseller data.'' CTIA states that the Mobile Telecommunications Sourcing Act, which defines primary place of use, does not apply to prepaid customers, as those customers are taxed at the point of sale, and using place of primary use for prepaid customers is likely infeasible. We seek comment regarding how best to assign prepaid subscribers to census tracts, based on CTIA's concern. In the *Report and Order,* we require mobile providers, on an interim basis, to assign prepaid and resold mobile voice and broadband subscribers to a census tract, based on their telephone number. Is there a methodology that can measure more accurately where these customers use their service, particularly for those mobile broadband subscribers that may only have an IP address? Should we require providers to attribute prepaid subscribers to the census tract where they purchased the service? Is this approach feasible, and does it increase the accuracy of the data? Could mobile providers submit aggregated data that samples where the device is primarily used without raising privacy or other concerns? Is there another consistent methodology that could be applied to postpaid and prepaid subscribers that accurately attributes those subscribers to a census tract?

C. Sunsetting the Form 477 Broadband Deployment Data Collection

69. Over the long term, we expect the Digital Opportunity Data Collection will largely displace the Form 477 process, at least with respect to the collection of granular deployment data. We therefore seek comment on discontinuing the broadband deployment data collection that is part of Form 477 at some point after the new collection has been established. Under what conditions would eliminating that part of the broadband data collection be appropriate? What would be an appropriate timetable for sunsetting both the mobile and fixed Form 477 broadband data collections? Are there other portions of the Form 477 collection we should consider sunsetting as well?

IV. Initial Regulatory Flexibility Analysis

70. As required by the Regulatory Flexibility Act of 1980, as amended (RFA), the Commission has prepared this Initial Regulatory Flexibility Analysis (IRFA) of the possible significant economic impact on a substantial number of small entities from the policies and rules proposed in this *Second FNPRM.* The Commission requests written public comment on this IRFA. Comments must be identified as responses to the IRFA and must be filed by the deadlines for comments on the *Second FNPRM.* The Commission will send a copy of the *Second FNPRM,* including this IRFA, to the Chief Counsel for Advocacy of the Small Business Administration (SBA). In addition, the *Second FNPRM* and IRFA (or summaries thereof) will be published in the **Federal Register**.

A. Need for, and Objectives of, the Proposed Rules

71. The Commission continues its ongoing efforts to ensure that the new collection for fixed broadband deployment reporting and crowdsourcing of that reporting as adopted in the *Report and Order* and the Form 477 collection will evolve to align with changes to technology, markets, and policy needs. In the *Second FNPRM,* the Commission raises issues for consideration and seeks comment on additional steps we can take to obtain more accurate and reliable fixed and mobile broadband deployment data. The probabilistic nature of mobile networks and the many factors that impact a user's experience make it difficult to predict with precision mobile coverage and speed or to develop a coverage map that always provides predictability for consumers. Although no mobile broadband map will consistently reflect consumer experience with complete accuracy, we recognize that we must take steps to improve the quality of the data we collect. Therefore, we seek further comment on the tradeoffs among different potential approaches for developing more accurate and reliable mobile broadband data. We also seek comment on additional technical standards for fixed broadband reporting as part of the Digital Opportunity Data Collection, steps that USAC and the Commission can take to make the best use of crowdsourced data, and ways that we can incorporate the filing of location-specific fixed broadband deployment data in the Digital Opportunity Data Collection.

B. Legal Basis

72. The proposed action is authorized pursuant to Sections 1–5, 201–206, 214, 218–220, 251, 252, 254, 256, 303(r), 332, 403, and 405 of the Communications Act of 1934, as amended, 47 U.S.C. 151–155, 201–206, 214, 218–220, 251, 252, 254, 256, 303(r), 332, 403, and 405.

C. Description and Estimate of the Number of Small Entities to Which the Proposed Rules Would Apply

73. The RFA directs agencies to provide a description of, and where feasible, an estimate of the number of small entities that may be affected by the proposed rules, if adopted. The RFA generally defines the term ''small entity'' as having the same meaning as the terms ''small business,'' ''small organization,'' and ''small governmental jurisdiction.'' In addition, the term ''small business'' has the same meaning as the term ''small-business concern'' under the Small Business Act. A small-business concern'' is one which: (1) Is independently owned and operated; (2) is not dominant in its field of operation; and (3) satisfies any additional criteria established by the Small Business Administration (SBA).

1. Total Small Entities

74. *Small Businesses, Small Organizations, Small Governmental Jurisdictions.* Our actions, over time, may affect small entities that are not easily categorized at present. We therefore describe here, at the outset,

three broad groups of small entities that could be directly affected herein. First, while there are industry-specific size standards for small businesses that are used in the regulatory flexibility analysis, according to data from the SBA's Office of Advocacy, in general a small business is an independent business having fewer than 500 employees. These types of small businesses represent 99.9% of all businesses in the United States, which translates to 28.8 million businesses.

75. Next, the type of small entity described as a ''small organization'' is generally ''any not-for-profit enterprise which is independently owned and operated and is not dominant in its field.'' Nationwide, as of August 2016, there were approximately 356,494 small organizations based on registration and tax data filed by nonprofits with the Internal Revenue Service (IRS).

76. Finally, the small entity described as a ''small governmental jurisdiction'' is defined generally as ''governments of cities, counties, towns, townships, villages, school districts, or special districts, with a population of less than fifty thousand.'' U.S. Census Bureau data from the 2012 Census of Governments indicate that there were 90,056 local governmental jurisdictions consisting of general purpose governments and special purpose governments in the United States. Based on this data, we estimate that at least 49,316 local government jurisdictions fall in the category of ''small governmental jurisdictions.''

2. Broadband Internet Access Service Providers

77. To ensure that this IRFA describes the universe of small entities that our action might affect, we discuss in turn several different types of entities that might be providing broadband internet access service.

78. *Internet Service Providers (Broadband).* Broadband internet service providers include wired (*e.g.,* cable, DSL) and VoIP service providers using their own operated wired telecommunications infrastructure fall in the category of Wired Telecommunication Carriers. Wired Telecommunications Carriers are comprised of establishments primarily engaged in operating and/or providing access to transmission facilities and infrastructure that they own and/or lease for the transmission of voice, data, text, sound, and video using wired telecommunications networks. Transmission facilities may be based on a single technology or a combination of technologies. The SBA size standard for this category classifies a business as small if it has 1,500 or fewer employees. U.S. Census Bureau data for 2012 show that there were 3,117 firms that operated that year. Of this total, 3,083 operated with fewer than 1,000 employees. Consequently, under this size standard the majority of firms in this industry can be considered small.

79. *Internet Service Providers (Non-Broadband).* Internet access service providers such as Dial-up internet service providers, VoIP service providers using client-supplied telecommunications connections, and internet service providers using client-supplied telecommunications connections (*e.g.,* dial-up ISPs) fall in the category of All Other Telecommunications. The SBA has developed a small business size standard for All Other Telecommunications, which consists of all such firms with gross annual receipts of $32.5 million or less. For this category, U.S. Census Bureau data for 2012 show that there were 1,442 firms that operated for the entire year. Of these firms, a total of 1,400 had gross annual receipts of less than $25 million. Consequently, under this size standard, a majority of firms in this industry can be considered small.

3. Wireline Providers

80. *Wired Telecommunications Carriers.* The U.S. Census Bureau defines this industry as ''establishments primarily engaged in operating and/or providing access to transmission facilities and infrastructure that they own and/or lease for the transmission of voice, data, text, sound, and video using wired communications networks. Transmission facilities may be based on a single technology or a combination of technologies. Establishments in this industry use the wired telecommunications network facilities that they operate to provide a variety of services, such as wired telephony services, including VoIP services, wired (cable) audio and video programming distribution, and wired broadband internet services. By exception, establishments providing satellite television distribution services using facilities and infrastructure that they operate are included in this industry.'' The SBA has developed a small business size standard for Wired Telecommunications Carriers, which consists of all such companies having 1,500 or fewer employees. U.S. Census Bureau data for 2012 show that there were 3,117 firms that operated that year. Of this total, 3,083 operated with fewer than 1,000 employees. Thus, under this size standard, the majority of firms in this industry can be considered small.

81. *Local Exchange Carriers (LECs).* Neither the Commission nor the SBA has developed a size standard for small businesses specifically applicable to local exchange services. The closest applicable NAICS Code category is Wired Telecommunications Carriers. Under the applicable SBA size standard, such a business is small if it has 1,500 or fewer employees. According to Commission data, U.S. Census data for 2012 show that there were 3,117 firms that operated that year. Of this total, 3,083 operated with fewer than 1,000 employees. Thus, under this category and the associated size standard, the Commission estimates that the majority of local exchange carriers are small entities.

82. *Incumbent Local Exchange Carriers (Incumbent LECs).* Neither the Commission nor the SBA has developed a small business size standard specifically for incumbent local exchange services. The closest applicable NAICS Code category is Wired Telecommunications Carriers. Under the applicable SBA size standard, such a business is small if it has 1,500 or fewer employees. According U.S. Census Bureau data for 2012, 3,117 firms operated in that year. Of this total, 3,083 operated with fewer than 1,000 employees. Consequently, the Commission estimates that most providers of incumbent local exchange service are small businesses that may be affected by our actions. According to Commission data, 1,307 Incumbent LECs reported that they were incumbent local exchange service providers. Of this total, an estimated 1,006 have 1,500 or fewer employees. Thus, using the SBA's size standard, the majority of Incumbent LECs can be considered small entities.

83. *Competitive Local Exchange Carriers (Competitive LECs), Competitive Access Providers (CAPs), Shared-Tenant Service Providers, and Other Local Service Providers.* Neither the Commission nor the SBA has developed a small business size standard specifically for these service providers. The appropriate NAICS Code category is Wired Telecommunications Carriers and under that size standard, such a business is small if it has 1,500 or fewer employees. U.S. Census Bureau data for 2012 indicate that 3,117 firms operated during that year. Of that number, 3,083 operated with fewer than 1,000 employees. Based on these data, the Commission concludes that the majority of Competitive LECs, CAPs, Shared-Tenant Service Providers, and Other Local Service Providers, are small entities. According to Commission data, 1,442 carriers reported that they were engaged in the provision of either

competitive local exchange services or competitive access provider services. Of these 1,442 carriers, an estimated 1,256 have 1,500 or fewer employees. In addition, 17 carriers have reported that they are Shared-Tenant Service Providers, and all 17 are estimated to have 1,500 or fewer employees. Also, 72 carriers have reported that they are Other Local Service Providers. Of this total, 70 have 1,500 or fewer employees. Consequently, based on internally researched FCC data, the Commission estimates that most providers of competitive local exchange service, competitive access providers, Shared-Tenant Service Providers, and Other Local Service Providers are small entities.

84. *Interexchange Carriers (IXCs).* Neither the Commission nor the SBA has developed a definition for Interexchange Carriers. The closest NAICS Code category is Wired Telecommunications Carriers. The applicable size standard under SBA rules consists of all such companies having 1,500 or fewer employees. U.S. Census Bureau data for 2012 indicate that 3,117 firms operated during that year. Of that number, 3,083 operated with fewer than 1,000 employees. According to internally developed Commission data, 359 companies reported that their primary telecommunications service activity was the provision of interexchange services. Of this total, an estimated 317 have 1,500 or fewer employees. Consequently, the Commission estimates that the majority of interexchange service providers are small entities.

85. *Operator Service Providers (OSPs).* Neither the Commission nor the SBA has developed a small business size standard specifically for operator service providers. The closest applicable size standard under SBA rules is the category of Wired Telecommunications Carriers. Under the size standard for Wired Telecommunications Carriers, such a business is small if it has 1,500 or fewer employees. U.S. Census Bureau data for 2012 show that there were 3,117 firms that operated that year. Of this total, 3,083 operated with fewer than 1,000 employees. Thus, under this size standard, the majority of firms in this industry can be considered small.

86. According to Commission data, 33 carriers have reported that they are engaged in the provision of operator services. Of these, an estimated 31 have 1,500 or fewer employees and two have more than 1,500 employees. Consequently, the Commission estimates that the majority of OSPs are small entities.

87. *Other Toll Carriers.* Neither the Commission nor the SBA has developed a definition for small businesses specifically applicable to Other Toll Carriers. This category includes toll carriers that do not fall within the categories of interexchange carriers, operator service providers, prepaid calling card providers, satellite service carriers, or toll resellers. The closest applicable size standard under SBA rules is for Wired Telecommunications Carriers and the applicable small business size standard under SBA rules consists of all such companies having 1,500 or fewer employees. U.S. Census data for 2012 indicate that 3,117 firms operated during that year. Of that number, 3,083 operated with fewer than 1,000 employees. According to Commission data, 284 companies reported that their primary telecommunications service activity was the provision of other toll carriage. Of these, an estimated 279 have 1,500 or fewer employees. Consequently, the Commission estimates that most Other Toll Carriers are small entities.

4. Wireless Providers—Fixed and Mobile

88. The broadband internet access service provider category covered by this Order may cover multiple wireless firms and categories of wireless services. Thus, to the extent the wireless services listed below are used by wireless firms for broadband internet access service, the proposed actions may have an impact on those small businesses as set forth above and further below. In addition, for those services subject to auctions, we note that, as a general matter, the number of winning bidders that claim to qualify as small businesses at the close of an auction does not necessarily represent the number of small businesses currently in service. Also, the Commission does not generally track subsequent business size unless, in the context of assignments and transfers or reportable eligibility events, unjust enrichment issues are implicated.

89. *Wireless Telecommunications Carriers (except Satellite).* This industry comprises establishments engaged in operating and maintaining switching and transmission facilities to provide communications via the airwaves. Establishments in this industry have spectrum licenses and provide services using that spectrum, such as cellular services, paging services, wireless internet access, and wireless video services. The appropriate size standard under SBA rules is that such a business is small if it has 1,500 or fewer employees. For this industry, U.S. Census data for 2012 show that there were 967 firms that operated for the entire year. Of this total, 955 firms had employment of 999 or fewer employees and 12 had employment of 1,000 employees or more. Thus, under this category and the associated size standard, the Commission estimates that the majority of wireless telecommunications carriers (except satellite) are small entities.

90. The Commission's own data—available in its Universal Licensing System—indicate that, as of August 31, 2018, there are 265 Cellular licensees that will be affected by our actions. The Commission does not know how many of these licensees are small, as the Commission does not collect that information for these types of entities. Similarly, according to internally-developed Commission data, 413 carriers reported that they were engaged in the provision of wireless telephony, including cellular service, Personal Communications Service (PCS), and Specialized Mobile Radio (SMR) Telephony services. Of this total, an estimated 261 have 1,500 or fewer employees, and 152 have more than 1,500 employees. Thus, using available data, we estimate that the majority of wireless firms can be considered small.

91. *Wireless Communications Services.* This service can be used for fixed, mobile, radiolocation, and digital audio broadcasting satellite uses. The Commission defined ''small business'' for the wireless communications services (WCS) auction as an entity with average gross revenues of $40 million for each of the three preceding years, and a ''very small business'' as an entity with average gross revenues of $15 million for each of the three preceding years. The SBA approved these small business size standards. In the Commission's auction for geographic area licenses in the WCS there were seven winning bidders that qualified as ''very small business'' entities, and one that qualified as a ''small business'' entity.

92. *1670–1675 MHz Services.* This service can be used for fixed and mobile uses, except aeronautical mobile. An auction for one license in the 1670–1675 MHz band was conducted in 2003. One license was awarded. The winning bidder was not a small entity.

93. *Wireless Telephony.* Wireless telephony includes cellular, personal communications services, and specialized mobile radio telephony carriers. The closest applicable SBA category is Wireless Telecommunications Carriers (except Satellite). Under the SBA small business size standard, a business is small if it

has 1,500 or fewer employees. For this industry, U.S. Census Bureau data for 2012 show that there were 967 firms that operated for the entire year. Of this total, 955 firms had fewer than 1,000 employees and 12 firms had 1,000 employees or more. Thus, under this category and the associated size standard, the Commission estimates that a majority of these entities can be considered small. According to Commission data, 413 carriers reported that they were engaged in wireless telephony. Of these, an estimated 261 have 1,500 or fewer employees and 152 have more than 1,500 employees. Therefore, more than half of these entities can be considered small.

94. *Broadband Personal Communications Service.* The broadband personal communications services (PCS) spectrum is divided into six frequency blocks designated A through F, and the Commission has held auctions for each block. The Commission initially defined a ''small business'' for C- and F-Block licenses as an entity that has average gross revenues of $40 million or less in the three previous calendar years. For F-Block licenses, an additional small business size standard for ''very small business'' was added and is defined as an entity that, together with its affiliates, has average gross revenues of not more than $15 million for the preceding three calendar years. These small business size standards, in the context of broadband PCS auctions, have been approved by the SBA. No small businesses within the SBA-approved small business size standards bid successfully for licenses in Blocks A and B. There were 90 winning bidders that claimed small business status in the first two C-Block auctions. A total of 93 bidders that claimed small business status won approximately 40% of the 1,479 licenses in the first auction for the D, E, and F Blocks. On April 15, 1999, the Commission completed the reauction of 347 C-, D-, E-, and F-Block licenses in Auction No. 22. Of the 57 winning bidders in that auction, 48 claimed small business status and won 277 licenses.

95. On January 26, 2001, the Commission completed the auction of 422 C and F Block Broadband PCS licenses in Auction No. 35. Of the 35 winning bidders in that auction, 29 claimed small business status. Subsequent events concerning Auction 35, including judicial and agency determinations, resulted in a total of 163 C and F Block licenses being available for grant. On February 15, 2005, the Commission completed an auction of 242 C-, D-, E-, and F-Block licenses in Auction No. 58. Of the 24 winning bidders in that auction, 16 claimed small business status and won 156 licenses. On May 21, 2007, the Commission completed an auction of 33 licenses in the A, C, and F Blocks in Auction No. 71. Of the 12 winning bidders in that auction, five claimed small business status and won 18 licenses. On August 20, 2008, the Commission completed the auction of 20 C-, D-, E-, and F-Block Broadband PCS licenses in Auction No. 78. Of the eight winning bidders for Broadband PCS licenses in that auction, six claimed small business status and won 14 licenses.

96. *Specialized Mobile Radio Licenses.* The Commission awards ''small entity'' bidding credits in auctions for Specialized Mobile Radio (SMR) geographic area licenses in the 800 MHz and 900 MHz bands to firms that had revenues of no more than $15 million in each of the three previous calendar years. The Commission awards ''very small entity'' bidding credits to firms that had revenues of no more than $3 million in each of the three previous calendar years. The SBA approved these small business size standards for the 900 MHz Service. The Commission held auctions for geographic area licenses in the 800 MHz and 900 MHz bands. The 900 MHz SMR auction began on December 5, 1995, and closed on April 15, 1996. Sixty bidders claiming that they qualified as small businesses under the $15 million size standard won 263 geographic area licenses in the 900 MHz SMR band. The 800 MHz SMR auction for the upper 200 channels began on October 28, 1997, and was completed on December 8, 1997. Ten bidders claiming that they qualified as small businesses under the $15 million size standard won 38 geographic area licenses for the upper 200 channels in the 800 MHz SMR band. A second auction for the 800 MHz band was held on January 10, 2002, and closed on January 17, 2002, and included 23 BEA licenses. One bidder claiming small business status won five licenses.

97. The auction of the 1,053 800 MHz SMR geographic area licenses for the General Category channels was conducted in 2000. Eleven bidders won 108 geographic area licenses for the General Category channels in the 800 MHz SMR band and qualified as small businesses under the $15 million size standard. In an auction completed in 2000, a total of 2,800 Economic Area licenses in the lower 80 channels of the 800 MHz SMR service were awarded. Of the 22 winning bidders, 19 claimed small business status and won 129 licenses. Thus, combining all four auctions, 41 winning bidders for geographic licenses in the 800 MHz SMR band claimed status as small businesses.

98. In addition, there are numerous incumbent site-by-site SMR licenses and licensees with extended implementation authorizations in the 800 and 900 MHz bands. We do not know how many firms provide 800 MHz or 900 MHz geographic area SMR service pursuant to extended implementation authorizations, nor how many of these providers have annual revenues of no more than $15 million. One firm has over $15 million in revenues. In addition, we do not know how many of these firms have 1,500 or fewer employees, which is the SBA-determined size standard. We assume, for purposes of this analysis, that all of the remaining extended implementation authorizations are held by small entities, as defined by the SBA.

99. *Lower 700 MHz Band Licenses.* The Commission previously adopted criteria for defining three groups of small businesses for purposes of determining their eligibility for special provisions such as bidding credits. The Commission defined a ''small business'' as an entity that, together with its affiliates and controlling principals, has average gross revenues not exceeding $40 million for the preceding three years. A ''very small business'' is defined as an entity that, together with its affiliates and controlling principals, has average gross revenues that are not more than $15 million for the preceding three years. Additionally, the lower 700 MHz Service had a third category of small business status for Metropolitan/Rural Service Area (MSA/RSA) licenses—''entrepreneur''—which is defined as an entity that, together with its affiliates and controlling principals, has average gross revenues that are not more than $3 million for the preceding three years. The SBA approved these small size standards. An auction of 740 licenses (one license in each of the 734 MSAs/RSAs and one license in each of the six Economic Area Groupings (EAGs)) commenced on August 27, 2002, and closed on September 18, 2002. Of the 740 licenses available for auction, 484 licenses were won by 102 winning bidders. Seventy-two of the winning bidders claimed small business, very small business, or entrepreneur status and won a total of 329 licenses. A second auction commenced on May 28, 2003, closed on June 13, 2003, and included 256 licenses: 5 EAG licenses and 476 Cellular Market Area licenses. Seventeen winning bidders claimed small or very small business status and

won 60 licenses, and nine winning bidders claimed entrepreneur status and won 154 licenses. On July 26, 2005, the Commission completed an auction of five licenses in the Lower 700 MHz band (Auction No. 60). There were three winning bidders for the five licenses. All three winning bidders claimed small business status.

100. In 2007, the Commission reexamined its rules governing the 700 MHz band in the *700 MHz Second Report and Order.* An auction of 700 MHz licenses commenced January 24, 2008, and closed on March 18, 2008, which included 176 Economic Area licenses in the A Block, 734 Cellular Market Area licenses in the B Block, and 176 EA licenses in the E Block. Twenty winning bidders, claiming small business status (those with attributable average annual gross revenues that exceed $15 million and do not exceed $40 million for the preceding three years) won 49 licenses. Thirty-three winning bidders claiming very small business status (those with attributable average annual gross revenues that do not exceed $15 million for the preceding three years) won 325 licenses.

101. *Upper 700 MHz Band Licenses.* In the *700 MHz Second Report and Order,* the Commission revised its rules regarding Upper 700 MHz licenses. On January 24, 2008, the Commission commenced Auction 73 in which several licenses in the Upper 700 MHz band were available for licensing: 12 Regional Economic Area Grouping licenses in the C Block, and one nationwide license in the D Block. The auction concluded on March 18, 2008, with 3 winning bidders claiming very small business status (those with attributable average annual gross revenues that do not exceed $15 million for the preceding three years) and winning five licenses.

102. *700 MHz Guard Band Licensees.* In 2000, in the 700 MHz Guard Band Order, the Commission adopted size standards for ''small businesses'' and ''very small businesses'' for purposes of determining their eligibility for special provisions such as bidding credits and installment payments. A small business in this service is an entity that, together with its affiliates and controlling principals, has average gross revenues not exceeding $40 million for the preceding three years. Additionally, a very small business is an entity that, together with its affiliates and controlling principals, has average gross revenues that are not more than $15 million for the preceding three years. SBA approval of these definitions is not required. An auction of 52 Major Economic Area licenses commenced on September 6, 2000, and closed on September 21, 2000. Of the 104 licenses auctioned, 96 licenses were sold to nine bidders. Five of these bidders were small businesses that won a total of 26 licenses. A second auction of 700 MHz Guard Band licenses commenced on February 13, 2001, and closed on February 21, 2001. All eight of the licenses auctioned were sold to three bidders. One of these bidders was a small business that won a total of two licenses.

103. *Air-Ground Radiotelephone Service.* The Commission previously used the SBA's small business size standard applicable to Wireless Telecommunications Carriers (except Satellite) for this service. The appropriate size standard under SBA rules is that such a business is small if it has 1,500 or fewer employees. For this industry, U.S. Census Bureau data for 2012 show that there were 967 firms that operated for the entire year. Of this total, 955 firms had fewer than 1,000 employees and 12 had employment of 1,000 employees or more. There are approximately 100 licensees in the Air-Ground Radiotelephone Service, and we estimate that almost all of them qualify as small entities under the SBA definition.

104. For purposes of assigning Air-Ground Radiotelephone Service licenses through competitive bidding, the Commission has defined ''small business'' as an entity that, together with controlling interests and affiliates, has average annual gross revenues for the preceding three years not exceeding $40 million. A ''very small business'' is defined as an entity that, together with controlling interests and affiliates, has average annual gross revenues for the preceding three years not exceeding $15 million. The SBA approved these definitions. In May 2006, the Commission completed an auction of nationwide commercial Air-Ground Radiotelephone Service licenses in the 800 MHz band (Auction No. 65). On June 2, 2006, the auction closed with two winning bidders winning two Air-Ground Radiotelephone Services licenses. Neither of the winning bidders claimed small business status.

105. *Advanced Wireless Services (AWS) (1710–1755 MHz and 2110–2155 MHz bands (AWS–1); 1915–1920 MHz, 1995–2000 MHz, 2020–2025 MHz and 2175–2180 MHz bands (AWS–2); 2155–2175 MHz band (AWS–3)).* For the AWS–1 bands, the Commission defined a ''small business'' as an entity with average annual gross revenues for the preceding three years not exceeding $40 million, and a ''very small business'' as an entity with average annual gross revenues for the preceding three years not exceeding $15 million. For AWS–2 and AWS–3, although we do not know for certain which entities are likely to apply for these frequencies, we note that the AWS–1 bands are comparable to those used for cellular service and personal communications service. The Commission has not yet adopted size standards for the AWS–2 or AWS–3 bands but proposes to treat both AWS–2 and AWS–3 similarly to broadband PCS service and AWS–1 service due to the comparable capital requirements and other factors, such as issues involved in relocating incumbents and developing markets, technologies, and services.

106. *3650–3700 MHz band.* In March 2005, the Commission released a *Report and Order and Memorandum Opinion and Order* that provides for nationwide, non-exclusive licensing of terrestrial operations, using contention-based technologies, in the 3650 MHz band (*i.e.,* 3650–3700 MHz). As of April 2010, more than 1,270 licenses have been granted and more than 7,433 sites have been registered. The Commission has not developed a definition of small entities applicable to 3650–3700 MHz band nationwide, non-exclusive licensees. However, we estimate that the majority of these licensees are internet Access Service Providers (ISPs) and that most of those licensees are small businesses.

107. *Fixed Microwave Services.* Microwave services include common carrier, private-operational fixed, and broadcast auxiliary radio services. They also include the Local Multipoint Distribution Service (LMDS), the Digital Electronic Message Service (DEMS), and the 24 GHz Service, where licensees can choose between common carrier and non-common carrier status. At present, there are approximately 36,708 common carrier fixed licensees and 59,291 private operational-fixed licensees and broadcast auxiliary radio licensees in the microwave services. There are approximately 135 LMDS licensees, three DEMS licensees, and three 24 GHz licensees. The Commission has not yet defined a small business with respect to microwave services. The closest applicable SBA category is Wireless Telecommunications Carriers (except Satellite), and the appropriate size standard for this category under SBA rules is that such a business is small if it has 1,500 or fewer employees. For this industry, U.S. Census Bureau data for 2012 show that there were 967 firms that operated for the entire year. Of this total, 955 firms had fewer than 1,000 employees and 12 had employment of 1,000 employees or more. Thus, under

this SBA category and the associated size standard, the Commission estimates that a majority of fixed microwave service licensees can be considered small.

108. The Commission does not have data specifying the number of these licensees that have more than 1,500 employees, and thus is unable at this time to estimate with greater precision the number of fixed microwave service licensees that would qualify as small business concerns under the SBA's small business size standard. Consequently, the Commission estimates that there are up to 36,708 common carrier fixed licensees and up to 59,291 private operational-fixed licensees and broadcast auxiliary radio licensees in the microwave services that may be small and may be affected by the rules and policies adopted herein. We note, however, that the common carrier microwave fixed licensee category does include some large entities.

109. *Broadband Radio Service and Educational Broadband Service.* Broadband Radio Service systems, previously referred to as Multipoint Distribution Service (MDS) and Multichannel Multipoint Distribution Service (MMDS) systems and ''wireless cable,'' transmit video programming to subscribers and provide two-way high speed data operations using the microwave frequencies of the Broadband Radio Service (BRS) and Educational Broadband Service (EBS) (previously referred to as the Instructional Television Fixed Service (ITFS)). In connection with the 1996 BRS auction, the Commission established a small business size standard as an entity that had annual average gross revenues of no more than $40 million in the previous three calendar years. The BRS auctions resulted in 67 successful bidders obtaining licensing opportunities for 493 Basic Trading Areas (BTAs). Of the 67 auction winners, 61 met the definition of a small business. BRS also includes licensees of stations authorized prior to the auction. At this time, we estimate that of the 61 small business BRS auction winners, 48 remain small business licensees. In addition to the 48 small businesses that hold BTA authorizations, there are approximately 392 incumbent BRS licensees that are considered small entities. After adding the number of small business auction licensees to the number of incumbent licensees not already counted, we find that there are currently approximately 440 BRS licensees that are defined as small businesses under either the SBA or the Commission's rules.

110. In 2009, the Commission conducted Auction 86, the sale of 78 licenses in the BRS areas. The Commission offered three levels of bidding credits: (1) A bidder with attributed average annual gross revenues that exceed $15 million and do not exceed $40 million for the preceding three years (small business) received a 15% discount on its winning bid; (2) a bidder with attributed average annual gross revenues that exceed $3 million and do not exceed $15 million for the preceding three years (very small business) received a 25% discount on its winning bid; and (3) a bidder with attributed average annual gross revenues that do not exceed $3 million for the preceding three years (entrepreneur) received a 35% discount on its winning bid. Auction 86 concluded in 2009 with the sale of 61 licenses. Of the ten winning bidders, two bidders that claimed small business status won 4 licenses; one bidder that claimed very small business status won three licenses; and two bidders that claimed entrepreneur status won six licenses.

111. In addition, the SBA's Cable Television Distribution Services small business size standard is applicable to EBS. There are presently 2,436 EBS licensees. All but 100 of these licenses are held by educational institutions. Educational institutions are included in this analysis as small entities. Thus, we estimate that at least 2,336 licensees are small businesses. Since 2007, Cable Television Distribution Services have been defined within the broad economic census category of Wired Telecommunications Carriers; that category is defined as follows: ''This industry comprises establishments primarily engaged in operating and/or providing access to transmission facilities and infrastructure that they own and/or lease for the transmission of voice, data, text, sound, and video using wired telecommunications networks. Transmission facilities may be based on a single technology or a combination of technologies.'' The SBA has developed a small business size standard for this category, which is: All such firms having 1,500 or fewer employees. To gauge small business prevalence for these cable services we must, however, use the most current census data that are based on the previous category of Cable and Other Program Distribution and its associated size standard: All such firms having $13.5 million or less in annual receipts. For this industry, U.S. Census data for 2012 show that there were 3,117 firms that operated that year. Of this total, 3,083 operated with fewer than 1,000 employees. Thus, the majority of these firms can be considered small.

5. Satellite Service Providers

112. *Satellite Telecommunications Providers.* This category comprises firms ''primarily engaged in providing telecommunications services to other establishments in the telecommunications and broadcasting industries by forwarding and receiving communications signals via a system of satellites or reselling satellite telecommunications.'' Satellite telecommunications service providers include satellite and earth station operators. The category has a small business size standard of $32.5 million or less in average annual receipts, under SBA rules. For this category, U.S. Census Bureau data for 2012 show that there were a total of 333 firms that operated for the entire year. Of this total, 299 firms had annual receipts of less than $25 million. Consequently, we estimate that the majority of satellite telecommunications providers are small entities.

113. *All Other Telecommunications.* The ''All Other Telecommunications'' category is comprised of entities that are primarily engaged in providing specialized telecommunications services, such as satellite tracking, communications telemetry, and radar station operation. This industry also includes establishments primarily engaged in providing satellite terminal stations and associated facilities connected with one or more terrestrial systems and capable of transmitting telecommunications to, and receiving telecommunications from, satellite systems. Establishments providing internet services or voice over internet protocol (VoIP) services via client-supplied telecommunications connections are also included in this industry. The SBA has developed a small business size standard for ''All Other Telecommunications,'' which consists of all such firms with gross annual receipts of $32.5 million or less. For this category, U.S. Census Bureau data for 2012 show that there were 1,442 firms that operated for the entire year. Of these firms, a total of 1,400 had gross annual receipts of less than $25 million. Consequently, a majority of ''All Other Telecommunications'' firms potentially affected by our action can be considered small.

6. Cable Service Providers

114. Because Section 706 of the Act requires us to monitor the deployment of broadband using any technology, we anticipate that some broadband service providers may not provide telephone

service. Accordingly, we describe below other types of firms that may provide broadband services, including cable companies, MDS providers, and utilities, among others.

115. *Cable and Other Subscription Programming.* This industry comprises establishments primarily engaged in operating studios and facilities for the broadcasting of programs on a subscription or fee basis. The broadcast programming is typically narrowcast in nature (*e.g.,* limited format, such as news, sports, education, or youth-oriented). These establishments produce programming in their own facilities or acquire programming from external sources. The programming material is usually delivered to a third party, such as cable systems or direct-to-home satellite systems, for transmission to viewers. The SBA size standard for this industry establishes as small, any company in this category which has annual receipts of $38.5 million or less. According to 2012 U.S. Census Bureau data, 367 firms operated for the entire year. Of that number, 319 operated with annual receipts of less than $25 million a year and 48 firms operated with annual receipts of $25 million or more. Based on this data, the Commission estimates that the majority of firms operating in this industry are small.

116. *Cable Companies and Systems (Rate Regulation).* The Commission has developed its own small business size standards for the purpose of cable rate regulation. Under the Commission's rules, a ''small cable company'' is one serving 400,000 or fewer subscribers nationwide. Industry data indicate that there are currently 4,600 active cable systems in the United States. Of this total, all but nine cable operators nationwide are small under the 400,000-subscriber size standard. In addition, under the Commission's rate regulation rules, a ''small system'' is a cable system serving 15,000 or fewer subscribers. Current Commission records show 4,600 cable systems nationwide. Of this total, 3,900 cable systems have fewer than 15,000 subscribers, and 700 systems have 15,000 or more subscribers, based on the same records. Thus, under this standard as well, we estimate that most cable systems are small entities.

117. *Cable System Operators (Telecom Act Standard).* The Communications Act of 1934, as amended, also contains a size standard for small cable system operators, which is ''a cable operator that, directly or through an affiliate, serves in the aggregate fewer than 1% of all subscribers in the United States and is not affiliated with any entity or entities whose gross annual revenues in the aggregate exceed $250,000,000.'' There are approximately 52,403,705 cable video subscribers in the United States today. Accordingly, an operator serving fewer than 524,037 subscribers shall be deemed a small operator if its annual revenues, when combined with the total annual revenues of all its affiliates, do not exceed $250 million in the aggregate. Based on available data, we find that all but nine incumbent cable operators are small entities under this size standard. We note that the Commission neither requests nor collects information on whether cable system operators are affiliated with entities whose gross annual revenues exceed $250 million. Although it seems certain that some of these cable system operators are affiliated with entities whose gross annual revenues exceed $250 million, we are unable at this time to estimate with greater precision the number of cable system operators that would qualify as small cable operators under the definition in the Communications Act.

7. All Other Telecommunications

118. *Electric Power Generators, Transmitters, and Distributors.* This U.S. industry is comprised of establishments that are primarily engaged in providing specialized telecommunications services, such as satellite tracking, communications telemetry, and radar station operation. This industry also includes entities primarily engaged in providing satellite terminal stations and associated facilities connected with one or more terrestrial systems and capable of transmitting telecommunications to, and receiving telecommunications from, satellite systems. Entities providing internet services or voice over internet protocol (VoIP) services via client-supplied telecommunications connections are also included in this industry. The closest applicable SBA category is ''All Other Telecommunications''. The SBA's small business size standard for ''All Other Telecommunications,'' consists of all such firms with gross annual receipts of $32.5 million or less. For this category, U.S. Census data for 2012 show that there were 1,442 firms that operated for the entire year. Of these firms, a total of 1,400 had gross annual receipts of less than $25 million. Consequently, we estimate that under this category and the associated size standard the majority of these firms can be considered small entities.

D. Description of Projected Reporting, Recordkeeping, and Other Compliance Requirements for Small Entities

119. The potential modifications proposed in the *Second FNPRM* if adopted, could, at least initially, impose some new reporting, recordkeeping, or other compliance requirements on some small entities. Small entities and other providers could potentially be required to submit coverage maps based on standardized parameters. Commenters have been asked to refresh the record from the *2017 Data Collection Improvement FNPRM* on the potential use of standardized coverage maps for mobile services in the context of Form 477 and to specifically discuss their experience with the approach used in the MF–II proceeding. Commenters also have been asked to refresh the record on whether to require on-the-ground data as part of the Form 477 data collection. In particular, the Commission asked whether it should require some actual speed test data, how it could impose such a requirement without being unduly burdensome to small providers, and the extent to which providers already collect on-the-ground data in their ordinary course of business.

120. In the *Second FNPRM,* the Commission also seeks comment on a requirement for providers to submit infrastructure information sufficient to allow us to verify the accuracy of providers' Form 477 filings. Anticipating that the collection of accurate and recent network infrastructure information would help the Commission to verify providers' filings, we propose to require small entities and other providers to submit, as part of their Form 477 filing, the following information: (1) The location of cell sites in decimal degrees; (2) the height (above ground and sea level), type, and directional orientation of transmit antennas at each cell site; (3) maximum radiated transmit power of the radio equipment at each cell site; (4) the capacity and type of backhaul used at each cell site; (5) deployed spectrum band and channel bandwidth in MHz; (6) throughput and the required signal strength and signal to noise ratio; (7) cell loading factors; (8) deployed technologies (*e.g.,* LTE Release 13) and; (9) any terrain and land use information used in deriving clutter factors or other losses associated with each cell site. Additionally, the Commission also requests updated comments on adopting a requirement that coverage maps be submitted in raster format, noting that such a requirement might be less burdensome than shapefiles.

121. As means of improving accuracy and reliability of mobile broadband filings, the Commission seeks comment on whether we should establish a challenge process similar to the MF–II challenge process to verify Form 477 filings. The adoption of such a process would allow states, local governments, Tribal entities, or other interested parties an opportunity to challenge providers' mobile broadband filings and could subject small entities and other providers to additional submission and compliance requirements. In addition, while the Commission has adopted the GIS reporting format for fixed broadband services, the Commission seeks comments on how to move to a location-based data requirement for small entities and other providers.

122. In addition, we seek comment on how best to ensure the collection of high-quality fixed broadband coverage data as part of the Digital Opportunity Data Collection. Although we are cognizant of the potential burdens that greater precision in reporting can entail, commenters have indicated in the record that the approach we adopt today—to collect coverage polygons of fixed-broadband service availability—will allow providers to submit more precise data with reasonable burdens. Nonetheless, we seek comment on steps the Commission can take to improve the quality of fixed broadband coverage polygons while minimizing the associated reporting burdens. In addition, as part of the Digital Opportunity Data Collection, the Commission is directing OEA, in consultation with WCB, WTB, and IB, to provide guidance to fixed providers regarding how to develop the polygons depicting fixed broadband coverage. Connected Nation expresses concern that small service providers in particular will struggle to comply with the new reporting requirements in the Digital Opportunity Data Collection unless they get assistance in creating their broadband coverage polygons. In the *Report and Order,* we identify help-desk support and clear instructions as ways we will assist fixed broadband providers with meeting the new filing obligations, and we seek comment on what other steps the Commission and USAC can take to help small fixed providers file accurate data as part of the new collection.

123. We also seek comment on whether to require fixed providers to provide latency reports, whether to impose penalties for entities that chronically file bad data, and how we can improve the existing satellite broadband collection to reflect more accurately current satellite broadband coverage availability. Additionally, we seek comment on how best to collect information relating to service availability data gathered from fixed providers. For example, we seek comment on how to establish a crowdsourced tracking system through USAC, how quickly fixed providers should be required to correct any data where they do not refute the alleged lack of coverage, and how we should instruct USAC to handle cases in which providers and the stakeholders disagree about whether service is actually available at a given location. ACA argues that it would be ''onerous if a smaller provider had to respond immediately to each and every submission from an individual or government entity'' and recommends that small providers be allowed to account for any inaccurate data at its next Digital Opportunity Data Collection filing. As a result, we seek comment on the best approach to timing for the crowdsourcing process, not only for small providers but for all filers. Finally, if a location-based process is adopted for fixed broadband deployment reporting, we ask about an appropriate transition time, especially for smaller providers.

124. The issues raised for consideration and comment in the *Second FNPRM* may require small entities to hire attorneys, engineers, consultants, or other professionals. At this time, however, the Commission cannot quantify the cost of compliance with any potential rule changes and compliance obligations for small entities that may result from the *Second FNPRM.* We expect our requests for information on potential burdens on small entities associated with matters raised in the *Second FNPRM* will provide us with information to assist with our evaluation of the cost of compliance on small entities of any reporting, recordkeeping, or other compliance requirements we adopt.

E. Steps Taken To Minimize the Significant Economic Impact on Small Entities and Significant Alternatives Considered

125. The RFA requires an agency to describe any significant, specifically small business, alternatives that it has considered in reaching its proposed approach, which may include (among others) the following four alternatives: (1) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance or reporting requirements under the rule for small entities; (3) the use of performance, rather than design, standards; and (4) an exemption from coverage of the rule, or any part thereof, for small entities.

126. To assist the Commission's evaluation of the economic impact on small entities, as a result of actions that may result from proposals and issues raised for consideration in the *Second FNPRM,* and to better explore options and alternatives, the Commission has sought comment from the public. More specifically, the Commission seeks comment on what burdens are associated with the potential requirements discussed in the preceding section and how such burdens can be minimized for small entities. For example, the Commission has sought comment on the potential burdens associated with requiring providers to submit on-the-ground data and/or mobile broadband and voice subscription data at the census tract level, particularly for small providers, and on steps the Commission could take to minimize the potential burdens.

127. In addressing possible changes to the Digital Opportunity Data Collection, we seek comment on lessening the burdens associated with the stringent timeliness and completeness requirements for the broadband coverage data to be submitted by smaller broadband providers. In addition, we seek comment on the burdens of a proposal for USAC to publish crowdsourced complaint data without directly informing the affected providers, which would require the provider to regularly check for pertinent complaints. Further, any requirement to timely submit corrected broadband deployment data may impose a burden on small providers, so we seek comment on ways to ease that burden. Finally, the creation of a new online portal for use with the Digital Opportunity Data Collection, generally, has the potential for errors to the disadvantage of small providers seeking USF funds, and we seek comment on how to lessen the potential for such errors.

128. More generally, the proposals and questions laid out in the *Second FNPRM* were designed to enable the Commission to understand the benefits, impact, and potential burdens associated with the different approaches that the Commission can pursue to achieve its objective of improving accuracy and reliability of its data collections. Before reaching its final conclusions and taking action in this proceeding, the Commission expects to review the comments filed in response to the *Second FNPRM* and more fully consider the economic impact on small

entities and how any impact can be minimized.

F. Federal Rules That May Duplicate, Overlap, or Conflict With the Proposed Rules

129. None.

V. Procedural Matters

130. *Ex Parte Rules.* This proceeding shall be treated as a ''permit-but-disclose'' proceeding in accordance with the Commission's *ex parte* rules. Persons making *ex parte* presentations must file a copy of any written presentation or a memorandum summarizing any oral presentation within two business days after the presentation (unless a different deadline applicable to the Sunshine period applies). Persons making oral *ex parte* presentations are reminded that memoranda summarizing the presentation must (1) list all persons attending or otherwise participating in the meeting at which the *ex parte* presentation was made, and (2) summarize all data presented and arguments made during the presentation. If the presentation consisted in whole or in part of the presentation of data or arguments already reflected in the presenter's written comments, memoranda, or other filings in the proceeding, then the presenter may provide citations to such data or arguments in his or her prior comments, memoranda, or other filings (specifying the relevant page and/or paragraph numbers where such data or arguments can be found) in lieu of summarizing them in the memorandum. Documents shown or given to Commission staff during *ex parte* meetings are deemed to be written *ex parte* presentations and must be filed consistent with 47 CFR 1.1206(b). In proceedings governed 47 CFR 1.49(f), or for which the Commission has made available a method of electronic filing, written *ex parte* presentations and memoranda summarizing oral *ex parte* presentations, and all attachments thereto, must be filed through the electronic comment filing system available for that proceeding and must be filed in their native format (*e.g.,* .doc, .xml, .ppt, searchable .pdf). Participants in this proceeding should familiarize themselves with the Commission's *ex parte* rules.

131. *Paperwork Reduction Act.* The *Second FNPRM* contains proposed new and modified information collection requirements subject to the Paperwork Reduction Act of 1995 (PRA), Public Law 104–13. The Commission, as part of its continuing effort to reduce paperwork burdens, invites the general public and the Office of Management and Budget to comment on the information collection requirements contained in the *Second FNPRM,* as required by the PRA. In addition, pursuant to the Small Business Paperwork Relief Act of 2002, Public Law 107–198 (44 U.S.C. 3506(c)(4)), we seek specific comment on how we might further reduce the information collection burden for small business concerns with fewer than 25 employees.

132. *Initial Regulatory Flexibility Analysis.* Pursuant to the Regulatory Flexibility Act (RFA), the Commission has prepared an Initial Regulatory Flexibility Analysis (IRFA) of the possible significant economic impact on small entities of the policies and actions considered in this *NPRM.* The IRFA is set forth above. Written public comments are requested on this IRFA. Comments must be identified as responses to the IRFA and must be filed by the deadlines for comments on the *Second FNPRM.* The Commission's Consumer and Governmental Affairs Bureau, Reference Information Center, will send a copy of the *Second FNPRM,* including the IRFA, to the Chief Counsel for Advocacy of the Small Business Administration.

133. *People with Disabilities:* To request materials in accessible formats for people with disabilities (braille, large print, electronic files, audio format), send an email to *fcc504@fcc.gov* or call the Consumer & Governmental Affairs Bureau at 202–418–0530 (voice), 202–418–0432 (tty).

VI. Clauses

134. Accordingly, *it is ordered* that, pursuant to Sections 1–4, 7, 201, 254, 301, 303, 309, 319, and 332 of the Communications Act of 1934, as amended, 47 U.S.C. 151–154, 157, 201, 254, 301, 303, 309, 319, and 332, this *Report and Order and Second Further Notice of Proposed Rulemaking is adopted.*

135. *It is further ordered* that the Commission's Consumer & Governmental Affairs Bureau, Reference Information Center, *shall send* a copy of this *Report and Order and Second Further Notice of Proposed Rulemaking,* including the Initial Regulatory Flexibility Analysis, to the Chief Counsel for Advocacy of the Small Business Administration.

Federal Communications Commission.

Marlene Dortch,

Secretary.

[FR Doc. 2019–18062 Filed 8–21–19; 8:45 am]

BILLING CODE 6712–01–P

DEPARTMENT OF COMMERCE

National Oceanic and Atmospheric Administration

50 CFR Part 679

RIN 0648–BJ03

Fisheries of the Exclusive Economic Zone Off Alaska; Rockfish Management in the Groundfish Fisheries of the Bering Sea and Aleutian Islands and the Gulf of Alaska

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

ACTION: Notice of availability of fishery management plan amendment; request for comments.

SUMMARY: The North Pacific Fishery Management Council has submitted Amendment 119 to the Fishery Management Plan for Groundfish of the Bering Sea and Aleutian Islands Management Area (BSAI FMP) and Amendment 107 to the Fishery Management Plan for Groundfish of the Gulf of Alaska (GOA FMP) (collectively Amendments 119/107) to the Secretary of Commerce (Secretary) for review. If approved, Amendments 119/107 would require that the operator of a catcher vessel required to have a federal fishery permit using hook-and-line, pot, or jig in the EEZ of the Bering Sea and Aleutian Islands (BSAI) and Gulf of Alaska (GOA) to retain and land all rockfish (*Sebastes* and *Sebastolobus species*) caught while fishing for groundfish or for Pacific halibut and establish a limit on the amount of rockfish caught as incidental catch allowed to enter commerce through barter, sale or trade. Amendments 119/107 are necessary to improve identification of rockfish species, improve data collection by providing more accurate estimates of total catch, reduce incentives to discard rockfish, reduce waste, reduce overall enforcement burden, and provide regulatory consistency. Amendments 119/107 are intended to promote the goals and objectives of the Magnuson-Stevens Fishery Conservation and Management Act, the BSAI FMP, the GOA FMP, and other applicable laws.

DATES: Comments must be received no later than October 21, 2019.

ADDRESSES: You may submit comments on this document, identified by NOAA–NMFS–2019–0068, by any of the following methods:

• *Electronic Submission:* Submit all electronic public comments via the

Federal e Rulemaking Portal. Go to *www.regulations.gov/#!docketDetail;D=NOAA-NMFS-2019-0068,* click the "Comment Now!" icon, complete the required fields, and enter or attach your comments.

- *Mail:* Submit written comments to Glenn Merrill, Assistant Regional Administrator, Sustainable Fisheries Division, Alaska Region NMFS. Mail comments to P.O. Box 21668, Juneau, AK 99802–1668.

Instructions: Comments sent by any other method, to any other address or individual, or received after the end of the comment period, may not be considered by NMFS. All comments received are a part of the public record and will generally be posted for public viewing on *www.regulations.gov* without change. All personal identifying information (*e.g.,* name, address), confidential business information, or otherwise sensitive information submitted voluntarily by the sender will be publicly accessible. NMFS will accept anonymous comments (enter "N/A" in the required fields if you wish to remain anonymous).

Electronic copies of Amendment 119 to the BSAI FMP, Amendment 107 to the GOA FMP, the Regulatory Impact Review (RIR; referred to as the "Analysis") and the draft National Environmental Policy Act (NEPA) Categorical Exclusion may be obtained from *www.regulations.gov.*

FOR FURTHER INFORMATION CONTACT: Josh Keaton, (907) 586–7228.

SUPPLEMENTARY INFORMATION: The Magnuson-Stevens Fishery and Conservation Act (Magnuson-Stevens Act) in section 304(a) and 305(d) requires that each regional fishery management council submit an amendment to a fishery management plan for review and approval, disapproval, or partial approval by the Secretary. The Magnuson-Stevens Act in section 304(a) also requires that the Secretary, upon receiving an amendment to a fishery management plan, immediately publish a notice in the **Federal Register** announcing that the amendment is available for public review and comment. The North Pacific Fishery Management Council (Council) has submitted Amendments 119/107 to the Secretary for review. This notice announces that proposed Amendments 119/107 to the FMPs are available for public review and comment.

In April 2019, the Council adopted Amendment 119/107 to the BSAI FMP and GOA FMP, respectively, which would require full retention of rockfish by CVs required to have a federal fishery permit using hook-and-line, pot, or jig gear in the BSAI and GOA groundfish and Individual Fishing Quota (IFQ)/Community Development Quota (CDQ) halibut fisheries even if NMFS prohibits retention of a rockfish species. If approved, Amendments 119/107 would also establish a limit on the amount of rockfish caught as incidental catch allowed to enter commerce through barter, sale, or trade. There is a need to establish such a limit or allowance that both provides an incentive for vessel operators to retain all rockfish and avoids elevated rates of rockfish incidental catch because rockfish maximum retainable amounts (MRA) would not apply under the proposed full retention requirement. This limit is called the maximum commerce allowance (MCA). The MCA would be calculated at each rockfish landing, and would limit the amount of rockfish allowed to enter commerce. The MCA for rockfish would be calculated as a percentage of the total retained groundfish and halibut landed during each delivery.

Amendment 119 would amend two sections of the BSAI FMP. First, in Table ES–2 in the Executive Summary, row "Retention and Utilization Requirements" would have a sentence added to read, "Rockfish: Catcher vessels using hook-and-line, pot, or jig gear must retain and land all rockfish."

Second, a new BSAI FMP Section "3.6.3.3 Full Rockfish Retention by Catcher Vessels using Hook-and-Line, Pot, or Jig Gear" would have a sentence added to read that "The operator of a catcher vessel required to have a federal fishery permit using hook-and-line, pot, or jig gear and participating in groundfish or halibut fisheries in the EEZ of the BSAI must retain and land all rockfish." A second sentence would be added to read, "*Maximum Commerce Allowance for Rockfish.* A vessel operator may sell, barter, or trade a round weight equivalent amount of rockfish that is less than or equal to the maximum commerce allowance established in regulations. The MCA is calculated as a percent of the aggregate round weight equivalent of halibut and groundfish species, other than rockfish, that are landed during the same fishing trip."

Amendment 107 to the GOA FMP would amend two sections of the GOA FMP. First, Table ES–2 in the Executive Summary, row "Retention and Utilization Requirements" would have a sentence added to read, "Rockfish: Catcher vessels using hook-and-line, pot, or jig gear must retain and land all rockfish."

Second, a new GOA FMP Section "3.6.3.3 Full Rockfish Retention by Catcher Vessels using Hook-and-Line, Pot, or Jig Gear" would have a sentence added to read "The operator of a catcher vessel required to have a federal fishery permit using hook-and-line, pot, or jig gear and participating in groundfish or halibut fisheries in the EEZ of the GOA must retain and land all rockfish." A second sentence would be added to read, "*Maximum Commerce Allowance for Rockfish.* A vessel operator may sell, barter, or trade a round weight equivalent amount of rockfish that is less than or equal to the maximum commerce allowance established in regulations. The MCA is calculated as a percent of the aggregate round weight equivalent of IFQ halibut and groundfish species, other than rockfish, that are landed during the same fishing trip."

Background

Rockfish are commercially important groundfish comprising 29 commonly caught species. Most of these species inhabit rocky areas in shallow to moderately deep waters that overlap with groundfish and halibut fisheries. Many rockfish species are sought for their commercial value. Except for thornyhead rockfish (Sebastolobus spp.), rockfish have a closed swim bladder, which regulates buoyancy. Quick changes in pressure that occur when rockfish are caught and brought to the surface damage internal organs, therefore rockfish are susceptible to high mortality when brought to the surface from depth. Virtually no rockfish survive once caught without using special handling procedures to return the rockfish to depth as soon as possible.

Many rockfish species are commonly caught as incidental catch by vessels directed fishing for other species using hook-and-line, pot, or jig gear. NMFS prohibits directed fishing for most rockfish species at the beginning of the year because the amount of the total allowable catch (TAC) for rockfish species or species groups do not support directed fishing. If a TAC is reached, NMFS prohibits retention of the species.

Since directed fishing by CVs using hook-and-line, pot, or jig gear is already prohibited for nearly all species of rockfish, NMFS limits retention through the MRA as the primary tool to regulate rockfish catch. The MRA is the proportion or percentage of retained catch of a species closed to directed fishing (incidental catch species) to the retained catch of a species open for directed fishing (basis species). When NMFS prohibits directed fishing for a groundfish species, retention of the catch of that species is allowed up to an

MRA based on percentages set forth in Table 10 and Table 11 to 50 CFR part 679. Section 679.20(d)(iii)(B) requires vessel operators to discard at sea any rockfish that exceeds the MRA. For the individual fishing quota (IFQ) halibut and IFQ sablefish fisheries, when IFQ halibut or IFQ sablefish is on board, retention of rockfish is already mandatory unless rockfish are required to be discarded because catch is in excess of the MRA or the rockfish is in prohibited species status (§ 679.7(f)(8)).

Full Retention

Since the majority of rockfish do not survive being caught, discards of rockfish increases waste. Rockfish must be discarded for two reasons: (1) When rockfish catch is in excess of an MRA; and (2) when a rockfish species is prohibited from being retained (in a prohibited species status). Amendments 119/107 would require full retention of all rockfish that are caught by CVs using hook-and-line, pot, or jig gear and remove the requirements for catcher vessels using hook-and-line, pot, or jig gear to discard rockfish.

The Council recommended, and NMFS proposes, requiring full retention of all rockfish caught by CVs required to have a federal fishery permit using hook-and-line, pot, or jig gear targeting groundfish and halibut in the GOA and BSAI for a number of reasons. These reasons include (1) improving the identification of rockfish species catch by vessels using electronic monitoring (EM); (2) providing more precise estimates of rockfish catch; (3) reducing waste and incentives to discard rockfish; (4) reducing overall enforcement burden; and (5) promoting more consistent management between State and Federal fisheries. These recommended revisions are described in more detail in the Analysis and the forthcoming proposed rule for Amendments 119/107.

Maximum Commerce Allowance

There is a need to establish a limit or allowance on the sale of rockfish caught as incidental catch that both provides an incentive for vessel operators to retain all rockfish and avoids elevated rates of rockfish incidental catch because rockfish MRAs would not apply under the proposed full retention requirement. These amendments would implement a new fishery management method known as the maximum commerce allowance (MCA). The MCA would be calculated when groundfish and halibut are landed at a processor. The MCA would limit the amount of rockfish allowed to enter commerce through barter, sale, or trade. Rockfish that cannot be sold could be consumed by vessel crew, donated to non-profits, processed into fishmeal, or discarded by the processing plant.

To address concerns raised by processors, the Council recommended allowing rockfish in excess of the MCA to be processed into meal. Allowing rockfish in excess of the MCA to be processed into meal is unlikely to provide any additional financial incentives to target rockfish due to the low value of fishmeal.

Before adopting its preferred alternatives for Amendment 119/107, the Council considered a range of alternatives and options. The Council determined, and NMFS agrees, that the alternative and options selected by the Council will improve estimates of rockfish catch, increase utilization of rockfish incidental catch, reduce overall enforcement burden, reduce regulatory complexity and promote more consistent management of rockfish between the State of Alaska and Federal fisheries.

NMFS is soliciting public comments on proposed Amendments 119/107 through the end of the comment period (see **DATES**). NMFS intends to publish in the **Federal Register** and seek public comment on the proposed rule that would implement Amendments 119/107 following NMFS's evaluation of the proposed rule under the Magnuson-Stevens Act.

Respondents do not need to submit the same comments on Amendments 119/107 and the proposed rule. All relevant written comments received by the end of the applicable comment period, whether specifically directed to the FMP amendments or the proposed rule will be considered by NMFS in the approval/disapproval decision for Amendments 119/107 and addressed in the response to comments in the final decision. Comments received after the end of the applicable comment period will not be considered in the approval/disapproval decision on Amendments 119/107. To be considered, comments must be received, not just postmarked or otherwise transmitted, by the last day of the comment period (see **DATES**).

Authority: 16 U.S.C. 1801 *et seq.*

Dated: August 19, 2019.

Alan D. Risenhoover,

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

[FR Doc. 2019–18130 Filed 8–21–19; 8:45 am]

BILLING CODE 3510–22–P

DEPARTMENT OF COMMERCE

National Oceanic and Atmospheric Administration

50 CFR Part 697

[Docket No. 190816–0015]

RIN 0648–BJ10

Atlantic Coastal Fisheries Cooperative Management Act Provisions; American Lobster Fishery; Control Date for Lobster Conservation Management Areas

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

ACTION: Advance notice of proposed rulemaking (ANPR); request for comments.

SUMMARY: The National Marine Fisheries Service (NMFS) announces a control date that may be used for potential changes to the lobster management program. This action is necessary to inform American lobster permit holders and any potential new entrants that future participation and eligibility may be affected by past participation, documentation of landings, effort, and/or gear configuration prior to the control date. The control date is intended to promote awareness of possible rulemaking and notify the public that actions taken after the control date may not be recognized in the future.

DATES: We must receive written comments on or before September 23, 2019.

ADDRESSES: You may submit comments on this document, identified by [NOAA–NMFS–2019–0095] by any of the following methods:

- *Electronic Submission:* Submit all electronic public comments via the Federal e-Rulemaking Portal. Go to [*NOAA–NMFS–2019–0095*], click the ''Comment Now!'' icon, complete the required fields, and enter or attach your comments.
- *Mail:* Submit written comments to Michael Pentony, Regional Administrator, National Marine Fisheries Service, 55 Great Republic Drive, Gloucester, MA 01930. Mark the outside of the envelope, ''Comments on Lobster Control Date.''

Instructions: Comments must be submitted by one of the above methods to ensure that the comments are received, documented, and considered by NMFS. We may not consider comments sent by any other method, to any other address or individual, or received after the end of the comment period. All comments received are a part of the public record and will generally be posted for public viewing on *www.regulations.gov* without change. All personal identifying information (*e.g.,* name, address, etc.) submitted voluntarily by the sender will be publicly accessible. Do not submit confidential business information, or otherwise sensitive or protected information. NMFS will accept anonymous comments (enter ''N/A'' in the required fields if you wish to remain anonymous). We accept attachments to electronic comments only in Microsoft Word or Excel, WordPerfect, or Adobe PDF file formats.

FOR FURTHER INFORMATION CONTACT: Laura Hansen, Fishery Management Specialist, 978–281–9225.

SUPPLEMENTARY INFORMATION:

Background

NMFS works cooperatively with the states to conserve the American lobster resource within the framework of the Atlantic States Marine Fisheries Commission's Interstate Fishery Management Plan for American Lobster (ISFMP). Through the ISFMP, the Commission adopts fishery conservation and management strategies for the American lobster resource and coordinates the efforts of the states and NMFS to implement these strategies.

To carry out Congressionally-mandated responsibilities under the Endangered Species Act and Marine Mammal Protection Act (MMPA), NMFS convened the Atlantic Large Whale Take Reduction Team (TRT) during the last week of April 2019. The TRT is composed of representatives from state and Federal fishery agencies, conservation groups, researchers, and the fishing industry, including the lobster industry. As required under the MMPA, the TRT is tasked with recommending management measures to reduce the risk of serious injury and entanglement of endangered whales in fishing gear. At the meeting, the New England states and the offshore lobster industry committed to reducing the risk of serious injury and mortality from lobster gear to North Atlantic right whales by 60 percent in all lobster management areas. The specific measures to achieve this goal are not yet finalized, but will focus on reducing the number, and lowering the breaking strength of, vertical lines used in the lobster trap fishery.

Following the outcome of the TRT meeting, the Commission met and voted to establish a control date of April 29, 2019, to notify American lobster permit holders and any potential new entrants that future participation and eligibility may be affected by past participation, documentation of landings, effort, and/or gear configuration prior to the control date. Participation in the fishery after the control date may not be treated the same as participation before the control date. NMFS will use April 29, 2019, as a control date for the same reasons outlined by the Commission. In the coming months, NMFS will be working with the states and the industry to develop more specific management measures to achieve the goals recommended by the TRT. Should the Commission take additional action, NMFS will consider complementary action pursuant to the Atlantic Coastal Fisheries Cooperative Management Act and the Magnuson-Stevens Fishery Conservation and Management Act.

This notification and control date do not impose any legal obligations, requirements, or expectation.

Authority: 16 U.S.C. 1801 *et seq.;* 16 U.S.C. 5101 *et seq.*

Dated: August 19, 2019.

Alan D. Risenhoover,

Acting Deputy Assistant Administrator for Regulatory Programs, National Marine Fisheries Service.

[FR Doc. 2019–18096 Filed 8–21–19; 8:45 am]

BILLING CODE 3510–22–P

Notices

Federal Register

Vol. 84, No. 163

Thursday, August 22, 2019

DEPARTMENT OF COMMERCE

Office of the Under Secretary for Economic Affairs

[Docket No. 190815–0014]

American Workforce Policy Advisory Board; Meeting

AGENCY: Office of the Under Secretary for Economic Affairs, Department of Commerce.

ACTION: Notice of public meeting.

SUMMARY: The Office of the Under Secretary for Economic Affairs announces the third meeting of the American Workforce Policy Advisory Board (Advisory Board). Discussions of the Advisory Board will include its progress toward achieving the goals set at its inaugural meeting on March 6, 2019, as well as other Advisory Board matters. The meeting will take place in Washington, DC on Wednesday, September 18, 2019.

DATES: The Advisory Board will meet on September 18, 2019; the meeting will begin at 9:00 a.m. and end at approximately 12:00 p.m. (EDT).

ADDRESSES: The meeting will be held at the Boys & Girls Clubs of Greater Washington (Richard England Clubhouse #14) 4103 Benning Rd. NE, Washington, DC 20019. The meeting is open to the public via audio conference technology. Audio instructions will be prominently posted on the Advisory Board homepage at: *https://www.commerce.gov/americanworker/american-workforce-policy-advisory-board.* Please note: The Advisory Board website will maintain the most current information on the meeting agenda, schedule, and location. These items may be updated without further notice in the **Federal Register**.

The public may also submit statements or questions via the Advisory Board email address, *AmericanWorkforcePolicyAdvisoryBoard@doc.gov* (please use the subject line ''September 2019 Advisory Board Meeting Public Comment''), or by letter to Sabrina Montes, c/o Office of Under Secretary for Economic Affairs, Department of Commerce, 1401 Constitution Avenue NW, Washington, DC 20230. If you wish the Advisory Board to consider your statement or question during the meeting, we must receive your written statement or question no later than 5 p.m. (EDT) four business days prior to the meeting. We will provide all statements or questions received after the deadline to the members; however, they may not consider them during the meeting.

FOR FURTHER INFORMATION CONTACT: Sabrina Montes, c/o Office of Under Secretary for Economic Affairs, Department of Commerce, 1401 Constitution Avenue NW, Washington, DC 20230, (301) 278–9268, or *sabrina.montes@bea.gov.*

SUPPLEMENTARY INFORMATION: The Secretary of Commerce and the Advisor to the President overseeing the Office of Economic Initiatives serve as the co-chairs of the Advisory Board. In addition to the co-chairs, the Advisory Board comprises 25 members that represent various sectors of the economy. The Board advises the National Council for the American Worker.

The September meeting will include discussions of initial recommendations under each of the four main goals of the Advisory Board:

- *Develop a Campaign to Promote Multiple Pathways to Career Success.* Companies, workers, parents, and policymakers have traditionally assumed that a university degree is the best, or only, path to a middle-class career. Employers and job seekers should be aware of multiple career pathways and skill development opportunities outside of traditional 4-year degrees.
- *Increase Data Transparency to Better Match American Workers with American Jobs.* High-quality, transparent, and timely data can significantly improve the ability of employers, students, job seekers, education providers, and policymakers to make informed choices about education and employment—especially for matching education and training programs to in-demand jobs and the skills needed to fill them.
- *Modernize Candidate Recruitment and Training Practices.* Employers often struggle to fill job vacancies, yet their hiring practices may actually reduce the pool of qualified job applicants. To acquire a talented workforce, employers must better identify the skills needed for specific jobs and communicate those needs to education providers, job seekers, and students.
- *Measure and Encourage Employer-led Training Investments.* The size, scope, and impacts of education and skills training investments are still not fully understood. There is a lack of consistent data on company balance sheets and in federal statistics. Business and policy makers need to know how much is spent on training, the types of workers receiving training, and the long-term value of the money and time spent in classroom and on-the-job training.

Sabrina L. Montes,

Designated Federal Official, American Workforce Policy Advisory Board, Bureau of Economic Analysis.

[FR Doc. 2019–18104 Filed 8–21–19; 8:45 am]

BILLING CODE 3510–MN–P

DEPARTMENT OF COMMERCE

Bureau of Industry and Security

Order Denying Export Privileges

In the Matter of: Adam Al Herz, Inmate Number: 13991–029, FMC Rochester, P.O. Box 4000, Rochester, MN 55903

On October 13, 2016, in the U.S. District Court for the Northern District of Iowa, Adam Al Herz (''Adam Herz'') was convicted of violating Section 38 of the Arms Export Control Act (22 U.S.C. 2778 (2012)) (''AECA''). Adam Herz was convicted of violating Section 38 of the AECA by knowingly and willfully attempting to export and cause to be exported, from the United States to Lebanon, firearms, ammunition, parts, accessories, attachments and associated equipment designated as defense articles on the United States Munitions List, without the required U.S. Department of State licenses. Adam Herz was sentenced to 240 months in prison, three years of supervised release, and an assessment of $300. Adam Herz also was placed on the U.S. Department of State Debarred List.

The Export Administration Regulations (''EAR'' or ''Regulations'') are administered and enforced by the

U.S. Department of Commerce's Bureau of Industry and Security (''BIS'').[1] Section 766.25 of the Regulations provides, in pertinent part, that the ''Director of [BIS's] Office of Exporter Services, in consultation with the Director of [BIS's] Office of Export Enforcement, may deny the export privileges of any person who has been convicted of a violation of . . . section 38 of the Arms Export Control Act (22 U.S.C. 2778).'' 15 CFR 766.25(a). The denial of export privileges under this provision may be for a period of up to 10 years from the date of the conviction. 15 CFR 766.25(d).[2] In addition, pursuant to Section 750.8 of the Regulations, BIS's Office of Exporter Services may revoke any BIS-issued licenses in which the person had an interest at the time of his/her conviction.[3]

BIS has received notice of Adam Herz's conviction for violating Section 38 of the AECA and has provided, pursuant to Section 766.25 of the Regulations, notice and an opportunity for Adam Herz to make a written submission to BIS. BIS has not received a submission from Adam Herz.

Based upon my review and consultations with BIS's Office of Export Enforcement, including its Director, and the facts available to BIS, I have decided to deny Adam Herz's export privileges under the Regulations for a period of 10 years from the date of Adam Herz's conviction. I have also decided to revoke any BIS-issued licenses in which Adam Herz had an interest at the time of his conviction.

Accordingly, it is hereby *ordered*:

First, from the date of this Order until October 13, 2026, Adam Al Herz, with a last known address of Inmate Number: 13991–029, FMC Rochester, P.O. Box 4000, Rochester, MN 55903, and when acting for or on his behalf, his successors, assigns, employees, agents or representatives (''the Denied Person''), may not, directly or indirectly, participate in any way in any transaction involving any commodity, software or technology (hereinafter collectively referred to as ''item'') exported or to be exported from the United States that is subject to the Regulations, including, but not limited to:

A. Applying for, obtaining, or using any license, license exception, or export control document;

B. Carrying on negotiations concerning, or ordering, buying, receiving, using, selling, delivering, storing, disposing of, forwarding, transporting, financing, or otherwise servicing in any way, any transaction involving any item exported or to be exported from the United States that is subject to the Regulations, or engaging in any other activity subject to the Regulations; or

C. Benefitting in any way from any transaction involving any item exported or to be exported from the United States that is subject to the Regulations, or from any other activity subject to the Regulations.

Second, no person may, directly or indirectly, do any of the following:

A. Export or reexport to or on behalf of the Denied Person any item subject to the Regulations;

B. Take any action that facilitates the acquisition or attempted acquisition by the Denied Person of the ownership, possession, or control of any item subject to the Regulations that has been or will be exported from the United States, including financing or other support activities related to a transaction whereby the Denied Person acquires or attempts to acquire such ownership, possession or control;

C. Take any action to acquire from or to facilitate the acquisition or attempted acquisition from the Denied Person of any item subject to the Regulations that has been exported from the United States;

D. Obtain from the Denied Person in the United States any item subject to the Regulations with knowledge or reason to know that the item will be, or is intended to be, exported from the United States; or

E. Engage in any transaction to service any item subject to the Regulations that has been or will be exported from the United States and which is owned, possessed or controlled by the Denied Person, or service any item, of whatever origin, that is owned, possessed or controlled by the Denied Person if such service involves the use of any item subject to the Regulations that has been or will be exported from the United States. For purposes of this paragraph, servicing means installation, maintenance, repair, modification or testing.

Third, after notice and opportunity for comment as provided in Section 766.23 of the Regulations, any other person, firm, corporation, or business organization related to Adam Herz by ownership, control, position of responsibility, affiliation, or other connection in the conduct of trade or business may also be made subject to the provisions of this Order in order to prevent evasion of this Order.

Fourth, in accordance with Part 756 of the Regulations, Adam Herz may file an appeal of this Order with the Under Secretary of Commerce for Industry and Security. The appeal must be filed within 45 days from the date of this Order and must comply with the provisions of Part 756 of the Regulations.

Fifth, a copy of this Order shall be delivered to Adam Herz and shall be published in the **Federal Register**.

Sixth, this Order is effective immediately and shall remain in effect until October 13, 2026.

Issued this 13th day of August, 2019.

Karen H. Nies-Vogel,

Director, Office of Exporter Services.

[FR Doc. 2019–18069 Filed 8–21–19; 8:45 am]

BILLING CODE P

[1] The Regulations are currently codified in the Code of Federal Regulations at 15 CFR parts 730–774 (2019). The Regulations originally issued under the Export Administration Act of 1979, as amended, 50 U.S.C. 4601–4623 (Supp. III 2015) (''EAA''), which lapsed on August 21, 2001. The President, through Executive Order 13,222 of August 17, 2001 (3 CFR, 2001 Comp. 783 (2002)), which has been extended by successive Presidential Notices, the most recent being that of August 8, 2018 (83 FR 39,871 (Aug. 13, 2018)), continued the Regulations in full force and effect under the International Emergency Economic Powers Act, 50 U.S.C. 1701, *et seq.* (2012) (''IEEPA''). On August 13, 2018, the President signed into law the John S. McCain National Defense Authorization Act for Fiscal Year 2019, which includes the Export Control Reform Act of 2018, Division A, Title XVII, Subtitle B of Public Law 115–232, 132 Stat. 2208 (''ECRA''). While Section 1766 of ECRA repeals the provisions of the EAA (except for three sections which are inapplicable here), Section 1768 of ECRA provides, in pertinent part, that all rules and regulations that were made or issued under the EAA, including as continued in effect pursuant to IEEPA, and were in effect as of ECRA's date of enactment (August 13, 2018), shall continue in effect according to their terms until modified, superseded, set aside, or revoked through action undertaken pursuant to the authority provided under ECRA.

[2] *See also* Section 11(h) of the EAA, 50 U.S.C. 4610(h) (Supp. III 2015); Sections 1760(e) and 1768 of ECRA, Title XVII, Subtitle B of Public Law 115–232, 132 Stat. 2208, 2225 and 2233 (Aug. 13, 2018); and note 1, *supra.*

[3] *See* notes 1 and 2, *supra.*

DEPARTMENT OF COMMERCE

Bureau of Industry and Security

Order Denying Export Privileges

In the Matter of: Bassem Afif Herz, Inmate Number: 13989–029, FCI Ray Brook, P.O. Box 900, Ray Brook, NY 12977

On December 12, 2016, in the U.S. District Court for the Northern District of Iowa, Bassem Afif Herz (''Bassem Herz'') was convicted of violating Section 38 of the Arms Export Control Act (22 U.S.C. 2778 (2012)) (''AECA''). Bassem Herz was convicted of violating Section 38 of the AECA by knowingly and willfully attempting to export and cause to be exported, from the United States to Lebanon, firearms and ammunition designated as defense articles on the United States Munitions List, without the required U.S. Department of State licenses. Bassem Herz was sentenced to 97 months in prison, three years of supervised release, and an assessment of $300. Bassem Herz also was placed on the U.S. Department of State Debarred List.

The Export Administration Regulations (''EAR'' or ''Regulations'') are administered and enforced by the U.S. Department of Commerce's Bureau of Industry and Security (''BIS'').[1] Section 766.25 of the Regulations provides, in pertinent part, that the ''Director of [BIS's] Office of Exporter Services, in consultation with the Director of [BIS's] Office of Export Enforcement, may deny the export privileges of any person who has been convicted of a violation of . . . section 38 of the Arms Export Control Act (22 U.S.C. 2778).'' 15 CFR 766.25(a). The denial of export privileges under this provision may be for a period of up to 10 years from the date of the conviction. 15 CFR 766.25(d).[2] In addition, pursuant to Section 750.8 of the Regulations, BIS's Office of Exporter Services may revoke any BIS-issued licenses in which the person had an interest at the time of his/her conviction.[3]

BIS has received notice of Bassem Herz's conviction for violating Section 38 of the AECA and has provided, pursuant to Section 766.25 of the Regulations, notice and an opportunity for Bassem Herz to make a written submission to BIS. BIS has not received a submission from Bassem Herz.

Based upon my review and consultations with BIS's Office of Export Enforcement, including its Director, and the facts available to BIS, I have decided to deny Bassem Herz's export privileges under the Regulations for a period of 10 years from the date of Bassem Herz's conviction. I have also decided to revoke any BIS-issued licenses in which Bassem Herz had an interest at the time of his conviction.

Accordingly, it is hereby *ordered:*

First, from the date of this Order until December 12, 2026, Bassem Afif Herz, with a last known address of Inmate Number: 13989–029, FCI Ray Brook, P.O. Box 900, Ray Brook, NY 12977, and when acting for or on his behalf, his successors, assigns, employees, agents or representatives (''the Denied Person''), may not, directly or indirectly, participate in any way in any transaction involving any commodity, software or technology (hereinafter collectively referred to as ''item'') exported or to be exported from the United States that is subject to the Regulations, including, but not limited to:

A. Applying for, obtaining, or using any license, license exception, or export control document;

B. Carrying on negotiations concerning, or ordering, buying, receiving, using, selling, delivering, storing, disposing of, forwarding, transporting, financing, or otherwise servicing in any way, any transaction involving any item exported or to be exported from the United States that is subject to the Regulations, or engaging in any other activity subject to the Regulations; or

C. Benefitting in any way from any transaction involving any item exported or to be exported from the United States that is subject to the Regulations, or from any other activity subject to the Regulations.

Second, no person may, directly or indirectly, do any of the following:

A. Export or reexport to or on behalf of the Denied Person any item subject to the Regulations;

B. Take any action that facilitates the acquisition or attempted acquisition by the Denied Person of the ownership, possession, or control of any item subject to the Regulations that has been or will be exported from the United States, including financing or other support activities related to a transaction whereby the Denied Person acquires or attempts to acquire such ownership, possession or control;

C. Take any action to acquire from or to facilitate the acquisition or attempted acquisition from the Denied Person of any item subject to the Regulations that has been exported from the United States;

D. Obtain from the Denied Person in the United States any item subject to the Regulations with knowledge or reason to know that the item will be, or is intended to be, exported from the United States; or

E. Engage in any transaction to service any item subject to the Regulations that has been or will be exported from the United States and which is owned, possessed or controlled by the Denied Person, or service any item, of whatever origin, that is owned, possessed or controlled by the Denied Person if such service involves the use of any item subject to the Regulations that has been or will be exported from the United States. For purposes of this paragraph, servicing means installation, maintenance, repair, modification or testing.

Third, after notice and opportunity for comment as provided in Section 766.23 of the Regulations, any other person, firm, corporation, or business organization related to Bassem Herz by ownership, control, position of responsibility, affiliation, or other connection in the conduct of trade or business may also be made subject to the provisions of this Order in order to prevent evasion of this Order.

Fourth, in accordance with Part 756 of the Regulations, Bassem Herz may file an appeal of this Order with the Under Secretary of Commerce for Industry and Security. The appeal must be filed within 45 days from the date of this Order and must comply with the provisions of Part 756 of the Regulations.

Fifth, a copy of this Order shall be delivered to Bassem Herz and shall be published in the **Federal Register**.

Sixth, this Order is effective immediately and shall remain in effect until December 12, 2026.

Issued this 13th day of August, 2019.

Karen H. Nies-Vogel,

Director, Office of Exporter Services.

[FR Doc. 2019–18068 Filed 8–21–19; 8:45 am]

BILLING CODE P

DEPARTMENT OF COMMERCE

Bureau of Industry and Security

Order Denying Export Privileges

In the Matter of: Sarah Majid Zeaiter, Inmate Number: 13993–029, FCI Waseca, P.O. Box 1731, Waseca, MN 56093

On October 14, 2016, in the U.S. District Court for the Northern District

[1] The Regulations are currently codified in the Code of Federal Regulations at 15 CFR parts 730–774 (2019). The Regulations originally issued under the Export Administration Act of 1979, as amended, 50 U.S.C. 4601–4623 (Supp. III 2015) (''EAA''), which lapsed on August 21, 2001. The President, through Executive Order 13,222 of August 17, 2001 (3 CFR, 2001 Comp. 783 (2002)), which has been extended by successive Presidential Notices, the most recent being that of August 8, 2018 (83 FR 39,871 (Aug. 13, 2018)), continued the Regulations in full force and effect under the International Emergency Economic Powers Act, 50 U.S.C. 1701, *et seq.* (2012) (''IEEPA''). On August 13, 2018, the President signed into law the John S. McCain National Defense Authorization Act for Fiscal Year 2019, which includes the Export Control Reform Act of 2018, Division A, Title XVII, Subtitle B of Public Law 115–232, 132 Stat. 2208 (''ECRA''). While Section 1766 of ECRA repeals the provisions of the EAA (except for three sections which are inapplicable here), Section 1768 of ECRA provides, in pertinent part, that all rules and regulations that were made or issued under the EAA, including as continued in effect pursuant to IEEPA, and were in effect as of ECRA's date of enactment (August 13, 2018), shall continue in effect according to their terms until modified, superseded, set aside, or revoked through action undertaken pursuant to the authority provided under ECRA.

[2] *See also* Section 11(h) of the EAA, 50 U.S.C. 4610(h) (Supp. III 2015); Sections 1760(e) and 1768 of ECRA, Title XVII, Subtitle B of Public Law 115–232, 132 Stat. 2208, 2225 and 2233 (Aug. 13, 2018); and note 1, *supra.*

[3] *See* notes 1 and 2, *supra.*

of Iowa, Sarah Majid Zeaiter (''Zeaiter'') was convicted of violating Section 38 of the Arms Export Control Act (22 U.S.C. 2778 (2012)) (''AECA''). Zeaiter was convicted of violating Section 38 of the AECA by knowingly and willfully attempting to export and cause to be exported, from the United States to Lebanon, firearms and ammunition designated as defense articles on the United States Munitions List, without the required U.S. Department of State licenses. Zeaiter was sentenced to 87 months in prison, three years of supervised release, and an assessment of $300. Zeaiter also was placed on the U.S. Department of State Debarred List.

The Export Administration Regulations (''EAR'' or ''Regulations'') are administered and enforced by the U.S. Department of Commerce's Bureau of Industry and Security (''BIS'').[1] Section 766.25 of the Regulations provides, in pertinent part, that the ''Director of [BIS's] Office of Exporter Services, in consultation with the Director of [BIS's] Office of Export Enforcement, may deny the export privileges of any person who has been convicted of a violation of . . . section 38 of the Arms Export Control Act (22 U.S.C. 2778).'' 15 CFR 766.25(a). The denial of export privileges under this provision may be for a period of up to 10 years from the date of the conviction. 15 CFR 766.25(d).[2] In addition, pursuant to Section 750.8 of the Regulations, BIS's Office of Exporter Services may revoke any BIS-issued licenses in which the person had an interest at the time of his/her conviction.[3]

BIS has received notice of Zeaiter's conviction for violating Section 38 of the AECA and has provided, pursuant to Section 766.25 of the Regulations, notice and an opportunity for Zeaiter to make a written submission to BIS. BIS has not received a submission from Zeaiter.

Based upon my review and consultations with BIS's Office of Export Enforcement, including its Director, and the facts available to BIS, I have decided to deny Zeaiter's export privileges under the Regulations for a period of 10 years from the date of Zeaiter's conviction. I have also decided to revoke any BIS-issued licenses in which Zeaiter had an interest at the time of her conviction.

Accordingly, it is hereby *ordered*:

First, from the date of this Order until October 14, 2026, Sarah Majid Zeaiter, with a last known address of Inmate Number: 13993–029, FCI Waseca, P.O. Box 1731, Waseca, MN 56093, and when acting for or on her behalf, her successors, assigns, employees, agents or representatives (''the Denied Person''), may not, directly or indirectly, participate in any way in any transaction involving any commodity, software or technology (hereinafter collectively referred to as ''item'') exported or to be exported from the United States that is subject to the Regulations, including, but not limited to:

A. Applying for, obtaining, or using any license, license exception, or export control document;

B. Carrying on negotiations concerning, or ordering, buying, receiving, using, selling, delivering, storing, disposing of, forwarding, transporting, financing, or otherwise servicing in any way, any transaction involving any item exported or to be exported from the United States that is subject to the Regulations, or engaging in any other activity subject to the Regulations; or

C. Benefitting in any way from any transaction involving any item exported or to be exported from the United States that is subject to the Regulations, or from any other activity subject to the Regulations.

Second, no person may, directly or indirectly, do any of the following:

A. Export or reexport to or on behalf of the Denied Person any item subject to the Regulations;

B. Take any action that facilitates the acquisition or attempted acquisition by the Denied Person of the ownership, possession, or control of any item subject to the Regulations that has been or will be exported from the United States, including financing or other support activities related to a transaction whereby the Denied Person acquires or attempts to acquire such ownership, possession or control;

C. Take any action to acquire from or to facilitate the acquisition or attempted acquisition from the Denied Person of any item subject to the Regulations that has been exported from the United States;

D. Obtain from the Denied Person in the United States any item subject to the Regulations with knowledge or reason to know that the item will be, or is intended to be, exported from the United States; or

E. Engage in any transaction to service any item subject to the Regulations that has been or will be exported from the United States and which is owned, possessed or controlled by the Denied Person, or service any item, of whatever origin, that is owned, possessed or controlled by the Denied Person if such service involves the use of any item subject to the Regulations that has been or will be exported from the United States. For purposes of this paragraph, servicing means installation, maintenance, repair, modification or testing.

Third, after notice and opportunity for comment as provided in Section 766.23 of the Regulations, any other person, firm, corporation, or business organization related to Zeaiter by ownership, control, position of responsibility, affiliation, or other connection in the conduct of trade or business may also be made subject to the provisions of this Order in order to prevent evasion of this Order.

Fourth, in accordance with Part 756 of the Regulations, Zeaiter may file an appeal of this Order with the Under Secretary of Commerce for Industry and Security. The appeal must be filed within 45 days from the date of this Order and must comply with the provisions of Part 756 of the Regulations.

Fifth, a copy of this Order shall be delivered to Zeaiter and shall be published in the **Federal Register**.

Sixth, this Order is effective immediately and shall remain in effect until October 14, 2026.

Issued this 13th day of August, 2019.

Karen H. Nies-Vogel,

Director, Office of Exporter Services.

[FR Doc. 2019–18066 Filed 8–21–19; 8:45 am]

BILLING CODE P

[1] The Regulations are currently codified in the Code of Federal Regulations at 15 CFR parts 730–774 (2019). The Regulations originally issued under the Export Administration Act of 1979, as amended, 50 U.S.C. 4601–4623 (Supp. III 2015) (''EAA''), which lapsed on August 21, 2001. The President, through Executive Order 13,222 of August 17, 2001 (3 CFR, 2001 Comp. 783 (2002)), which has been extended by successive Presidential Notices, the most recent being that of August 8, 2018 (83 FR 39,871 (Aug. 13, 2018)), continued the Regulations in full force and effect under the International Emergency Economic Powers Act, 50 U.S.C. 1701, *et seq.* (2012) (''IEEPA''). On August 13, 2018, the President signed into law the John S. McCain National Defense Authorization Act for Fiscal Year 2019, which includes the Export Control Reform Act of 2018, Division A, Title XVII, Subtitle B of Public Law 115–232, 132 Stat. 2208 (''ECRA''). While Section 1766 of ECRA repeals the provisions of the EAA (except for three sections which are inapplicable here), Section 1768 of ECRA provides, in pertinent part, that all rules and regulations that were made or issued under the EAA, including as continued in effect pursuant to IEEPA, and were in effect as of ECRA's date of enactment (August 13, 2018), shall continue in effect according to their terms until modified, superseded, set aside, or revoked through action undertaken pursuant to the authority provided under ECRA.

[2] *See also* Section 11(h) of the EAA, 50 U.S.C. 4610(h) (Supp. III 2015); Sections 1760(e) and 1768 of ECRA, Title XVII, Subtitle B of Public Law 115–232, 132 Stat. 2208, 2225 and 2233 (Aug. 13, 2018); and note 1, *supra.*

[3] *See* notes 1 and 2, *supra.*

DEPARTMENT OF COMMERCE

Bureau of Industry and Security

Order Denying Export Privileges

In the Matter of: Ali Afif Al Herz, Inmate Number: 13992–029, FCI Greenville, P.O. Box 5000, Greenville, IL 62246

On October 31, 2016, in the U.S. District Court for the Northern District of Iowa, Ali Afif Al Herz (''Ali Herz'') was convicted of violating Section 38 of the Arms Export Control Act (22 U.S.C. 2778 (2012)) (''AECA''). Ali Herz was convicted of violating Section 38 of the AECA by knowingly and willfully attempting to export and cause to be exported, from the United States to Lebanon, firearms, ammunition, parts, accessories, attachments and associated equipment designated as defense articles on the United States Munitions List, without the required U.S. Department of State licenses. Ali Herz was sentenced to 342 months in prison, three years of supervised release, a fine of $150,000, and an assessment of $400. Ali Herz also was placed on the U.S. Department of State Debarred List.

The Export Administration Regulations (''EAR'' or ''Regulations'') are administered and enforced by the U.S. Department of Commerce's Bureau of Industry and Security (''BIS'').[1] Section 766.25 of the Regulations provides, in pertinent part, that the ''Director of [BIS's] Office of Exporter Services, in consultation with the Director of [BIS's] Office of Export Enforcement, may deny the export privileges of any person who has been convicted of a violation of . . . section 38 of the Arms Export Control Act (22 U.S.C. 2778).'' 15 CFR 766.25(a). The denial of export privileges under this provision may be for a period of up to 10 years from the date of the conviction. 15 CFR 766.25(d).[2] In addition, pursuant to Section 750.8 of the Regulations, BIS's Office of Exporter Services may revoke any BIS-issued licenses in which the person had an interest at the time of his/her conviction.[3]

BIS has received notice of Ali Herz's conviction for violating Section 38 of the AECA and has provided, pursuant to Section 766.25 of the Regulations, notice and an opportunity for Ali Herz to make a written submission to BIS. BIS has not received a submission from Ali Herz.

Based upon my review and consultations with BIS's Office of Export Enforcement, including its Director, and the facts available to BIS, I have decided to deny Ali Herz's export privileges under the Regulations for a period of 10 years from the date of Ali Herz's conviction. I have also decided to revoke any BIS-issued licenses in which Ali Herz had an interest at the time of his conviction.

Accordingly, it is hereby *ordered:*

First, from the date of this Order until October 31, 2026, Ali Afif Al Herz, with a last known address of Inmate Number: 13992–029, FCI Greenville, P.O. Box 5000, Greenville, IL 62246, and when acting for or on his behalf, his successors, assigns, employees, agents or representatives (''the Denied Person''), may not, directly or indirectly, participate in any way in any transaction involving any commodity, software or technology (hereinafter collectively referred to as ''item'') exported or to be exported from the United States that is subject to the Regulations, including, but not limited to:

A. Applying for, obtaining, or using any license, license exception, or export control document;

B. Carrying on negotiations concerning, or ordering, buying, receiving, using, selling, delivering, storing, disposing of, forwarding, transporting, financing, or otherwise servicing in any way, any transaction involving any item exported or to be exported from the United States that is subject to the Regulations, or engaging in any other activity subject to the Regulations; or

C. Benefitting in any way from any transaction involving any item exported or to be exported from the United States that is subject to the Regulations, or from any other activity subject to the Regulations.

Second, no person may, directly or indirectly, do any of the following:

A. Export or reexport to or on behalf of the Denied Person any item subject to the Regulations;

B. Take any action that facilitates the acquisition or attempted acquisition by the Denied Person of the ownership, possession, or control of any item subject to the Regulations that has been or will be exported from the United States, including financing or other support activities related to a transaction whereby the Denied Person acquires or attempts to acquire such ownership, possession or control;

C. Take any action to acquire from or to facilitate the acquisition or attempted acquisition from the Denied Person of any item subject to the Regulations that has been exported from the United States;

D. Obtain from the Denied Person in the United States any item subject to the Regulations with knowledge or reason to know that the item will be, or is intended to be, exported from the United States; or

E. Engage in any transaction to service any item subject to the Regulations that has been or will be exported from the United States and which is owned, possessed or controlled by the Denied Person, or service any item, of whatever origin, that is owned, possessed or controlled by the Denied Person if such service involves the use of any item subject to the Regulations that has been or will be exported from the United States. For purposes of this paragraph, servicing means installation, maintenance, repair, modification or testing.

Third, after notice and opportunity for comment as provided in Section 766.23 of the Regulations, any other person, firm, corporation, or business organization related to Ali Herz by ownership, control, position of responsibility, affiliation, or other connection in the conduct of trade or business may also be made subject to the provisions of this Order in order to prevent evasion of this Order.

Fourth, in accordance with Part 756 of the Regulations, Ali Herz may file an appeal of this Order with the Under Secretary of Commerce for Industry and Security. The appeal must be filed within 45 days from the date of this Order and must comply with the provisions of Part 756 of the Regulations.

[1] The Regulations are currently codified in the Code of Federal Regulations at 15 CFR parts 730–774 (2019). The Regulations originally issued under the Export Administration Act of 1979, as amended, 50 U.S.C. 4601–4623 (Supp. III 2015) (''EAA''), which lapsed on August 21, 2001. The President, through Executive Order 13,222 of August 17, 2001 (3 CFR, 2001 Comp. 783 (2002)), which has been extended by successive Presidential Notices, the most recent being that of August 8, 2018 (83 FR 39,871 (Aug. 13, 2018)), continued the Regulations in full force and effect under the International Emergency Economic Powers Act, 50 U.S.C. 1701, *et seq.* (2012) (''IEEPA''). On August 13, 2018, the President signed into law the John S. McCain National Defense Authorization Act for Fiscal Year 2019, which includes the Export Control Reform Act of 2018, Division A, Title XVII, Subtitle B of Public Law 115–232, 132 Stat. 2208 (''ECRA''). While Section 1766 of ECRA repeals the provisions of the EAA (except for three sections which are inapplicable here), Section 1768 of ECRA provides, in pertinent part, that all rules and regulations that were made or issued under the EAA, including as continued in effect pursuant to IEEPA, and were in effect as of ECRA's date of enactment (August 13, 2018), shall continue in effect according to their terms until modified, superseded, set aside, or revoked through action undertaken pursuant to the authority provided under ECRA.

[2] *See also* Section 11(h) of the EAA, 50 U.S.C. 4610(h) (Supp. III 2015); Sections 1760(e) and 1768 of ECRA, Title XVII, Subtitle B of Public Law 115–232, 132 Stat. 2208, 2225 and 2233 (Aug. 13, 2018); and note 1, *supra.*

[3] *See* notes 1 and 2, *supra.*

Fifth, a copy of this Order shall be delivered to Ali Herz and shall be published in the **Federal Register**.

Sixth, this Order is effective immediately and shall remain in effect until October 31, 2026.

Issued this 13th day of August, 2019.

Karen H. Nies-Vogel,

Director, Office of Exporter Services.

[FR Doc. 2019–18073 Filed 8–21–19; 8:45 am]

BILLING CODE 3510–33–P

DEPARTMENT OF COMMERCE

National Oceanic and Atmospheric Administration

RIN 0648–XV033

New England Fishery Management Council; Public Meeting

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

ACTION: Notice; public meeting.

SUMMARY: The New England Fishery Management Council (Council) is scheduling a public meeting of its Groundfish Advisory Panel to consider actions affecting New England fisheries in the exclusive economic zone (EEZ). Recommendations from this group will be brought to the full Council for formal consideration and action, if appropriate.

DATES: This meeting will be held on Monday, September 16, 2019 at 9 a.m.

ADDRESSES: The meeting will be held at the Hilton Garden Inn, 100 Boardman Street, Boston, MA 02129; phone: (617) 567–6789.

Council address: New England Fishery Management Council, 50 Water Street, Mill 2, Newburyport, MA 01950.

FOR FURTHER INFORMATION CONTACT: Thomas A. Nies, Executive Director, New England Fishery Management Council; telephone: (978) 465–0492.

SUPPLEMENTARY INFORMATION:

Agenda

The Groundfish Advisory Panel will review the draft Environmental Impact Statement (DEIS) and recommend preliminary preferred alternatives, as well as discuss draft alternatives focusing on (1) 2020 total allowable catches for U.S./Canada stocks of Eastern Georges Bank (GB) cod, Eastern GB haddock, and GB yellowtail flounder and (2) revisions to the GB cod Incidental Catch TAC to remove the allocation to the Closed Area I (CAI) Haddock Special Access Program (SAP). The Advisory Panel will also discuss a draft list of possible groundfish priorities for 2020 and will also receive an update on the Commercial Electronic Vessel Trip Reporting (eVTR) Omnibus Framework, which proposes to implement electronic VTRs for all vessels with commercial permits for species managed by the Mid-Atlantic and New England Fishery Management Councils. They will also make recommendations to the Groundfish Committee, and discuss other business as necessary.

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 Act, provided the public has been notified of the Council's intent to take final action to address the emergency.

Special Accommodations

This meeting is physically accessible to people with disabilities. Requests for sign language interpretation or other auxiliary aids should be directed to Thomas A. Nies, Executive Director, at (978) 465–0492, at least 5 days prior to the meeting date. This meeting will be recorded. Consistent with 16 U.S.C. 1852, a copy of the recording is available upon request.

Authority: 16 U.S.C. 1801 *et seq.*

Dated: August 16, 2019.

Tracey L. Thompson,

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

[FR Doc. 2019–18071 Filed 8–21–19; 8:45 am]

BILLING CODE 3510–22–P

DEPARTMENT OF COMMERCE

National Oceanic and Atmospheric Administration

RIN 0648–XH050

Fisheries of the Exclusive Economic Zone Off Alaska; Bering Sea and Aleutian Islands Crab Rationalization Cost Recovery Program

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

ACTION: Notification of fee percentage.

SUMMARY: NMFS publishes notification of a 1.70 percent fee for cost recovery under the Bering Sea and Aleutian Islands Crab Rationalization Program. This action is intended to provide holders of crab allocations with the 2019/2020 crab fishing year fee percentage so they can calculate the required cost recovery fee payment that must be submitted by July 31, 2020.

DATES: The Crab Rationalization Program Registered Crab Receiver permit holder is responsible for submitting the fee liability payment to NMFS by July 31, 2020.

FOR FURTHER INFORMATION CONTACT: Doug Duncan, (907) 586–7228.

SUPPLEMENTARY INFORMATION:

Background

NMFS Alaska Region administers the Bering Sea and Aleutian Islands Crab Rationalization Program (Program) in the North Pacific. Fishing under the Program began on August 15, 2005. Regulations implementing the Program can be found at 50 CFR part 680.

The Program is a limited access privilege program authorized by section 313(j) of the Magnuson-Stevens Fishery Conservation and Management Act (Magnuson-Stevens Act). The Program includes a cost recovery provision to collect fees to recover the actual costs directly related to the management, data collection, and enforcement of the Program. The Program implemented under the authority of section 313(j) is consistent with the cost recovery provisions included under section 304(d)(2)(A) of the Magnuson-Stevens Act. NMFS developed the cost recovery provision to conform to statutory requirements and to reimburse the agency for the actual costs directly related to the management, data collection, and enforcement of the Program. The cost recovery provision allows collection of 133 percent of the actual management, data collection, and enforcement costs up to 3 percent of the ex-vessel value of crab harvested under the Program. The Program provides that a proportional share of fees charged be forwarded to the State of Alaska for reimbursement of its share of management and data collection costs for the Program.

A crab allocation holder generally incurs a cost recovery fee liability for every pound of crab landed. Catcher vessel and processor quota shareholders split the cost recovery fees equally with each paying half, while catcher/processor quota shareholders pay the full fee percentage for crab processed at sea. The crab allocations subject to cost recovery include Individual Fishing Quota, Crew Individual Fishing Quota, Individual Processing Quota, Community Development Quota, and the Adak community allocation. The

Registered Crab Receiver (RCR) permit holder must collect the fee liability from the crab allocation holder who is landing crab. Additionally, the RCR permit holder must collect their own fee liability for all crab delivered to the RCR. The RCR permit holder is responsible for submitting this payment to NMFS on or before July 31, in the year following the crab fishing year in which landings of crab were made.

The dollar amount of the fee due is determined by multiplying the fee percentage (not to exceed 3 percent) by the ex-vessel value of crab debited from the allocation. Specific details on the Program's cost recovery provision may be found in the implementing regulations at 50 CFR 680.44.

Fee Percentage

Each year, NMFS calculates and publishes in the **Federal Register** the fee percentage according to the factors and methodology described at § 680.44(c)(2). The formula for determining the fee percentage is the ''direct program costs'' divided by ''value of the fishery,'' where ''direct program costs'' are the direct program costs for the Program for the previous fiscal year, and ''value of the fishery'' is the ex-vessel value of the catch subject to the crab cost recovery fee liability for the current year. Fee collections for any given year may be less than, or greater than, the actual costs and fishery value for that year, because, by regulation, the fee percentage is established in the first quarter of a crab fishery year based on the fishery's value and costs in the prior year.

According to the fee percentage formula described above, the estimated percentage of costs to value for the 2018/2019 fishery was 1.70 percent. Therefore, the fee percentage will be 1.70 percent for the 2019/2020 crab fishing year. This is a decrease of 0.15 percent from the 2018/2019 fee percentage of 1.85 percent (83 FR 34119, July 19, 2018). Direct program costs for managing the fishery decreased by 0.7 percent from 2017/2018 to 2018/2019, while fishery value increased 8.5 percent, resulting in the decreased fee percentage. Similar to previous years, the largest direct program costs were incurred by the Alaska Department of Fish and Game and the NOAA Office of Law Enforcement.

Authority: 16 U.S.C. 1862; Pub. L. 109–241; Pub. L. 109–479.

Dated: August 15, 2019.

Alan D. Risenhoover,

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

[FR Doc. 2019–18127 Filed 8–21–19; 8:45 am]

BILLING CODE 3510–22–P

DEPARTMENT OF COMMERCE

National Oceanic and Atmospheric Administration

RIN 0648–XV034

New England Fishery Management Council; Public Meeting

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

ACTION: Notice; public meeting.

SUMMARY: The New England Fishery Management Council (Council) is scheduling a public meeting of its Groundfish Committee to consider actions affecting New England fisheries in the exclusive economic zone (EEZ). Recommendations from this group will be brought to the full Council for formal consideration and action, if appropriate.

DATES: This meeting will be held on Tuesday, September 17, 2019 at 9 a.m.

ADDRESSES: The meeting will be held at the Hilton Garden Inn, 100 Boardman Street, Boston, MA 02129; phone: (617) 567–6789.

Council address: New England Fishery Management Council, 50 Water Street, Mill 2, Newburyport, MA 01950.

FOR FURTHER INFORMATION CONTACT: Thomas A. Nies, Executive Director, New England Fishery Management Council; telephone: (978) 465–0492.

SUPPLEMENTARY INFORMATION:

Agenda

The committee will review the draft Environmental Impact Statement (DEIS) and recommend preliminary preferred alternatives, as well as discuss draft alternatives focusing on (1) 2020 total allowable catches for U.S./Canada stocks of Eastern Georges Bank (GB) cod, Eastern GB haddock, and GB yellowtail flounder and (2) revisions to the GB cod Incidental Catch TAC to remove the allocation to the Closed Area I (CAI) Haddock Special Access Program (SAP). The committee will also discuss a draft list of possible groundfish priorities for 2020 and will also receive an update on the Commercial Electronic Vessel Trip Reporting (eVTR) Omnibus Framework, which proposes to implement electronic VTRs for all vessels with commercial permits for species managed by the Mid-Atlantic and New England Fishery Management Councils. The committee will also review Groundfish Plan Development Team, Groundfish Advisory Panel, and Transboundary Management Guidance Committee recommendations and make recommendations to the Council, and discuss other business as necessary. A Closed Session will be held for Committee members only to review the Recreation Advisory Panel and Groundfish Advisory Panel applications for 2020–22 and provide recommendations.

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 Act, provided the public has been notified of the Council's intent to take final action to address the emergency.

Special Accommodations

This meeting is physically accessible to people with disabilities. Requests for sign language interpretation or other auxiliary aids should be directed to Thomas A. Nies, Executive Director, at (978) 465–0492, at least 5 days prior to the meeting date. This meeting will be recorded. Consistent with 16 U.S.C. 1852, a copy of the recording is available upon request.

Authority: 16 U.S.C. 1801 *et seq.*

Dated: August 16, 2019.

Tracey L. Thompson,

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

[FR Doc. 2019–18072 Filed 8–21–19; 8:45 am]

BILLING CODE 3510–22–P

DEPARTMENT OF COMMERCE

National Oceanic and Atmospheric Administration

RIN 0648–XR022

Marine Mammals; File No. 22884

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

ACTION: Notice; receipt of application.

SUMMARY: Notice is hereby given that Mark Baumgartner, Ph.D., Woods Hole Oceanographic Institution, MS No. 33, Biology Department, Woods Hole, MA

02543 has applied in due form for a permit to conduct research on two species of marine mammals.

DATES: Written, telefaxed, or email comments must be received on or before September 23, 2019.

ADDRESSES: The application and related documents are available for review by selecting ''Records Open for Public Comment'' from the ''Features'' box on the Applications and Permits for Protected Species (APPS) home page, *https://apps.nmfs.noaa.gov,* and then selecting File No. 22884 from the list of available applications.

These documents are also available upon written request or by appointment in the Permits and Conservation Division, Office of Protected Resources, NMFS, 1315 East-West Highway, Room 13705, Silver Spring, MD 20910; phone: (301) 427–8401; fax: (301) 713–0376.

Written comments on this application should be submitted to the Chief, Permits and Conservation Division, at the address listed above. Comments may also be submitted by facsimile to (301) 713–0376, or by email to *NMFS.Pr1Comments@noaa.gov.* Please include the File No. in the subject line of the email comment.

Those individuals requesting a public hearing should submit a written request to the Chief, Permits and Conservation Division at the address listed above. The request should set forth the specific reasons why a hearing on this application would be appropriate.

FOR FURTHER INFORMATION CONTACT: Shasta McClenahan or Amy Hapeman, (301) 427–8401.

SUPPLEMENTARY INFORMATION: The subject permit is requested under the authority of the Marine Mammal Protection Act of 1972, as amended (MMPA; 16 U.S.C. 1361 *et seq.*), the regulations governing the taking and importing of marine mammals (50 CFR part 216), the Endangered Species Act of 1973, as amended (ESA; 16 U.S.C. 1531 *et seq.*), and the regulations governing the taking, importing, and exporting of endangered and threatened species (50 CFR parts 222–226).

The applicant proposes to take up to 80 endangered North Atlantic right whales (NARW; *Eubalaena glacialis*) annually by Level B harassment during vessel surveys in the Atlantic Ocean from the Gulf of Maine through the mid-Atlantic Bight. Feeding NARW may be approached by vessel for counts, observations, and collection of prey samples to determine the NARW prey species in various habitats, and to characterize the abundance and vertical distribution of those prey. Up to 20 endangered sei whales (*Balaenoptera borealis*) may be incidentally harassed if feeding in the same areas as the target NARW. The permit would be valid for five years from the date of issuance.

In compliance with the National Environmental Policy Act of 1969 (42 U.S.C. 4321 *et seq.*), an initial determination has been made that the activity proposed is categorically excluded from the requirement to prepare an environmental assessment or environmental impact statement.

Concurrent with the publication of this notice in the **Federal Register**, NMFS is forwarding copies of the application to the Marine Mammal Commission and its Committee of Scientific Advisors.

Dated: August 19, 2019.

Julia Marie Harrison,

Chief, Permits and Conservation Division, Office of Protected Resources, National Marine Fisheries Service.

[FR Doc. 2019–18118 Filed 8–21–19; 8:45 am]

BILLING CODE 3510–22–P

DEPARTMENT OF COMMERCE

National Oceanic and Atmospheric Administration

RIN 0648–XV032

New England Fishery Management Council; Public Meeting

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

ACTION: Notice; public meeting.

SUMMARY: The New England Fishery Management Council (Council) is scheduling a public meeting of its Herring Joint Committee and Advisory Panel to consider actions affecting New England fisheries in the exclusive economic zone (EEZ). Recommendations from this group will be brought to the full Council for formal consideration and action, if appropriate.

DATES: This meeting will be held on Tuesday, September 10, 2019 at 9 a.m.

ADDRESSES: The meeting will be held at the Sheraton Harborside, 250 Market Street, Portsmouth, NH 03801; telephone: (603) 431–2300.

Council address: New England Fishery Management Council, 50 Water Street, Mill 2, Newburyport, MA 01950.

FOR FURTHER INFORMATION CONTACT: Thomas A. Nies, Executive Director, New England Fishery Management Council; telephone: (978) 465–0492.

SUPPLEMENTARY INFORMATION:

Agenda

The Committee and Advisory Panel will review preliminary analysis being prepared for a New England Fishery Management Council Discussion Document on spawning of Atlantic herring on Georges Bank and discuss possible next steps. They will provide input on a debrief of the Management Strategy Evaluation (MSE) process used to develop Amendment 8 to the Atlantic Herring Fishery Management Plan. The group will also provide initial input on potential 2020 work priorities for the Herring Fishery Management Plan that will be forwarded to the Council. They also plan to receive an update on the Commercial Electronic Vessel Trip Reporting (eVTR) Omnibus Framework, which proposes to implement eVTRs for all vessels with commercial permits for species managed by the Mid-Atlantic and New England Fishery Management Councils. There will be a closed session for the Herring Committee only to review Herring Advisory Panel applications for 2020–22 and provide recommendations. Other business may be discussed as necessary

Although non-emergency issues not contained on this agenda may come before this Council for discussion, those issues may not be the subject of formal action during this meeting. Council 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 Act, provided the public has been notified of the Council's intent to take final action to address the emergency.

Special Accommodations

This meeting is physically accessible to people with disabilities. This meeting will be recorded. Consistent with 16 U.S.C. 1852, a copy of the recording is available upon request. Requests for sign language interpretation or other auxiliary aids should be directed to Thomas A. Nies, Executive Director, at (978) 465–0492, at least 5 days prior to the meeting date.

Authority: 16 U.S.C. 1801 *et seq.*

Dated: August 16, 2019.

Tracey L. Thompson,

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

[FR Doc. 2019–18070 Filed 8–21–19; 8:45 am]

BILLING CODE 3510–22–P

COMMODITY FUTURES TRADING COMMISSION

Agency Information Collection Activities: Notice of Intent To Extend Collection 3038–0085: Rule 50.50 End-User Notification of Non-Cleared Swap

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice.

SUMMARY: The Commodity Futures Trading Commission (''CFTC'' or ''Commission'') is announcing an opportunity for public comment on the proposed renewal of a collection of certain information by the agency. Under the Paperwork Reduction Act (''PRA''), Federal agencies are required to publish notice in the **Federal Register** concerning each proposed collection of information, including each proposed extension of an existing collection of information, and to allow 60 days for public comment. This notice solicits comments on the renewal of the reporting requirement that is embedded in the final rule adopting the end-user exception to the Commission's swap clearing requirement.

DATES: Comments must be submitted on or before October 21, 2019.

ADDRESSES: You may submit comments, identified by ''Rule 50.50 End-User Notification of Non-Cleared Swap, OMB Control No. 3038–0085,'' by any of the following methods:

• The CFTC's website, at *http://comments.cftc.gov/*. Follow the instructions for submitting comments through the website.

• *Mail:* Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581.

• *Hand Delivery/Courier:* Same as Mail above.

Please submit your comments using only one method. All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to *http://www.cftc.gov*.

FOR FURTHER INFORMATION CONTACT: Melissa A. D'Arcy, Special Counsel, Division of Clearing and Risk, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581; (202) 418–5086; email: *mdarcy@cftc.gov*.

SUPPLEMENTARY INFORMATION: Under the PRA, 44 U.S.C. 3501 *et seq.,* Federal agencies must obtain approval from the Office of Management and Budget (''OMB'') for each collection of information they conduct or sponsor. ''Collection of Information'' is defined in 44 U.S.C. 3502(3) and 5 CFR 1320.3 and includes agency requests or requirements that members of the public submit reports, keep records, or provide information to a third party. Section 3506(c)(2)(A) of the PRA, 44 U.S.C. 3506(c)(2)(A), requires Federal agencies to provide a 60-day notice in the **Federal Register** concerning each proposed collection of information, including each proposed extension of an existing collection of information, before submitting the collection to OMB for approval. To comply with this requirement, the CFTC is publishing notice of the proposed extension of the currently approved collection of information listed below.

Title: Rule 50.50 End-User Notification of Non-Cleared Swap (OMB Control No. 3038–0085). This is a request for an extension of a currently approved information collection.

Abstract: CFTC Rule 50.50 specifies the requirements for eligible end-users who may elect the end-user exception from the Commission's swap clearing requirement, as provided under section 2(h)(7) of the Commodity Exchange Act (''CEA''). Rule 50.50 requires the counterparties to report certain information to a swap data repository registered with the Commission, or to the Commission directly, if one or more counterparties elects the end-user exception. The rule establishes a reporting requirement for end-users that is critical to ensuring compliance with the Commission's clearing requirement under section 2(h)(1) of the CEA and is necessary in order for Commission staff to prevent abuse of the end-user exception. In addition, this collection relates to information that the Commission needs to monitor elections of the end-user exception and to assess market risks.

With respect to the collection of information, the CFTC invites comments on:

• Whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information will have a practical use;

• The accuracy of the Commission's estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used;

• Ways to enhance the quality, usefulness, and clarity of the information to be collected; and

• Ways to minimize the burden of collection of information on those who are to respond, including through the use of appropriate automated electronic, mechanical, or other technological collection techniques or other forms of information technology; *e.g.,* permitting electronic submission of responses.

You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that you believe is exempt from disclosure under the Freedom of Information Act, a petition for confidential treatment of the exempt information may be submitted according to the procedures established in § 145.9 of the Commission's regulations.[1]

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from *http://www.cftc.gov* that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the information collection request will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the Freedom of Information Act.

Burden Statement: The Commission is revising its estimate of the burden for this collection for eligible end-users electing the end-user exception under CFTC Rule 50.50. The Commission is decreasing the estimated number of respondents from 1,815 to 1,600 based on an observed decrease in the number of entities electing the exception. The respondent burden for this collection is estimated to be as follows:

Estimated Number of Respondents: 1,600.

Estimated Average Burden Hours per Respondent: 0.58 hours.

Estimated Total Annual Burden Hours: 928 hours.

Frequency of Collection: On occasion; annually.

There are no capital costs or operating and maintenance costs associated with this collection.

(Authority: 44 U.S.C. 3501 *et seq.*)

Dated: August 19, 2019.

Robert Sidman,

Deputy Secretary of the Commission.

[FR Doc. 2019–18111 Filed 8–21–19; 8:45 am]

BILLING CODE 6351–01–P

[1] 17 CFR 145.9.

COMMODITY FUTURES TRADING COMMISSION

Agency Information Collection Activities: Notice of Intent To Extend Collection 3038–0102: Clearing Exemption for Certain Swaps Entered Into by Cooperatives

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice.

SUMMARY: The Commodity Futures Trading Commission (''CFTC'' or ''Commission'') is announcing an opportunity for public comment on the proposed renewal of a collection of certain information by the agency. Under the Paperwork Reduction Act (''PRA''), Federal agencies are required to publish notice in the **Federal Register** concerning each proposed collection of information, including each proposed extension of an existing collection of information, and to allow 60 days for public comment. This notice solicits comments on the reporting requirements related to permitting certain cooperatives to elect not to clear certain swaps that otherwise would be required to be cleared, provided that they meet certain conditions.

DATES: Comments must be submitted on or before October 21, 2019.

ADDRESSES: You may submit comments, identified by ''Clearing Exemption for Certain Swaps Entered into by Cooperatives,'' and OMB Control No. 3038–0102, by any of the following methods:

- The Agency's website, at *http://comments.cftc.gov/*. Follow the instructions for submitting comments through the website.
- *Mail:* Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581.
- *Hand Delivery/Courier:* Same as Mail above.

Please submit your comments using only one method. All comments must be submitted in English, or if not, accompanied by an English translation. Comments will be posted as received to *http://www.cftc.gov*.

FOR FURTHER INFORMATION CONTACT: Melissa A. D'Arcy, Special Counsel, Division of Clearing and Risk, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581; (202) 418–5086; email: *mdarcy@cftc.gov*.

SUPPLEMENTARY INFORMATION: Under the PRA, 44 U.S.C. 3501 *et seq.,* Federal agencies must obtain approval from the Office of Management and Budget (''OMB'') for each collection of information they conduct or sponsor. ''Collection of Information'' is defined in 44 U.S.C. 3502(3) and 5 CFR 1320.3 and includes agency requests or requirements that members of the public submit reports, keep records, or provide information to a third party. Section 3506(c)(2)(A) of the PRA, 44 U.S.C. 3506(c)(2)(A), requires Federal agencies to provide a 60-day notice in the **Federal Register** concerning each proposed collection of information, including each proposed extension of an existing collection of information, before submitting the collection to OMB for approval. To comply with this requirement, the CFTC is publishing notice of the proposed extension of the currently approved collection of information listed below.

Title: Clearing Exemption for Certain Swaps Entered into by Cooperatives (OMB Control No. 3038–0102). This is a request for an extension of a currently approved information collection.

Abstract: Section 2(h)(1)(A) of the Commodity Exchange Act (''CEA'') requires certain entities to submit swaps for clearing if they are required to be cleared by the Commission. Commission regulation 50.51 permits certain cooperatives to elect not to clear certain swaps that otherwise would be required to be cleared, provided that they meet certain conditions. The rule establishes a reporting requirement for cooperatives that is critical to ensuring compliance with the Commission's clearing requirement under section 2(h)(1) of the CEA and is necessary in order for Commission staff to prevent abuse of the cooperative exemption. In addition, this collection relates to information that the Commission needs to monitor elections of the cooperative exemption and to assess market risks.

With respect to the collection of information, the CFTC invites comments on:

- Whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information will have a practical use;
- The accuracy of the Commission's estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used;
- Ways to enhance the quality, usefulness, and clarity of the information to be collected; and
- Ways to minimize the burden of collection of information on those who are to respond, including through the use of appropriate automated electronic, mechanical, or other technological collection techniques or other forms of information technology; *e.g.,* permitting electronic submission of responses.

You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that you believe is exempt from disclosure under the Freedom of Information Act, a petition for confidential treatment of the exempt information may be submitted according to the procedures established in § 145.9 of the Commission's regulations.[1]

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse or remove any or all of your submission from *http://www.cftc.gov* that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the information collection request will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under the Freedom of Information Act.

Burden Statement: The Commission is not revising its estimate of the burden for this collection for eligible entities electing the cooperative exemption under Commission regulation 50.51. The Commission anticipates that there will continue to be approximately 25 eligible respondents and the hourly burden will remain the same. The respondent burden for this collection is estimated to be as follows:

Estimated Number of Respondents: 25.

Estimated Average Burden Hours per Respondent: 1 hour.

Estimated Total Annual Burden Hours: 25 hours.

Frequency of Collection: On occasion; annually.

There are no capital costs or operating and maintenance costs associated with this collection.

(Authority: 44 U.S.C. 3501 *et seq.*)

Dated: August 19, 2019.

Robert Sidman,

Deputy Secretary of the Commission.

[FR Doc. 2019–18112 Filed 8–21–19; 8:45 am]

BILLING CODE 6351–01–P

[1] 17 CFR 145.9.

DEPARTMENT OF DEFENSE

Office of the Secretary

Reserve Forces Policy Board (RFPB); Notice of Federal Advisory Committee Meeting

AGENCY: Office of the Secretary of Defense for Personnel and Readiness, DoD.

ACTION: Notice of Federal Advisory Committee meeting.

SUMMARY: The Department of Defense (DoD) is publishing this notice to announce that the following Federal Advisory Committee meeting of the Reserve Forces Policy Board will take place.

DATES: The RFPB will hold an open meeting to the public Tuesday, September 10, 2019 from 8:55 a.m. to 3:10 p.m.

ADDRESSES: The RFPB meeting address is the Army Navy Country Club, 1700 Army Navy Drive, Arlington, VA 22202.

FOR FURTHER INFORMATION CONTACT: Mr. Alex Sabol, Designated Federal Officer, (703) 681–0577 (Voice), (703) 681–0002 (Facsimile), Email—*Alexander.J.Sabol.Civ@Mail.Mil.* Mailing address is Reserve Forces Policy Board, 5113 Leesburg Pike, Suite 601, Falls Church, VA 22041. Website: *http://rfpb.defense.gov/.* The most up-to-date changes to the meeting can be found on the RFPB's website.

SUPPLEMENTARY INFORMATION: This meeting is being held under the provisions of the Federal Advisory Committee Act (FACA) (5 U.S.C., Appendix), the Government in the Sunshine Act (5 U.S.C. 552b), and 41 CFR 102–3.140 and 102–3.150.

Purpose of the Meeting: The purpose of the meeting is to obtain, review and evaluate information related to strategies, policies, and practices designed to improve and enhance the capabilities, efficiency, and effectiveness of the Reserve Components.

Agenda: The RFPB will hold an open meeting to the public Wednesday, September 10, 2019 from 8:55 a.m. to 3:10 p.m. The meeting will focus on discussions with the Federal Emergency Management Agency (FEMA) and will discuss FEMA's perspectives on the use of the National Guard and Reserve in responding to disasters; the National Commission of the Military, National, and Public Service will discuss the Commission's charter and their analysis on the future of the Selective Service System and the Individual Ready Reserve; the Assistant Secretary of Defense for Manpower and Reserve Affairs, Performing the Duties of the Under Secretary of Defense for Personnel and Readiness remarks will provide an update on current initiatives within the Department of Defense; the Reserve Organization of America (ROA) will provide ROA's perspectives on their initiatives and the ongoing legislative actions concerning policies affecting the Reserve Components; the United Service Organizations (USO) Inc. will provide the USO's ongoing initiatives and programs which provide valuable services and support to our military service members; the Employer Support of the Guard and Reserve Freedom Award Panel Discussion on Reserve Employees will discuss employer's ongoing challenges as well as policy recommendations to improve the hiring and retention of Reserve members; and the Board meeting will conclude with a briefing from the Subcommittee on Ensuring a Ready, Capable, Available, and Sustainable Operational Reserve that will provide the subcommittee's review of the Reserve Components' cost study findings for a proposed RFPB recommendation to the Secretary of Defense.

Meeting Accessibility: Pursuant to 5 U.S.C. 552b, as amended and 41 CFR 102–3.140 through 102–3.165, and subject to the availability of space, the meeting is open to the public from 8:55 a.m. to 3:10 p.m. Seating is based on a first-come, first-served basis. All members of the public who wish to attend the public meeting must contact Mr. Alex Sabol, the Designated Federal Officer, not later than 12:00 p.m. on Monday, September 9, 2019, as listed in the **FOR FURTHER INFORMATION CONTACT** section.

Written Statements: Pursuant to 41 CFR 102–3.105(j) and 102–3.140 and section 10(a)(3) of the FACA, interested persons may submit written statements to the RFPB at any time about its approved agenda or at any time on the Board's mission. Written statements should be submitted to the RFPB's Designated Federal Officer at the address or facsimile number listed in the **FOR FURTHER INFORMATION CONTACT** section. If statements pertain to a specific topic being discussed at the planned meeting, then these statements must be submitted no later than five (5) business days prior to the meeting in question. Written statements received after this date may not be provided to or considered by the RFPB until its next meeting. The Designated Federal Officer will review all timely submitted written statements and provide copies to all the committee members before the meeting that is the subject of this notice. Please note that since the RFPB operates under the provisions of the FACA, all submitted comments and public presentations will be treated as public documents and will be made available for public inspection, including, but not limited to, being posted on the RFPB's website.

Dated: August 19, 2019.

Aaron T. Siegel,

Alternate OSD Federal Register Liaison Officer, Department of Defense.

[FR Doc. 2019–18136 Filed 8–21–19; 8:45 am]

BILLING CODE 5001–06–P

ELECTION ASSISTANCE COMMISSION

Meeting: Technical Guidelines Development Committee; "Voluntary Voting Systems Guidelines and Usability Requirements"

AGENCY: U.S. Election Assistance Commission.

ACTION: Notice of conference call meeting.

DATES: Thursday, September 5, 2019, 11:00 a.m.–1:00 p.m. (EDT).

ADDRESSES: EAC Technical Guidelines Development Committee Conference Call.

To listen and monitor the event as an attendee:

1. Go to: *https://eac-meetings.webex.com/webappng/sites/eac-meetings/meeting/info/134066332820856117?MTID=m0b1d44da1a8a5977cd251c6821a3b983.*

2. Click ''Join Now''. To join the audio conference only: 1. Call the number below and enter the access code. U.S. TOLL FREE: +1–855–892–3345, U.S. TOLL: +1–415–527–5035, Access code: 901 574 364 (See toll-free dialing restrictions at *https://www.webex.com/pdf/tollfree_restrictions.pdf*).

For assistance, contact the host, Jerome Lovato at *https://www.eac.gov/contact/.*

FOR FURTHER INFORMATION CONTACT: Jerome Lovato, Telephone: (301) 563–3929.

SUPPLEMENTARY INFORMATION:

Purpose: In accordance with the Federal Advisory Committee Act (FACA), Public Law 92–463, as amended (5 U.S.C. Appendix 2), the U.S. Election Assistance Commission (EAC) Technical Guidelines Development Committee will conduct a conference call to discuss Voluntary Voting System Guidelines and Usability Requirements.

Agenda: The Technical Guidelines Development Committee (TGDC) will discuss the Voluntary Voting System Guidelines 2.0 (VVSG 2.0) Cybersecurity Requirements. TGDC will discuss the next TGDC meeting dates and the continuing steps to develop the Requirements. There may be votes conducted on this call.

The TGDC will discuss the Usability and Accessibility Requirements of the VVSG 2.0. Draft VVSG Requirements can be found at the TWiki page link: *https://collaborate.nist.gov/voting/bin/view/Voting/VVSG20Draft Requirements.* The most current version of the draft VVSG 2.0 Requirements is clearly marked at the top of the page to ensure the latest version is the topic of discussion at the time of the meetings. As stated in the disclaimer (and in each document), the Requirements are in a draft state and are not yet ready for final posting in their current form. These are provided ''as is'' for facilitating our on-going discussions, but do not yet represent an official or final version. Members of the public may submit relevant written statements about the meeting's content to the TGDC no later than 3:00 p.m. EDT on Wednesday, September 4, 2019.

Statements may be sent electronically via *https://www.eac.gov/contact/,* via standard mail addressed to the U.S. Election Assistance Commission, TGDC, 1335 East West Highway, Suite 4300, Silver Spring, MD 20910, or by fax at 301–734–3108. Notice of this meeting is being published less than 15 days prior to the meeting date and time because the TGDC was unable to establish a quorum prior to the 15 day publication requirement.

This conference call will be open to the public.

Dated: August 16, 2019.

Clifford D. Tatum,

General Counsel, U.S. Election Assistance Commission.

[FR Doc. 2019–18053 Filed 8–21–19; 8:45 am]

BILLING CODE 6820–KF–P

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

[Docket No. IC19–23–000]

Commission Information Collection Activities (FERC–725P1); Comment Request

AGENCY: Federal Energy Regulatory Commission, Department of Energy.

ACTION: Comment request.

SUMMARY: In compliance with the requirements of the Paperwork Reduction Act of 1995, the Federal Energy Regulatory Commission (Commission or FERC) is submitting its information collection FERC–725P1 (Mandatory Reliability Standards: PRC–005–6 Reliability Standard) to the Office of Management and Budget (OMB) for review of the information collection requirements. Any interested person may file comments directly with OMB and should address a copy of those comments to the Commission as explained below. The Commission previously published a Notice in the **Federal Register** on May 31, 2019, requesting public comments. The Commission received no comments and is making this notation in its submittal to OMB.

DATES: Comments on the collection of information are due by September 23, 2019.

ADDRESSES: Comments filed with OMB, identified by the OMB Control No. 1902–0280, should be sent via email to the Office of Information and Regulatory Affairs: *oira_submission@omb.gov.* Attention: Federal Energy Regulatory Commission Desk Officer.

A copy of the comments should also be sent to the Commission, in Docket No. IC19–23–000, by either of the following methods:

- *eFiling at Commission's Website: http://www.ferc.gov/docs-filing/efiling.asp.*
- *Mail/Hand Delivery/Courier:* Federal Energy Regulatory Commission, Secretary of the Commission, 888 First Street NE, Washington, DC 20426.

Instructions: All submissions must be formatted and filed in accordance with submission guidelines at: *http://www.ferc.gov/help/submission-guide.asp.* For user assistance contact FERC Online Support by email at *ferconlinesupport@ferc.gov,* or by phone at: (866) 208–3676 (toll-free), or (202) 502–8659 for TTY.

Docket: Users interested in receiving automatic notification of activity in this docket or in viewing/downloading comments and issuances in this docket may do so at *http://www.ferc.gov/docs-filing/docs-filing.asp.*

FOR FURTHER INFORMATION CONTACT: Ellen Brown may be reached by email at *DataClearance@FERC.gov,* by telephone at (202) 502–8663, and by fax at (202) 273–0873.

SUPPLEMENTARY INFORMATION:

Title: FERC–725P1 (Mandatory Reliability Standards: PRC–005–6 Reliability Standard).

OMB Control No.: 1902–0280.

Abstract: The Commission requires the information collected by the FERC–725P1 to implement the statutory provisions of section 215 of the Federal Power Act (FPA). On August 8, 2005, Congress enacted into law the Electricity Modernization Act of 2005, which is Title XII, Subtitle A, of the Energy Policy Act of 2005 (EPAct 2005). EPAct 2005 added a new section 215 to the FPA, which required a Commission-certified Electric Reliability Organization (ERO) to develop mandatory and enforceable Reliability Standards, which are subject to Commission review and approval. Once approved, the Reliability Standards may be enforced by the ERO subject to Commission oversight, or the Commission can independently enforce Reliability Standards.

On February 3, 2006, the Commission issued Order No. 672, implementing section 215 of the FPA. Pursuant to Order No. 672, the Commission certified one organization, North American Electric Reliability Corporation (NERC), as the ERO. The Reliability Standards developed by the ERO and approved by the Commission apply to users, owners and operators of the Bulk-Power System as set forth in each Reliability Standard.

On November 13, 2015, the North American Electric Reliability Corporation (NERC) filed a petition for Commission approval of proposed Reliability Standard PRC–005–6 (Protection System, Automatic Reclosing, and Sudden Pressure Relaying Maintenance). NERC also requested approval of the proposed implementation plan for PRC–005–6, and the retirement of previous versions of Reliability Standard PRC–005.

NERC explained in its petition that Reliability Standard PRC–005–6 represents an improvement upon the most recently-approved version of the standard, PRC–005–4. FERC approved the proposed Reliability Standard PRC–005–6 on December 18, 2015.

Type of Respondent: Planning Coordinators (PCs) and Generator Owners (GOs).

Estimate of Annual Burden: [1] The Commission estimates the annual public reporting burden for the information collection as:

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[1] ''Burden'' is the total time, effort, or financial resources expended by persons to generate, maintain, retain, or disclose or provide information to or for a Federal agency. For further explanation of what is included in the information collection burden, refer to Title 5 Code of Federal Regulations 1320.3.

[2] Entities affected by the PRC–005–6 Reliability Standard are registered to serve any of the following roles:

- PC = Planning Coordinators;
- GO = Generator Owners.

Some entities are registered to serve both roles.

[3] The estimated hourly cost (salary plus benefits) provided in this section is based on the salary

FERC–725P1: MANDATORY RELIABILITY STANDARDS: PRC–005–6 [2]

	Number of respondents (1)	Annual number of responses per respondent (2)	Total number of responses (1) * (2) = (3)	Average burden hours and cost per response [3] (4)	Total annual burden hours and total annual cost [4] (3) * (4) = (5)
PRC–005–6 Reliability Standard	[5] 996	1	996	2 hrs.; $133.80	1,992 hrs.; $133,265 [6]

Comments: Comments are invited on: (1) Whether the collection of information is necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility; (2) the accuracy of the agency's estimate of the burden and cost of the collection of information, including the validity of the methodology and assumptions used; (3) ways to enhance the quality, utility and clarity of the information collection; and (4) ways to minimize the burden of the collection of information on those who are to respond, including the use of automated collection techniques or other forms of information technology.

Dated: August 16, 2019.

Nathaniel J. Davis, Sr.,

Deputy Secretary.

[FR Doc. 2019–18125 Filed 8–21–19; 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 exempt wholesale generator filings:

Docket Numbers: EG19–168–000.
Applicants: SR Arlington II MT, LLC.
Description: Notice of Self-Certification of Exempt Wholesale Generator Status of SR Arlington II MT, LLC.
Filed Date: 8/16/19.
Accession Number: 20190816–5149.
Comments Due: 5 p.m. ET 9/6/19.

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

Docket Numbers: ER19–2621–000.
Applicants: FirstLight Power Management LLC.
Description: Compliance filing: Notice of Succession and New eTariff Baseline Filing to be effective 8/17/2019.
Filed Date: 8/16/19.
Accession Number: 20190816–5072.
Comments Due: 5 p.m. ET 9/6/19.

Docket Numbers: ER19–2622–000.
Applicants: FirstLight Hydro Generating Company.
Description: Tariff Cancellation: Notice of Cancellation to be effective 8/17/2019.
Filed Date: 8/16/19.
Accession Number: 20190816–5079.
Comments Due: 5 p.m. ET 9/6/19.

Docket Numbers: ER19–2623–000.
Applicants: California Independent System Operator Corporation.
Description: § 205(d) Rate Filing: 2019–08–16 EIM Implementation Agreement With Turlock Irrigation Dist. to be effective 1/1/2011.
Filed Date: 8/16/19.
Accession Number: 20190816–5090.
Comments Due: 5 p.m. ET 9/6/19.

Docket Numbers: ER19–2624–000.
Applicants: Merrill Lynch Commodities, Inc.
Description: § 205(d) Rate Filing: normal 2019 to be effective 8/17/2019.
Filed Date: 8/16/19.
Accession Number: 20190816–5132.
Comments Due: 5 p.m. ET 9/6/19.

Docket Numbers: ER19–2625–000.
Applicants: PacifiCorp.
Description: § 205(d) Rate Filing: BPA NITSA—(Idaho Falls Power) Rev 3 to be effective 8/1/2019.
Filed Date: 8/16/19.
Accession Number: 20190816–5140.
Comments Due: 5 p.m. ET 9/6/19.

Docket Numbers: ER19–2626–000.
Applicants: Rosewater Wind Farm LLC.
Description: Baseline eTariff Filing: Market-Based Rate Application to be effective 10/16/2019.
Filed Date: 8/16/19.
Accession Number: 20190816–5163.
Comments Due: 5 p.m. ET 9/6/19.

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: August 16, 2019.

Nathaniel J. Davis, Sr.,

Deputy Secretary.

[FR Doc. 2019–18123 Filed 8–21–19; 8:45 am]

BILLING CODE 6717–01–P

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

[Project No. 10934–032]

Sugar River Hydro II, LLC; Notice of Application Accepted for Filing, Soliciting Comments, Protests and Motions To Intervene

Take notice that the following hydroelectric application has been filed with the Commission and is available for public inspection:

a. *Type of Proceeding:* Extension of License Term.

b. *Project No.:* P–10934–032.

c. *Date Filed:* July 17, 2019.

d. *Licensee:* Sugar River Hydro II, LLC.

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figures (*http://www.bls.gov/oes/current/naics2_22.htm*) and benefits (*http://www.bls.gov/news.release/ecec.nr0.htm*) for May 2017 posted by the Bureau of Labor Statistics for the Utilities sector. The hourly estimates for salary plus benefits are $66.90/hour based on the Electrical Engineering career (Occupation Code: 17–2071).

[4] Total Annual Cost is rounded-up from $133,264.80 to $133,265.

[5] 20 (PC role only) + 927 (GO role only) + 49 (joint role as PC and GO) = 996 unique entities.

[6] This number is rounded from $133,264.80.

e. *Name and Location of Project:* Sugar River II Hydroelectric Project, located on the Sugar River, in the Town of Newport, Sullivan County, New Hampshire.

f. *Filed Pursuant to:* Federal Power Act, 16 U.S.C. 791a–825r.

g. *Licensee Contact Information:* Sugar River Hydro II, LLC, c/o Ronald K DeCola, Managing Partner, 169 Sunapee Street, LLC, Managing Partner, 300 River Road, Suite 110, Manchester, NH 03104; Phone: (603) 289–2738; Email: *rkdecola@gmail.com.*

h. *FERC Contact:* Ashish Desai, (202) 502–8370, *Ashish.Desai@ferc.gov.*

i. Deadline for filing comments, motions to intervene and protests, is 30 days from the issuance date of this notice by the Commission. The Commission strongly encourages electronic filing. Please file motions to intervene, protests, comments, and recommendations, using the Commission's eFiling system at *http://www.ferc.gov/docs-filing/efiling.asp.* Commenters can submit brief comments up to 6,000 characters, without prior registration, using the eComment system at *http://www.ferc.gov/docs-filing/ecomment.asp.* You must include your name and contact information at the end of your comments. For assistance, please contact FERC Online Support at *FERCOnlineSupport@ferc.gov,* (866) 208–3676 (toll free), or (202) 502–8659 (TTY). In lieu of electronic filing, please send a paper copy to: Secretary, Federal Energy Regulatory Commission, 888 First Street NE, Washington, DC 20426. The first page of any filing should include docket number P–10934–032.

j. *Description of Proceeding:* Sugar River Hydro II, LLC, licensee for the Sugar River II Hydroelectric Project No. 10934 requests that the Commission extend the 30-year license term for the project by nine years and ten months, from April 30, 2121 to February 28, 2031. The licensee requests the license extension to facilitate a basin-wide relicensing approach with two other projects located on the Sugar River, the Sweetwater and Lower Valley Projects located approximately 15 river miles and 18 river miles downstream of the Sugar River II Project, respectively. In addition, the licensee states that the license extension would allow the licensee to recoup costs associated with rehabilitating and improving the project after a January 2018 ice storm caused damage to the project.

The licensee's request includes letters and email correspondence from the U.S. Fish and Wildlife Service, New Hampshire Fish and Game Department, and New Hampshire Department of Environmental Service, all stating that they do not support extending the license term.

k. This notice is available for review and reproduction at the Commission in the Public Reference Room, Room 2A, 888 First Street NE, Washington, DC 20426. The filing may also be viewed on the Commission's website at *http://www.ferc.gov/docs-filing/elibrary.asp.* Enter the Docket number (P–10934–032) excluding the last three digits in the docket number field to access the notice. You may also register online at *http://www.ferc.gov/docs-filing/esubscription.asp* to be notified via email of new filings and issuances related to this or other pending projects. For assistance, call toll-free 1–866–208–3676 or email *FERCOnlineSupport@ferc.gov.* For TTY, call (202) 502–8659.

l. Individuals desiring to be included on the Commission's mailing list should so indicate by writing to the Secretary of the Commission.

m. *Comments, Protests, or Motions To Intervene:* Anyone may submit comments, a protest, or a motion to intervene in accordance with the requirements of Rules of Practice and Procedure, 18 CFR 385.210, .211, and .214. In determining the appropriate action to take, the Commission will consider all protests or other comments filed, but only those who file a motion to intervene in accordance with the Commission's Rules may become a party to the proceeding. Any comments, protests, or motions to intervene must be received on or before the specified comment date for the particular application.

n. *Filing and Service of Responsive Documents:* Any filing must (1) bear in all capital letters the title COMMENTS, PROTEST, or MOTION TO INTERVENE as applicable; (2) set forth in the heading the name of the applicant and the project number of the application to which the filing responds; (3) furnish the name, address, and telephone number of the person protesting or intervening; and (4) otherwise comply with the requirements of 18 CFR 385.2001 through 385.2005. All comments, motions to intervene, or protests must set forth their evidentiary basis and otherwise comply with the requirements of 18 CFR 4.34(b). All comments, motions to intervene, or protests should relate to the request to extend the license term. Agencies may obtain copies of the application directly from the applicant. A copy of any protest or motion to intervene must be served upon each representative of the applicant specified in the particular application. If an intervener files comments or documents with the Commission relating to the merits of an issue that may affect the responsibilities of a particular resource agency, they must also serve a copy of the document on that resource agency. A copy of all other filings in reference to this application must be accompanied by proof of service on all persons listed in the service list prepared by the Commission in this proceeding, in accordance with 18 CFR 4.34(b) and 385.2010.

Dated: August 16, 2019.

Nathaniel J. Davis, Sr.,

Deputy Secretary.

[FR Doc. 2019–18126 Filed 8–21–19; 8:45 am]

BILLING CODE 6717–01–P

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

[Docket No. CP19–498–000]

Spire Storage West, LLC; Notice of Request Under Blanket Authorization

Take notice that on August 9, 2019, Spire Storage West, LLC (Spire Storage), 3773 Richmond Avenue, Suite 300, Houston, Texas 77046, filed in the above referenced docket a prior notice request pursuant to sections 157.205, 157.208, and 157.213(b) of the Commission's regulations under the Natural Gas Act (NGA) and its blanket certificate issued in Docket No. CP11–24–000 for authorization to convert four existing observation wells to injection/withdrawal usage and to construct related pipeline facilities at its Clear Creek Plant natural gas storage facility in Uinta County, Wyoming. Spire Storage states that the proposed project will allow it to operate the Clear Creek Plant up to its maximum certificated injection and withdrawal capabilities on a more predictable and sustainable basis. Spire Storage estimates the cost of the project to be approximately $6.0 million, all as more fully set forth in the request which is on file with the Commission and open to public inspection.

The filing is available for review at the Commission in the Public Reference Room or may be viewed on the Commission's website web at *http://www.ferc.gov* using the eLibrary link. Enter the docket number excluding the last three digits in the docket number field to access the document. For assistance, contact FERC at *FERCOnlineSupport@ferc.gov* or call toll-free, (886) 208–3676 or TYY, (202) 502–8659.

Any questions regarding this application should be directed to James

F. Bowe, Jr., King & Spalding, LLP, 1700 Pennsylvania Avenue NW, Suite 200, Washington, DC 20006, by telephone at (202) 626–9601, by fax at (202) 626–3737, or by email at *jbowe@kslaw.com.*

Any person or the Commission's staff may, within 60 days after issuance of the instant notice by the Commission, file pursuant to Rule 214 of the Commission's Procedural Rules (18 CFR 385.214) a motion to intervene or notice of intervention and pursuant to section 157.205 of the regulations under the NGA (18 CFR 157.205), a protest to the request. If no protest is filed within the time allowed therefore, the proposed activity shall be deemed to be authorized effective the day after the time allowed for filing a protest. If a protest is filed and not withdrawn within 30 days after the allowed time for filing a protest, the instant request shall be treated as an application for authorization pursuant to section 7 of the NGA.

Pursuant to section 157.9 of the Commission's rules, 18 CFR 157.9, within 90 days of this Notice the Commission staff will either: Complete its environmental assessment (EA) and place it into the Commission's public record (eLibrary) for this proceeding; or issue a Notice of Schedule for Environmental Review. If a Notice of Schedule for Environmental Review is issued, it will indicate, among other milestones, the anticipated date for the Commission staff's issuance of the EA for this proposal. The filing of the EA in the Commission's public record for this proceeding or the issuance of a Notice of Schedule for Environmental Review will serve to notify federal and state agencies of the timing for the completion of all necessary reviews, and the subsequent need to complete all federal authorizations within 90 days of the date of issuance of the Commission staff's EA.

Persons who wish to comment only on the environmental review of this project should submit an original and two copies of their comments to the Secretary of the Commission. Environmental commenters will be placed on the Commission's environmental mailing list and will be notified of any meetings associated with the Commission's environmental review process. Environmental commenters will not be required to serve copies of filed documents on all other parties. However, the non-party commenters will not receive copies of all documents filed by other parties or issued by the Commission and will not have the right to seek court review of the Commission's final order.

The Commission strongly encourages electronic filings of comments, 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 3 copies of the protest or intervention to the Federal Energy regulatory Commission, 888 First Street NE, Washington, DC 20426.

Dated: August 16, 2019.

Nathaniel J. Davis, Sr.,

Deputy Secretary.

[FR Doc. 2019–18124 Filed 8–21–19; 8:45 am]

BILLING CODE 6717–01–P

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

Combined Notice of Filings #1

Take notice that the Commission received the following exempt wholesale generator filings:

Docket Numbers: EG19–166–000.
Applicants: Rosewater Wind Farm LLC.
Description: Notice of Self-Certification of Exempt Wholesale Generator Status of Rosewater Wind Farm LLC.
Filed Date: 8/16/19.
Accession Number: 20190816–5019.
Comments Due: 5 p.m. ET 9/6/19.

Docket Numbers: EG19–167–000.
Applicants: Kaheawa Wind Power, LLC.
Description: Notice of Self-Certification of Exempt Wholesale Generator Status of Kaheawa Wind Power, LLC.
Filed Date: 8/16/19.
Accession Number: 20190816–5065.
Comments Due: 5 p.m. ET 9/6/19.

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

Docket Numbers: ER15–1883–006; ER10–1836–016; ER10–1841–015; ER10–1845–015; ER10–1846–011; ER10–1849–017; ER10–1851–009; ER10–1852–029; ER10–1855–011; ER10–1857–010; ER10–1887–017; ER10–1890–012; ER10–1897–015; ER10–1899–011; ER10–1905–015; ER10–1907–014; ER10–1918–015; ER10–1920–019; ER10–1925–015; ER10–1927–015; ER10–1928–019; ER10–1930–009; ER10–1931–010; ER10–1932–010; ER10–1935–010; ER10–1950–015; ER10–1952–017; ER10–1961–017; ER10–1962–012; ER10–1964–015; ER10–2005–015; ER10–2006–016; ER10–2551–012; ER11–2160–012; ER11–26–015; ER11–2642–012; ER11–3635–012; ER12–1228–019; ER12–2226–009; ER12–2227–017; ER12–569–018; ER13–1991–011; ER13–1992–011; ER13–2112–008; ER13–712–019; ER13–752–010; ER15–1418–006; ER15–1925–011; ER15–2101–006; ER15–2477–006; ER15–2582–004; ER15–2601–004; ER15–2676–010; ER16–1672–008; ER16–2190–007; ER16–2191–007; ER16–2275–007; ER16–2276–007; ER16–2453–008; ER16–632–004; ER16–90–006; ER16–91–006; ER17–2152–004; ER17–2340–003; ER18–1534–003; ER18–1771–005; ER18–1863–002; ER18–1952–005; ER18–1978–003; ER18–2118–003; ER18–2246–004; ER18–882–003; ER19–1003–002; ER19–1392–003; ER19–1393–002; ER19–1394–002; ER19–987–002/

Applicants: Adelanto Solar, LLC, Adelanto Solar II, LLC, Armadillo Flats Wind Project, LLC, Ashtabula Wind, LLC, Ashtabula Wind II, LLC, Ashtabula Wind III, LLC, Baldwin Wind, LLC, Blackwell Wind, LLC, Blythe Solar 110, LLC, Blythe Solar II, LLC, Breckinridge Wind Project, LLC, Brady Interconnection, LLC, Brady Wind, LLC, Brady Wind II, LLC, Butler Ridge Wind Energy Center, LLC, Carousel Wind Farm, LLC, Casa Mesa Wind, LLC, Cedar Bluff Wind, LLC, Chaves County Solar, LLC, Cimarron Wind Energy, LLC, Coolidge Solar I, LLC, Cottonwood Wind Project, LLC, Crystal Lake Wind Energy I, LLC, Crystal Lake Wind Energy I, LLC, Crystal Lake Wind III, LLC, Day County Wind, LLC, Desert Sunlight 250, LLC, Desert Sunlight 300, LLC, East Hampton Energy Storage Center, LLC, Elk City Renewables II, LLC, Elk City Wind, LLC, Endeavor Wind I, LLC, Endeavor Wind II, LLC, Energy Storage Holdings, LLC, Ensign Wind, LLC, ESI Vansycle Partners, L.P., Florida Power & Light Company, FPL Energy Burleigh County Wind, LLC, FPL Energy Cape, LLC, FPL Energy Cowboy Wind, LLC, FPL Energy Green Power Wind, LLC, FPL Energy Hancock County Wind, LLC, FPL Energy Illinois Wind, LLC, FPL Energy Montezuma Wind, LLC, FPL Energy Mower County, LLC, FPL Energy North Dakota Wind, LLC, FPL Energy North Dakota Wind II, LLC, FPL Energy Oklahoma Wind, LLC, FPL Energy Oliver Wind I, LLC, FPL Energy Oliver Wind II, LLC, FPL Energy Sooner Wind, LLC, FPL Energy South Dakota Wind, LLC, FPL Energy Stateline II, Inc., FPL Energy Vansycle, L.L.C, FPL Energy Wyman, LLC, FPL Energy Wyman IV, LLC, Garden Wind, LLC, Genesis Solar, LLC, Golden Hills Interconnection, LLC, Golden Hills North Wind, LLC, Golden Hills Wind, LLC, Golden West Power Partners, LLC, Gray County Wind Energy, LLC, Green

Mountain Storage, LLC, Gulf Power Company, LLC, Hatch Solar Energy Center I, LLC, Hawkeye Power Partners, LLC, Heartland Divide Wind Project, LLC, High Lonesome Mesa Wind, LLC, High Majestic Wind Energy Center, LLC, High Majestic Wind II, LLC, High Winds, LLC, Kingman Wind Energy I, LLC, Kingman Wind Energy II, LLC, Lake Benton Power Partners II, LLC, Langdon Renewables, LLC, Limon Wind, LLC

Description: Notice of Change in Status of the NextEra MBR Sellers (Part 1).

Filed Date: 8/15/19.

Accession Number: 20190815–5219.

Comments Due: 5 p.m. ET 9/5/19.

Docket Numbers: ER19–2619–000.

Applicants: Midcontinent Independent System Operator, Inc.

Description: § 205(d) Rate Filing: 2019–08–15_Revisions to Fast Automatic Generation Control Signals to be effective 10/15/2019.

Filed Date: 8/15/19.

Accession Number: 20190815–5182.

Comments Due: 5 p.m. ET 9/5/19.

Docket Numbers: ER19–2620–000.

Applicants: Idaho Power Company.

Description: Idaho Power Company submits Average System Cost Filing for Sales of Electric Power to the Bonneville Power Administration, FY 2020–2021.

Filed Date: 8/15/19.

Accession Number: 20190815–5209.

Comments Due: 5 p.m. ET 9/5/19.

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 85.214) 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: August 16, 2019.

Nathaniel J. Davis, Sr.,

Deputy Secretary.

[FR Doc. 2019–18122 Filed 8–21–19; 8:45 am]

BILLING CODE 6717–01–P

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

[Project No. 516–503]

Dominion Energy South Carolina, Inc.; Notice of Application Accepted for Filing and Soliciting Comments, Motions To Intervene, and Protests

Take notice that the following hydroelectric application has been filed with the Commission and is available for public inspection:

a. *Application Type:* Non-project use of project lands and waters.

b. *Project No:* 516–503.

c. *Date Filed:* May 24, 2019.

d. *Applicant:* Dominion Energy South Carolina, Inc.

e. *Name of Project:* Saluda Hydroelectric Project.

f. *Location:* The project is located on the Lake Murray in Lexington County, South Carolina.

g. *Filed Pursuant to:* Federal Power Act, 16 U.S.C. 791a–825r.

h. *Applicant Contact:* Billy Chastain, Manager, Lake Management Program, Dominion Energy South Carolina, 6248 Bush River Road, Columbia, SC 29212, (803) 217–7149.

i. *FERC Contact:* Mary Karwoski, (678) 245–3027, *mary.karwoski@ferc.gov.*

j. *Deadline for filing comments, motions to intervene, and protests:* August 19, 2019.

The Commission strongly encourages electronic filing. Please file comments, motions to intervene, and protests using the Commission's eFiling system at *http://www.ferc.gov/docs-filing/efiling.asp.* Commenters can submit brief comments up to 6,000 characters, without prior registration, using the eComment system at *http://www.ferc.gov/docs-filing/ecomment.asp.* You must include your name and contact information at the end of your comments. For assistance, please contact FERC Online Support at *FERCOnlineSupport@ferc.gov,* (866) 208–3676 (toll free), or (202) 502–8659 (TTY). In lieu of electronic filing, please send a paper copy to: Secretary, Federal Energy Regulatory Commission, 888 First Street NE, Washington, DC 20426. The first page of any filing should include docket number P–516–503. Comments emailed to Commission staff are not considered part of the Commission record.

The Commission's Rules of Practice and Procedure require all intervenors filing documents with the Commission to serve a copy of that document on each person whose name appears on the official service list for the project. Further, if an intervenor files comments or documents with the Commission relating to the merits of an issue that may affect the responsibilities of a particular resource agency, they must also serve a copy of the document on that resource agency.

k. *Description of Request:* The licensee seeks authorization to permit the construction of non-project docks for the temporary mooring of twenty watercraft for lake access to a proposed restaurant. The location of the restaurant is 3348 U.S. Highway 378, Leesville, South Carolina, 29070. The proposed docks would consist of (2) ten slip, 75-foot long by 100-foot wide commercial docks, spaced 200 feet apart along the shoreline. The permittee has obtained necessary permits from the U.S. Army Corps of Engineers and the South Carolina Department of Health and Environmental Control.

l. *Locations of the Application:* A copy of the application is available for inspection and reproduction at the Commission's Public Reference Room, located at 888 First Street NE, Room 2A, Washington, DC 20426, or by calling (202) 502–8371. This filing may also be viewed on the Commission's website at *http://www.ferc.gov* using the ''eLibrary'' link. Enter the docket number excluding the last three digits in the docket number field to access the document. You may also register online at *http://www.ferc.gov/docs-filing/esubscription.asp* to be notified via email of new filings and issuances related to this or other pending projects. For assistance, call 1–866–208–3676 or email *FERCOnlineSupport@ferc.gov,* for TTY, call (202) 502–8659. A copy is also available for inspection and reproduction at the address in item (h) above. Agencies may obtain copies of the application directly from the applicant.

m. Individuals desiring to be included on the Commission's mailing list should so indicate by writing to the Secretary of the Commission.

n. *Comments, Protests, or Motions to Intervene:* Anyone may submit comments, a protest, or a motion to intervene in accordance with the requirements of Rules of Practice and Procedure, 18 CFR 385.210, .211, .214, respectively. In determining the appropriate action to take, the Commission will consider all protests or other comments filed, but only those who file a motion to intervene in accordance with the Commission's Rules may become a party to the proceeding. Any comments, protests, or motions to intervene must be received on or before the specified comment date for the particular application.

o. *Filing and Service of Documents:* Any filing must (1) bear in all capital letters the title COMMENTS, PROTEST, or MOTION TO INTERVENE as applicable; (2) set forth in the heading the name of the applicant and the project number of the application to which the filing responds; (3) furnish the name, address, and telephone number of the person commenting, protesting or intervening; and (4) otherwise comply with the requirements of 18 CFR 385.2001 through 385.2005. All comments, motions to intervene, or protests must set forth their evidentiary basis. Any filing made by an intervenor must be accompanied by proof of service on all persons listed in the service list prepared by the Commission in this proceeding, in accordance with 18 CFR 385.2010.

Dated: July 18, 2019.

Kimberly D. Bose,

Secretary.

[FR Doc. 2019–18140 Filed 8–21–19; 8:45 am]

BILLING CODE 6717–01–P

DEPARTMENT OF ENERGY

Western Area Power Administration

Pick-Sloan Missouri Basin Program—Eastern Division-Rate Order No. WAPA–188

AGENCY: Western Area Power Administration, DOE.

ACTION: Notice of proposed transmission and ancillary services formula rates.

SUMMARY: Western Area Power Administration (WAPA) proposes new formula rates for the Pick-Sloan Missouri Basin Program—Eastern Division (P–SMBP—ED) transmission and ancillary services. These rates will be used by WAPA's Upper Great Plains Region (UGP) to provide rate data to the Southwest Power Pool, Inc. (SPP), the Regional Transmission Organization of which UGP is a member. The existing rates for services expire on September 30, 2020. The proposed rates should not result in increased overall costs to customers compared to the current formula rates because the increase to the Operating Reserves rate is expected to be offset by a similar reduction in the transmission rate.

DATES: A consultation and comment period will begin August 22, 2019 and end November 20, 2019. WAPA will present a detailed explanation of the proposed formula rates and other modifications at public information forums on the following dates and times:

1. September 24, 2019, 9 a.m. to 10:30 a.m. CDT in Omaha, Nebraska, and
2. September 25, 2019, 9 a.m. to 10:30 a.m. CDT in Bismarck, North Dakota.

WAPA will accept oral and written comments at public comment forums on the following dates and times:

1. September 24, 2019, 11 a.m. to no later than 12 p.m. CDT in Omaha, Nebraska, and
2. September 25, 2019, 11 a.m. to no later than 12 p.m. CDT in Bismarck, North Dakota.

WAPA will accept written comments any time during the consultation and comment period.

ADDRESSES: Written comments and requests to be informed of Federal Energy Regulatory Commission (FERC) actions concerning the proposed formula rates submitted by WAPA to FERC for approval should be sent to: Mr. Jody Sundsted, Regional Manager, Upper Great Plains Region, Western Area Power Administration, 2900 4th Avenue North, Billings, MT 59101–1266; or email: *UGPTRates@wapa.gov.* WAPA will post information about the proposed formula rates and written comments received to the ''Rates'' folder on UGP's Open Access Same-Time Information System (OASIS), UGP's rates website, and the ''Western Area Power Administration UGP Information'' link on SPP's Member Related Postings website at the following locations, respectively:

http://www.oasis.oati.com/wapa/index.html

https://www.wapa.gov/regions/UGP/rates/Pages/rates.aspx

http://opsportal.spp.org/OASIS/Directory/Member%20Related%20Postings.

In addition, WAPA will post information by email about the proposed formula rates to the SPP ''Formula Rate Posting Information Notification'' Exploder List: *frpin@spplist.spp.org.*[1] Copies of the posted information will be provided upon request.

Public information and comment forum locations are:

1. Holiday Inn Omaha Downtown Airport, 1420 Cuming Street, Omaha, NE 68102, and
2. Radisson Hotel Bismarck, 605 East Broadway, Bismarck, ND 58501.

FOR FURTHER INFORMATION CONTACT: Ms. Linda Cady-Hoffman, Rates Manager, Upper Great Plains Region, Western Area Power Administration, 2900 4th Avenue North, Billings, MT 59101–1266; telephone: (406) 255–2920; email: *cady@wapa.gov.*

SUPPLEMENTARY INFORMATION: On November 19, 2015, FERC approved and confirmed Rate Schedules WAUGP–ATRR, WAUGP–AS1, WAUW–AS3, WAUW–AS4, WAUW–AS5, WAUW–AS6 and WAUW–AS7 under Rate Order No. WAPA–170 on a final basis for a 5-year period through September 30, 2020.[2] These existing rate schedules consist of separate formula-based rates for transmission service and ancillary services for the transmission facilities in the P–SMBP—ED that UGP transferred to the functional control of SPP. The proposed rates continue the formula-based methodology that includes an annual update to the financial data in the rate formulas with only limited changes to: (1) The Rate Formula Templates to increase transparency; (2) the Rate Formula Implementation Protocols to clarify UGP's rate implementation and annual update procedures; (3) the Operating Reserves formula rates to incorporate costs associated with UGP's current reserve sharing group membership; and (4) the Rate Schedules for Energy Imbalance and Generator Imbalance to accommodate possible participation in a Western Interconnection energy imbalance service market. WAPA intends the proposed formula-based rates, if adopted, to go into effect on October 1, 2020. The charges under the rates would be updated on January 1 of each year thereafter. The proposed formula rates would remain in effect until September 30, 2025, or until WAPA changes the formula rates through another public rate process pursuant to 10 CFR part 903, whichever occurs first.

UGP is a Transmission Owner member of SPP pursuant to negotiated provisions in its SPP Membership Agreement and the SPP Bylaws and SPP Open Access Transmission Tariff (SPP OATT). Transmission and ancillary services are provided by SPP under the SPP OATT for UGP's facilities transferred to the functional control of SPP. UGP has transmission facilities in both the Eastern and Western Interconnections separated by the Miles City direct current tie and the Fort Peck Power Plant substation. UGP operates

[1] Information on how to subscribe to SPP's email Exploder Lists is available at *https://www.spp.org/stakeholder-center/exploder-lists/.*

[2] Order Confirming and Approving Rate Schedules on a Final Basis, FERC Docket No. EF15–8–000, 153 FERC ¶ 61,213 (2015). FERC also accepted the inclusion of UGP's revenue requirements for transmission and ancillary services under the SPP Open Access Transmission Tariff, FERC Docket No. ER15–2354–000, 152 FERC ¶ 61,257 (2015).

its Western Area Power Administration, Upper Great Plains West (WAUW) Balancing Authority Area in the Western Interconnection as the Balancing Authority (BA), and has not placed the portion of its transmission system located in the Western Interconnection into SPP's Integrated Marketplace. UGP still provides ancillary services associated with its WAUW in the Western Interconnection as the BA.

UGP needs to adopt new formula rates for transmission and ancillary services so that UGP's costs can continue to be recovered under the SPP OATT. UGP's revenue requirements are added to the annual revenue requirements of other transmission owners in the multi-owner SPP pricing Zone 19, also identified as the Upper Missouri Zone (UMZ) for transmission service billed by SPP within the UMZ. UGP's revenue requirements under these proposed rates also impact other costs for transmission service within the broader SPP footprint. The proposed formula rates provide UGP sufficient revenue to pay all annual costs, including interest expenses, and repay investment.

Proposed Formula Transmission Rates

UGP proposes to continue to use its current formula rate calculation methodology for its Annual Transmission Revenue Requirement (ATRR), currently provided under Rate Schedule WAUGP–ATRR. This rate schedule includes UGP's transmission facilities in both the Eastern and Western Interconnections that are transferred to the functional control of SPP and used by SPP in order to provide transmission service in the UMZ under the SPP OATT. Consistent with UGP's current formula rates, UGP proposes to continue recovering transmission system expenses and investments on a forward-looking basis by using projections to estimate transmission costs for the upcoming year, with a true-up of incurred costs in a subsequent year. Transmission-related annual costs include operation and maintenance, interest, administrative and general costs, and depreciation. Cost data is submitted to SPP in standard revenue requirement templates and classified as either ''Zonal'' or ''Regional'' costs as defined under the SPP OATT. ''Zonal'' costs are recovered within the local pricing zone while ''Regional'' costs are recovered across the entire SPP footprint. UGP is only proposing changes to the ATRR Formula Rate Template to more clearly and transparently document the facilities and associated portion of UGP's costs that are classified as ''Zonal'' versus ''Regional'' under the SPP OATT. The Formula Rate Template for ATRR and related information will be posted on the UGP OASIS, the UGP rates website, and the SPP Member Related Postings website at the locations listed above.

Proposed Formula Rate Protocols

For transmission and ancillary services provided under the SPP OATT, UGP proposes to continue to provide information relating to UGP's rate implementation and annual updates in Formula Rate Implementation Protocols (Protocols), which together with the Formula Rate Templates (Templates), comprise the Formula Rates that are submitted to SPP to be incorporated in the SPP OATT. UGP proposes changes to its current Protocols to clarify and include additional detail regarding UGP's rate implementation and annual update procedures. UGP was one of the first transmission owners in the UMZ to develop Protocols. Therefore, UGP needs to update its Protocols to be more consistent with the Protocols of other transmission owners in the UMZ that were developed and approved after UGP joined SPP. All relevant information regarding customer meetings will also be contained in the Protocols. The Protocols will be posted on the UGP OASIS, the UGP rates website, and the SPP Member Related Postings website at the locations listed above.

Proposed Formula Rates for SSCD Service

UGP proposes to continue to use its current formula rate calculation methodology for Scheduling, System Control, and Dispatch Service (SSCD), currently provided under Rate Schedule WAUGP–AS1 for the SPP UMZ. This rate schedule also includes transmission facilities in the WAUW. UGP proposes to include additional information regarding implementation and annual updates for SSCD in its revised Protocols. The Formula Rate Template for SSCD and related information will be posted on the UGP OASIS, the UGP rates website, and the SPP Member Related Postings website at the locations listed above.

Proposed Formula Rate for Regulation and Frequency Response Service

UGP proposes to continue to use its current formula rate calculation methodology for Regulation and Frequency Response Service (Regulation), currently provided under Rate Schedule WAUW–AS3. This rate schedule addresses Regulation associated with UGP's WAUW in the Western Interconnection. UGP proposes to include additional information regarding implementation and annual updates for Regulation in its revised Protocols. Given the SPP Integrated Marketplace does not extend into the Western Interconnection, UGP will continue to provide Regulation in the WAUW as the BA, primarily from United States Army Corps of Engineers generation facilities. The Formula Rate Template and related information for Regulation will be posted on the UGP OASIS, the UGP rates website, and the SPP Member Related Postings website at the locations listed above.

Proposed Formula Rates for Operating Reserves Service—Spinning and Supplemental

UGP proposes to continue to use its current formula rate calculation methodology for Operating Reserve—Spinning Reserve Service and for Operating Reserve—Supplemental Reserve Service (collectively, Operating Reserves), currently provided under Rate Schedules WAUW–AS5 and WAUW–AS6, respectively. These rate schedules address Operating Reserves associated with UGP's WAUW in the Western Interconnection. UGP proposes a change to the rate formulas to incorporate costs associated with its current reserve sharing group membership. In addition, UGP proposes to include additional information regarding implementation and annual updates for Operating Reserves in its revised Protocols. Given the SPP Integrated Marketplace does not extend into the Western Interconnection, UGP will continue to provide Operating Reserves in the WAUW as the BA. UGP utilizes the reserve requirement of the reserve sharing group of which UGP is currently a member for its transmission system in the Western Interconnection. The Formula Rate Templates for Operating Reserves and related information will be posted on the UGP OASIS, the UGP rates website, and the SPP Member Related Postings website at the locations listed above.

Proposed Formula Rates for Energy Imbalance and Generator Imbalance Services

UGP proposes to continue to use its current formula rate calculation methodologies for Energy Imbalance Service (Energy Imbalance), currently provided under Rate Schedule WAUW–AS4, and Generator Imbalance Service (Generator Imbalance), currently provided under Rate Schedule WAUW–AS7. These rate schedules address Energy Imbalance and Generator Imbalance associated with UGP's WAUW in the Western Interconnection. UGP is proposing changes to Rate

Schedules WAUW–AS4 and WAUW–AS7 to accommodate possible participation in a Western Interconnection energy imbalance service market by UGP as the BA. UGP proposes to include additional information regarding implementation and annual updates for Energy Imbalance and Generator Imbalance in its revised Protocols. Given that the SPP Integrated Marketplace does not extend into the Western Interconnection, UGP will continue to provide Energy Imbalance and Generator Imbalance in the WAUW as the BA from its own resources or from resources available to it, including possible participation in a Western Interconnection energy imbalance service market. The Formula Rate Templates and related information for Energy Imbalance and Generator Imbalance will be posted on the UGP OASIS, the UGP rates website, and the SPP Member Related Postings website at the locations listed above.

Legal Authority

Existing DOE procedures for public participation in power and transmission rate adjustments (10 CFR part 903) were published on September 18, 1985 and February 21, 2019.[3] The proposed action is a major rate adjustment, as defined by 10 CFR part 903.2(e). In accordance with 10 CFR 903.15(a) and 10 CFR 903.16(a), WAPA will hold public information and public comment forums for this rate adjustment. WAPA will review and consider all timely public comments at the conclusion of the consultation and comment period and make amendments or adjustments to the proposal as appropriate. Proposed rates will be forwarded to the Assistant Secretary for Electricity for approval on an interim basis.

WAPA is establishing the formula rates for P–SMBP—ED in accordance with Section 302 of the Department of Energy (DOE) Organization Act (42 U.S.C. 7152). This Act transferred to, and vested in, the Secretary of Energy the power marketing functions of the Secretary of the Interior and the Bureau of Reclamation (Reclamation) under the Reclamation Act of 1902 (ch. 1093, 32 Stat. 388), as amended and supplemented by subsequent laws, particularly section 9(c) of the Reclamation Project Act of 1939 (43 U.S.C. 485h(c)); section 5 of the Flood Control Act of 1944 (16 U.S.C. 825s); and other acts that specifically apply to the project involved.

By Delegation Order No. 00–037.00B, effective November 19, 2016, the Secretary of Energy delegated: (1) The authority to develop power and transmission rates to WAPA's Administrator; (2) the authority to confirm, approve, and place such rates into effect on an interim basis to the Deputy Secretary of Energy; and (3) the authority to confirm, approve, and place into effect on a final basis, or to remand or disapprove such rates, to FERC. By Delegation Order No. 00–002.00Q, effective November 1, 2018, the Secretary of Energy also delegated to the Under Secretary of Energy the authority to confirm, approve, and place into effect on an interim basis power and transmission rates for WAPA. By Redelegation Order No. 00–002.10D, effective June 4, 2019, the Under Secretary of Energy further delegated to the Assistant Secretary for Electricity the authority to confirm, approve, and place into effect on an interim basis power and transmission rates for WAPA.

[3] 50 FR 37835 (Sept 18, 1985) and 84 FR 5347 (Feb. 21, 2019).

Availability of Information

All brochures, studies, comments, letters, memorandums, or other documents that WAPA initiates or uses to develop the proposed formula rates are available for inspection and copying at the Upper Great Plains Region, Western Area Power Administration, located at 2900 4th Avenue North, Billings, Montana. Many of these documents and supporting information are available on UGP's rates website at *http://www.wapa.gov/ugp/rates/default.htm* and the other posting locations listed above.

Ratemaking Procedure Requirements

Environmental Compliance

In compliance with the National Environmental Policy Act (NEPA) of 1969 (42 U.S.C. 4321–4347); the Council on Environmental Quality Regulations for implementing NEPA (40 CFR parts 1500–1508); and DOE NEPA Implementing Procedures and Guidelines (10 CFR part 1021), WAPA is in the process of determining whether an environmental assessment or an environmental impact statement should be prepared or if this action can be categorically excluded from those requirements.

Determination Under Executive Order 12866

WAPA has an exemption from centralized regulatory review under Executive Order 12866; accordingly, no clearance of this notice by the Office of Management and Budget is required.

Dated: August 9, 2019.

Mark A. Gabriel,

Administrator.

[FR Doc. 2019–18163 Filed 8–21–19; 8:45 am]

BILLING CODE 6450–01–P

ENVIRONMENTAL PROTECTION AGENCY

[EPA–HQ–OECA–2009–0494; FRL–9998–79–OECA]

Proposed Information Collection Request; Comment Request; Tips and Complaints Regarding Environmental Violations (Renewal)

AGENCY: Environmental Protection Agency (EPA).

ACTION: Notice.

SUMMARY: The Environmental Protection Agency is planning to submit an information collection request (ICR), ''Tips and Complaints Regarding Environmental Violations'' (EPA ICR No. 2219.06, OMB Control No. 2020–0032), to the Office of Management and Budget (OMB) for review and approval in accordance with the Paperwork Reduction Act. Before doing so, EPA is soliciting public comments on specific aspects of the proposed information collection as described below. This is a proposed extension of the ICR, which is currently approved through January 21, 2020. 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.

DATES: Comments must be submitted on or before October 21, 2019.

ADDRESSES: Submit your comments, referencing Docket ID No. EPA–HQ–OECA–2009–0494, online using *www.regulations.gov* (our preferred method), by email to *docket.oeca@epa.gov,* or by mail to: EPA Docket Center, Environmental Protection Agency, Mail Code 28221T, 1200 Pennsylvania Ave. NW, Washington, DC 20460.

EPA's policy is that all comments received will be included in the public docket without change including any personal information provided, unless the comment includes profanity, threats, information claimed to be Confidential Business Information (CBI) or other information whose disclosure is restricted by statute.

FOR FURTHER INFORMATION CONTACT: Michael Le Desma; Legal Counsel Division; Office of Criminal Enforcement, Forensics and Training; Environmental Protection Agency, Building 25, Box 25227, Denver Federal

Center, Denver, CO 80025; telephone number: (303) 462–9453; fax number: (303) 462–9075; email address: *ledesma.michael@epa.gov.*

SUPPLEMENTARY INFORMATION: Supporting documents which explain in detail the information that the EPA will be collecting are available in the public docket for this ICR. The docket can be viewed online at *www.regulations.gov* or in person at the EPA Docket Center, WJC West, Room 3334, 1301 Constitution Ave. NW, Washington, DC. The telephone number for the Docket Center is 202–566–1744. For additional information about EPA's public docket, visit *http://www.epa.gov/dockets.*

Pursuant to section 3506(c)(2)(A) of the PRA, EPA is soliciting comments and information to enable it to: (i) 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; (ii) evaluate the accuracy of the Agency's estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used; (iii) enhance the quality, utility, and clarity of the information to be collected; and (iv) minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated electronic, mechanical, or other technological collection techniques or other forms of information technology, *e.g.,* permitting electronic submission of responses. EPA will consider the comments received and amend the ICR as appropriate. The final ICR package will then be submitted to OMB for review and approval. At that time, EPA will issue another **Federal Register** notice to announce the submission of the ICR to OMB and the opportunity to submit additional comments to OMB.

Abstract: EPA tips and complaints web form is intended to provide an easy and convenient means by which members of the public can supply information to EPA regarding suspected violations of environmental law. The decision to provide a tip or complaint is entirely voluntary and use of the webform when supplying a tip or complaint is also entirely voluntary. Tippers need not supply contact information or other personal identifiers. Those who do supply such information, however, should know that this information may be shared by EPA with appropriate administrative, law enforcement, and judicial entities engaged in investigating or adjudicating the tip or complaint.

Form Numbers: None.

Respondents/affected entities: Respondents are expected to be members of the general public as well as employees of any company subject to federal environmental regulation. There is no specific industry or group of industries about which EPA expects tips or complaints.

Respondent's obligation to respond: voluntary.

Estimated number of respondents: 1,431 per month (total).

Frequency of response: generally, a one-time response.

Total estimated burden: 8,586 hours (per year). Burden is defined at 5 CFR 1320.03(b).

Total estimated cost: $343,165 (per year), includes no annualized capital or operation & maintenance costs.

Changes in Estimates: There is an increase of 3,443 hours in the total estimated respondent burden compared with the ICR currently approved by OMB. This increase reflects the fact that tips and complaints are being filed at a higher rate as the website becomes more widely known, a strong indication of the success of this program. There has been no change in the information being reported or the estimated burden per respondent.

Dated: August 13, 2019.

Henry Barnet,

Director, Office of Criminal Enforcement, Forensics and Training.

[FR Doc. 2019–18133 Filed 8–21–19; 8:45 am]

BILLING CODE 6560–50–P

ENVIRONMENTAL PROTECTION AGENCY

[EPA–HQ–OAR–2018–0279; FRL–9998–51–OAR]

Release of Integrated Review Plan for the Ozone National Ambient Air Quality Standards

AGENCY: Environmental Protection Agency (EPA).

ACTION: Notice of availability.

SUMMARY: On or about August 26, 2019, the Environmental Protection Agency (EPA) will make available the final document, *Integrated Review Plan for the Ozone National Ambient Air Quality Standards* (IRP). This document contains plans for the current review of the air quality criteria and national ambient air quality standards (NAAQS) for photochemical oxidants including ozone (O_3). The primary and secondary O_3 NAAQS are set to protect the public health and the public welfare from O_3 and other photochemical oxidants in ambient air.

ADDRESSES: This document will be available on the EPA's website at *https://www.epa.gov/naaqs/ozone-o3-air-quality-standards.* The document will be accessible under ''Planning Documents'' from the current review.

FOR FURTHER INFORMATION CONTACT: Dr. Deirdre L. Murphy, Office of Air Quality Planning and Standards, (Mail Code C504–06), U.S. Environmental Protection Agency, Research Triangle Park, NC 27711; telephone number: (919) 541–0729, fax number: (919) 541–0237; or email: *murphy.deirdre@epa.gov.*

SUPPLEMENTARY INFORMATION:

I. General Information

A. How can I get copies of this document and related information?

1. Docket. EPA has established a docket for this action under Docket ID No. EPA–HQ–OAR–2018–0279. A separate docket established for the Integrated Science Assessment being prepared for this action (EPA–HQ–ORD–2018–0274) is also incorporated into the rulemaking docket for this review. Publicly available docket materials are available electronically through *www.regulations.gov* or may be viewed at the Air and Radiation Docket and Information Center, EPA/DC, EPA West, Room 3334, 1301 Constitution Ave. NW, Washington, DC. The Public Reading Room is open from 8:30 a.m. to 4:30 p.m., Monday through Friday, excluding legal holidays. The telephone number for the Public Reading Room is (202) 566–1744, and the telephone number for the Air and Radiation Docket and Information Center is (202) 566–1742.

2. The document announced today and related information will be available via the internet on the EPA's website at *https://www.epa.gov/naaqs/ozone-o3-air-quality-standards.* The document announced today will be accessible under ''Planning Documents'' from the current review.

II. Information Specific to This Document

Two sections of the Clean Air Act (CAA or the Act) govern the establishment and revision of the NAAQS. Section 108 directs the Administrator to identify and list certain air pollutants and then issue ''air quality criteria'' for those pollutants. The air quality criteria are to ''accurately reflect the latest scientific knowledge useful in indicating the kind and extent of all identifiable effects on public health or welfare which may be expected from the presence of such pollutant in the ambient air. . .'' (CAA section 108(a)(2)). Under section 109 of the Act, the EPA is then to establish primary (health-based) and secondary (welfare-based) NAAQS for each pollutant for which the EPA has issued air quality criteria. Section 109(d)(1) of the Act requires periodic review and, if appropriate, revision of existing air quality criteria. Revised air quality criteria are to reflect advances in scientific knowledge on the effects of the pollutant on public health and welfare. Under the same provision, the EPA is also to periodically review and, if appropriate, revise the NAAQS, based on the revised air quality criteria.

The Act additionally requires appointment of an independent scientific review committee that is to periodically review the existing air quality criteria and NAAQS and to recommend any new standards and revisions of existing criteria and standards as may be appropriate (CAA section 109(d)(2)(A)–(B)). Since the early 1980s, the requirement for an independent scientific review committee has been fulfilled by the Clean Air Scientific Advisory Committee (CASAC).

Presently the EPA is reviewing the air quality criteria and NAAQS for photochemical oxidants and O_3.[1] The document announced in this notice has been developed as part of the planning phase for the review. In this phase, a draft IRP was prepared jointly by the EPA's National Center for Environmental Assessment, within the Office of Research and Development, and the Office of Air Quality Planning and Standards, within the Office of Air and Radiation. The draft IRP was the subject of a consultation with CASAC on November 29, 2018 and was available for public comment (83 FR 55163, November 2, 2018; 83 FR 55528, November 6, 2018). The document announced today has been prepared after consideration of CASAC and public comments. This IRP presents EPA's current plans for the schedule for the entire review, the process for conducting the review, and the key policy-relevant science issues that will guide the review. This document does not represent and should not be construed to represent any final EPA policy, viewpoint, or determination.

Dated: August 16, 2019.

Panagiotis Tsirigotis,

Director, Office of Air Quality Planning and Standards.

[FR Doc. 2019–18087 Filed 8–21–19; 8:45 am]

BILLING CODE 6560–50–P

[1] The EPA's call for information for this review was issued on June 26, 2018 (83 FR 29785).

FEDERAL COMMUNICATIONS COMMISSION

[OMB 3060–0710]

Information Collection Being Submitted for Review and Approval to the Office of Management and Budget

AGENCY: Federal Communications Commission.

ACTION: Notice and request for comments.

SUMMARY: As part of its continuing effort to reduce paperwork burdens, and as required by the Paperwork Reduction Act (PRA) of 1995, the Federal Communications Commission (FCC or the Commission) invites the general public and other Federal agencies to take this opportunity to comment on the following information collection. Comments are requested concerning: Whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information shall have practical utility; the accuracy of the Commission's burden estimate; ways to enhance the quality, utility, and clarity of the information collected; ways to minimize the burden of the collection of information on the respondents, including the use of automated collection techniques or other forms of information technology; and ways to further reduce the information collection burden on small business concerns with fewer than 25 employees.

The Commission may not conduct or sponsor a collection of information unless it displays a currently valid Office of Management and Budget (OMB) control number. No person shall be subject to any penalty for failing to comply with a collection of information subject to the PRA that does not display a valid OMB control number.

DATES: Written comments should be submitted on or before September 23, 2019. If you anticipate that you will be submitting comments, but find it difficult to do so within the period of time allowed by this notice, you should advise the contacts listed below as soon as possible.

ADDRESSES: Direct all PRA comments to Nicholas A. Fraser, OMB, via email *Nicholas_A._Fraser@omb.eop.gov;* and to Nicole Ongele, FCC, via email *PRA@fcc.gov* and to *Nicole.Ongele@fcc.gov.* Include in the comments the OMB control number as shown in the **SUPPLEMENTARY INFORMATION** below.

FOR FURTHER INFORMATION CONTACT: For additional information or copies of the information collection, contact Nicole Ongele at (202) 418–2991. To view a copy of this information collection request (ICR) submitted to OMB: (1) Go to the web page *http://www.reginfo.gov/public/do/PRAMain*, (2) look for the section of the web page called ''Currently Under Review,'' (3) click on the downward-pointing arrow in the ''Select Agency'' box below the ''Currently Under Review'' heading, (4) select ''Federal Communications Commission'' from the list of agencies presented in the ''Select Agency'' box, (5) click the ''Submit'' button to the right of the ''Select Agency'' box, (6) when the list of FCC ICRs currently under review appears, look for the OMB control number of this ICR and then click on the ICR Reference Number. A copy of the FCC submission to OMB will be displayed.

SUPPLEMENTARY INFORMATION: As part of its continuing effort to reduce paperwork burdens, and as required by the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501–3520), the Federal Communications Commission (FCC or the Commission) invites the general public and other Federal agencies to take this opportunity to comment on the following information collection.

Comments are requested concerning: Whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information shall have practical utility; the accuracy of the Commission's burden estimate; ways to enhance the quality, utility, and clarity of the information collected; ways to minimize the burden of the collection of information on the respondents, including the use of automated collection techniques or other forms of information technology; and ways to further reduce the information collection burden on small business concerns with fewer than 25 employees.

OMB Control Number: 3060–0710.

Title: Policy and Rules Under Parts 1 and 51 Concerning the Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96–98, Sections 47 CFR 1.1403–1.1404; 47 CFR part 51; 47 CFR 51.100—51.807; 47 CFR 20.11.

Form Number: N/A.

Type of Review: Extension of a currently approved collection.

Respondents: Business or other for-profit.

Number of Respondents and Responses: 15,282 respondents; 1,067,987 responses.

Estimated Time per Response: 0.50–4,000 hours.

Obligation to Respond: Required to obtain or retain benefits. Statutory authority for this information collection is contained in sections 1–4, 201–205, 214, 224, 251, 252, and 303(r) of the Communications Act of 1934, as amended, and section 601 of the Telecommunications Act of 1996. 47 U.S.C. 151–154, 201–205, 224, 251, 252, 303(r), and 601.

Frequency of Response: On occasion reporting requirement, recordkeeping requirement, and third-party disclosure requirement.

Total Annual Burden: 645,798 hours.

Total Annual Cost: No cost.

Privacy Act Impact Assessment: No impacts.

Nature of Extent of Confidentiality: The Commission is not requesting that the respondents submit confidential information to the FCC. Respondents may, however, request confidential treatment for information they believe to be confidential under 47 CFR Section 0.459 of the Commission's rules.

Needs and Uses: This collection will be submitted as an extension of a currently approved collection to the Office of Management and Budget (OMB) in order to obtain the full three-year clearance.

The Commission adopted rules to implement the First Report and Order on Reconsideration issued in CC Docket No. 96–98. That Order implemented parts of sections 251 and 252 of the Telecommunications Act of 1996 that affect local competition. Incumbent local exchange carriers (ILECs) are required to offer interconnection, unbundled network elements (UNEs), transport and termination, and wholesale rates for certain services to new entrants. Incumbent LECs must price such services and rates that are cost-based and just and reasonable and provide access to right-of-way as well as establish reciprocal compensation arrangements for the transport and termination of telecommunications traffic.

Federal Communications Commission.

Marlene Dortch,

Secretary, Office of the Secretary.

[FR Doc. 2019–18064 Filed 8–21–19; 8:45 am]

BILLING CODE 6712–01–P

FEDERAL COMMUNICATIONS COMMISSION

[OMB 3060–1092]

Information Collection Being Reviewed by the Federal Communications Commission

AGENCY: Federal Communications Commission.

ACTION: Notice and request for comments.

SUMMARY: As part of its continuing effort to reduce paperwork burdens, and as required by the Paperwork Reduction Act of 1995 (PRA), the Federal Communications Commission (FCC or Commission) invites the general public and other Federal agencies to take this opportunity to comment on the following information collections. Comments are requested concerning: Whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information shall have practical utility; the accuracy of the Commission's burden estimate; ways to enhance the quality, utility, and clarity of the information collected; ways to minimize the burden of the collection of information on the respondents, including the use of automated collection techniques or other forms of information technology; and ways to further reduce the information collection burden on small business concerns with fewer than 25 employees.

The FCC may not conduct or sponsor a collection of information unless it displays a currently valid Office of Management and Budget (OMB) control number. No person shall be subject to any penalty for failing to comply with a collection of information subject to the PRA that does not display a valid OMB control number.

DATES: Written comments should be submitted on or before October 21, 2019. If you anticipate that you will be submitting comments but find it difficult to do so within the period of time allowed by this notice, you should advise the contacts below as soon as possible.

ADDRESSES: Direct all PRA comments to Cathy Williams, FCC, via email: *PRA@fcc.gov* and to *Cathy.Williams@fcc.gov.*

FOR FURTHER INFORMATION CONTACT: For additional information about the information collection, contact Cathy Williams at (202) 418–2918.

SUPPLEMENTARY INFORMATION:

OMB Control Number: 3060–1092.

Title: Interim Procedures for Filing Applications Seeking Approval for Designated Entity Reportable Eligibility Events and Annual Reports.

Form Numbers: FCC Forms 609–T and 611–T.

Type of Review: Extension of a currently approved collection.

Respondents: Business or other for-profit entities; Not-for profit institutions; and State, Local and Tribal Governments.

Number of Respondents: 1,100 respondents; 2,750 responses.

Estimated Time per Response: .50 hours to 6 hours.

Frequency of Response: On occasion and annual reporting requirements.

Obligation to Respond: Required to obtain or retain benefits. Statutory authority for this information collection is contained in 47 U.S.C. 4(i), 308(b), 309(j)(3) and 309(j)(4).

Total Annual Burden: 7,288 hours.

Total Annual Cost: $2,223,375.

Privacy Impact Assessment: No impact(s).

Nature and Extent of Confidentiality: In general, there is no need for confidentiality. On a case by case basis, the Commission may be required to withhold from disclosure certain information about the location, character, or ownership of a historic property, including traditional religious sites.

Needs and Uses: The Commission will submit this expiring information collection to the Office of Management and Budget (OMB) after this comment period to obtain the three year clearance from them. FCC Form 609–T is used by Designated Entities (DEs) to request prior Commission approval pursuant to Section 1.2114 of the Commission's rules for any reportable eligibility event. The data collected on the form is used by the FCC to determine whether the public interest would be served by the approval of the reportable eligibility event.

FCC Form 611–T is used by DE licensees to file an annual report, pursuant to Section 1.2110(n) of the Commission's rules, related to eligibility for designated entity benefits.

The information collected will be used to ensure that only legitimate small businesses reap the benefits of the Commission's designated entity program. Further, this information will assist the Commission in preventing companies from circumventing the objectives of the designated entity eligibility rules by allowing us to review: (1) The FCC 609–T applications seeking approval for ''reportable eligibility events'' and (2) the FCC Form 611–T annual reports to ensure that licensees receiving designated entity benefits are in compliance with the Commission's policies and rules.

Federal Communications Commission.

Marlene Dortch,

Secretary, Office of the Secretary.

[FR Doc. 2019–18065 Filed 8–21–19; 8:45 am]

BILLING CODE 6712–01–P

FEDERAL COMMUNICATIONS COMMISSION

Federal Advisory Committee, North American Numbering Council

AGENCY: Federal Communications Commission.

ACTION: Notice of intent.

SUMMARY: The Federal Communications Commission (FCC or Commission) hereby announces that that the charter of the North American Numbering Council (hereinafter Committee) will be renewed for a two-year period pursuant to the Federal Advisory Committee Act (FACA) and following consultation with the Committee Management Secretariat, General Services Administration.

ADDRESSES: Federal Communications Commission, 445 12th Street SW, Washington, DC 20554.

FOR FURTHER INFORMATION CONTACT: Marilyn Jones, Designated Federal Officer, Federal Communications Commission, Wireline Competition Bureau, (202) 418–2357 or email: *Marilyn.Jones@fcc.gov.*

SUPPLEMENTARY INFORMATION: After consultation with the General Services Administration, the Commission intends to renew the charter on or before September 18, 2019 providing the Committee with authorization to operate for two years.

The purpose of the Committee is to advise the Commission and to make recommendations that foster efficient and impartial North American Numbering Plan administration. The Committee will advise the Commission on numbering policy and technical issues in areas of responsibility the Commission has entrusted to the Committee, with a focus on examining numbering in the changing world of communications.

Advisory Committee

The Committee will be organized under, and will operate in accordance with, the provisions of the Federal Advisory Committee Act (FACA) (5 U.S.C. App. 2). The Committee will be solely advisory in nature. Consistent with FACA and its requirements, each meeting of the Committee will be open to the public unless otherwise noticed. A notice of each meeting will be published in the **Federal Register** at least fifteen (15) days in advance of the meeting. Records will be maintained of each meeting and made available for public inspection. All activities of the Committee will be conducted in an open, transparent, and accessible manner. The Committee shall terminate two (2) years from the filing date of its charter, or earlier upon the completion of its work as determined by the Chairman of the FCC, unless its charter is renewed prior to the termination date.

During the Committee's next term, it is anticipated that the Committee will meet in Washington, DC approximately four (4) times a year. The first meeting date and agenda topics will be described in a Public Notice issued and published in the **Federal Register** at least fifteen (15) days prior to the first meeting date. In addition, as needed, working groups or subcommittees (ad hoc or steering) will be established to facilitate the Committee's work between meetings of the full Committee. Meetings of the Committee will be fully accessible to individuals with disabilities.

Federal Communications Commission.

Marilyn Jones,

Senior Counsel for Number Administration, Wireline Competition Bureau.

[FR Doc. 2019–18099 Filed 8–21–19; 8:45 am]

BILLING CODE 6712–01–P

FEDERAL DEPOSIT INSURANCE CORPORATION

Sunshine Act Meeting

TIME AND DATE: Pursuant to the provisions of the ''Government in the Sunshine Act'' (5 U.S.C. 552b), notice is hereby given that at 11:02 a.m. on Tuesday, August 20, 2019, the Board of Directors of the Federal Deposit Insurance Corporation met in closed session to consider matters related to the Corporation's supervision, corporate, and resolution activities.

PLACE: The meeting was held in the Board Room located on the sixth floor of the FDIC Building located at 550 17th Street NW, Washington, DC.

STATUS: The meeting was closed to the public.

MATTERS TO BE CONSIDERED: In calling the meeting, the Board determined, on motion of Director Martin J. Gruenberg, seconded by Director Joseph M. Otting (Comptroller of the Currency), and concurred in by Kathleen L. Kraninger (Director, Consumer Financial Protection Bureau) and Chairman Jelena McWilliams, that Corporation business required its consideration of the matters which were to be the subject of this meeting on less than seven days' notice to the public; that no earlier notice of the meeting was practicable; that the public interest did not require consideration of the matters in a meeting open to public observation; and that the matters could be considered in a closed meeting by authority of subsections (c)(4), (c)(6), (c)(8), (c)(9)(A)(ii), and (c)(9)(B) of the ''Government in the Sunshine Act'' (5 U.S.C. 552b(c)(4), (c)(6), (c)(8), (c)(9)(A)(ii), and (c)(9)(B).

CONTACT PERSON FOR MORE INFORMATION: Requests for further information concerning the meeting may be directed to Robert E. Feldman, Executive Secretary of the Corporation, at 202–898–7043.

Dated at Washington, DC, on August 20, 2019.

Federal Deposit Insurance Corporation.

Robert E. Feldman,

Executive Secretary.

[FR Doc. 2019–18205 Filed 8–20–19; 4:15 pm]

BILLING CODE 6714–01–P

FEDERAL RESERVE SYSTEM

Formations of, Acquisitions by, and Mergers of Bank Holding Companies

The companies listed in this notice have applied to the Board for approval, pursuant to the Bank Holding Company Act of 1956 (12 U.S.C. 1841 *et seq.*) (BHC Act), Regulation Y (12 CFR part 225), and all other applicable statutes and regulations to become a bank holding company and/or to acquire the assets or the ownership of, control of, or the power to vote shares of a bank or bank holding company and all of the banks and nonbanking companies owned by the bank holding company, including the companies listed below.

The applications listed below, as well as other related filings required by the Board, are available for immediate inspection at the Federal Reserve Bank indicated. The applications will also be available for inspection at the offices of the Board of Governors. Interested persons may express their views in writing on the standards enumerated in the BHC Act (12 U.S.C. 1842(c)). If the proposal also involves the acquisition of a nonbanking company, the review also includes whether the acquisition of the nonbanking company complies with the standards in section 4 of the BHC Act (12 U.S.C. 1843). Unless otherwise noted, nonbanking activities will be conducted throughout the United States.

Unless otherwise noted, comments regarding each of these applications must be received at the Reserve Bank indicated or the offices of the Board of Governors not later than September 20, 2019.

A. Federal Reserve Bank of Dallas (Robert L. Triplett III, Senior Vice President) 2200 North Pearl Street, Dallas, Texas 75201–2272:

1. *WSB Bancshares, Inc., Wellington, Texas;* to acquire First Paducah

Bancshares of Texas, Inc., and indirectly, First National Bank of Paducah, both of Paducah, Texas.

Board of Governors of the Federal Reserve System, August 16, 2019.

Yao-Chin Chao,

Assistant Secretary of the Board.

[FR Doc. 2019–18059 Filed 8–21–19; 8:45 am]

BILLING CODE P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Agency for Healthcare Research and Quality

Agency Information Collection Activities: Proposed Collection; Comment Request

AGENCY: Agency for Healthcare Research and Quality, HHS.

ACTION: Notice.

SUMMARY: This notice announces the intention of the Agency for Healthcare Research and Quality (AHRQ) to request that the Office of Management and Budget (OMB) approve the proposed information collection project ''Outcome Measure Harmonization and Data Infrastructure for Patient Centered Outcomes Research in Depression.''

DATES: Comments on this notice must be received by 60 days after date of publication.

ADDRESSES: Written comments should be submitted to: Doris Lefkowitz, Reports Clearance Officer, AHRQ, by email at *doris.lefkowitz@AHRQ.hhs.gov.*

Copies of the proposed collection plans, data collection instruments, and specific details on the estimated burden can be obtained from the AHRQ Reports Clearance Officer.

FOR FURTHER INFORMATION CONTACT: Doris Lefkowitz, AHRQ Reports Clearance Officer, (301) 427–1477, or by emails at *doris.lefkowitz@AHRQ.hhs.gov.*

SUPPLEMENTARY INFORMATION:

Proposed Project

Outcome Measure Harmonization and Data Infrastructure for Patient Centered Outcomes Research in Depression

The Agency for Healthcare Research and Quality's (AHRQ) mission is to produce evidence to make health care safer, higher quality, more accessible, equitable, and affordable, and to work within the U.S. Department of Health and Human Services and with other partners to make sure that the evidence is understood and used.

In support of this mission, AHRQ funded a prior project to harmonize the outcome measures collected across patient registries and routine clinical practice, with the goals of supporting the development of a robust data infrastructure that can consistently and efficiently collect high-quality data on outcome measures that are relevant to patients and clinicians and supporting patient-centered outcomes research and quality improvement. Harmonized outcome measures would also form the foundation for learning healthcare systems. Of note, AHRQ has supported the development of the Outcome Measures Framework (OMF). The OMF is a conceptual model for classifying outcomes that are relevant to patients and providers across most conditions. AHRQ, in collaboration with the U.S. Food and Drug Administration and the National Library of Medicine, recently supported an effort to use the OMF as a content model for developing harmonized outcome measures in specific disease areas, including depression.

Major depressive disorder (MDD) is a common mental disorder that affects an estimated 16.2 million adults and 3.1 million adolescents in the United States. Characterized by changes in mood, cognitive function, and/or physical function that persist for two or more weeks, MDD can reduce quality of life substantially, impair function at home, work, school, and in social settings, and result in increased mortality due to suicide. MDD also is a major cause of disability, with an economic burden of approximately $210.5 billion per year in the United States.

Despite the burden of MDD and the availability of treatment, the condition is often undiagnosed and untreated. In 2016, the U.S. Preventive Services Task Force recommended screening for depression in the general adult population, including pregnant and postpartum women, and in adolescents. While routine screening is intended to improve diagnosis and treatment of MDD, many questions remain, such as about the comparative effectiveness of different treatment approaches, the incidence of adverse events, when to add medications for patients who do not respond to an initial course of treatment, how and why depression recurs, and how to classify and treat treatment-resistant depression. Patient registries capture a wealth of data on depression treatment patterns and outcomes in the United States and could serve as the foundation for a national research infrastructure to address these and other research questions. Yet, a lack of harmonization in the outcome measures collected by each registry makes it challenging, if not impossible, to link and compare data across registries and related efforts. As documented in the prior project, existing registries use different outcome measures (*e.g.,* remission as defined by the PHQ–9 vs. HAM–D) and capture data at different timepoints.

Depression registries offer an excellent opportunity to demonstrate the feasibility and value of implementing the harmonized outcome measures. Existing registries already capture some of the harmonized depression measures for quality reporting, although at different timepoints; capture of these measures and the additional measures at consistent intervals will enable the registries to generate more robust data suitable for research purposes.

AHRQ is now proposing to implement the harmonized depression outcome measures developed under the prior project in two patient registries (the PRIME Registry and PsychPRO) and a health system setting. The purpose of this project is to demonstrate that capturing the harmonized outcome measures in the clinical workflow and submitting these data to different registries can improve clinical care, reduce the burden of registry participation, and increase the utility of registry data for research purposes. The objectives of the project are to:

—Demonstrate that collection of the harmonized outcome measures is feasible, sustainable, and useful for clinicians participating in primary care and mental health patient registries.

—Demonstrate that collection of the harmonized outcome measures is feasible, sustainable, and useful for clinicians in a health system setting.

Evaluate whether collection of the harmonized measures increases the utility of registry data for research purposes.

The project is being conducted by AHRQ through its contractor, OM1, Inc., pursuant to AHRQ's statutory authority to conduct and support research on healthcare and on systems for the delivery of such care, including activities with respect to the quality, effectiveness, efficiency, appropriateness and value of healthcare services and with respect to the outcomes of such services. 42 U.S.C. 299a(a)(1) and (3).

Method of Collection

To achieve the goals of this project the following data collections will be implemented:

(1) Patient Health Questionnaire-9 (PHQ–9)—the PHQ–9 is a brief, 9-item

scale that is completed by patients and reviewed by clinicians at three points during this project. The scale is used to measure depression severity, to monitor changes in depression severity over time, and to calculate the harmonized outcome measures for depression remission, response, recurrence, and suicide ideation and behavior.

(2) Frequency, Intensity, and Burden of Side Effects Ratings (FIBSER)—the FIBSER is a brief, 3-item scale that is completed by patients and reviewed by clinicians at three points during this project. The scale is used to measure the burden of side effects related to depression treatment and to calculate the harmonized outcome measure for adverse events.

(3) Clinician Survey—the clinician survey is a brief, 20-question survey that clinicians in the health system setting will be asked to complete once at the conclusion of the project. The survey captures information on the value of the harmonized outcome measures for informing patient care.

Users of the information captured in this project will fall into two categories: Clinicians providing care for patients with depression; and researchers using the de-identified data to answer a patient-centered outcomes research question. AHRQ will receive summary findings from the data analysis only; no patient-level data will be shared with AHRQ.

Estimated Annual Respondent Burden

A key objective of this project is to demonstrate that the harmonized outcome measures can be captured as part of the routine clinical workflow, with little to no added burden for clinicians and patients. The harmonized measures will be calculated primarily with existing data extracted from electronic medical records (EMRs). Extraction of these data will not represent an additional burden for clinicians. Patients participating in this project will be asked to complete up to two patient-reported outcome measures—the Patient Health Questionnaire-9 (PHQ–9) and the Frequency, Intensity, and Burden of Side Effects Ratings (FIBSER). Burden is estimated below for completion of these instruments by the patient respondent. Clinicians participating in the health system component of the project will be asked to complete the Clinician Survey. Burden is estimated below for completion of this survey by the clinician respondent.

Exhibit 1 shows the estimated annualized burden hours for the patient respondent's time to complete the PHQ–9 and FIBSER at three time points as part of this project and for the clinician respondent to complete the Clinician Survey at one time point during this project. The PHQ–9 is a brief, 9-item scale used to measure depression severity. The FIBSER is a brief, 3-item scale used to measure the burden of side effects related to depression treatment. The Clinician Survey is a brief, 20-question survey designed to assess the value of the harmonized outcome measures for informing patient care. The PHQ–9 is used in routine clinical practice to screen for depression and monitor changes in depression severity over time, as recommended by the U.S. Preventive Services Task Force. For some participants in this project, completion of the PHQ–9 is part of their existing clinical care routine and does not represent an extra burden. For example, the PHQ–9 is already captured routinely for participants in the PsychPRO registry. The estimates below do not include participants in the PsychPRO registry for that reason.

Because the primary objective of this project is to determine the feasibility and value of extracting the relevant data and calculating the measures, a formal sample size has not been calculated. We estimate that the 20 participating sites in the two patient registries will each enroll 10 patients, for a total of 200 patients. We estimate that the 5 participating sites at the health system will each enroll 10 patients, for a total of 50 patients. We did not include the PsychPRO enrollment in the PHQ–9 estimates, as the PHQ–9 is already collected in this registry and does not represent extra burden. We also do not anticipate implementing the FIBSER at the health system sites. Therefore, the total number of respondents for the PHQ–9 is estimated at 150, and the total number of respondents for the FIBSER is estimated at 200. We anticipate that three clinicians associated with each of the five health system sites will complete the Clinician Survey. Therefore, the total number of respondents for the Clinician Survey is estimated at 15.

Based on existing literature, it is estimated that completion of the PHQ–9 takes, on average, 3 minutes, and the FIBSER takes, on average, 2 minutes to complete. Participants in the patient registries will be asked to complete the PHQ–9 and FIBSER three times over the course of a year, for a total time of 15 minutes per year. Participants from the health system will be asked to complete the PHQ–9 three times over the course of a year. Clinicians from the health system sites will be asked to complete the Clinician Survey once, at the conclusion of the project; the survey is designed to be completed in 5 minutes or less. If 150 respondents complete the PHQ–9 three times over the course of one year, the estimated annualized burden would be 22.5 hours. If 200 respondents complete the FIBSER three times over the course of one year, the estimated annualized burden would be 20 hours. If 15 clinicians complete the Clinician Survey once over the course of one year, the estimated annualized burden would be 1.25 hours. The total estimated annualized burden would be 43.75 hours.

EXHIBIT 1—ESTIMATED ANNUALIZED BURDEN HOURS

Form name	Number of respondents	Number of responses per respondent	Minutes per response	Total burden hours
PHQ–9	150	3	3	22.5
FIBSER	200	3	2	20
Clinician Survey	15	1	5	1.25
Total	365			43.75

Exhibit 2 shows the estimated cost burden associated with the respondent's time to complete the PHQ–9, FIBSER, and Clinician Survey as part of this project. The total cost burden to respondents is estimated at an average of $1,110.93 annually. The duration of this project is one year.

EXHIBIT 2—ESTIMATED ANNUALIZED COST BURDEN

Form name	Number of respondents	Total burden hours	Average hourly wage rate	Total cost burden
PHQ–9	150	22.5	* $24.98	$562.05
FIBSER	200	20	* 24.98	499.6
Clinician Survey	15	1.25	# 39.42	49.28
Total	365	42.5	24.98	1,110.93

* Based on the mean wages for all occupations, 00–0000. May 2018 National Occupational Employment and Wage Estimates. U.S. Department of Labor, Bureau of Labor Statistics. Available at: *https://www.bls.gov/oes/current/oes_nat.htm#00-0000.*

Based on the mean wages for Healthcare Practitioners and Technical Occupations, 29–0000. May 2018 National Occupational Employment and Wage Estimates. U.S. Department of Labor, Bureau of Labor Statistics. Available at: *https://www.bls.gov/oes/current/oes_nat.htm#29-0000.*

Request for Comments

In accordance with the Paperwork Reduction Act, comments on AHRQ's information collection are requested with regard to any of the following: (a) Whether the proposed collection of information is necessary for the proper performance of AHRQ's health care research and health care information dissemination functions, including whether the information will have practical utility; (b) the accuracy of AHRQ's estimate of burden (including hours and costs) of the proposed collection(s) of information; (c) ways to enhance the quality, utility and clarity of the information to be collected; and (d) ways to minimize the burden of the collection of information upon the respondents, including the use of automated collection techniques or other forms of information technology.

Comments submitted in response to this notice will be summarized and included in the Agency's subsequent request for OMB approval of the proposed information collection. All comments will become a matter of public record.

Dated: August 19, 2019.

Virginia L. Mackay-Smith,

Associate Director.

[FR Doc. 2019–18113 Filed 8–21–19; 8:45 am]

BILLING CODE 4160–90–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Centers for Disease Control and Prevention

Informational Meeting: The Importation of Infectious Biological Agents, Infectious Substances and Vectors; Public Webcast

AGENCY: Centers for Disease Control and Prevention (CDC), Department of Health and Human Services (HHS).

ACTION: Notice of public webcast.

SUMMARY: The Centers for Disease Control and Prevention (CDC), Department of Health and Human Services (HHS), is hosting a public webcast to address import permit regulations for infectious biological agents, infectious substances, and vectors. Besides CDC, presenters for this webcast may include representatives from the U.S. Department of Transportation, U.S. Department of Agriculture, Department of Homeland Security, and U.S. National Authority for Containment (NAC) of Polioviruses.

DATES: The webcast will be held on December 4, 2019, from 11 a.m. to 4 p.m. (EST). Registration instructions are found on the HHS/CDC Import Permit Program website, *https://www.cdc.gov/cpr/ipp/index.htm.*

ADDRESSES: The webcast will be broadcast from the Centers for Disease Control and Prevention, 1600 Clifton Road NE, Atlanta, Georgia 30329.

FOR FURTHER INFORMATION CONTACT: Samuel S. Edwin, Director, Division of Select Agents and Toxins, Centers for Disease Control and Prevention, 1600 Clifton Road NE, Mailstop H–21–7, Atlanta, Georgia 30329. Telephone: (404) 718–2000.

SUPPLEMENTARY INFORMATION: This webcast is an opportunity for all interested parties (*e.g.,* academic institutions; biomedical centers; commercial manufacturing facilities; federal, state, and local laboratories, including clinical and diagnostic laboratories; research facilities; exhibition facilities; and educational facilities) to obtain specific guidance and information regarding import permit regulations for the importation of infectious biological agents, infectious substances and vectors. The webcast will also provide assistance to those interested in applying for an import permit from federal agencies within the United States. Instructions for registration are found on the HHS/CDC Import Permit Program website, *https://www.cdc.gov/cpr/ipp/index.htm.*

Participants must register by November 22, 2019. This is a webcast-only event and there will be no on-site participation at the HHS/CDC broadcast facility.

Dated: August 19, 2019.

Sandra Cashman,

Executive Secretary, Centers for Disease Control and Prevention.

[FR Doc. 2019–18100 Filed 8–21–19; 8:45 am]

BILLING CODE 4163–18–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration

[Docket No. FDA–2019–P–0076]

Determination That ZONEGRAN (Zonisamide) Capsules, 50 Milligrams, Was Not Withdrawn From Sale for Reasons of Safety or Effectiveness

AGENCY: Food and Drug Administration, HHS.

ACTION: Notice.

SUMMARY: The Food and Drug Administration (FDA or Agency) has determined that ZONEGRAN (zonisamide) capsules, 50 milligrams (mg), was not withdrawn from sale for reasons of safety or effectiveness. This determination means that FDA will not begin procedures to withdraw approval of abbreviated new drug applications (ANDAs) that refer to this drug product, and it will allow FDA to continue to approve ANDAs that refer to the product as long as they meet relevant legal and regulatory requirements.

FOR FURTHER INFORMATION CONTACT: Daniel Gottlieb, Center for Drug Evaluation and Research, Food and Drug Administration, 10903 New Hampshire Ave., Bldg. 51, Rm. 6210, Silver Spring, MD 20993–0002, 301–796–6650, *Daniel.Gottlieb@fda.hhs.gov.*

SUPPLEMENTARY INFORMATION: In 1984, Congress enacted the Drug Price Competition and Patent Term Restoration Act of 1984 (Pub. L. 98–417) (the 1984 amendments), which authorized the approval of duplicate versions of drug products under an

ANDA procedure. ANDA applicants must, with certain exceptions, show that the drug for which they are seeking approval contains the same active ingredient in the same strength and dosage form as the ''listed drug,'' which is a version of the drug that was previously approved. ANDA applicants do not have to repeat the extensive clinical testing otherwise necessary to gain approval of a new drug application (NDA).

The 1984 amendments include what is now section 505(j)(7) of the Federal Food, Drug, and Cosmetic Act (21 U.S.C. 355(j)(7)), which requires FDA to publish a list of all approved drugs. FDA publishes this list as part of the ''Approved Drug Products With Therapeutic Equivalence Evaluations,'' which is known generally as the ''Orange Book.'' Under FDA regulations, drugs are removed from the list if the Agency withdraws or suspends approval of the drug's NDA or ANDA for reasons of safety or effectiveness or if FDA determines that the listed drug was withdrawn from sale for reasons of safety or effectiveness (21 CFR 314.162).

A person may petition the Agency to determine, or the Agency may determine on its own initiative, whether a listed drug was withdrawn from sale for reasons of safety or effectiveness. This determination may be made at any time after the drug has been withdrawn from sale, but must be made prior to approving an ANDA that refers to the listed drug (§ 314.161 (21 CFR 314.161)). FDA may not approve an ANDA that does not refer to a listed drug.

ZONEGRAN (zonisamide) capsules, 50 mg, is the subject of NDA 020789, held by Sunovion Pharmaceuticals Inc., and initially approved on August 22, 2003. ZONEGRAN (zonisamide) is indicated as adjunctive therapy in the treatment of partial seizures in adults with epilepsy. ZONEGRAN (zonisamide) capsules, 50 mg, is currently listed in the ''Discontinued Drug Product List'' section of the Orange Book.

Unichem Pharmaceuticals (USA), Inc., submitted a citizen petition dated December 28, 2018 (Docket No. FDA–2019–P–0076), under 21 CFR 10.30, requesting that the Agency determine whether ZONEGRAN (zonisamide) capsules, 50 mg, was withdrawn from sale for reasons of safety or effectiveness.

After considering the citizen petition and reviewing Agency records and based on the information we have at this time, FDA has determined under § 314.161 that ZONEGRAN (zonisamide) capsules, 50 mg, was not withdrawn for reasons of safety or effectiveness. The petitioner has identified no data or other information suggesting that this drug product was withdrawn for reasons of safety or effectiveness. We have carefully reviewed our files for records concerning the withdrawal of ZONEGRAN (zonisamide) capsules, 50 mg, from sale. We have also independently evaluated relevant literature and data for possible postmarketing adverse events. We have found no information that would indicate that this drug product was withdrawn from sale for reasons of safety or effectiveness.

Accordingly, the Agency will continue to list ZONEGRAN (zonisamide) capsules, 50 mg, in the ''Discontinued Drug Product List'' section of the Orange Book. The ''Discontinued Drug Product List'' delineates, among other items, drug products that have been discontinued from marketing for reasons other than safety or effectiveness. FDA will not begin procedures to withdraw approval of approved ANDAs that refer to this drug product. Additional ANDAs for this drug product may also be approved by the Agency as long as they meet all other legal and regulatory requirements for the approval of ANDAs. If FDA determines that labeling for this drug product should be revised to meet current standards, the Agency will advise ANDA applicants to submit such labeling.

Dated: August 16, 2019.

Lowell J. Schiller,

Principal Associate Commissioner for Policy.

[FR Doc. 2019–18089 Filed 8–21–19; 8:45 am]

BILLING CODE 4164–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Health Resources and Services Administration

Meeting of the National Advisory Council on Migrant Health

AGENCY: Health Resources and Services Administration (HRSA), Department of Health and Human Services (HHS).

ACTION: Notice.

SUMMARY: In accordance with the Federal Advisory Committee Act, this notice announces that the Secretary's National Advisory Council on Migrant Health (NACMH) has scheduled a public meeting. Information about NACMH and the agenda for this meeting can be found on the NACMH website at *https://bphc.hrsa.gov/qualityimprovement/strategicpartnerships/nacmh/index.html.*

DATE: November 6–7, 9 a.m.–5 p.m. Eastern Time (ET).

ADDRESSES: 5600 Fishers Lane, 5W07, Rockville, Maryland 20857 (in-person).

FOR FURTHER INFORMATION CONTACT: Esther Paul, NACMH Designated Federal Officer (DFO), Strategic Initiatives and Planning Division, Office of Policy and Program Development, Bureau of Primary Health Care, HRSA, 5600 Fishers Lane, 16N38B, Rockville, Maryland 20857; 301–594–4300; or *epaul@hrsa.gov.*

SUPPLEMENTARY INFORMATION: NACMH provides advice and recommendations to the Secretary of HHS on policy, program development, and other matters of significance concerning the activities under section 217 of the Public Health Service (PHS) Act, as amended (42 U.S.C. 218). Specifically, NACMH consults with and makes recommendations to the Secretary of HHS concerning the organization, operation, selection, and funding of migrant health centers, and other entities under grants and contracts under section 330 of the PHS Act (42 U.S.C. 254b). NACMH meets twice each calendar year, or at the discretion of the DFO in consultation with the NACMH Chair.

During the November 6–7, 2019, meeting, NACMH will discuss issues related to migrant and seasonal agricultural worker health. Agenda items are subject to change as priorities dictate. Refer to the NACMH website for any updated information concerning the meeting. Members of the public will have the opportunity to provide comments. Public participants may submit written statements in advance of the scheduled meeting. Oral comments will be honored in the order they are received and may be limited as time allows. Requests to submit a written statement or make oral comments to NACMH should be sent to Esther Paul, DFO, using the contact information above at least three business days prior to the meeting.

Individuals who plan to attend and need special assistance or another reasonable accommodation should notify Esther Paul at the address and phone number listed above at least 10 business days prior to the meeting. Since this meeting occurs in a federal government building, attendees must go through a security check to enter the building. Non-U.S. Citizen attendees must notify HRSA of their planned attendance at least 20 business days prior to the meeting in order to facilitate their entry into the building. All attendees are required to present government-issued identification prior to entry.

Maria G. Button,

Director, Division of the Executive Secretariat.

[FR Doc. 2019–18117 Filed 8–21–19; 8:45 am]

BILLING CODE 4165–15–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Health Resources and Services Administration

Agency Information Collection Activities: Submission to OMB for Review and Approval; Public Comment Request; the Stem Cell Therapeutic Outcomes Database, OMB No. 0915–0310–Revision

AGENCY: Health Resources and Services Administration (HRSA), Department of Health and Human Services (HHS).

ACTION: Notice.

SUMMARY: In compliance with of the Paperwork Reduction Act of 1995, HRSA has submitted an Information Collection Request (ICR) to the Office of Management and Budget (OMB) for review and approval. Comments submitted during the first public review of this ICR will be provided to OMB. OMB will accept further comments from the public during the review and approval period.

DATES: Comments on this ICR should be received no later than September 23, 2019.

ADDRESSES: Submit your comments, including the ICR Title, to the desk officer for HRSA, either by email to *OIRA_submission@omb.eop.gov* or by fax to (202) 395–5806.

FOR FURTHER INFORMATION CONTACT: To request a copy of the clearance requests submitted to OMB for review, email Lisa Wright-Solomon, the HRSA Information Collection Clearance Officer at *paperwork@hrsa.gov* or call (301) 443–1984.

SUPPLEMENTARY INFORMATION:

Information Collection Request Title: The Stem Cell Therapeutic Outcomes Database OMB No. 0915–0310—Revision.

Abstract: The Stem Cell Therapeutic and Research Act of 2005, Public Law (Pub. L.) 109–129, as amended by the Stem Cell Therapeutic and Research Reauthorization Act of 2015, Public Law 114–104 (the Act), provides for the collection and maintenance of human blood stem cells for the treatment of patients and research. HRSA's Healthcare Systems Bureau has established the Stem Cell Therapeutic Outcomes Database. Operation of this database necessitates certain recordkeeping and reporting requirements to perform the functions related to hematopoietic stem cell transplantation under contract to HHS. The Act requires the Secretary to contract for the establishment and maintenance of information related to patients who have received stem cell therapeutic products and to do so using a standardized, electronic format. Data is collected from transplant centers, under contract, by the Medical College of Wisconsin's Center for International Blood and Marrow Transplant Research and is used for ongoing analysis of transplant outcomes. Over time, there is an expected increase in the number of recipients for whom data are reported as an increasing number of transplants are performed annually and survivorship after transplantation improves.

A 60-day notice was published in the **Federal Register** on March 7, 2019, vol. 84, No. 45; pp. 8334–8335. There were no public comments.

Need and Proposed Use of the Information: HRSA uses the information to carry out its statutory responsibilities. Information is needed to monitor the clinical status of transplantation and provide the Secretary of HHS with an annual report of transplant center specific survival data. Modifications of these forms fall into several categories: Consolidating questions and removing duplicate questions across the forms, implementing 'check all that apply' formatting to reduce data entry time, and removing items no longer clinically significant (*e.g.,* drugs). These modifications reduced the overall hours of burden inventory.

Likely Respondents: Transplant Centers.

Burden Statement: Burden in this context means the time expended by persons to generate, maintain, retain, disclose or provide the information requested. This includes the time needed to review instructions; to develop, acquire, install and utilize technology and systems for the purpose of collecting, validating and verifying information, processing and maintaining information, and disclosing and providing information; to train personnel and to be able to respond to a collection of information; to search data sources; to complete and review the collection of information; and to transmit or otherwise disclose the information. The total annual burden hours estimated for this ICR are summarized in the table below.

TOTAL ESTIMATED ANNUALIZED BURDEN HOURS

Form name	Number of respondents [1]	Number of responses per respondent	Total responses	Average burden per response (in hours)	Total burden hours
Baseline Pre-Transplant Essential Data (TED)	200	48	9,600	[2] 0.68	6,560
Disease Classification	200	48	9,600	[3] 0.43	4,160
Product Form (includes Infusion, HLA, and Infectious Disease Marker inserts)	200	45	9,000	1.00	9,000
100-day Post-TED	200	48	9,600	0.85	8,160
6 month Post-TED	200	43	8,600	0.85	7,310
1 year Post-TED	200	40	8,000	0.65	5,200
2 year Post-TED	200	34	6,800	0.65	4,420
3+ years Post-TED	200	172	34,400	[4] 0.52	17,773
Total	200		95,600		62,583

[1] The total of 200 is the number of centers completing the form; the same group will complete all of the forms.

[2] The decimal is rounded down, and the actual number is .683333333.

[3] The decimal is rounded down, and the actual number is .433333333.

[4] The decimal is rounded up, and the actual number is .516667.

Maria G. Button,

Director, Division of the Executive Secretariat.

[FR Doc. 2019–18088 Filed 8–21–19; 8:45 am]

BILLING CODE 4165–15–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

National Institutes of Health

National Institute On Aging; Notice of Closed Meeting

Pursuant to section 10(d) of the Federal Advisory Committee Act, as amended, 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 Aging Special Emphasis Panel; AD Centers Review.

Date: September 19–20, 2019.

Time: 1:30 p.m. to 5:00 p.m.

Agenda: To review and evaluate grant applications.

Place: Bethesda North Marriott Hotel & Conference Center, 5701 Marinelli Road, Rockville, MD 20852.

Contact Person: Maurizio Grimaldi, MD, Ph.D., Scientific Review Officer, Scientific Review Branch, National Institute on Aging, National Institutes of Health, 7201 Wisconsin Avenue, Gateway Building, Suite 2W200, Bethesda, MD 20892, 301–496–9374, *grimaldim2@mail.nih.gov*.

(Catalogue of Federal Domestic Assistance Program Nos. 93.866, Aging Research, National Institutes of Health, HHS)

Dated: August 16, 2019.

Miguelina Perez,

Program Analyst, Office of Federal Advisory Committee Policy.

[FR Doc. 2019–18079 Filed 8–21–19; 8:45 am]

BILLING CODE 4140–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

National Institutes of Health

National Institute on Aging; Notice of Closed Meeting

Pursuant to section 10(d) of the Federal Advisory Committee Act, as amended, 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 Aging Special Emphasis Panel; Aging and Mobility.

Date: September 13, 2019.

Time: 4:30 p.m. to 6:30 p.m.

Agenda: To review and evaluate grant applications.

Place: National Institute on Aging, Gateway Building, 7201 Wisconsin Avenue, Suite 2W200, Bethesda, MD 20892.

Contact Person: Anita H. Undale, MD, Ph.D., Scientific Review Officer, Scientific Review Branch, National Institute on Aging, National Institutes of Health, Gateway Building, Suite 2W200, 7201 Wisconsin Avenue, Bethesda, MD 20892, 301–827–7428, *anita.undale@nih.gov.*

(Catalogue of Federal Domestic Assistance Program Nos. 93.866, Aging Research, National Institutes of Health, HHS)

Dated: August 16, 2019.

Miguelina Perez,

Program Analyst, Office of Federal Advisory Committee Policy.

[FR Doc. 2019–18078 Filed 8–21–19; 8:45 am]

BILLING CODE 4140–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

National Institutes of Health

National Institute of General Medical Sciences; Notice of Closed Meeting

Pursuant to section 10(d) of the Federal Advisory Committee Act, as amended, 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: NIGMS Initial Review Group Training and Workforce Development Subcommittee—D Review of MARC and RISE applications

Date: October 24–25, 2019.

Time: 8:00 a.m. to 6:00 p.m.

Agenda: To review and evaluate grant applications.

Place: Hilton Garden Inn Bethesda, 7301 Waverly Street, Bethesda, MD 20814.

Contact Person: Tracy Koretsky, Ph.D., Scientific Review Officer, Office of Scientific Review, National Institute of General Medical Sciences, National Institutes of Health, 45 Center Drive, MSC 6200, Room 3AN.12F, Bethesda, MD 20892, 301 594 2886, *tracy.koretsky@nih.gov*.

(Catalogue of Federal Domestic Assistance Program Nos. 93.375, Minority Biomedical Research Support; 93.821, Cell Biology and Biophysics Research; 93.859, Pharmacology, Physiology, and Biological Chemistry Research; 93.862, Genetics and Developmental Biology Research; 93.88, Minority Access to Research Careers; 93.96, Special Minority Initiatives; 93.859, Biomedical Research and Research Training, National Institutes of Health, HHS)

Dated: August 16, 2019.

Miguelina Perez,

Program Analyst, Office of Federal Advisory Committee Policy.

[FR Doc. 2019–18082 Filed 8–21–19; 8:45 am]

BILLING CODE 4140–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

National Institutes of Health

National Institute on Aging; Notice of Closed Meeting

Pursuant to section 10(d) of the Federal Advisory Committee Act, as amended, 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 Aging Special Emphasis Panel; Neuroimaging of AD and Related Dementias.

Date: September 24, 2019.

Time: 1:00 p.m. to 2:00 p.m.

Agenda: To review and evaluate grant applications.

Place: National Institute on Aging, Gateway Building, 7201 Wisconsin Avenue, Suite 2C212, Bethesda, MD 20892.

Contact Person: Alexander Parsadanian, Ph.D., Scientific Review Officer, Scientific Review Branch, National Institute on Aging, Gateway Building 2C/212, 7201 Wisconsin Avenue, Bethesda, MD 20892, 301–496–9666, *parsadaniana@nia.nih.gov.*

(Catalogue of Federal Domestic Assistance Program Nos. 93.866, Aging Research, National Institutes of Health, HHS)

Dated: August 16, 2019.

Miguelina Perez,

Program Analyst, Office of Federal Advisory Committee Policy.

[FR Doc. 2019–18080 Filed 8–21–19; 8:45 am]

BILLING CODE 4140–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

National Institutes of Health

National Institute Of General Medical Sciences; Notice of Closed Meeting

Pursuant to section 10(d) of the Federal Advisory Committee Act, as amended, 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 of General Medical Sciences Special Emphasis Panel; Review of NIGMS Pathway to Independence Award K99/R00 Applications.

Date: November 8, 2019.

Time: 8:00 a.m. to 6:00 p.m.

Agenda: To review and evaluate grant applications.

Place: DoubleTree Hotel Downtown Bethesda, 8120 Wisconsin Avenue, Bethesda, MD 20814.

Contact Person: Isaah S. Vincent, Ph.D., Scientific Review Officer, Office of Scientific Review, National Institute of General Medical Sciences, National Institutes of Health, 45 Center Drive, Room 3AN12L, Bethesda, MD 20892, 301–594–2948, *isaah.vincent@nih.gov.*

(Catalogue of Federal Domestic Assistance Program Nos. 93.375, Minority Biomedical Research Support; 93.821, Cell Biology and Biophysics Research; 93.859, Pharmacology, Physiology, and Biological Chemistry Research; 93.862, Genetics and Developmental Biology Research; 93.88, Minority Access to Research Careers; 93.96, Special Minority Initiatives; 93.859, Biomedical Research and Research Training, National Institutes of Health, HHS)

Dated: August 16, 2019.

Miguelina Perez,

Program Analyst, Office of Federal Advisory Committee Policy.

[FR Doc. 2019–18081 Filed 8–21–19; 8:45 am]

BILLING CODE 4140–01–P

DEPARTMENT OF HOMELAND SECURITY

U.S. Citizenship and Immigration Services

[OMB Control Number 1615–0126]

Agency Information Collection Activities; Extension, Without Change, of a Currently Approved Collection: Collection of Qualitative Feedback Through Focus Groups

AGENCY: U.S. Citizenship and Immigration Services, Department of Homeland Security.

ACTION: 30-Day notice.

SUMMARY: The Department of Homeland Security (DHS), U.S. Citizenship and Immigration Services (USCIS) will be submitting 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. The purpose of this notice is to allow an additional 30 days for public comments.

DATES: The purpose of this notice is to allow an additional 30 days for public comments. Comments are encouraged and will be accepted until September 23, 2019.

ADDRESSES: Written comments and/or suggestions regarding the item(s) contained in this notice, especially regarding the estimated public burden and associated response time, must be directed to the OMB USCIS Desk Officer via email at *dhsdeskofficer@omb.eop.gov.* All submissions received must include the agency name and the OMB Control Number 1615–0126 in the subject line.

You may wish to consider limiting the amount of personal information that you provide in any voluntary submission you make. For additional information please read the Privacy Act notice that is available via the link in the footer of *http://www.regulations.gov.*

FOR FURTHER INFORMATION CONTACT: USCIS, Office of Policy and Strategy, Regulatory Coordination Division, Samantha Deshommes, Chief, 20 Massachusetts Avenue NW, Washington, DC 20529–2140, Telephone number (202) 272–8377 (This is not a toll-free number; comments are not accepted via telephone message.). Please note contact information provided here is solely for questions regarding this notice. It is not for individual case status inquiries. Applicants seeking information about the status of their individual cases can check Case Status Online, available at the USCIS website at *http://www.uscis.gov,* or call the USCIS Contact Center at (800) 375–5283; TTY (800) 767–1833.

SUPPLEMENTARY INFORMATION:

Comments

The information collection notice was previously published in the **Federal Register** on May 29, 2019, at 84 FR 24812, allowing for a 60-day public comment period. USCIS did receive two comments in connection with the 60-day notice.

You may access the information collection instrument with instructions, or additional information by visiting the Federal eRulemaking Portal site at: *http://www.regulations.gov* and enter USCIS–2012–0004 in the search box. Written comments and suggestions from the public and affected agencies should address one or more of the following four points:

(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, including the validity of the methodology and assumptions used;

(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, electronic, mechanical, or other technological collection techniques or other forms of information technology, *e.g.,* permitting electronic submission of responses.

Overview of This Information Collection

(1) *Type of Information Collection Request:* Extension, Without Change, of a Currently Approved Collection.

(2) *Title of the Form/Collection:* Collection of Qualitative Feedback through Focus Groups.

(3) *Agency form number, if any, and the applicable component of the DHS sponsoring the collection:* Form G–1542; USCIS.

(4) *Affected public who will be asked or required to respond, as well as a brief abstract: Primary:* Individuals or households; Business or other for-profit. Executive Order 12862 directs Federal agencies to provide service to the public that matches or exceeds the best service available in the private sector. In order to work continuously to ensure that our

programs are effective and meet our customers' needs, Department of Homeland Security/U.S. Citizenship and Immigration Services seeks to obtain OMB approval of a generic clearance to collect qualitative feedback on our service delivery. By qualitative feedback we mean information that provides useful insights on perceptions and opinions, but are not statistical surveys that yield quantitative results that can be generalized to the population of study. This collection of information is necessary to enable the Agency to garner customer and stakeholder feedback in an efficient, timely manner, in accordance with our commitment to improving service delivery. The information collected from our customers and stakeholders will help ensure that users have an effective, efficient, and satisfying experience with the Agency's programs. This feedback will provide insights into customer or stakeholder perceptions, experiences and expectations, provide an early warning of issues with service, or focus attention on areas where communication, training or changes in operations might improve delivery of products or services. These collections will allow for ongoing, collaborative and actionable communications between the Agency and its customers and stakeholders. It will also allow feedback to contribute directly to the improvement of program management.

(5) *An estimate of the total number of respondents and the amount of time estimated for an average respondent to respond:* The estimated total number of respondents for the information collection G–1542 is 3,000 and the estimated hour burden per response is 1.5 hours.

(6) *An estimate of the total public burden (in hours) associated with the collection:* The total estimated annual hour burden associated with this collection is 4,500 hours.

(7) *An estimate of the total public burden (in cost) associated with the collection:* The estimated total annual cost burden associated with this collection of information is $0.

Dated: August 19, 2019.

Samantha L. Deshommes,

Chief, Regulatory Coordination Division, Office of Policy and Strategy, U.S. Citizenship and Immigration Services, Department of Homeland Security.

[FR Doc. 2019–18116 Filed 8–21–19; 8:45 am]

BILLING CODE 9111–97–P

DEPARTMENT OF THE INTERIOR

Fish and Wildlife Service

[FWS–R4–ES–2019–N101; FXES11140400000–178–FF04EF2000]

Receipt of Incidental Take Permit Application and Proposed Habitat Conservation Plan for the Sand Skink and Blue-Tailed Mole Skink, Osceola County, FL; Categorical Exclusion

AGENCY: Fish and Wildlife Service, Interior.

ACTION: Notice of availability; request for comments and information.

SUMMARY: We, the Fish and Wildlife Service (Service), announce receipt of an application from Mattamy Homes (applicant) for an incidental take permit (ITP) under the Endangered Species Act. The applicant requests the ITP to take the federally listed sand skink and blue-tailed mole skink incidental to construction in Osceola County, Florida. We request public comment on the application, which includes the applicant's proposed habitat conservation plan (HCP), and the Service's preliminary determination that this HCP qualifies as ''low-effect,'' categorically excluded, under the National Environmental Policy Act. To make this determination, we used our environmental action statement and low-effect screening form, both of which are also available for public review.

DATES: We must receive your written comments on or before September 23, 2019.

ADDRESSES:

Obtaining Documents: You may obtain copies of the documents by any of the following methods:

- *Telephone:* Alfredo Begazo, 772–469–4234.
- *Email: alfredo_begazo@fws.gov.*
- *U.S. mail:* Alfredo Begazo, South Florida Ecological Services Office, Attn Mattamy Homes Permit TE69953C–1, U.S. Fish and Wildlife Service, 1339 20th Street, Vero Beach, FL 32960–3559.
- *In-person:* The documents may be reviewed by appointment during normal business hours at the above address. Please call to make an appointment.
- *Fax:* Alfredo Begazo, 772–562–4288.

Submitting Comments: If you wish to submit comments on any of the documents, you may do so in writing via the above email address, U.S. mail address, or fax number, or you may hand-deliver comments to the above address during regular business hours.

FOR FURTHER INFORMATION CONTACT: Alfredo Begazo, by U.S. mail (see **ADDRESSES**) or via phone at 772–469–4234. Individuals who are hearing impaired or speech impaired may call the Federal Relay Service at 800–877–8339 for TTY assistance.

SUPPLEMENTARY INFORMATION: We, the Fish and Wildlife Service (Service), announce receipt of an application from Mattamy Homes (applicant) for an incidental take permit (ITP) under the Endangered Species Act of 1973, as amended (ESA; 16 U.S.C. 1531 *et seq.*). The applicant requests the ITP to take the federally listed sand skink (*Neoseps reynoldsi*) and blue-tailed mole skink (*Eumeces egregius lividus*) (skinks) incidental to the construction of a residential development (project) in Osceola County, Florida. We request public comment on the application, which includes the applicant's proposed habitat conservation plan (HCP) and the Service's preliminary determination that this HCP qualifies as ''low-effect,'' categorically excluded under the National Environmental Policy Act (NEPA; 42 U.S.C. 4321 *et seq.*). To make this determination, we used our environmental action statement and low-effect screening form, both of which are also available for public review.

Project

Mattamy Homes requests a 5-year ITP to take skinks incidental to the conversion of approximately 5.04 acres of occupied skink foraging and sheltering habitat for the construction of a residential development located on a 83.29-acre parcel in Sections 18 and 19, Township 25 South, and Range 27 East, Osceola County, Florida. The applicant proposes to mitigate for take of the skinks by purchasing credits equivalent to 10.08 acres of skink-occupied habitat from a Service-approved conservation bank in Osceola County. The Service would require the applicant to purchase the credits prior to engaging in land clearing activities on the parcel.

Public Availability of Comments

Before including your address, phone number, email address, or other personal identifying information in your comment, be aware that your entire comment—including your personal identifying information—may be made available to the public. While you may request that we withhold your personal identifying information, we cannot guarantee that we will be able to do so.

Our Preliminary Determination

The Service has made a preliminary determination that the applicant's project, including land clearing, construction of the residential development, and the proposed mitigation measure would individually and cumulatively have a minor or negligible effect on the skinks and the environment. Therefore, we have preliminarily concluded that the ITP for this project would qualify for categorical exclusion and the HCP is low effect under our NEPA regulations at 43 CFR 46.205 and 46.210. A low-effect HCP is one that would result in (1) minor or negligible effects on federally listed, proposed, and candidate species and their habitats; (2) minor or negligible effects on other environmental values or resources; and (3) impacts that, when considered together with the impacts of other past, present, and reasonable foreseeable similarly situated projects, would not over time result in significant cumulative effects to environmental values or resources.

Next Steps

The Service will evaluate the application and the comments received to determine whether to issue the requested permit. We will also conduct an intra-Service consultation pursuant to section 7 of the ESA to evaluate the effects of the proposed take. After considering the above findings, we will determine whether the permit issuance criteria of section 10(a)(1)(B) of the ESA have been met. If met, the Service will issue ITP number TE69953C–1 to Mattamy Homes.

Authority

The Service provides this notice under section 10(c) (16 U.S.C. 1539(c)) of the ESA and NEPA regulation 40 CFR 1506.6.

Roxanna Hinzman,

Field Supervisor, South Florida Ecological Services Office.

[FR Doc. 2019–18095 Filed 8–21–19; 8:45 am]

BILLING CODE 4333–15–P

DEPARTMENT OF THE INTERIOR

Bureau of Land Management

[LLWO250000.L12200000.PM0000; OMB Control Number 1004–0119]

Agency Information Collection Activities; Permits for Recreation on Public Lands

AGENCY: Bureau of Land Management, Interior.

ACTION: Notice of information collection; request for comment.

SUMMARY: In accordance with the Paperwork Reduction Act of 1995, the Bureau of Land Management (BLM) is proposing to renew an information collection control number.

DATES: Interested persons are invited to submit comments on or before October 21, 2019.

ADDRESSES: Send your comments on this information collection request (ICR) by mail to Jean Sonneman. U.S. Department of the Interior, Bureau of Land Management, 1849 C Street NW, Room 2134LM, Washington, DC 20240; or by email to *jsonneman@blm.gov.* Please reference OMB Control Number 1004–0119 in the subject line of your comments.

FOR FURTHER INFORMATION CONTACT: To request additional information about this Information Collection Request (ICR), please contact David Ballenger by email at *dballeng@blm.gov,* or by telephone at 202–912–7642. Persons who use a telecommunication device for the deaf may call the Federal Relay Service at 1–800–877–8339, to leave a message for the above person.

SUPPLEMENTARY INFORMATION: In accordance with the Paperwork Reduction Act of 1995, the BLM provides the general public and other Federal agencies with an opportunity to comment on new, proposed, revised, and continuing collections of information. This helps to assess the impact of the BLM's information collection requirements and minimize the public's reporting burden. It also helps the public understand the BLM's information-collection requirements and provides the requested data in the desired format.

The BLM is soliciting comments on the proposed ICR that is described below. The BLM is especially interested in public comment addressing the following issues: (1) Is the collection necessary to the proper functions of the BLM; (2) Will this information be processed and used in a timely manner; (3) Is the estimate of burden accurate; (4) How might the BLM enhance the quality, utility, and clarity of the information to be collected; and (5) How might the BLM minimize the burden of this collection on the respondents, including through the use of information technology.

Comments that you submit in response to this notice are a matter of public record. The BLM will include or summarize each comment in its request to OMB to approve this ICR. 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 in your comment to the BLM to withhold your personal identifying information from public review, the BLM cannot guarantee that it will be able to do so.

The following information pertains to this request:

Abstract: Control number 1004–0119 allows the BLM to collect the required information to authorize commercial, competitive, and an organized group of recreational uses of public lands.

Title of Collection: Permits for Recreation on Public Lands (43 CFR part 2930).

OMB Control Number: 1004–0119.

Form: 2930–1, Special Recreation Permit Application.

Type of Review: Extension of a currently approved collection.

Description of Respondents: Applicants for recreational use of public lands managed by the BLM.

Estimated Number of Annual Respondents: 1,323.

Estimated Number of Annual Responses: 1,323.

Estimated Completion Time per Response: Varies from the 4 hours per response.

Total Estimated Number of Annual Burden Hours: 5,292.

Respondent's Obligation: Responses are required to obtain or retain a benefit.

Frequency of Collection: On occasion.

Total Estimated Annual Non-hour Burden Cost: Respondents are not required to purchase additional computer hardware or software to comply with this information collection. Individual states can charge an application fee to defray procession costs. The BLM estimated annual non-hour cost based on current application fees is $5,540.

The estimated annual burdens of this collection are itemized below:

A. Type of response	B. Number of responses	C. Hours per response	D. Total hours (column B × column C)
Special Recreation Permit Application (43 CFR part 2930) Form 2930–1 related non-form information	1,323	4	5,292
Totals	1,323	....	5,292

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 authority for this action is the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*)

Chandra Little,

Acting Information Collection Clearance Officer, Bureau of Land Management.

[FR Doc. 2019–18157 Filed 8–21–19; 8:45 am]

BILLING CODE 4310–84–P

INTERNATIONAL TRADE COMMISSION

Notice of Receipt of Complaint; Solicitation of Comments Relating to the Public Interest

AGENCY: U.S. International Trade Commission.

ACTION: Notice.

SUMMARY: Notice is hereby given that the U.S. International Trade Commission has received a complaint entitled *Certain Collapsible and Portable Furniture, DN 3404*; the Commission is soliciting comments on any public interest issues raised by the complaint or complainant's filing pursuant to the Commission's Rules of Practice and Procedure.

FOR FURTHER INFORMATION CONTACT: Lisa R. Barton, Secretary to the Commission, U.S. International Trade Commission, 500 E Street SW, Washington, DC 20436, telephone (202) 205–2000. The public version of the complaint can be accessed on the Commission's Electronic Document Information System (EDIS) at *https://edis.usitc.gov,* and will be available for inspection during official business hours (8:45 a.m. to 5:15 p.m.) in the Office of the Secretary, U.S. International Trade Commission, 500 E Street SW, Washington, DC 20436, telephone (202) 205–2000.

General information concerning the Commission may also be obtained by accessing its internet server at United States International Trade Commission (USITC) at *https://www.usitc.gov*. The public record for this investigation may be viewed on the Commission's Electronic Document Information System (EDIS) at *https://edis.usitc.gov*. Hearing-impaired persons are advised that information on this matter can be obtained by contacting the Commission's TDD terminal on (202) 205–1810.

SUPPLEMENTARY INFORMATION: The Commission has received a complaint and a submission pursuant to § 210.8(b) of the Commission's Rules of Practice and Procedure filed on behalf of GCI Outdoor, Inc. on August 16, 2019. The complaint alleges violations of section 337 of the Tariff Act of 1930 (19 U.S.C. 1337) in the importation into the United States, the sale for importation, and the sale within the United States after importation of certain collapsible and portable furniture. The complaint names as respondents: Denovo Brands, LLC of Bentonville, AR; Zhenli (Zhangzhou) Industrial Co., Ltd. of China; Fujian Zenithen Consumer Products Co., Ltd. of China; Zenithen Hong Kong Ltd. of Hong Kong; Zenithen USA LLC of Upland, CA; and Westfield Outdoor, Inc. d/b/a Westfield Outdoors of Indianapolis, IN. The complainant requests that the Commission issue a limited exclusion order, cease and desist orders and impose a bond upon respondents' alleged infringing articles during the 60-day Presidential review period pursuant to 19 U.S.C. 1337(j).

Proposed respondents, other interested parties, and members of the public are invited to file comments on any public interest issues raised by the complaint or § 210.8(b) filing. Comments should address whether issuance of the relief specifically requested by the complainant in this investigation would affect the public health and welfare in the United States, competitive conditions in the United States economy, the production of like or directly competitive articles in the United States, or United States consumers.

In particular, the Commission is interested in comments that:

(i) Explain how the articles potentially subject to the requested remedial orders are used in the United States;

(ii) Identify any public health, safety, or welfare concerns in the United States relating to the requested remedial orders;

(iii) Identify like or directly competitive articles that complainant, its licensees, or third parties make in the United States which could replace the subject articles if they were to be excluded;

(iv) Indicate whether complainant, complainant's licensees, and/or third party suppliers have the capacity to replace the volume of articles potentially subject to the requested exclusion order and/or a cease and desist order within a commercially reasonable time; and

(v) Explain how the requested remedial orders would impact United States consumers.

Written submissions on the public interest must be filed no later than by close of business, eight calendar days after the date of publication of this notice in the **Federal Register**. There will be further opportunities for comment on the public interest after the issuance of any final initial determination in this investigation. Any written submissions on other issues must also be filed by no later than the close of business, eight calendar days after publication of this notice in the **Federal Register**. Complainant may file replies to any written submissions no later than three calendar days after the date on which any initial submissions were due. Any submissions and replies filed in response to this Notice are limited to five (5) pages in length, inclusive of attachments.

Persons filing written submissions must file the original document electronically on or before the deadlines stated above and submit 8 true paper copies to the Office of the Secretary by noon the next day pursuant to § 210.4(f) of the Commission's Rules of Practice and Procedure (19 CFR 210.4(f)). Submissions should refer to the docket number (''Docket No. 3404'') in a prominent place on the cover page and/ or the first page. (*See* Handbook for Electronic Filing Procedures, Electronic Filing Procedures. [1]) Persons with questions regarding filing should contact the Secretary (202–205–2000).

Any person desiring to submit a document to the Commission in

[1] Handbook for Electronic Filing Procedures: *https://www.usitc.gov/documents/handbook_on_filing_procedures.pdf*.

confidence must request confidential treatment. All such requests should be directed to the Secretary to the Commission and must include a full statement of the reasons why the Commission should grant such treatment. *See* 19 CFR 201.6. Documents for which confidential treatment by the Commission is properly sought will be treated accordingly. All information, including confidential business information and documents for which confidential treatment is properly sought, submitted to the Commission for purposes of this Investigation may be disclosed to and used: (i) By the Commission, its employees and Offices, and contract personnel (a) for developing or maintaining the records of this or a related proceeding, or (b) in internal investigations, audits, reviews, and evaluations relating to the programs, personnel, and operations of the Commission including under 5 U.S.C. Appendix 3; or (ii) by U.S. government employees and contract personnel,[2] solely for cybersecurity purposes. All nonconfidential written submissions will be available for public inspection at the Office of the Secretary and on EDIS.[3]

This action is taken under the authority of section 337 of the Tariff Act of 1930, as amended (19 U.S.C. 1337), and of §§ 201.10 and 210.8(c) of the Commission's Rules of Practice and Procedure (19 CFR 201.10, 210.8(c)).

By order of the Commission.

Issued: August 19, 2019.

Lisa Barton,

Secretary to the Commission.

[FR Doc. 2019–18114 Filed 8–21–19; 8:45 am]

BILLING CODE 7020–02–P

[2] All contract personnel will sign appropriate nondisclosure agreements.

[3] Electronic Document Information System (EDIS): *https://edis.usitc.gov.*

INTERNATIONAL TRADE COMMISSION

[Investigation No. 337–TA–1122]

Certain Convertible Sofas and Components Thereof; Commission Determination Not To Review the Final Initial Determination Finding No Violation of Section 337; Termination of the Investigation

AGENCY: U.S. International Trade Commission.

ACTION: Notice.

SUMMARY: Notice is hereby given that the U.S. International Trade Commission (the ''Commission'') has determined not to review the final initial determination (''ID'') in the above-captioned investigation finding no violation of Section 337 of the Tariff Act of 1930, as amended, 19 U.S.C. 337 (''Section 337''). The investigation is hereby terminated.

FOR FURTHER INFORMATION CONTACT: Carl P. Bretscher, Office of the General Counsel, U.S. International Trade Commission, 500 E Street SW, Washington, DC 20436, telephone (202) 205–2382. Copies of non-confidential documents filed in connection with this investigation are or will be available for inspection during official business hours (8:45 a.m. to 5:15 p.m.) in the Office of the Secretary, U.S. International Trade Commission, 500 E Street SW, Washington, DC 20436, telephone (202) 205–2000. General information concerning the Commission may also be obtained by accessing its internet server (*https://www.usitc.gov*). The public record for this investigation may be viewed on the Commission's Electronic Docket Information System (''EDIS'') (*https://edis.usitc.gov*). Hearing-impaired persons are advised that information on this matter can be obtained by contacting the Commission's TDD terminal, telephone (202) 205–1810.

SUPPLEMENTARY INFORMATION: On July 13, 2018, the Commission instituted the present investigation based on a complaint filed by Sauder Manufacturing Co. of Archbold, Ohio. 83 FR 32686 (July 13, 2018). The complaint alleges a violation of Section 337 has occurred through the importation into the United States, sale for importation, and sale within the United States after importation of certain convertible sofas that purportedly infringe Sauder's U.S. Design Patent No. D716,576 (''the D'576 patent''). *Id.* The Commission's notice of investigation named Krug, Inc. (''Krug'') of Kitchener, Ontario, Canada, as the sole respondent. *Id.* The Office of Unfair Import Investigations was not named as a party. *Id.*

The presiding administrative law judge (''ALJ'') set the target date for completion of this investigation for November 13, 2019 (16 months). Order No. 3 (July 27, 2018). The ALJ scheduled the evidentiary hearing for March 18–22, 2019 and the deadline for issuing the final ID for July 12, 2019. Order No. 4 (Aug. 3, 2018). The parties, in response to an inquiry from the ALJ, subsequently agreed that the issues in this investigation could be resolved with a hearing on the briefs rather than a live evidentiary hearing. *See* Joint Statement Stipulating to a Hearing on the Briefs and Corresponding Proposed Procedural Schedule (Nov. 9, 2018). The ALJ adopted their recommendations, with some revisions, and scheduled a hearing for March 19, 2019, to hear the parties' arguments on their submissions. Order No. 5 (Nov. 19, 2018). The ALJ did not change the deadline for issuing the final ID or the target date for completion of the investigation. *Id.*

On July 12, 2019, the ALJ issued the final ID, which finds that: (1) The accused Krug convertible sofas do not infringe the D'576 patent; (2) prosecution history estoppel bars Sauder from accusing Krug sofas with soft top arms of infringing the D'576 patent; and (3) the D'576 patent claim is invalid under 35 U.S.C. 112 for lack of written description. ID at 18, 34, 54, 58. The ID concludes that importation of the accused Krug products does not violate Section 337. *Id.* at 1, 58.

No party filed a petition to review the subject ID. The Commission has determined not to review the subject ID. The investigation is hereby terminated.

The authority for the Commission's determination is contained in Section 337 of the Tariff Act of 1930, as amended (19 U.S.C. 1337), and in Part 210 of the Commission's Rules of Practice and Procedure (19 CFR part 210).

Issued: August 19, 2019.

By order of the Commission.

Lisa Barton,

Secretary to the Commission.

[FR Doc. 2019–18115 Filed 8–21–19; 8:45 am]

BILLING CODE 7020–02–P

DEPARTMENT OF LABOR

Mine Safety and Health Administration

Petitions for Modification of Application of Existing Mandatory Safety Standard

AGENCY: Mine Safety and Health Administration, Labor.

ACTION: Notice.

SUMMARY: This notice is a summary of petition for modification submitted to the Mine Safety and Health Administration (MSHA) by the parties listed below.

DATES: All comments on the petition must be received by MSHA's Office of Standards, Regulations, and Variances on or before September 23, 2019.

ADDRESSES: You may submit your comments, identified by ''docket number'' on the subject line, by any of the following methods:

1. *Email: zzMSHA-comments@dol.gov.* Include the docket number of

the petition in the subject line of the message.

2. *Facsimile:* 202–693–9441.

3. *Regular Mail or Hand Delivery:* MSHA, Office of Standards, Regulations, and Variances, 201 12th Street South, Suite 4E401, Arlington, Virginia 22202–5452, Attention: Sheila McConnell, Director, Office of Standards, Regulations, and Variances. Persons delivering documents are required to check in at the receptionist's desk in Suite 4E401. Individuals may inspect a copy of the petition and comments during normal business hours at the address listed above.

MSHA will consider only comments postmarked by the U.S. Postal Service or proof of delivery from another delivery service such as UPS or Federal Express on or before the deadline for comments.

FOR FURTHER INFORMATION CONTACT: Sheila McConnell, Office of Standards, Regulations, and Variances at 202–693–9447 (voice), *mcconnell.sheila.a@dol.gov* (email), or 202–693–9440 (fax). [These are not toll-free numbers.]

SUPPLEMENTARY INFORMATION: Section 101(c) of the Federal Mine Safety and Health Act of 1977 and Title 30 of the Code of Federal Regulations Part 44 govern the application, processing, and disposition of petitions for modification.

I. Background

Section 101(c) of the Federal Mine Safety and Health Act of 1977 (Mine Act) allows the mine operator or representative of miners to file a petition to modify the application of any mandatory safety standard to a coal or other mine if the Secretary of Labor determines that:

1. An alternative method of achieving the result of such standard exists which will at all times guarantee no less than the same measure of protection afforded the miners of such mine by such standard; or

2. That the application of such standard to such mine will result in a diminution of safety to the miners in such mine.

In addition, the regulations at 30 CFR 44.10 and 44.11 establish the requirements and procedures for filing petitions for modification.

II. Petitions for Modification

Docket Number: M–2019–021–C.

Petitioner: Monongalia County Coal Company, P.O. Box 72, Brave, Pennsylvania 15316.

Mine: Monongalia County Mine, MSHA I.D. No. 46–01968, located in Monongalia County, West Virginia.

Regulation Affected: 30 CFR 75.503 (Permissible electric face equipment; maintenance) and 18.35(a)(5)(i) (Portable (trailing) cables and cords).

Modification Request: The petitioner seeks modification of the existing standard to permit trailing cable lengths of up to 1,000 feet in all sections.

The petitioner states that:

(1) The petitioner is developing longwall panels (gate sections) as part of a continuing mining cycle. The longwall development panels consist of a three or four entry system with a maximum of 300-foot blocks to improve roof and abutment pressure control during longwall mining. Petitioner states that ventilation is also improved by limiting the number of stoppings, which have a built-in ventilation pressure loss factor. Additionally, pillar stability is increased due to the increased block sizes associated with the necessity of longer trailing cables. There is a need for cable lengths greater than 600, 700, or 800 feet for this development system.

(2) The petitioner is also developing mains and submains sections as part of a continuing mining cycle. These sections consist of a six to eight entry system with a maximum of 300-foot blocks to improve roof and abutment pressure control during longwall mining. Petitioner states that ventilation is also improved by limiting the number of stoppings, which have a built-in ventilation pressure loss factor. Additionally, pillar stability is increased due to the increased block sizes associated with the necessity of longer trailing cables. There is a need for cable lengths greater than 600, 700, or 850 feet for this development system.

(3) The need to add additional electrical components such as distribution boxes and/or electrical connections throughout the section to achieve required cable length is decreased.

(4) Provided with this petition is a summary of short-circuit calculations justifying the instantaneous trip setting for the circuit breakers protecting the trailing cables supplying power to continuous mining section machines in the Monongalia County Mine.

(5) As an alternative to specific compliance with 30 CFR 75.503, (18.35), the petitioner proposes the following:

—The petition applies only to trailing cable supplying three-phase, 995-volt power to continuous mining machines and trailing cable supplying three-phase, 575-volt power to loading machines, shuttle cars, roofbolters, section ventilation fans, and de-gas drills.

—The maximum length of the 995- and 575-volt trailing cables will be 1,000 feet.

—The 995-volt continuous mining machine trailing cables will not be smaller than 2/0. The 575-volt trailing cables for loading machines, small roof bolters, de-gas drills, and section ventilation fans will not be smaller than No. 2 American Wire Gauge (AWG). The 575-volt large roof bolters and AC shuttle car trailing cables will not be smaller than No. 4 AWG.

—All circuit breakers used to protect 2/0 trailing cables exceeding 850 feet in length will have instantaneous trip units calibrated to trip at 1,500 amperes. The trip setting of these circuit breakers will be sealed or locked, and will have a permanent, legible labels. Each label will identify the circuit breaker as being suitable for protecting 2/0 cables. The label will be maintained to be legible.

—Replacement instantaneous trip units used to protect 2/0 trailing cables will be calibrated to trip at 1,500 amperes and this setting will be sealed or locked.

—All circuit breakers used to protect No. 2 AWG trailing cables exceeding 700 feet in length will have instantaneous trip units calibrated to trip at 800 amperes. The trip setting of these circuit breakers will be sealed or locked, and will have permanent, legible labels. Each label will identify the circuit breaker as being suitable for protecting No. 2 AWG cables. The label will be maintained to be legible.

—Replacement instantaneous trip units used to protect No. 2 AWG trailing cables will be calibrated to trip at 800 amperes and this setting will be sealed or locked.

—All circuit breakers used to protect No. 4 AWG trailing cables exceeding 600 feet in length will have instantaneous trip units calibrated to trip at 500 amperes. The trip setting of these circuit breakers will be sealed or locked, and will have permanent, legible labels. Each label will identify the circuit breaker as being suitable for protecting No. 4 AWG cables. The label will be maintained to be legible.

—Replacement instantaneous trip units used to protect No. 4 AWG trailing cables, will be calibrated to trip at 500 amperes and this setting will be sealed or locked.

—At the beginning of each production shift, persons designated by the operator will visually examine the trailing cables to ensure that the cables are in safe operating condition and that the instantaneous settings of the specially calibrated breakers do not have seals or locks removed and that they do not exceed the settings stipulated in Paragraphs items 3, 4, and 5, under Item No. 5.

—Any trailing cable that is not in safe operating condition will be removed from service immediately and repaired or replaced.
—Each splice or repair in the trailing cables will be made in a workmanlike manner and in accordance with the instructions of the manufacturer of the splice or repair materials. The outer jacket of each splice or repair will be vulcanized with flame-resistant material or made with material that has been accepted by MSHA as flame-resistant.
—In the event the mining methods or operating procedures cause or contribute to the damage of any trailing cable, the cable will be removed from service immediately and repaired or replaced. Also, additional precautions will be taken to ensure that in the future the cable is protected and maintained in safe operating condition.
—Permanent warning labels will be installed and maintained on the cover(s) of the power center identifying the location of each sealed or locked short-circuit protection device. These labels will warn miners not to change or alter the short-circuit settings.
—The petitioner's alternative method will not be implemented until all miners who have been designated to examine the integrity of seals or locks and to verify the short-circuit settings and proper procedures for examining trailing cables for defects and damage have received all the elements of training specified in this petition.
—Within 60 days after the proposed decision and order becomes final, the petitioner will submit proposed revisions for the approved 30 CFR part 48 training plan to the District Manager. The training will include the following elements:

a. Mining methods and operating procedures that will protect the trailing cables against damage;

b. The proper procedures for examining trailing cables to ensure the cables are in safe operating condition;

c. The hazards of setting the circuit breakers too high to adequately protect the trailing cables; and

d. How to verify that the circuit interrupting device(s) protecting the trailing cable(s) are properly set and maintained.

The procedure as specified in 30 CFR 48.3 for approval of proposed revisions to already approved training plans will apply.

The petitioner asserts that the proposed alternative method will at all times guarantee no less than the same measure of protection afforded by the existing standard.

Docket Number: M–2019–022–C.

Petitioner: Sunrise Coal, LLC, 12661 N Agricare Road, Oaktown, Indiana 47561.

Mine: Oaktown Fuels No. 1, MSHA I.D. No. 12–02394, located in Knox County, Indiana.

Regulation Affected: 30 CFR 75.500(d) (Permissible electric equipment).

Modification Request: The petitioner requests a modification of the existing standard to permit the use of nonpermissible, low-voltage or battery-powered electronic testing and diagnostic equipment in or inby the last open crosscut.

The petitioner states that:

(1) The nonpermissible, low-voltage or battery-powered electronic testing and diagnostic equipment to be used includes laptop computers; oscilloscopes; vibration analysis machines; cable fault detectors; point temperature and distance probes, infrared temperature devices; insulation testers; voltage, current, and resistance meters and power testers; electronic tachometers, signal analyzer and ultrasonic measuring devices; and other similar testing and diagnostic equipment.

(2) All nonpermissible, low-voltage or battery-powered electronic testing and diagnostic equipment to be used in or inby the last open crosscut will be examined prior to use by a certified person, as defined in 30 CFR 75.153, to ensure equipment is being maintained in a safe operating condition.

(3) The examinations of the nonpermissible, low-voltage or battery-powered electronic testing and diagnostic equipment will include:
—Inspecting the contact points to ensure a secure connection to the battery;
—Reinserting the battery and powering up and shutting down to ensure proper connections; and
—Checking the battery compartment cover or battery attachment to ensure that it is securely fastened.

(4) The results of such inspections will be recorded in the examination book prior to the equipment being used underground and will be made available to MSHA and the miners at the mine, on request.

(5) A qualified person, as defined in 30 CFR 75.151, will continuously monitor for methane immediately before and during the use of nonpermissible, low-voltage or battery-powered electronic testing and diagnostic equipment in or inby the last open crosscut.

(6) Nonpermissible, low-voltage or battery-powered electronic testing and diagnostic equipment will not be used if methane is detected in concentrations at or above one percent. When a one percent or more methane concentration is detected while the nonpermissible, low-voltage or battery-powered electronic testing and diagnostic equipment is being used, the equipment will be deenergized immediately and withdrawn outby the last open crosscut.

(7) All hand-held methane detectors will be MSHA-approved and maintained in permissible and proper operating condition.

(8) All electronic testing and diagnostic equipment will be used in accordance with the manufacturer's recommendations.

(9) Qualified personnel engaged in the use of electronic testing and diagnostic equipment will be trained to recognize the hazards and limitations associated with the use of such equipment.

The petitioner asserts that the proposed alternative method will at all times guarantee no less than the same measure of protection afforded by the existing standard.

Docket Number: M–2019–023–C.

Petitioner: Sunrise Coal, LLC, 12661 N Agricare Road, Oaktown, Indiana 47561.

Mine: Oaktown Fuels No. 2, MSHA I.D. No. 12–02418, located in Knox County, Indiana.

Regulation Affected: 30 CFR 75.500(d) (Permissible electric equipment).

Modification Request: The petitioner requests a modification of the existing standard to permit the use of nonpermissible, low-voltage or battery-powered electronic testing and diagnostic equipment in or inby the last open crosscut.

The petitioner states that:

(1) The nonpermissible, low-voltage or battery-powered electronic testing and diagnostic equipment to be used includes laptop computers; oscilloscopes; vibration analysis machines; cable fault detectors; point temperature and distance probes, infrared temperature devices; insulation testers; voltage, current, and resistance meters and power testers; electronic tachometers, signal analyzer and ultrasonic measuring devices; and other similar testing and diagnostic equipment.

(2) All nonpermissible, low-voltage or battery-powered electronic testing and diagnostic equipment to be used in or inby the last open crosscut will be examined prior to use by a certified person, as defined in 30 CFR 75.153, to ensure equipment is being maintained in a safe operating condition.

(3) The examinations of the nonpermissible, low-voltage or battery-

powered electronic testing and diagnostic equipment will include:

—Checking the instrument for any physical damage and the integrity of the case;
—Removing the battery and inspecting for corrosion;
—Inspecting the contact points to ensure a secure connection to the battery;
—Reinserting the battery and powering up and shutting down to ensure proper connections; and
—Checking the battery compartment cover or battery attachment to ensure that it is securely fastened.

(4) The results of such inspections will be recorded in the examination book prior to the equipment being used underground and will be made available to MSHA and the miners at the mine, on request.

(5) A qualified person, as defined in 30 CFR 75.151, will continuously monitor for methane immediately before and during the use of nonpermissible, low-voltage or battery-powered electronic testing and diagnostic equipment in or inby the last open crosscut.

(6) Nonpermissible, low-voltage or battery-powered electronic testing and diagnostic equipment will not be used if methane is detected in concentrations at or above one percent. When a one percent or more methane concentration is detected while the nonpermissible, low-voltage or battery-powered electronic testing and diagnostic equipment is being used, the equipment will be deenergized immediately and withdrawn outby the last open crosscut.

(7) All hand-held methane detectors will be MSHA-approved and maintained in permissible and proper operating condition.

(8) All electronic testing and diagnostic equipment will be used in accordance with the manufacturer's recommendations.

(9) Qualified personnel engaged in the use of electronic testing and diagnostic equipment will be trained to recognize the hazards and limitations associated with the use of such equipment.

The petitioner asserts that the proposed alternative method will at all times guarantee no less than the same measure of protection afforded by the existing standard.

Roslyn Fontaine,

Deputy Director, Office of Standards, Regulations, and Variances.

[FR Doc. 2019–18097 Filed 8–21–19; 8:45 am]

BILLING CODE 4520–43–P

NATIONAL SCIENCE FOUNDATION

Astronomy and Astrophysics Advisory Committee; Notice of Meeting

In accordance with the Federal Advisory Committee Act (Pub. L. 92–463, as amended), the National Science Foundation (NSF) announces the following meeting:

Name and Committee Code: Astronomy and Astrophysics Advisory Committee (#13883).

Date and Time: September 26, 2019; 9:00 a.m.–5:00 p.m.; September 27, 2019; 9:00 a.m.–12:00 p.m.

Place: National Science Foundation, 2415 Eisenhower Avenue, Alexandria, VA 22314, Room E2020.

Type of Meeting: Open.

Attendance information for the meeting will be forthcoming on the website: *https://www.nsf.gov/mps/ast/aaac.jsp.*

Contact Person: Dr. Christopher Davis, Program Director, Division of Astronomical Sciences, Suite W 9136; National Science Foundation, 2415 Eisenhower Avenue, Alexandria, VA 22314; Telephone: 703–292–4910.

Purpose of Meeting: To provide advice and recommendations to the National Science Foundation (NSF), the National Aeronautics and Space Administration (NASA) and the U.S. Department of Energy (DOE) on issues within the field of astronomy and astrophysics that are of mutual interest and concern to the agencies.

Agenda: To hear presentations of current programming by representatives from NSF, NASA, DOE and other agencies relevant to astronomy and astrophysics; to discuss current and potential areas of cooperation between the agencies; to formulate recommendations for continued and new areas of cooperation and mechanisms for achieving them.

Dated: August 19, 2019.

Crystal Robinson,

Committee Management Officer.

[FR Doc. 2019–18101 Filed 8–21–19; 8:45 am]

BILLING CODE 7555–01–P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–86698; File No. SR–NYSEArca–2018–83]

Self-Regulatory Organizations; NYSE Arca, Inc.; Notice of Filing of Amendment No. 4 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 4, Regarding Changes to Investments of the iShares Bloomberg Roll Select Commodity Strategy ETF

August 16, 2019.

I. Introduction

On December 19, 2018, NYSE Arca, Inc. (''Exchange'' or ''NYSE Arca'') filed with the Securities and Exchange Commission (''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'') [1] and Rule 19b–4 thereunder,[2] a proposed rule change regarding changes to investments of the iShares Bloomberg Roll Select Commodity Strategy ETF (''Fund''), shares (''Shares'') of which are currently listed and traded on the Exchange under NYSE Arca Rule 8.600–E. The proposed rule change was published for comment in the **Federal Register** on December 31, 2018.[3] On February 13, 2019, pursuant to Section 19(b)(2) of the Act,[4] the Commission designated a longer period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change.[5] On March 6, 2019, the Exchange filed Amendment No. 1 to the proposed rule change, which replaced and superseded the proposed rule change as originally filed, and on March 14, 2019, the Exchange filed Amendment No. 2 to the proposed rule change, which replaced and superseded the proposed rule change, as modified by Amendment No. 1. On March 21, 2019, the Commission noticed the proposed rule change, as modified by Amendment No. 2, and instituted proceedings under Section 19(b)(2)(B) of the Act [6] to determine

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 84931 (December 21, 2018), 83 FR 67741.

[4] 15 U.S.C. 78s(b)(2).

[5] *See* Securities Exchange Act Release No. 85117, 84 FR 5124 (February 20, 2019). The Commission designated March 31, 2019, as the date by which the Commission would approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change.

[6] 15 U.S.C. 78s(b)(2)(B).

whether to approve or disapprove the proposed rule change, as modified by Amendment No. 2.[7] On March 29, 2019, the Exchange filed Amendment No. 3 to the proposed rule change, which replaced and superseded the proposed rule change, as modified by Amendment No. 2. On June 26, 2019, the Commission designated a longer period for Commission action on the proceedings to determine whether to approve or disapprove the proposed rule change.[8] On August 16, 2019, the Exchange filed Amendment No. 4 to the proposed rule change, which replaced and superseded the proposed rule change, as modified by Amendment No. 3.[9] The Commission has received no comment letters on the proposal.

The Commission is publishing this notice and order to solicit comments on the proposed rule change, as modified by Amendment No. 4, from interested persons and is approving the proposed rule change, as modified by Amendment No. 4, on an accelerated basis.

II. Summary of the Exchange's Description of the Proposal, as Modified by Amendment No. 4[10]

The Exchange proposes certain changes regarding investments of the Fund, Shares of which are currently listed and traded on the Exchange under NYSE Arca Rule 8.600–E, which governs the listing and trading of Managed Fund Shares on the Exchange. Shares of the Fund commenced listing and trading on the Exchange on April 5, 2018 under the generic listing standards under Commentary.01 to NYSE Arca Rule 8.600–E.

The Shares are offered by iShares U.S. ETF Trust (''Trust''), which is registered with the Commission as an open-end management investment company.[11] The Fund is a series of the Trust.

BlackRock Fund Advisors (''Adviser'') is the investment adviser for the Fund.[12] BlackRock Investments, LLC is the distributor for the Fund's Shares. State Street Bank and Trust Company serves as the administrator, custodian and transfer agent for the Fund.

A. Fund Investments

According to the Exchange, the Fund's investment objective is to seek to provide exposure, on a total return basis, to a diversified group of commodities. The Fund is actively managed and will seek to achieve its investment objective in part[13] by, under normal market conditions,[14] investing in ''Listed Derivatives'' (as defined below) and ''OTC Derivatives'' (as defined below) referencing the Bloomberg Roll Select Commodity Index (''Reference Benchmark'').[15] In connection with investments in swaps on the Reference Benchmark, the Fund is expected to establish new swaps contracts on an ongoing basis and replace expiring contracts.[16] Swaps subsequently entered into by the Fund may have terms that differ from the swaps the Fund previously held.[17] The Fund expects generally to pay a fixed payment rate and certain swap related fees to the swap counterparty and receive the total return of the Reference Benchmark, including in the event of negative performance by the Reference Benchmark, negative return (*i.e.,* a payment from the Fund to the swap

[7] *See* Securities Exchange Act Release No. 85385, 84 FR 11582 (March 27, 2019).

[8] *See* Securities Exchange Act Release No. 86199, 84 FR 31647 (July 2, 2019). The Commission extended the date by which the Commission shall approve or disapprove the proposed rule change to August 28, 2019.

[9] In Amendment No. 4, the Exchange: (1) Modified the description of the Reference Benchmark (as defined below); (2) modified the types of reference assets for the derivative instruments in which the Fund may invest; (3) clarified that the Fund may invest in Short-Term Fixed Income Securities (as defined below) other than cash equivalents on an ongoing basis for cash management purposes only; (4) modified the instruments included in the Short-Term Fixed Income Securities that the Fund may invest in for cash management purposes (and which would be excluded from the requirements of Commentary .01(b)(1)–(4) to NYSE Arca Rule 8.600–E); (5) represented that the Fund's holdings in non-convertible corporate debt securities will not exceed 30% of the weight of Fund's holdings in cash equivalents and Short-Term Fixed Income Securities, collectively; (6) specified that all exchange-traded notes (''ETNs'') which the Fund may hold will be listed and traded in the U.S. on a national securities exchange and the Fund will not invest in inverse or leveraged ETNs; (7) modified its proposal relating to the Fund's holdings in Listed Derivatives (as defined below) to, among other things, (a) state that the Fund does not currently meet the requirements of Commentary .01(d)(2) to NYSE Arca Rule 8.600–E with respect to investments in Listed Derivatives; (b) propose to allow the Fund to hold up to 60% of the weight of the portfolio (including gross notional exposures) in Listed Derivatives based on reference assets consisting of the Reference Benchmark or commodities from the same sectors as those included in the Reference Benchmark; and (c) represent that all Listed Derivatives utilized by the Fund will be traded on exchanges that are members of the Intermarket Surveillance Group (''ISG'') or with which the Exchange has in place a comprehensive surveillance sharing agreement (''CSSA''); (8) amended representations relating to the Fund's holdings in OTC Derivatives (as defined below) to, among other things, (a) add a representation that the Fund's holdings in OTC Derivatives will comply with the requirements of Commentary .01(f) to NYSE Arca Rule 8.600–E; and (b) remove a representation that the aggregate gross notional value of OTC Derivatives based on any five or fewer underlying reference assets would not exceed 65% of the weight of the portfolio (including gross notional exposures), and the aggregate gross notional value of OTC Derivatives based on any single underlying reference asset would not exceed 30% of the weight of the portfolio (including gross notional exposures); (9) added a representation by the Adviser that futures on all commodities in the Reference Benchmark are traded on futures exchanges that are members of the ISG or with which the Exchange has in place a CSSA; (10) clarified that other than Commentary .01(b)(1)–(4) (with respect to Short-Term Fixed Income Securities), .01(d)(2) (with respect to Listed Derivatives), and .01(e) (with respect to OTC Derivatives), the Fund's portfolio will meet all other requirements of NYSE Arca Rule 8.600–E and Commentary .01 thereto; (11) specified that quotation and last sale information for exchange-traded funds (''ETFs'') and ETNs that the Fund may hold will be available via the Consolidated Tape Association high-speed line; (12) specified that the Reference Benchmark index methodology and constituent list are available via Bloomberg; and (13) made other technical and conforming changes. Amendment No. 4 is available at: *https://www.sec.gov/comments/sr-nysearca-2018-83/srnysearca201883.htm.*

[10] For a complete description of the Exchange's proposal, as amended, *see* Amendment No. 4, *supra* note 9.

[11] According to the Exchange, on February 21, 2018, the Trust filed with the Commission its registration statement on Form N–1A under the Securities Act of 1933 and under the Investment Company Act of 1940 (''1940 Act'') relating to the Fund (File Nos. 333–179904 and 811–22649) (''Registration Statement''). In addition, the Exchange states that the Commission has issued an order upon which the Trust may rely, granting certain exemptive relief under the 1940 Act. *See* Investment Company Act Release No. 29571 (January 24, 2011) (File No. 812–13601).

[12] According to the Exchange, the Adviser is not registered as a broker-dealer but is affiliated with a broker-dealer, and has implemented and will maintain a fire wall with respect to its broker-dealer affiliate regarding access to information concerning the composition and/or changes to the portfolio. In the event (a) the Adviser becomes registered as a broker-dealer or newly affiliated with a broker-dealer, or (b) any new adviser or sub-adviser is a registered broker-dealer or becomes affiliated with a broker-dealer, it will implement and maintain a fire wall with respect to its relevant personnel or its broker-dealer affiliate regarding access to information concerning the composition and/or changes to the portfolio, and will be subject to procedures designed to prevent the use and dissemination of material non-public information regarding such portfolio. The Exchange also represents that the Adviser and its related personnel are subject to the provisions of Rule 204A–1 under the Investment Advisers Act of 1940 relating to codes of ethics.

[13] The Fund's investment objective is also achieved by investing in cash, cash equivalents, Commodity Investments, Fixed Income Securities, and Short-Term Fixed Income Securities (each as defined or described below).

[14] The term ''normal market conditions'' is defined in NYSE Arca Rule 8.600–E(c)(5).

[15] According to the Exchange, the Bloomberg Roll Select Commodity Index is a version of the Bloomberg Commodity Index that aims to mitigate the effects of contango on index performance (as described further below). For each commodity, the index rolls into the futures contract showing the most backwardation or least contango, selecting from those contracts with nine months or fewer until expiration.

[16] Swaps on the Reference Benchmark are included in ''Commodity Investments'' as defined below.

[17] Although the Fund may hold swaps on the Reference Benchmark, or direct investments in the same futures contracts as those included in the Reference Benchmark, the Fund is not obligated to invest in any futures contracts included in, and does not seek to replicate the performance of, the Reference Benchmark.

counterparty). In seeking total return, the Fund additionally aims to generate interest income and capital appreciation through a cash management strategy consisting primarily of cash, cash equivalents,[18] and fixed income securities other than cash equivalents, as described below.

The Reference Benchmark is composed of 22 futures contracts across 20 physical agricultural, livestock, energy, precious metals and industrial metals commodities listed on U.S. regulated futures exchanges or non-U.S. futures exchanges with which the Exchange has in place a CSSA. The Reference Benchmark reflects the returns from these commodities and provides broad-based exposure to commodities as an asset class by using liquidity and sector caps to avoid overconcentration in any single commodity or commodity sector. The Reference Benchmark employs a contract roll strategy intended to minimize the effects of contango and maximize the effects of backwardation.[19]

The Fund will invest in financial instruments described below that provide exposure to commodities and not in the physical commodities themselves.

The Fund (through its Subsidiary (as defined below)) may hold the following listed derivative instruments: Futures, options, and swaps on the Reference Benchmark or on commodities from the same sectors as those included in the Reference Benchmark, currencies, U.S. and non-U.S. equity securities, fixed income securities (as defined in Commentary .01(b) to NYSE Arca Rule 8.600–E, but excluding Short-Term Fixed Income Securities (as defined below)), interest rates, and U.S. Treasuries, or a basket or index of any of the foregoing (collectively, ''Listed Derivatives'').[20]

The Fund (through its Subsidiary) may hold the following over-the-counter (''OTC'') derivative instruments: Forwards, options, and swaps on the Reference Benchmark or on commodities from the same sectors as those included in the Reference Benchmark, currencies, U.S. and non-U.S. equity securities, fixed income securities (as defined in Commentary .01(b) to NYSE Arca Rule 8.600–E, but excluding Short-Term Fixed Income Securities), and interest rates, or a basket or index of any of the foregoing (collectively, ''OTC Derivatives,'' [21] and together with Listed Derivatives, ''Commodity Investments'').[22]

The Fund may hold cash, cash equivalents and fixed income securities other than cash equivalents, as described further below.

Specifically, the Fund may invest in Short-Term Fixed Income Securities (as defined below) other than cash equivalents on an ongoing basis for cash management purposes.[23] Short-Term Fixed Income Securities will have a maturity of no longer than 397 days and include only the following: (i) Money market instruments; (ii) obligations issued or guaranteed by the U.S. government, its agencies or instrumentalities (including government-sponsored enterprises); (iii) negotiable certificates of deposit, bankers' acceptances, fixed-time deposits and other obligations of U.S. and non-U.S. banks (including non-U.S. branches) and similar institutions; (iv) commercial paper; (v) non-convertible corporate debt securities (*e.g.,* bonds and debentures); (vi) repurchase agreements; and (vii) sovereign debt obligations of non-U.S. countries excluding emerging market countries (''Non-U.S. Sovereign Debt'') [24] (collectively, ''Short-Term Fixed Income Securities''). Any of these securities may be purchased on a current or forward-settled basis.[25]

The Fund also may invest in fixed income securities as defined in Commentary .01(b) to NYSE Arca Rule 8.600–E,[26] other than cash equivalents and Short-Term Fixed Income Securities, with remaining maturities longer than 397 days (''Fixed Income Securities''). Such Fixed Income Securities will comply with the requirements of Commentary .01(b) to NYSE Arca Rule 8.600–E.[27]

The Fund may also hold ETNs [28] and ETFs.[29]

The Fund's exposure to Commodity Investments is obtained by investing through a wholly-owned subsidiary organized in the Cayman Islands

[18] Cash equivalents are the short-term instruments enumerated in Commentary .01(c) to NYSE Arca Rule 8.600–E.

[19] According to the Exchange, in order to maintain exposure to a futures contract on a particular commodity, an investor must sell the position in the expiring contract and buy a new position in a contract with a later delivery month, which is referred to as ''rolling.'' If the price for the new futures contract is less than the price of the expiring contract, then the market for the commodity is said to be in ''backwardation.'' In these markets, roll returns are positive, which is referred to as ''positive carry.'' The term ''contango'' is used to describe a market in which the price for a new futures contract is more than the price of the expiring contract. In these markets, roll returns are negative, which is referred to as ''negative carry.'' The Reference Benchmark seeks to employ a positive carry strategy that emphasizes commodities and futures contract months with the greatest degree of backwardation and lowest degree of contango, resulting in net gains through positive roll returns.

[20] Examples of Listed Derivatives the Fund may invest in include exchange traded futures contracts similar to those found in the Reference Benchmark, exchange traded futures contracts on the Reference Benchmark, swaps on commodity futures contracts similar to those found in the Reference Benchmark, and futures and options that correlate to the investment returns of commodities without investing directly in physical commodities.

[21] Examples of OTC Derivatives the Fund may invest in include swaps on commodity futures contracts similar to those found in the Reference Benchmark and options that correlate to the investment returns of commodities without investing directly in physical commodities.

[22] As discussed in Section II.D (Application of Generic Listing Requirements), the Fund's and the Subsidiary's holdings in Listed Derivatives and OTC Derivatives will not comply with the criteria in Commentary .01(d)(2) and .01(e) of NYSE Arca Rule 8.600–E, respectively.

[23] As discussed in Section II.D (Application of Generis Listing Requirements), the Short-Term Fixed Income Securities will not comply with the requirements of Commentary .01(b)(1)–(4) to NYSE Arca Rule 8.600–E.

[24] According to the Exchange, an ''emerging market country'' is a country that, at the time the Fund invests in the related fixed income instruments, is classified as an emerging or developing economy by any supranational organization such as the International Bank of Reconstruction and Development or any affiliate thereof (the ''World Bank'') or the United Nations, or related entities, or is considered an emerging market country for purposes of constructing a major emerging market securities index.

[25] To the extent that the Fund and the Subsidiary invest in cash and Short-Term Fixed Income Securities that are cash equivalents (*i.e.,* that have maturities of less than 3 months) as specified in Commentary .01(c) to NYSE Arca Rule 8.600–E, such investments will comply with Commentary .01(c) and may be held without limitation. Non-convertible corporate debt securities and Non-U.S. Sovereign Debt are not included as cash equivalents in Commentary .01(c).

[26] Commentary .01(b) to NYSE Arca Rule 8.600–E defines fixed income securities as debt securities that are notes, bonds, debentures or evidence of indebtedness that include, but are not limited to, U.S. Department of Treasury securities (''Treasury Securities''), government-sponsored entity securities (''GSEs''), municipal securities, trust preferred securities, supranational debt and debt of a foreign country or a subdivision thereof, investment grade and high yield corporate debt, bank loans, mortgage and asset backed securities, and commercial paper.

[27] Among the Fixed Income Securities in which the Fund may invest are commodity-linked notes.

[28] ETNs are securities as described in NYSE Arca Rule 5.2–E(j)(6) (Equity Index-Linked Securities, Commodity-Linked Securities, Currency-Linked Securities, Fixed Income Index-Linked Securities, Futures-Linked Securities and Multifactor Index-Linked Securities). All ETNs will be listed and traded in the U.S. on a national securities exchange. The Fund will not invest in inverse or leveraged (*e.g.,* 2X, –2X, 3X or –3X) ETNs.

[29] For purposes of the filing, the term ''ETFs'' includes Investment Company Units (as described in NYSE Arca Rule 5.2–E(j)(3)); Portfolio Depositary Receipts (as described in NYSE Arca Rule 8.100–E); and Managed Fund Shares (as described in NYSE Arca Rule 8.600–E). All ETFs will be listed and traded in the U.S. on a national securities exchange. The Fund will not invest in inverse or leveraged (*e.g.,* 2X, –2X, 3X or –3X) ETFs.

(''Subsidiary'').[30] The Fund controls the Subsidiary, and the Subsidiary is advised by the Adviser and has the same investment objective as the Fund. In compliance with the requirements of Sub-Chapter M of the Internal Revenue Code of 1986, the Fund may invest up to 25% of its total assets in the Subsidiary. The Subsidiary is not an investment company registered under the 1940 Act and is a company organized under the laws of the Cayman Islands. The Trust's Board of Trustees (''Board'') has oversight responsibility for the investment activities of the Fund, including its investment in the Subsidiary, and the Fund's role as sole shareholder of the Subsidiary.

The Fund's Commodity Investments held in the Subsidiary are intended to provide the Fund with exposure to broad commodities. The Subsidiary may hold cash and cash equivalents.

B. Investment Restrictions

The Fund and the Subsidiary will not invest in securities or other financial instruments that have not been described in the proposed rule change.

The Fund's holdings in non-convertible corporate debt securities shall not exceed 30% of the weight of Fund's holdings in cash equivalents and Short-Term Fixed Income Securities, collectively.

The Fund's investments, including derivatives, will be consistent with the Fund's investment objective and will not be used to enhance leverage (although certain derivatives and other investments may result in leverage). That is, the Fund's investments will not be used to seek performance that is the multiple or inverse multiple (*e.g.,* 2X or −3X) of the Fund's Reference Benchmark.

C. Use of Derivatives by the Fund

Investments in derivative instruments will be made in accordance with the Fund's investment objective and policies. To limit the potential risk associated with such transactions, the Fund will enter into offsetting transactions or segregate or ''earmark'' assets determined to be liquid by the Adviser in accordance with procedures established by the Board. In addition, the Fund has included appropriate risk disclosure in its offering documents, including leveraging risk. Leveraging risk is the risk that certain transactions of the Fund, including the Fund's use of derivatives, may give rise to leverage, causing the Fund to be more volatile than if it had not been leveraged.

The Adviser believes there will be minimal, if any, impact to the arbitrage mechanism as a result of the Fund's use of derivatives. The Adviser understands that market makers and participants should be able to value derivatives as long as the positions are disclosed with relevant information. The Adviser believes that the price at which Shares of the Fund trade will continue to be disciplined by arbitrage opportunities created by the ability to purchase or redeem Shares of the Fund at their net asset value (''NAV''), which should ensure that Shares of the Fund will not trade at a material discount or premium in relation to their NAV.

The Exchange states that the Adviser does not believe there will be any significant impacts to the settlement or operational aspects of the Fund's arbitrage mechanism due to the use of derivatives.

D. Application of Generic Listing Requirements

The Exchange represents that the portfolio of the Fund will not meet all of the ''generic'' listing requirements of Commentary .01 to NYSE Arca Rule 8.600–E applicable to the listing of Managed Fund Shares. The Exchange represents that, other than Commentary .01 (b)(1–4) (with respect to Short-Term Fixed Income Securities), Commentary .01(d)(2) (with respect to Listed Derivatives), and .01(e) (with respect to OTC Derivatives) to NYSE Arca Rule 8.600–E, as described below, the Fund's portfolio will meet all other requirements of NYSE Arca Rule 8.600–E.[31]

According to the Exchange, the Fund's investments currently comply with the generic requirements set forth in Commentary .01(b)(1)–(4) to NYSE Arca Rule 8.600–E.[32] The Exchange proposes that, going forward, the Fund's investments in Short-Term Fixed Income Securities will not comply with the requirements set forth in Commentary .01(b)(1)–(4) to NYSE Arca Rule 8.600–E. The Exchange states that while the requirements set forth in Commentary .01(b)(1)–(4) include rules intended to ensure that the fixed income securities included in a fund's portfolio are sufficiently large and diverse, and have sufficient publicly available information regarding the issuances, the Exchange believes that any concerns regarding non-compliance are mitigated by the types of instruments that the Fund would hold. The Exchange represents that the Fund's Short-Term Fixed Income Securities primarily would include those instruments that are included in the definition of cash and cash equivalents,[33] but are not considered cash and cash equivalents because they have maturities of three months or longer. The Exchange believes, however, that all Short-Term Fixed Income Securities, including non-convertible corporate debt securities [34] and Non-U.S. Sovereign Debt (which are not cash equivalents as enumerated in Commentary .01(c) to Rule 8.600–E), are less susceptible than other types of fixed income instruments both to price manipulation and volatility and that the holdings as proposed are generally consistent with the policy concerns which Commentary .01(b)(1)–(4) is intended to address. Because the Short-Term Fixed Income Securities will

[30] The Exchange represents that all statements related to the Fund's investments and restrictions are applicable to the Fund and Subsidiary collectively.

[31] The Exchange states that the Adviser represents, in particular, that the Fund's holdings in OTC Derivatives will comply with the requirements of Commentary .01(f) to NYSE Arca Rule 8.600–E, which provides, in part, that to the extent that OTC derivatives are used to gain exposure to individual equities and/or fixed income securities, or to indexes of equities and/or indexes of fixed income securities, the aggregate gross notional value of such exposure will meet the generic listing criteria applicable to equities and fixed income securities (including gross notional exposures) set forth in Commentary .01(a) and .01(b) to NYSE Arca Rule 8.600–E, respectively.

[32] Commentary .01(b)(1)–(4) to NYSE Arca Rule 8.600–E requires that the components of the fixed income portion of a portfolio meet the following criteria initially and on a continuing basis: (1) Components that in the aggregate account for at least 75% of the fixed income weight of the portfolio each shall have a minimum original principal amount outstanding of $100 million or more; (2) no component fixed-income security (excluding Treasury Securities and GSEs) shall represent more than 30% of the fixed income weight of the portfolio, and the five most heavily weighted component fixed income securities in the portfolio (excluding Treasury Securities and GSEs) shall not in the aggregate account for more than 65% of the fixed income weight of the portfolio; (3) an underlying portfolio (excluding exempted securities) that includes fixed income securities shall include a minimum of 13 non-affiliated issuers, provided, however, that there shall be no minimum number of non-affiliated issuers required for fixed income securities if at least 70% of the weight of the portfolio consists of equity securities as described in Commentary .01(a); and (4) component securities that in aggregate account for at least 90% of the fixed income weight of the portfolio must be either (a) from issuers that are required to file reports pursuant to Sections 13 and 15(d) of Act; (b) from issuers that have a worldwide market value of its outstanding common equity held by non-affiliates of $700 million or more; (c) from issuers that have outstanding securities that are notes, bonds debentures, or evidence of indebtedness having a total remaining principal amount of at least $1 billion; (d) exempted securities as defined in Section 3(a)(12) of Act; or (e) from issuers that are a government of a foreign country or a political subdivision of a foreign country.

[33] *See supra* note 18.

[34] The Exchange notes that the Fund's holdings in non-convertible corporate debt securities will not exceed 30% of the weight of the Fund's holdings in cash equivalents and Short-Term Fixed Income Securities, collectively.

consist of high-quality fixed income securities described above, the Exchange believes that the policy concerns that Commentary .01(b)(1)–(4) are intended to address are otherwise mitigated and that the Fund should be permitted to hold these securities in a manner that may not comply with Commentary .01(b)(1)–(4).

The Exchange states that the Fund does not currently meet the requirements of Commentary .01(d)(2) to NYSE Arca Rule 8.600–E with respect to the Fund's and the Subsidiary's investments in Listed Derivatives.[35] The Exchange proposes to facilitate the continued listing and trading of Shares of the Fund notwithstanding the fact that the Fund does not meet the requirements of Commentary .01(d)(2) to Rule 8.600–E. Specifically, the Exchange is proposing to allow the Fund to hold up to 60% of the weight of its portfolio (including gross notional exposures) in Listed Derivatives based on reference assets consisting of the Reference Benchmark or commodities from the same sectors as those included in the Reference Benchmark. With respect to the Fund's and the Subsidiary's investment in derivatives on the Reference Benchmark, the Exchange notes that the Reference Benchmark provides broad-based exposure to commodities as an asset class, as it is composed of 22 futures contracts across 20 physical agricultural, livestock, energy, precious metals and industrial metals commodities listed on U.S. regulated futures exchanges or non-U.S. futures exchanges with which the Exchange has in place a CSSA.[36] The Exchange states that the Reference Benchmark reflects the returns from these commodities and uses liquidity and sector caps to avoid overconcentration in any single commodity or commodity sector.

The Exchange states that by holding Listed Derivatives in excess of the parameters included in Commentary .01(d)(2) to NYSE Arca Rule 8.600–E, the Fund and the Subsidiary would be able to invest a greater portion of the Fund's assets in Listed Derivatives rather than OTC Derivatives. According to the Exchange, this would provide the Fund with greater flexibility in meeting its investment objective while reducing counterparty risk associated with the Fund's and the Subsidiary's investments in OTC Derivatives. In addition, the Exchange represents that all Listed Derivatives utilized by the Fund would be traded on exchanges that are members of the ISG or with which the Exchange has in place a CSSA.

The Exchange represents that the Fund's holdings in OTC Derivatives currently comply with the requirements set forth in Commentary .01(e) to NYSE Arca Rule 8.600–E.[37] The Exchange proposes that, going forward, the Fund's holdings in OTC Derivatives will not comply with the requirements set forth in Commentary .01(e) to NYSE Arca Rule 8.600–E. Specifically, the Exchange proposes that up to 60% of the Fund's assets (calculated as the aggregate gross notional value) may be invested in OTC Derivatives. The Exchange states that the Adviser believes that it is important to provide the Fund with additional flexibility to manage risk associated with its investments and, depending on market conditions, it may be critical that the Fund be able to utilize available OTC Derivatives to efficiently gain exposure to the multiple commodities that underlie the Reference Benchmark, as well as commodity futures contracts similar to those found in the Reference Benchmark. The Exchange states that OTC Derivatives can be tailored to provide specific exposure to the Fund's Reference Benchmark, as well as commodity futures contracts similar to those found in the Reference Benchmark, allowing the Fund to more efficiently meet its investment objective.[38] The Exchange further states that if the Fund were to gain commodity exposure exclusively through the use of listed futures, the Fund's holdings in listed futures would be subject to position limits and accountability levels established by an exchange, and such limitations would restrict the Fund's ability to gain efficient exposure to the commodities in the Reference Benchmark, or futures contracts similar to those found in the Reference Benchmark, thereby impeding the Fund's ability to satisfy its investment objective.

The Exchange represents that the Adviser and its affiliates actively monitor counterparty credit risk exposure (including for OTC derivatives) and evaluate counterparty credit quality on a continuous basis. With respect to the Fund's (and the Subsidiary's) investments in derivatives on the Reference Benchmark or on commodities from the same sectors as those included in the Reference Benchmark, the Exchange states that the Reference Benchmark provides broad-based exposure to commodities as an asset class, as it is composed of 22 futures contracts across 20 physical agricultural, livestock, energy, precious metals, and industrial metals commodities listed on U.S. regulated futures exchanges or non-U.S. futures exchanges with which the Exchange has in place a CSSA. In addition, the Exchange states that the Adviser represents that futures on all commodities in the Reference Benchmark are traded on futures exchanges that are members of the ISG or with which the Exchange has in place a CSSA.

III. Discussion and Commission's Findings

After careful review, the Commission finds that the proposed rule change, as modified by Amendment No. 4, is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.[39] In particular, the Commission finds that the proposed rule change, as modified by Amendment No. 4, is consistent with Section 6(b)(5) of the Act,[40] which requires, among other things, that the Exchange's rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in

[35] Commentary .01(d)(2) to NYSE Arca Rule 8.600–E provides that the aggregate gross notional value of listed derivatives based on any five or fewer underlying reference assets shall not exceed 65% of the weight of the portfolio (including gross notional exposures), and the aggregate gross notional value of listed derivatives based on any single underlying reference asset shall not exceed 30% of the weight of the portfolio (including gross notional exposures).

[36] The Exchange states that the commodity futures included in the Reference Benchmark are traded on the CME Group, Inc. (''CME''), ICE Futures U.S. (''ICE U.S.''), ICE Futures Europe (''ICE Europe''), and the London Metal Exchange (''LME''). The Exchange further states that ICE U.S., ICE Europe, and CME are members of the ISG, and that the Exchange has in place a CSSA with the LME.

[37] Commentary .01(e) to NYSE Arca Rule 8.600–E provides that, on an initial and continuing basis, no more than 20% of the assets in the portfolio may be invested in OTC derivatives (calculated as the aggregate gross notional value of the OTC derivatives).

[38] As an example, the Exchange states that the Reference Benchmark is composed of 22 futures contracts across 20 physical commodities, which may not be sufficiently liquid and would not provide the commodity exposure the Fund requires to meet its investment objective if the Fund were to invest in the futures directly. The Exchange states that a total return swap can be structured to provide exposure to the same futures contracts as exist in the Reference Benchmark, as well as commodity futures contracts similar to those found in the Reference Benchmark, while providing sufficient efficiency to allow the Fund to more easily meet its investment objective.

[39] In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

[40] 15 U.S.C. 78f(b)(5).

general, to protect investors and the public interest.

According to the Exchange, other than Commentary .01(b)(1)–(4) with respect to Short-Term Fixed Income Securities, Commentary .01(d)(2) with respect to Listed Derivatives, and Commentary .01(e) with respect to OTC Derivatives, the Fund's portfolio will meet all requirements of Commentary .01 to NYSE Arca Rule 8.600–E, and the Shares of the Fund will conform to the initial and continued listing criteria under NYSE Arca Rule 8.600–E.

The Fund's investments in Short-Term Fixed Income Securities will not meet the requirements for fixed income securities set forth in Commentary .01(b)(1)–(4) to NYSE Arca Rule 8.600–E.[41] The Commission, however, believes that the limited nature of the Fund's investment in, and certain restrictions on, the Short Term Fixed Income Securities helps to mitigate concerns regarding the Shares being susceptible to manipulation because of the Fund's investment in the Short Term Fixed Income Securities.[42] Specifically, the Exchange states that Short-Term Fixed Income Securities primarily will include instruments that are included in the definition of cash equivalents, but are not considered cash equivalents because they have maturities of three months or longer. As proposed, the Fund's investments in Short-Term Fixed Income Securities will also include non-convertible corporate debt securities, but such holdings would be limited to 30% of the weight of the Fund's holdings in cash equivalents and Short-Term Fixed Income Securities, collectively. In addition, the Fund's investments in Short-Term Fixed Income Securities would include sovereign debt, but would exclude sovereign debt obligations of emerging market countries. Further, the Fund will invest in Short Term Fixed Income Securities for cash management purposes, and the Short Term Fixed Income Securities in which the Fund may invest will have maturities of no longer than 397 days.[43]

The Fund's investments in Listed Derivatives currently do not comply with Commentary .01(d)(2) to NYSE Arca Rule 8.600–E, which requires that the aggregate gross notional value of listed derivatives based on any five or fewer underlying reference assets not exceed 65% of the weight of the portfolio (including gross notional exposures), and the aggregate gross notional value of listed derivatives based on any single underlying reference asset not exceed 30% of the weight of the portfolio (including gross notional exposures). To facilitate the continued listing and trading of the Shares, the Exchange proposes to allow the Fund to hold up to 60% of the weight of the portfolio (including gross notional exposures) in Listed Derivatives based on reference assets consisting of the Reference Benchmark or commodities from the same sectors as those included in the Reference Benchmark. The Exchange states that allowing the Fund to invest in Listed Derivatives on the Reference Benchmark in excess of the limitations in Commentary .01(d)(2) will provide the Fund with greater flexibility in meeting its investment objective while reducing counterparty risk associated with investments in OTC Derivatives by allowing the Fund to rely to a greater extent on investments in Listed Derivatives.[44]

The Commission believes that certain factors help to mitigate concerns that the Fund's investment in Listed Derivatives will make the Shares susceptible to manipulation. Specifically, with respect to Listed Derivatives on the Reference Benchmark or commodities from the same sectors as those included in the Reference Benchmark, the Exchange represents that (i) the Reference Benchmark includes at least 22 futures contracts across 20 physical agricultural, livestock, energy, precious metals, and industrial metals commodities listed on U.S. regulated futures exchanges or non-U.S. futures exchanges with which the Exchange has in place a CSSA; (ii) futures on all commodities in the Reference Benchmark are traded on futures exchanges that are members of the ISG or with which the Exchange has in place a CSSA; and (iii) the Reference Benchmark uses liquidity and sector caps to avoid overconcentration in any single commodity or commodity sector. In addition, the Exchange represents that all Listed Derivatives utilized by the Fund will be traded on exchanges that are members of the ISG or with which the Exchange has in place a CSSA.

The Fund's investments in OTC Derivatives will not comply with Commentary .01(e) to NYSE Arca Rule 8.600–E, which requires that no more than 20% of the assets of the Fund be invested in OTC derivatives (calculated as the aggregate gross notional value of such OTC derivatives). In the alternative, the Exchange proposes that up to 60% of the Fund's assets (calculated as the aggregate gross notional value) may be invested in OTC Derivatives.[45] The Exchange states that it may be necessary for the Fund to utilize OTC Derivatives in order to more efficiently hedge its portfolio or to meet its investment objective.[46]

As with Listed Derivatives, the Commission believes that certain factors help to mitigate concerns that the Fund's investment in OTC Derivatives will make the Shares susceptible to manipulation. As discussed above, with respect to OTC Derivatives on the Reference Benchmark or on commodities from the same sectors as those included in the Reference Benchmark, the Exchange represents that (i) the Reference Benchmark includes at least 22 futures contracts across 20 physical agricultural, livestock, energy, precious metals, and industrial metals commodities listed on U.S. regulated futures exchanges or non-U.S. futures exchanges with which the Exchange has in place a CSSA; (ii) futures on all commodities in the Reference Benchmark are traded on futures exchanges that are members of the ISG or with which the Exchange has in place a CSSA; and (iii) the Reference Benchmark uses liquidity and sector caps to avoid overconcentration in any single commodity or commodity sector. Moreover, on a daily basis, the Fund will be required to disclose on its website the information regarding the Disclosed Portfolio required under NYSE Arca Rule 8.600–E(c)(2), to the extent applicable,[47] and the website

[41] *See supra* note 32.

[42] The Commission notes that all the fixed income securities the Fund may invest in other than those included in Short-Term Fixed Income Securities and cash equivalents will comply with the requirements of Commentary .01(b) to NYSE Arca Rule 8.600–E, and the cash equivalents the Fund may invest in will comply with the requirements of Commentary .01(c). *See supra* Section II.A.

[43] *See supra* Section II.A.

[44] *See supra* Section II.D.

[45] The Exchange represents that the Adviser and its affiliates actively monitor counterparty credit risk exposure for OTC derivatives and evaluate counterparty credit quality on a continuous basis. *See supra* Section II.D. Moreover, the Exchange states that investments in derivative instruments will be made in accordance with the Fund's investment objective and policies. To limit the potential risk associated with such transactions, the Fund will enter into offsetting transactions or segregate or ''earmark'' assets determined to be liquid by the Adviser in accordance with procedures established by the Trust's Board of Trustees. In addition, the Fund has included appropriate risk disclosure in its offering documents, including leveraging risk. *See supra* Section II. C.

[46] *See supra* Section II. D.

[47] NYSE Arca Rule 8.600–E(c)(2) requires that the website for each series of Managed Fund Shares disclose the following information regarding the Disclosed Portfolio, to the extent applicable: (A) Ticker symbol; (B) CUSIP or other identifier; (C) description of the holding; (D) with respect to holdings in derivatives, the identity of the security, commodity, index or other asset upon which the derivative is based; (E) the strike price for any

information will be publicly available at no charge.[48]

The Exchange represents that all statements and representations made in the filing regarding: (1) The description of the portfolio holdings or reference assets; (2) limitations on portfolio holdings or reference assets; or (3) the applicability of Exchange listing rules specified in the rule filing constitute continued listing requirements for listing the Shares on the Exchange. In addition, the Exchange represents that the issuer must notify the Exchange of any failure by the Fund to comply with the continued listing requirements and, pursuant to its obligations under Section 19(g)(1) of the Act, the Exchange will monitor[49] for compliance with the continued listing requirements. If the Fund is not in compliance with the applicable listing requirements, the Exchange will commence delisting procedures under NYSE Arca Rule 5.5–E(m).

For the foregoing reasons, the Commission finds that the proposed rule change, as modified by Amendment No. 4, is consistent with Section 6(b)(5) of the Act[50] and the rules and regulations thereunder applicable to a national securities exchange.

IV. Solicitation of Comments on Amendment No. 4 to the Proposed Rule Change

Interested persons are invited to submit written views, data, and arguments concerning whether Amendment No. 4 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–NYSEArca–2018–83 on the subject line.

Paper Comments

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090.

All submissions should refer to File Number SR–NYSEArca–2018–83. 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 website (*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 website 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 the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–NYSEArca–2018–83 and should be submitted on or before September 12, 2019.

V. Accelerated Approval of the Proposed Rule Change, as Modified by Amendment No. 4

The Commission finds good cause to approve the proposed rule change, as modified by Amendment No. 4, prior to the thirtieth day after the date of publication of notice of the filing of Amendment No. 4 in the **Federal Register**. The Commission notes that Amendment No. 4 clarified the permitted investments of the Fund and the application of NYSE Arca Rule 8.600–E, Commentary .01 to the Fund's investments. Amendment No. 4 also provided other clarifications and additional information to the proposed rule change. The changes and additional information in Amendment No. 4 assist the Commission in evaluating the Exchange's proposal and in determining that the listing and trading of the Shares is consistent with the Act. Accordingly, the Commission finds good cause, pursuant to Section 19(b)(2) of the Act,[51] to approve the proposed rule change, as modified by Amendment No. 4, on an accelerated basis.

VI. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[52] that the proposed rule change (SR–NYSEArca–2018–83), as modified by Amendment No. 4 thereto, be, and it hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[53]

Jill M. Peterson,

Assistant Secretary.

[FR Doc. 2019–18074 Filed 8–21–19; 8:45 am]

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options; (F) the quantity of each security or other asset held as measured by (i) par value, (ii) notional value, (iii) number of shares, (iv) number of contracts, and (v) number of units; (G) maturity date; (H) coupon rate; (I) effective date; (J) market value; and (K) percentage weighting of the holding in the portfolio.

[48] *See* Amendment No. 4, *supra* note 9 at 19.

[49] The Commission notes that certain proposals for the listing and trading of exchange-traded products include a representation that the exchange will "surveil" for compliance with the continued listing requirements. *See, e.g.,* Securities Exchange Act Release No. 77499 (April 1, 2016), 81 FR 20428, 20432 (April 7, 2016) (SR–BATS–2016–04). In the context of this representation, it is the Commission's view that "monitor" and "surveil" both mean ongoing oversight of compliance with the continued listing requirements. Therefore, the Commission does not view "monitor" as a more or less stringent obligation than "surveil" with respect to the continued listing requirements.

[50] 15 U.S.C. 78f(b)(5).

[51] 15 U.S.C. 78s(b)(2).

[52] *Id.*

[53] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–86699; File No. SR–EMERALD–2019–30]

Self-Regulatory Organizations; MIAX Emerald, LLC; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Amend Exchange Rule 520, Limitations on Orders

August 16, 2019.

Pursuant to the provisions of 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 August 7, 2019, MIAX Emerald, LLC ("MIAX Emerald" or "Exchange") filed with the Securities and Exchange Commission ("Commission") a 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 Substance of the Proposed Rule Change

The Exchange is filing a proposal to amend Exchange Rule 520, Limitations on Orders, to remove certain order entry restrictions prohibiting Electronic

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

Exchange Members[3] from effectively operating as Market Makers[4] on the Exchange.

The text of the proposed rule change is available on the Exchange's website at *http://www.miaxoptions.com/rule-filings/emerald* at MIAX Emerald'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, 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 these 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 aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to amend Exchange Rule 520, Limitations on Orders, to remove certain order entry restrictions prohibiting EEMs from effectively operating as Market Makers on the Exchange. The proposed rule change is similar to the recent filing submitted by the Exchange's affiliate, Miami International Securities Exchange, LLC (''MIAX'').[5] Currently, subsection (a)(1) of Exchange Rule 520 provides that the Exchange shall designate classes in which EEMs may enter into the System,[6] as principal or as agent, buy and sell limit orders in the same option series, for the account or accounts of the same or related beneficial owners. Currently, subsection (a)(2) of Exchange Rule 520 provides that, in all other classes, EEMs shall not enter into the System, as principal or agent, limit orders in the same options series, for the account or accounts of the same or related beneficial owners, in such a manner that the EEM or the beneficial owner(s) effectively is operating as a market maker by holding itself out as willing to buy and sell such option contract on a regular or continuous basis. Subsection (a)(2) further provides that in determining whether an EEM or beneficial owner effectively is operating as a Market Maker, the Exchange will consider, among other things: The simultaneous or near-simultaneous entry of limit orders to buy and sell the same option contract; the multiple acquisition and liquidation of positions in the same options series during the same day; and the entry of multiple limit orders at different prices in the same options series.

The Exchange now proposes to amend Exchange Rule 520(a) to delete current subsection (a)(1) and to modify current subsection (a)(2) such that, for all option classes, the restrictions prohibiting EEMs from effectively operating as Market Makers will only be applicable to Priority Customer Orders[7] since Priority Customer Orders have priority at any price over the bids and offers of non-Priority Customer Orders. Current Exchange Rule 520(a)(2) was adopted to limit the ability of Members that are not Market Makers to compete on preferential terms within the Exchange's System. Because Priority Customer Orders are provided with certain benefits such as priority of bids and offers, the Exchange believes that Priority Customer Orders should continue to be subject to the restrictions set out in current Exchange Rule 520(a)(2). However, because broker-dealer orders do not have priority over bids and offers of Market Makers, the Exchange no longer believes it is necessary to impose the restrictions set out in current Exchange Rule 520(a)(2) on the entry of broker-dealer orders. Similarly, because Voluntary Professional orders do not have priority over bids and offers of Market Makers, the Exchange does not believe it is necessary to impose the restrictions set out in current Exchange Rule 520(a)(2) on Voluntary Professional orders.[8]

Pursuant to this proposal, the Exchange will allow EEMs to enter buy and sell limit orders in the same options series for the account or accounts of the same beneficial owners, other than for the account(s) of Priority Customers, and will no longer need to designate specific classes for EEMs to engage in this type of activity. Accordingly, the Exchange believes that subsection (a)(1) of the current rule is no longer necessary and is redundant. Therefore, the Exchange proposes to delete subsection (a)(1). Similarly, the Exchange proposes to delete the beginning text of subsection (a)(2), which states ''In all other classes,'' as this rule text is no longer necessary in accordance with the Exchange's proposal to also delete subsection (a)(1).

Additionally, the Exchange proposes to insert text into the first sentence of current Exchange Rule 520(a)(2) to specify that Priority Customer Orders would continue to be subject to the restrictions of that subsection. The Exchange proposes to delete the text in the first sentence of current subsection (a)(2) regarding limit orders entered by EEMs as principal or agent to clarify that all Priority Customer Orders are

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[3] The term ''Electronic Exchange Member'' or ''EEM'' means the holder of a Trading Permit who is not a Market Maker. Electronic Exchange Members are deemed ''members'' under the Exchange Act. *See* Exchange Rule 100.

[4] The term ''Market Makers'' refers to ''Lead Market Makers'', ''Primary Lead Market Makers'' and ''Registered Market Makers'' collectively. *See* Exchange Rule 100.

[5] *See* Securities Exchange Act Release No. 86534 (July 31, 2019), 84 FR 38316 (August 6, 2019(SR–MIAX–2019–33).

[6] The term ''System'' means the automated trading system used by the Exchange for the trading of securities. *See* Exchange Rule 100.

[7] The term ''Priority Customer Order'' means an order for the account of a Priority Customer. *See* Exchange Rule 100. The term ''Priority Customer'' means a person or entity that (i) is not a broker or dealer in securities, and (ii) does not place more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s). The number of orders shall be counted in accordance with Interpretation and Policy .01 of Exchange Rule 100.

[8] The Exchange notes that this rule change would only eliminate the restrictions of Exchange Rule 520(a)(2) in the manner proposed. Members would continue to remain subject to the requirements of MIAX Rule 303, incorporated by reference into the MIAX Emerald Rulebook (which requires Members to establish, maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of such Member's business, to prevent the misuse of material, nonpublic information by such Member or persons associated with such Member); MIAX Rule 301, Interpretation and Policy .02, also incorporated by reference into the MIAX Emerald Rulebook (which considers it conduct inconsistent with just and equitable principles of trade for any person associated with a Member who has knowledge of all material terms and conditions of: (a) An order and a solicited order, (b) an order being facilitated, or (c) orders being crossed, the execution of which are imminent, to enter, based on such knowledge, an order to buy or sell an option for the same underlying security as any option that is the subject of the order, or an order to buy or sell the security underlying such class, or any order to buy or sell any related instrument until (1) the terms of the order and any changes in the terms of the order of which the person associated with the Member has knowledge are disclosed to the trading crowd, or (2) the trade can no longer reasonably be considered imminent in view of the passage of time since the order was received); and Exchange Rule 520(b) (which provides that EEMs may not execute as principal orders they represent as agent unless (i) agency orders are first exposed on the Exchange for at least one (1) second, (ii) the EEM has been bidding or offering on the Exchange for at least one (1) second prior to receiving an agency order that is executable against such bid or offer, or (iii) the EEM utilizes the MIAX Emerald PRIME or the PRIME Solicitation Mechanism pursuant to Rule 515A); and Exchange Rule 520(c) (which provides that EEMs may not execute orders they represent as agent on the Exchange against orders solicited from Members and non-member broker-dealers to transact with such orders unless the unsolicited order is first exposed on the Exchange for at least one (1) second, or the EEM utilizes the MIAX Emerald PRIME or the PRIME Solicitation Mechanism pursuant to Rule 515A).

subject to the restrictions of that subsection. The Exchange also proposes to amend the hierarchical scheme in the first sentence of current subsection (a)(2) to insert romanettes ''(i)'' and ''(ii)'' to clarify the two conditions that must exist for the entry of Priority Customer Orders to be subject to the restrictions of current subsection (a)(2). The Exchange further proposes to delete the text in the first sentence of current subsection (a)(2) that states ''or related'' when referring to the account or accounts of the same beneficial owner. The purpose of this change is to remove outdated rule text and to align the Exchange's proposed rule with a competing options exchange that has a rule consistent with this proposal.[9] The Exchange believes this is a non-substantive change and is consistent with the Exchange's proposal to delete subsection (a)(1) of the rule. The Exchange does not believe that deleting the text ''or related'' will have any impact to Members as the remaining text continues to apply to ''the account or accounts of the same beneficial owner(s).'' The Exchange also proposes to capitalize the term ''Market Maker'' throughout current subsection (a)(2) to harmonize the rule text to the definition of Market Maker in Exchange Rule 100 and clarify that the rule text of current subsection (a)(2) refers to Market Makers on the Exchange. The Exchange proposes to delete the term ''Electronic Exchange Member'' in the second sentence of current subsection (a)(2) as the purpose of this proposed rule change is to remove the restrictions of current subsection (a)(2) as they currently pertain to EEMs effectively operating as Market Makers. Additionally, the Exchange proposes to replace the term ''option contract'' throughout current subsection (a)(2) with the term ''security'' or ''securities,'' where appropriately used in the singular or plural. The purpose of these proposed changes are to align the Exchange's proposed rule with competing options exchanges that have rules consistent with this proposal as well as with the Exchange's affiliate, MIAX.[10]

Further, Exchange Rule 520(a)(2) currently provides that, in determining whether an EEM or beneficial owner effectively is operating as a Market Maker, the Exchange will consider, among other things: The simultaneous or near-simultaneous entry of limit orders to buy and sell the same option contract; the multiple acquisition and liquidation of positions in the same options during the same day; and the entry of multiple limit orders at different prices in the same options series. The Exchange proposes to remove the second condition pertaining to the multiple acquisition and liquidation of positions from its list of factors used for determining whether an EEM or beneficial owner is operating as a Market Maker. In light of the proliferation of day trading activity and the fact that such a prohibition does not exist on other markets,[11] the Exchange no longer believes this activity should be considered a factor in determining whether an EEM or beneficial owner is effectively acting as a Market Maker.

With the proposed changes, Exchange Rule 520(a) would be amended to state as follows:

> Electronic Exchange Members shall not enter into the System Priority Customer Orders in the same options series if (i) the orders are limit orders for the account or accounts of the same beneficial owner(s) and (ii) the limit orders are entered in such a manner that the beneficial owner(s) effectively is operating as a Market Maker by holding itself out as willing to buy and sell such securities on a regular or continuous basis. In determining whether a beneficial owner effectively is operating as a Market Maker, the Exchange will consider, among other things, the simultaneous or near-simultaneous entry of limit orders to buy and sell the same security and the entry of multiple limit orders at different prices in the same security.

Accordingly, the restrictions contained in current Exchange Rule 520(a)(2) against entering limit orders into the System would no longer be applicable to EEMs, except when entering Priority Customer Orders for account of the same beneficial owner. Further, current Exchange Rule 520(a)(1) would be deleted in its entirety.

2. Statutory Basis

The Exchange believes that its proposed rule change is consistent with Section 6(b) of the Act[12] in general, and furthers the objectives of Section 6(b)(5) of the Act[13] 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 regulating, clearing, settling, processing information with respect to, and facilitating transactions in, securities, 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 Exchange believes its proposal promotes just and equitable principles of trade, removes impediments to and perfects the mechanisms of a free and open market and a national market system, and in general, protects investors and the public interest by removing the prohibition on EEMs from entering limit orders in such a manner to effectively operate as Market Makers will more freely permit the entry of orders by EEMs, resulting in more orders on the Exchange. The increase in more orders on the Exchange should increase liquidity on the Exchange, which would benefit all market participants.

The Exchange believes its proposal to prohibit EEMs from entering Priority Customer Orders for the account of the same beneficial owner such that the beneficial owner is effectively operating as a Market Maker continues to promote just and equitable principles of trade because Priority Customer Orders have priority over the bids and offers of non-Priority Customer Orders. Because Priority Customers are provided with certain benefits such as priority of bids and offers, the Exchange believes its proposal to continue to subject Priority Customer Orders to the restrictions of current Exchange Rule 520(a)(2) will protect investors and the public interest. The Exchange believes its proposal to remove the restrictions of current subsection (a)(2) on EEMs entering broker-dealer and Voluntary Professional orders in such a manner that the EEM is effectively operating as a Market Maker promotes just and equitable principles of trade because those orders do not receive the same benefits as Priority Customer Orders, such as priority of bids and offers.

Similarly, the Exchange believes its proposal to delete subsection (a)(1) and specific text in subsection (a)(2) promotes just and equitable principles of trade, removes impediments to and perfects the mechanisms of a free and open market and a national market system, and in general, protects investors and the public interest by removing provisions of the rule text that no longer apply in light of the Exchange's proposal to allow EEMs to

[9] *See* Cboe Exchange, Inc. Rules, CHAPTER VI. DOING BUSINESS ON THE EXCHANGE FLOOR, Rule 6.8, Prohibition Against Customers Functioning as Market-Makers; Securities Exchange Act Release No. 59700 (April 2, 2009), 67 FR 16246 (April 9, 2009)(SR–CBOE–2009–009) (Order Approving a Proposed Rule Change To Amend its Rules Prohibiting Members From Functioning as Market Makers).

[10] *See id.; see also* Nasdaq ISE, LLC, Options 3 Options Trading Rules, Section 22(a); Securities Exchange Act Release No. 63017 (September 29, 2010), 75 FR 61795 (October 6, 2010)(SR–ISE–2010–95); *see also* MIAX Rule 520(a).

[11] *See id.*

[12] 15 U.S.C. 78f(b).

[13] 15 U.S.C. 78f(b)(5).

enter buy and sell limit orders in the same options series for the account or accounts of the same beneficial owners, other than for the account(s) of Priority Customers. Accordingly, the Exchange will no longer need to designate specific classes for EEMs to engage in this type of market making activity pursuant to subsection (a)(1). This proposed change will provide greater clarity to Members and the public regarding the Exchange's rules and it is in the public interest for rules to be accurate and concise so as to eliminate the potential for confusion.

The Exchange believes its proposal to remove the second condition pertaining to the multiple acquisition and liquidation of positions from its list of factors used for determining whether an EEM or beneficial owner is operating as a Market Maker promotes just and equitable principles of trade, removes impediments to and perfects the mechanisms of a free and open market and a national market system, and in general, protects investors and the public interest because of the proliferation of day trading activity and the fact that such a prohibition does not exist on other markets.[14]

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.

Intra-Market Competition

Specifically, the Exchange believes that removing the prohibition on EEMs from entering limit orders such that EEMs may enter limit orders in such a manner to effectively operate as Market Makers will further promote competition on the Exchange, increase order flow and liquidity, leading to tighter, more efficient markets to the benefit of all market participants.

The Exchange believes that the prohibition on EEMs from entering Priority Customer Orders for the account of the same beneficial owner such that the beneficial owner is effectively operating as a Market Maker does not impose any burden on competition that is not necessary or appropriate because Priority Customers are provided with certain benefits such as priority of bids and offers that are not shared by other market participants.

Inter-Market Competition

The Exchange believes that its proposal to remove the prohibition on EEMs from entering limit orders such that EEMs may enter limit orders in such a manner to effectively operate as Market Makers will not impose any burden on intermarket competition not necessary or appropriate in furtherance of the purposes of the Act because of the proliferation of day trading activity and the fact that such a prohibition does not exist on other markets.[15]

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) of the Act[16] and Rule 19b–4(f)(6) thereunder.[17]

A proposed rule change filed pursuant to Rule 19b–4(f)(6) under the Act[18] normally does not become operative for 30 days after the date of its filing. However, Rule 19b–4(f)(6)(iii)[19] 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 requested that the Commission waive the 30-day operative delay so that the proposed rule change may become operative upon filing. Waiver of the operative delay would allow the Exchange to immediately harmonize with similar rules on other exchanges that allow EEMs to effectively operate as Market Makers. Therefore, the Commission believes that waiver of the 30-day operative delay is consistent with the protection of investors and the public interest. Accordingly, the Commission hereby waives the operative delay and designates the proposed rule change operative upon filing.[20]

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. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule change should be approved or disapproved.

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–EMERALD–2019–30 on the subject line.

Paper Comments

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090.

All submissions should refer to File Number SR–EMERALD–2019–30. 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 website (*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 website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549 on official

[14] *See supra* notes 9 and 10.

[15] *Id.*

[16] 15 U.S.C. 78s(b)(3)(A).

[17] 17 CFR 240.19b–4(f)(6). In addition, Rule 19b–4(f)(6)(iii) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change, along with a brief description and 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. The Exchange has satisfied this requirement.

[18] 17 CFR 240.19b–4(f)(6).

[19] 17 CFR 240.19b–4(f)(6)(iii).

[20] For purposes only of waiving the 30-day operative delay, the Commission also has considered the proposed rule's impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–EMERALD–2019–30, and should be submitted on or before September 12, 2019.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[21]

Jill M. Peterson,

Assistant Secretary.

[FR Doc. 2019–18075 Filed 8–21–19; 8:45 am]

BILLING CODE 8011–01–P

[21] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–86700; File No. SR–FINRA–2019–017]

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Order Approving a Proposed Rule Change To Amend FINRA Rules 2210 (Communications With the Public) and 2241 (Research Analysts and Research Reports)

August 16, 2019.

I. Introduction

On June 20, 2019, Financial Industry Regulatory Authority, Inc. (''FINRA'') filed with the Securities and Exchange Commission (''SEC or Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Exchange Act'') [1] and Rule 19b–4 thereunder,[2] a proposed rule change to amend FINRA Rules 2210 (Communications with the Public) and 2241 (Research Analysts and Research Reports) to conform to the requirements of the Fair Access to Investment Research Act of 2017 (''FAIR Act'').[3] The proposed rule change would eliminate the ''quiet period'' restrictions in FINRA Rule 2241 on publishing a research report or making a public appearance concerning a covered investment fund and would create a filing exclusion under FINRA Rule 2210 for covered investment fund research reports.

The proposed rule change was published for comment in the **Federal Register** on July 8, 2019.[4] The public comment period closed on July 29, 2019. The Commission received one comment letter in response to the Notice, supporting the proposed rule change.[5] This order approves the proposed rule change.

II. Description of the Proposed Rule Change [6]

The FAIR Act requires the SEC to propose and adopt rule amendments that would extend the current safe harbor under Securities Act of 1933 (''Securities Act'') Rule 139 [7] to a ''covered investment fund research report'' upon terms and conditions that the SEC determines are necessary or appropriate in the public interest, for the protection of investors, and for the promotion of capital formation.[8] The FAIR Act directs that in implementing the safe harbor for covered investment fund research reports, the SEC is required to: (1) Meet specified requirements concerning the safe harbor's conditions, (2) prohibit any self-regulatory organization (''SRO'') from maintaining or enforcing specified rules regarding such reports, and (3) provide that a covered investment fund research report is not subject to the sales material filing requirements in section 24(b) of the Investment Company Act of 1940 (''Investment Company Act'').[9]

On November 30, 2018, the SEC adopted its final rules and rule amendments to implement the FAIR Act.[10] New Rule 139b expanded the Rule 139 safe harbor to include covered investment fund research reports, subject to specified conditions. Specifically, Rule 139b established a safe harbor for an unaffiliated broker or dealer participating in a securities offering of a covered investment fund to publish or distribute a covered investment fund research report. If the conditions in Rule 139b are satisfied, the publication or distribution of a covered investment fund research report would be deemed not to be an offer for sale or offer to sell the covered investment fund's securities for purposes of sections 2(a)(10) and 5(c) of the Securities Act. Rule 139b also adopted the FAIR Act's definitions of ''covered investment fund,'' ''covered investment fund research report,'' and ''research report,'' subject to minor non-substantive revisions.[11]

The SEC also adopted new Rule 24b–4 under the Investment Company Act, which specifies that a covered investment fund research report as defined in Rule 139b that concerns a fund registered under the Investment Company Act shall not be subject to section 24(b) of the Investment Company Act or any rules or regulations thereunder, unless the report is not subject to SRO rules relating to research reports, including rules governing communications with the public.[12] Section 24(b) of the Investment Company Act generally requires certain registered investment companies and their underwriters to file sales material concerning those funds with the SEC within 10 days of use.[13]

Changes to FINRA Rules Required by the FAIR Act

As discussed in the Notice, FINRA has interpreted the FAIR Act as requiring it to make two changes to FINRA Rules. Therefore, FINRA has proposed: (1) To amend Rule 2241 to eliminate the quiet period restrictions on publishing a research report or making a public appearance concerning a covered investment fund that is the subject of such a report; and (2) to amend Rule 2210 to create a filing exclusion for covered investment fund research reports that qualify for the Securities Act Rule 139b safe harbor.

FINRA Equity Research Rules

FINRA Rule 2241 governs the publication of research reports concerning equity securities and the analysts that produce such research. Rule 2241 requires members to establish, maintain and enforce written policies and procedures reasonably designed to identify and effectively manage conflicts of interest related to the preparation, content and distribution of research reports and public appearances by research

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Fair Access to Investment Research Act of 2017, Public Law 115–66, 131 Stat. 1196 (2017).

[4] *See* Exchange Act Release No. 86257 (Jul. 1, 2018), 84 FR 32492 (Jul. 8, 2019) (File No. SR–FINRA–2019–017 (''Notice'').

[5] *See* Letter from the Dorothy Donohue, Deputy General Counsel, Investment Company Institute (''ICI''), dated July 29, 2019 (''ICI Letter''), available at *https://www.sec.gov.*

[6] The subsequent description of the proposed rule change is substantially excerpted from FINRA's description in the Notice. *See* Notice, 84 FR at 32492–32497.

[7] 17 CFR 230.139.

[8] *See* Section 2(a) of the FAIR Act.

[9] *See* Section 2(b) of the FAIR Act.

[10] *See* Securities Act Release No. 10580 (Nov. 30, 2018), 83 FR 64180 (Dec. 13, 2018) (the ''Release'').

[11] *See* 17 CFR 230.139b(c).

[12] *See* 17 CFR 270.24b–4.

[13] *See* 15 U.S.C. 80a–24(b). This filing requirement applies to sales material concerning any registered open-end management investment company, any registered unit investment trust (''UIT''), or any registered face-amount certificate company (''FACC'').

analysts.[14] Among other things, these policies and procedures also must define periods during which the member must not publish or otherwise distribute research reports, and research analysts must not make public appearances, related to the issuer (''quiet periods''). As discussed in the Notice, these quiet periods restrict a member that has participated as an underwriter or dealer in an initial public offering (''IPO''), as well as managers and co-managers of secondary offerings, from publishing research or having its research analysts make public appearances.[15]

While Rule 2241 excludes from its definition of ''research report'' communications related to mutual funds, the Rule does apply to communications that meet the definition of ''research report'' under Rule 2241 concerning other covered investment funds, including closed-end funds (''CEFs''), exchange-traded funds (''ETFs''), BDCs, UITs, and commodity or currency funds.[16] Therefore, research reports (as defined under Rule 2241) on covered investment funds (other than mutual funds) are subject to Rule 2241's quiet periods if such research reports are published by an underwriter or dealer in the IPO or manager or co-manager of a secondary offering.

As discussed above, Section 2(b) of the FAIR Act requires the SEC to prohibit any SRO from maintaining or enforcing any rule that would prohibit the ability of a member to:

- Publish or distribute a covered investment fund research report solely because the member is also participating in a registered offering or other distribution of the fund; or
- Participate in a registered offering or other distribution of securities of a covered investment fund solely because the member has published or distributed a covered investment fund research report about the fund or its securities.[17]

Therefore, FINRA's proposal to amend Rule 2241 excepts from the Rule's quiet period requirements the publication or distribution of research reports and research analysts' public appearances if the member has participated in the offering of the subject company's securities.[18] Under this new proposed exception, the quiet period requirements shall not apply to a research report or a public appearance following any offering of the securities of a covered investment fund that is the subject of a covered investment fund research report.[19] Although the FAIR Act does not address quiet periods for public appearances by research analysts, FINRA also proposes to eliminate such quiet periods for public appearances concerning a covered investment fund. Under Rule 2241, quiet periods for both research reports and public appearances are the same, and FINRA believes elimination of both quiet periods would advance the policy objectives of the FAIR Act.[20]

Elimination of Filing Requirement

As discussed above, section 24(b) of the Investment Company Act requires registered open-end management investment companies, registered UITs, registered FACCs, and their underwriters to file sales material for the funds with the SEC within 10 days of first use. Investment Company Act Rule 24b–3 provides that any sales material shall be deemed filed with the SEC for purposes of section 24(b) upon filing with a registered national securities association that has adopted rules providing standards for the investment company advertising practices of its members and has established and implemented procedures to review that advertising.[21]

Accordingly, virtually all principal underwriters of mutual funds, ETFs, UITs and FACCs satisfy the section 24(b) requirement by filing their sales material with FINRA. Rule 2210 requires members to file within 10 business days of first use or publication retail communications that promote or recommend a specific registered investment company or family of registered investment companies (including mutual funds, ETFs, variable insurance products, CEFs and UITs), as well as retail communications that concern any other registered security that is derived from or based on a single security, a basket of securities, an index, a commodity, a debt issuance or a foreign currency.[22]

As discussed in the Notice, pursuant to section 2(b)(4) of the FAIR Act, the SEC has adopted Investment Company Act Rule 24b–4, which provides that a covered investment fund research report, as defined in Securities Act Rule 139b(c)(3), of a covered investment fund registered as an investment company under the Investment Company Act, shall not be subject to section 24(b) of the Act or any rules or regulations thereunder. However, a covered investment fund research report is still subject to the section 24(b) filing requirement if the report is not subject to the content standards of any SRO rules related to research reports, including those contained in the SRO's rules governing communications with the public regarding investment companies or substantially similar standards.[23]

As discussed above, section 2(c)(2) of the FAIR Act provides that nothing in the Investment Company Act shall be construed as in any way limiting the authority of any SRO to examine or supervise a member's practices in connection with the member's publication or distribution of a covered investment fund research report for compliance with applicable provisions of the Federal securities laws or SRO rules related to research reports, including those contained in rules governing communications with the public, or to ''require the filing of communications with the public the purpose of which is not to provide research and analysis of covered investment funds.''[24] Accordingly,

[14] *See* FINRA Rule 2241(b)(1).

[15] *See* Notice, 84 FR at 32493. *See also,* FINRA Rule 2241(b)(2)(I). This provision contains specified exceptions to the quiet periods for research reports and public appearances following an offering of securities of an Emerging Growth Company, for reports or appearances that discuss significant news or events concerning a subject company, and for reports and appearances regarding subject companies with ''actively traded securities'' as defined in SEC Regulation M.

[16] *See* FINRA Rule 2241(a)(11).

[17] *See* Section 2(b)(3) of the FAIR Act.

[18] As discussed above, because the definition of ''research report'' under Rule 2241 is narrower than the definition of ''research report'' under the FAIR Act, not all covered investment fund research reports are subject to Rule 2241. Nevertheless, to the extent that a covered investment fund research report is also a research report subject to Rule 2241, the publication and distribution of such reports will not be subject to the rule's quiet periods.

[19] FINRA also proposes to define the terms ''covered investment fund'' and ''covered investment fund research report'' as having the same meanings as in Securities Act Rule 139b. *See* Proposed FINRA Rules 2241(a)(15) and (16).

[20] FINRA rules do not prohibit a member from participating in a registered offering or other distribution of securities of a covered investment fund solely because the member has published research about the fund. Accordingly, there is no need to amend any FINRA rule to meet this requirement of section 2(b)(3) of the FAIR Act or Securities Act Rule 139b(b).

[21] FINRA is currently the only national securities association registered under the Exchange Act that has adopted such rules and procedures.

[22] *See* FINRA Rules 2210(c)(3)(A) and (D). For a one-year period beginning on the date reflected in FINRA's Central Registration Depository (CRD) system as the date that FINRA membership became effective, a member also must file with FINRA at least 10 business days prior to first use any broadly disseminated retail communication, regardless of whether it concerns a registered investment company. *See* FINRA Rule 2210(c)(1)(A). In addition, a member must file at least 10 business days prior to first use any retail communication concerning registered investment companies that includes performance rankings or comparisons that are not generally published, or that were created by the investment company, its underwriter, or an affiliate. *See* FINRA Rule 2210(c)(2)(A).

[23] *See* 17 CFR 270.24b–4.

[24] *See* section 2(c)(2) of the FAIR Act.

FINRA interpreted the FAIR Act as requiring FINRA to create a filing exclusion in Rule 2210 for covered investment fund research reports, but permits FINRA to require the filing of a covered investment fund research report if the purpose of the report is not to provide research and analysis of covered investment funds.[25]

Further, FINRA stated it intended to create a rule that furthers the purposes of the FAIR Act, protects investors, and is relatively straightforward for broker-dealers to implement. FINRA believes that these objectives could best be achieved if the filing exclusion applies to any ''covered investment fund research report'' as defined by Rule 139b that qualifies for the Rule 139b safe harbor.[26] Moreover, FINRA believes that the SEC, through rulemaking, had determined which research reports should be subject to the Rule 139b safe harbor, and there is no policy reason to create a filing exclusion for covered investment fund research reports that differed from this standard.

As stated above, the FAIR Act authorizes FINRA to require members to file any covered investment fund research report the purpose of which is not to provide research and analysis of covered investment funds. As described more fully in the Notice, FINRA considered how and whether to treat such reports.[27] FINRA believes that the intent of the FAIR Act and Rule 139b is to increase the volume and publication of research reports on covered investment funds subject to appropriate conditions, and thus believes that its proposed filing exclusion should be consistent with this approach. Moreover, FINRA believes that Rule 139b's requirements reflect the Commission's careful consideration of balancing the need for more fund research with investor protection.[28] For these reasons, FINRA has proposed to exclude from filing all covered investment fund research reports that qualify for the Rule 139b safe harbor.[29]

Therefore, FINRA has proposed to create a new filing exclusion under Rule 2210 for ''any covered investment fund research report that is deemed for purposes of sections 2(a)(10) and 5(c) of the Securities Act not to constitute an offer for sale or offer to sell a security under Securities Act Rule 139b.'' [30] FINRA also proposed to define ''covered investment fund research report'' as having the same meaning given that term in paragraph (c)(3) of Securities Act 139b.[31]

Affiliated Research Reports

The FAIR Act and Securities Act Rule 139b define ''covered investment fund research report'' to exclude a research report to the extent that the report is published or distributed by the covered investment fund, any affiliate of the covered investment fund, or any broker or dealer that is an investment adviser (or an affiliated person of an investment adviser) for the covered investment fund.[32] Thus, research reports published or distributed by a covered investment fund, its affiliate, or any broker-dealer that is an investment adviser (or an affiliate of the investment adviser) for the covered investment fund will still have to be filed under Investment Company Act section 24(b) and FINRA Rule 2210.[33]

In some cases, an investment adviser or another affiliate of a registered investment company will enter into an agreement with an unaffiliated broker-dealer to act as the principal underwriter for the fund (''third-party distributor''). As described in the Notice, third-party distributors provide a variety of services pursuant to their distribution agreements with investment companies. Typically, these funds' investment advisers or the funds themselves prepare the retail communications, and then submit the communications to the third-party distributor for compliance review and filing with FINRA and may be posted on the investment adviser's or the fund's or an affiliate's websites or through other media. As the SEC noted in the Release, one factor to consider in evaluating whether a research report has been published or distributed by a person covered by the affiliate exclusion from the definition of covered investment fund research report is the extent of such person's involvement in the preparation of the research report.[34] The Commission refers to such affiliate involvement or endorsement as ''the entanglement or adoption theory, respectively.'' [35]

Thus, FINRA stated that it will not consider research reports on covered investment funds to be excluded from filing under the proposed changes to Rule 2210 if personnel of the covered investment fund, any affiliate of the fund, or any broker-dealer that is the investment adviser or an affiliated person of the investment adviser were entangled with the preparation of the report, or had adopted its contents after it had been prepared.[36]

III. Comment Summary

As noted above, the Commission received one comment letter on the proposed rule change, supporting the proposal.[37] The commenter strongly supports FINRA's proposed amendments, stating that the proposal aligns FINRA's quiet period requirements and filing exclusion applicable to covered investment funds with the SEC's rules adopted to implement the FAIR Act and does so in a manner that is streamlined and straightforward.[38] The commenter believes FINRA's clarification of the applicability of quiet periods of Rule 2241 removes a potential ambiguity and impediment to broker-dealers' use of the safe harbor.[39] The commenter agrees with FINRA's determination that the proposed filing exclusion in FINRA Rule 2210 for covered investment fund research reports not differ from the standard adopted by the SEC in Rule 139b.[40] The commenter strongly supports this streamlined approach proposed by FINRA as benefitting investors, funds and broker-dealers by

[25] *See* Notice, 83 FR at 32494.

[26] In the Notice, FINRA summarized comments that the Commission had discussed in the Release that recommended that FINRA modify its rules. FINRA also explained that it did not modify the definition of ''research report'' under FINRA Rule 2241 to match the definition of ''research report'' under the FAIR Act and Rule 139b because FINRA believes that it would be inconsistent with the requirements of Section 15D of the Exchange Act to do so. *See* Notice, 83 FR at 32494–32495.

[27] *See,* Notice, 83 FR 32495.

[28] *See generally* Release, *supra* note 10, at 64183–64193.

[29] Of course, FINRA may still review such reports through examinations, targeted sweeps, or spot checks, and such reports will remain subject to the content standards of FINRA rules governing communications with the public. *See* Section 2(c)(2) of the FAIR Act; *see also* Release, *supra* note 10, at 64194 and fn. 185.

[30] *See* Notice, proposed FINRA Rule 2210(c)(7)(P).

[31] *See* Notice, proposed FINRA Rule 2210(a)(7).

[32] *See* Section 2(f)(3) of the FAIR Act and Securities Act Rule 139b(c)(3).

[33] If a research report concerns both a covered investment fund that is an affiliate of the member that is publishing or distributing the research report, as well as a third-party fund that is not affiliated with the member publishing or distributing the report, the research report would not qualify as a covered investment fund research report. *See* Release, *supra* note 7, at 64191 (stating that ''[w]e believe extending the rule 139b safe harbor to affiliated funds in industry research reports (whether industry representation or comprehensive list reports) would not be consistent with the intent and plain language of section 2(f)(3) of the FAIR Act'').

[34] *See* Release, *supra* note 10, at 64182.

[35] *See supra* note 34.

[36] *See* Release, *supra* note 10, at 64181–64183 (discussion of affiliate exclusion). For example, if a third-party distributor publishes or distributes research concerning a fund that was written by personnel of the fund's investment adviser, the report still would be subject to filing under Rule 2210.

[37] *See supra* note 5.

[38] *See* ICI Letter.

[39] *Id.*

[40] *Id.*

ensuring broker-dealers producing such reports need only conduct one legal analysis to comply with both the SEC and FINRA rules.[41] According to the commenter, the streamlined amendments would help facilitate broker-dealers' use of the safe harbor which the commenter believes would generate useful fund information for investors.[42]

IV. Discussion and Commission Findings

After careful review of the proposed rule change and the comment letter, the Commission finds that the proposal is consistent with the requirements of the Exchange Act and the rules and regulations thereunder that are applicable to a national securities association.[43] Specifically, the Commission finds that the proposed rule change is consistent with Section 15A(b)(6) of the Exchange Act,[44] which requires, among other things, that FINRA rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

Protection of Investors and the Public Interest

The Commission considers FINRA's proposed changes to the FINRA Rule 2241 quiet periods applicable to publication of covered investment fund research reports to be consistent with the language and purposes of the FAIR Act. In addition, the Commission believes that FINRA's additional proposed change to eliminate quiet periods applicable to public appearances involving an offering of covered investment fund securities provides consistency and clarity with respects to members that produce research reports for covered investment funds.

The Commission believes that the proposed rule change would clarify the applicability of FINRA Rule 2241 quiet periods to covered investment funds that are subject of a research report, as well as further the purposes of the FAIR Act which directed the SEC to extend the current safe harbor available under Securities Act Rule 139 to a covered investment fund research report. The Commission believes the extension of the safe harbor in Rule 139b should improve investors' access to potentially useful and timely information about such covered investment funds which furthers the public interest. The consistency of standards in Rule 139b and FINRA Rule 2241 provides clarity to broker-dealers, funds and their affiliates which in turn reduces the cost of compliance.

The Commission also believes that the proposed filing exclusion under FINRA Rule 2210 for covered investment fund research reports that qualify for the Rule 139b safe harbor is consistent with the FAIR Act's intent to increase the volume and publication of research reports on covered investment funds subject to appropriate conditions. The Commission believes that this proposed rule change will improve efficiency and reduce regulatory burden without diminishing investor protection. Specifically, the consistency of standards in Rule 139b and FINRA Rule 2210 provides clarity to broker-dealers, funds and their affiliates as to which research reports constitute ''covered investment fund research reports,'' which in turn reduces the cost of compliance. In addition, FINRA retains other methods to review covered investment fund research reports, such as through examinations, targeted sweeps, or spot checks. Thus, the Commission considers proposed FINRA Rule 2210 and its consistency with the Rule 139b safe harbor as a clear and appropriate approach to furthering the purposes of the FAIR Act and is consistent with protecting investors and the public interest.

Taking into consideration FINRA's views and the commenter's support, the Commission believes that the proposal is consistent with the Exchange Act. In particular, the Commission believes that the proposed rule change is appropriate and designed to protect investors and the public interest, consistent with Section 15(A)(b)(6) of the Exchange Act. For these reasons, the Commission finds that the proposed rule change is consistent with the Exchange Act and the rules and regulations thereunder.

V. Conclusion

It is therefore ordered pursuant to Section 19(b)(2) of the Exchange Act[45] that the proposal (SR–FINRA–2018–019), be and hereby is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[46]

Jill M. Peterson,

Assistant Secretary.

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[41] *Id.*

[42] *Id.*

[43] In approving this rule change, the Commission has considered the rule's impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

[44] 15 U.S.C. 78o–3(b)(6).

[45] 15 U.S.C. 78s(b)(2).

[46] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–86696; File No. SR–NYSE–2019–44]

Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing of Proposed Rule Change To Add Certain Rules to the List of Minor Rule Violations in Rule 9217; Delete Obsolete Rules and Increase the Maximum Fine for Minor Rule Violations

August 16, 2019.

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 August 8, 2019, New York Stock Exchange LLC (''NYSE'' or the ''Exchange'') filed with the Securities and Exchange Commission (''SEC'' or ''Commission'') the proposed rule change as described in Items I, II, and III 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 Substance of the Proposed Rule Change

The Exchange proposes to (1) add certain rules to the list of minor rule violations in Rule 9217; (2) delete obsolete rules from Rule 9217; and (3) increase the maximum fine for minor rule violations to $5,000 in order to more closely align the Exchange's minor rule plan with that of its affiliates. The proposed rule change is available on the Exchange's website 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

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

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 (1) add certain rules to the list of minor rule violations in Rule 9217; (2) delete obsolete rules from Rule 9217; and (3) increase the maximum fine for minor rule violations to $5,000 in order to more closely align the Exchange's minor rule plan with that of its affiliates.

Rule 9217 sets forth the list of rules under which a member organization or covered person may be subject to a fine under a minor rule violation plan as described in proposed Rule 9216(b). The Exchange proposes the following amendments to Rules 9217 and 9216(b).

Proposed Rule Change

The Exchange proposes to add the following new introductory paragraph to Rule 9217:

Nothing in this Rule shall require the Exchange to impose a fine for a violation of any rule under this Minor Rule Plan. If the Exchange determines that any violation is not minor in nature, the Exchange may, at its discretion, proceed under the Rule 9000 Series rather than under this Rule.

The language is based on NYSE Arca Rule 10.9217(d).

Proposed Additions to Rule 9217

The Exchange proposes to add the following rules to the list of rules in Rule 9217 eligible for disposition pursuant to a fine under Rule 9216(b):

- Rule 7.30 (Authorized Traders)
- Rule 76 (''Crossing'' Orders)
- Rule 103(a)(i) (Registration and Capital Requirements of DMM Units)
- Rule 1210 (Registration Requirements)
- Rule 3110(a) and (b)(1) (Supervision)

The Exchange also proposes that all of the registration and other requirements set forth in Rule 345 be eligible for a minor rule fine.

Rule 7.30 establishes requirements for member organizations relating to Authorized Traders. The rule is based on NYSE Arca, Inc.'s (''NYSE Arca'') Rule 7.30–E (Authorized Traders), which is eligible for NYSE Arca's Minor Rule Plan.[3]

Rule 76 is substantially similar to NYSE American LLC (''NYSE American'') Rule 934NY(a)(1) (Crossing) and NYSE Arca Rule 6.47–O(a)(1) (''Crossing'' Orders—OX), which govern manual crosses on those respective exchanges' options trading Floors. NYSE American Rule 934NY(a)(1) is eligible for NYSE American's Minor Rule Plan, and NYSE Arca Rule 6.47–O(a)(1) is eligible for NYSE Arca's Minor Rule Plan.[4]

Rule 103(a)(1) provides that no member organization shall act as a Designated Market Maker (''DMM'') unit in any security unless such member organization is registered as a DMM unit in such security with the Exchange and unless the Exchange has approved of the member organization acting as a DMM unit and not withdrawn such approval. The rule is substantially similar to NYSE Arca Rule 7.20–E(a) (Registration of Market Makers) and NYSE National Rule 7.20 (Registration of Market Makers), which similarly require that market makers on those exchanges be registered in a security and that the registration has not been suspended or cancelled. Both NYSE Arca Rule 7.20–E(a) and NYSE National Rule 7.20 are eligible for minor rule fines.[5]

Similarly, Rule 1210, which was adopted in October 2018,[6] sets forth the requirements for persons engaged in the investment banking or securities business of a member organization to be registered with the Exchange as a representative or principal in each category of registration appropriate to his or her functions and responsibilities as specified in Rule 1220. The Exchange proposes to add Rule 1210 to the list of minor rules in Rule 9217. The Exchange believes that having the ability to issue a minor rule fine for failing to comply with the registration requirements of Rule 1210 would be consistent with and complement the Exchange's current ability to issue minor rule fines for other registration violations (*e.g.,* Rule 345).

Rule 3110 is the Exchange's supervision rule. The Exchange proposes to add subsections (a) and (b)(1) of Rule 3110, governing failure of a member organization to establish and maintain a supervisory system and failure to establish, maintain, and enforce written supervisory procedures, respectively, to Rule 9217. Failure to supervise individuals and accounts is currently eligible for minor rule fines in the rules of the Exchange's affiliate NYSE Arca.[7]

Finally, Rule 345 sets forth certain employee registration, approval and other exchange requirements, including the requirements pertaining to the registration of a securities lending representative, Securities Trader or direct supervisor thereof. Currently, the only violation of Rule 345 that is eligible for a minor rule fine is failure of a member organization to have individuals responsible and qualified for the position of Securities Lending Supervisor. The Exchange proposes that all of registration and other requirements set forth in Rule 345 be eligible for a minor rule fine. The proposed change would be consistent with the practice on the Exchange's affiliates whose comparable rule is eligible for a minor rule fine.[8]

Proposed Deletions From Rule 9217

The Exchange proposes to delete the following rules from Rule 9217 as obsolete:

- Rule 706, which was deleted in 2014.[9]
- Rule 312(h), which is marked ''Reserved'' in the Exchange's rules and was deleted in 2010.[10]
- Rule 382(a). Rule 382 is also marked ''Reserved'' and was deleted in 2011.[11]

[3] *See* Securities Exchange Act Release No. 81225 (July 27, 2017), 82 FR 36033, 36035 (August 2, 2017) (SR–NYSE–2017–35). *See also* NYSE Arca Rule 10.12(i)(4) (NYSE Arca Rule 7.30–E); NYSE Arca Rule 10.9217(f)(4). NYSE Arca Rule 10.12 is NYSE Arca's legacy minor rule plan and applies only to matters for which a written statement was served under Rule 10.12 prior to May 27, 2019; thereafter, Rules 10.9216(b) and 10.9217 apply. *See generally* NYSE Arca Rules 10.0 (preamble) and 10.9001.

[4] *See* NYSE American Rule 9217 (Rule 934NY); NYSE Arca Rules 10.12(h)(3) and 10.9217(e)(3). *See* note 4, *supra.*

[5] *See* NYSE Arca Rules 10.12(i)(5) and 10.9217(f)(5); NYSE National Rule 10.9217(d).

[6] *See* Securities Exchange Act Release No. 84336 (October 2, 2018), 83 FR 50727 (October 9, 2018) (SR–NYSE–2018–44).

[7] *See* NYSE Arca Rules 11.18 (Supervision), 10.12(j)(8) and 10.9217(g)(8).

[8] *See, e.g.,* NYSE Arca Rules 2.24.03 (Registration—Employees of ETP Holders), 10.12(j)(11) and 10.9217(g)(11). *See also* NYSE National Rules 2.2 (Obligations of ETP Holders and the Exchange) and 10.9217(e).

[9] *See* Securities Exchange Act Release No. 72916 (August 26, 2014), 79 FR 52094 (September 2, 2014) (SR–NYSE–2014–44).

[10] *See* Securities Exchange Act Release No. 61557 (February 22, 2010), 75 FR 9472 (March 2, 2010) (SR–NYSE–2010–10). NYSE Rule 4110(c)(2), based on the comparable FINRA rule, incorporates Rule 312(h) in part. The Exchange is not proposing to add Rule 4110(c)(2) to Rule 9217.

[11] *See* Securities Exchange Act Release No. 64888 (July 14, 2011), 76 FR 43368 (July 20, 2011) (SR–NYSE–2011–33). NYSE Rule 4311, based on the comparable FINRA rule, was based in part on NYSE Rule 382. The Exchange is not proposing to add Rule 4311 to Rule 9217.

• Rule 791(c), which was also deleted in 2014.[12]

• Rules 352(b) & (c). Rule 352 is marked ''Reserved'' and was deleted in 2009.[13]

• Rule 392, which is also marked ''Reserved'' and was deleted in 2009.[14]

• Rule 410A, which was deleted in 2013.[15]

• Rule 445(4), which is marked ''Reserved'' and was deleted in 2009.[16]

Eligible Fine Amounts

The maximum fine for minor rule violations under Rule 9216(b) is currently $2,500. The maximum fine under the Exchange's legacy minor rule plan set forth in Rule 476A previously was $5,000. In adopting its current disciplinary rules in 2013, the Exchange believed it appropriate to lower the maximum fine amount to achieve harmony with the rules of the Financial Industry Regulatory Authority (''FINRA'').[17] The Exchange's affiliates NYSE American, NYSE National and NYSE Arca, however, have since harmonized their disciplinary rules with the Exchange and adopted or retained a $5,000 maximum fine for minor rule violations.[18] The Exchange accordingly proposes to adopt the same maximum fine amount in order to harmonize the maximum fine level with its affiliated exchanges. The Exchange also proposes to adopt the same 24-month rolling period to calculate second and subsequent fines as that used by its affiliated exchanges.

To effectuate this change, the Exchange proposes to add the following fine chart contained in Rule 476A, the Exchange's legacy rule governing the imposition of minor rule fines, to Rule 9217:[19]

Fine amount	Individual
First Time Fined	$1,000
Second Time Fined **	2,500
Subsequent Fines **	5,000
Fine amount	**Member organization**
First Time Fined	2,500
Subsequent Fines **	5,000

** Within a ''rolling'' 24-month period.

As noted, rather than the 12-month rolling period in Rule 476A, the Exchange proposes a 24-month ''rolling'' period from the date of the violation in order to harmonize with its affiliates.[20]

In order to add clarity to the Exchange's rules, the Exchange also proposes to add a paragraph immediately before the proposed chart based on NYSE Arca Rule 10.9217(h) that sets forth how the beginning and end of the 24-month rolling period is to be determined. Except for references that reflect the Exchange's membership and use of the phrase ''minor rule violation plan letter'' rather than ''Notice of Minor Rule Plan Fine,'' the paragraph is substantially the same as NYSE Arca Rule 10.9217(h).[21]

In order to further harmonize the Exchange's rules with those if its affiliates, and because a fine of $5,000 would exceed the maximum amount in Securities Exchange Act Rule 19d–1(c)(2) for a minor rule plan,[22] the Exchange proposes to change the titles of Rules 9216 and 9217. Specifically, the phrase ''Plan Pursuant to SEA Rule 19d–1(c)(2)'' would be replaced with ''Procedure for Imposition of Fines for Minor Violation(s) of Rules'' in the title of Rule 9216. The same phrase in Rule 9217 would be replaced with ''Rule 9216(b).'' The titles of both rules would thereby be the same as the titles of NYSE Arca Rules 10.9216 and 10.9217 and NYSE National Rules 10.9216 and 10.9217, respectively. The Exchange proposes to make similar conforming changed to Rule 9216(b)(1) by removing references to SEA Rule 19d–1(c)(2) and the maximum fine level of $2,500, and by adding language specifying that the Exchange may impose a fine in accordance with the fine amounts and fine levels set forth in Rule 9217.

2. Statutory Basis

The proposed rule change is consistent with Section 6(b) of the Act,[23] in general, and furthers the objectives of Section 6(b)(5),[24] in particular, because 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.

Minor rule fines provide a meaningful sanction for minor or technical violations of rules. The Exchange believes that the proposed rule change will strengthen the Exchange's ability to carry out its oversight and enforcement responsibilities in cases where full disciplinary proceedings are unwarranted in view of the minor nature of the particular violation. Specifically, the proposed rule change is designed to prevent fraudulent and manipulative acts and practices because it will provide the Exchange the ability to issue a minor rule fine for violations of its rules governing authorized traders, crossing orders, DMM registration and capital requirements, and general registration and supervision requirements in situations where a more formal disciplinary action may not be warranted or appropriate.

In addition, the Exchange believes that adding rules based on the rules of its affiliate to the Exchange's minor rule plan and the associated fine levels would promote fairness and consistency in the marketplace by permitting the Exchange to issue a minor rule fine for violations of substantially similar rules that are eligible for minor rule treatment on the Exchange's affiliate, thereby harmonizing minor rule plan fines

[12] *See* Release No. 72916, 79 FR at 52094.

[13] *See* Securities Exchange Act Release No. 61158 (December 11, 2009), 75 FR 67942 (December 21, 2009) (SR–NYSE–2009–123). Rule 352 was replaced by Rule 2150. Violations of Rule 2150(b) & (c) are currently eligible for a minor rule fine under Rule 9217.

[14] *See* Securities Exchange Act Release No. 59965 (May 21, 2009), 74 FR 25783 (May 29, 2009) (SR–NYSE–2009–25).

[15] *See* Securities Exchange Act Release No. 68678 (January 16, 2013), 78 FR 5213 (January 24, 2013) (SR–NYSE–2013–02) (Notice) (''Release No. 68678''); *see also* Securities Exchange Act Release No. 69045 (March 5, 2013), 78 FR 15394 (March 11, 2013) (SR–NYSE–2013–02) (Approval Order). Rule 410A was replaced by Rule 8211. Both rules were initially retained in Rule 9217, but there is no longer any reason to retain Rule 410A in Rule 9217.

[16] *See* Securities Exchange Act Release No. 61273 (December 31, 2009), 75 FR 1091 (January 1, 2010) (SR–NYSE–2009–134).

The Exchange proposes to correct a typographical error in Rule 9217. Rule 9217 refers to Rule 3010(a). The correct reference should be to Rule 3110(a), the Exchange's supervision rule, which was added to Rule 9217 in 2014. *See* Securities Exchange Act Release No. 73554 (November 6, 2014), 79 FR 67508 (November 13, 2014) (SR–NYSE–2014–56).

[17] *See* Release No. 68678, 78 FR at 5226.

[18] For instance, the maximum fine for minor rule violations under NYSE Arca's legacy Minor Rule Plan set forth in Rule 10.12 is $5,000. NYSE Arca retained the $5,000 maximum when it adopted its new disciplinary rules. *See* NYSE Arca Rule 10.9217(a). *See also* NYSE American Rule 9217 & NYSE National Rule 10.9217.

[19] When the Exchange adopted Rule 9217 as part of its adoption of FINRA's disciplinary rules, the Exchange retained the list of rules set forth in Rule 476A. *See* Release No. 69045, 78 FR at 15396. The Exchange did not retain the chart in Rule 476A because, as noted above, the maximum fine under Rule 476A previously was $5,000.

[20] *See* NYSE Arca Rule 10.9217 (violations applied in a rolling 24-month period); NYSE American Rule 9217 (same).

[21] Pursuant to the new paragraph the Exchange proposes to add to Rule 9217 based on NYSE Arca Rule 10.9217(d) discussed above, the Exchange is not required to impose a fine for a violation under its Minor Rule Plan. The Exchange may, at its discretion, bring formal disciplinary action against a member or associated person that has violated its rules.

[22] 17 CFR 240.19d–1(c)(2).

[23] 15 U.S.C. 78f(b).

[24] 15 U.S.C. 78f(b)(5).

across affiliated exchanges for the same conduct. Deletion of obsolete rules from the minor rule plan would thus remove impediments to and perfect the mechanism of a free and open market by ensuring that persons subject to the Exchange's jurisdiction, regulators, and the investing public can more easily navigate and understand the Exchange's rulebook.

Finally, in connection with the fine levels specified in the proposed rule change, adding clarifying language describing how the ''rolling period'' is determined would further the goal of transparency and add clarity to the Exchange's rules. The Exchange believes that adding such clarifying language would also be consistent with the public interest and the protection of investors because investors will not be harmed and in fact would benefit from increased transparency, thereby reducing potential confusion.

The Exchange further believes that the proposed amendments to Rule 9217 are consistent with Section 6(b)(6) of the Act,[25] which provides that members and persons associated with members shall be appropriately disciplined for violation of the provisions of the rules of the exchange, by expulsion, suspension, limitation of activities, functions, and operations, fine, censure, being suspended or barred from being associated with a member, or any other fitting sanction. As noted, the proposed rule change would provide the Exchange ability to sanction minor or technical violations pursuant to the Exchange's rules and would increase the amounts of fines in order for the Exchange to better deter violative activity.

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. The proposed change is not designed to address any competitive issue but rather to update the Exchange's rules to strengthen the Exchange's ability to carry out its oversight and enforcement functions and deter potential violative conduct.

The Exchange also believes that the proposed change to remove obsolete rules from the list of rules eligible for minor rule fines would not be inconsistent with the public interest and the protection of investors because investors will not be harmed and in fact would benefit from increased clarity and transparency, thereby reducing potential confusion.

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

Within 45 days of the date of publication of this notice in the **Federal Register** or *up to 90 days* (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve or disapprove the proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

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–2019–044 on the subject line.

Paper Comments

• Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090.

All submissions should refer to File Number SR–NYSE–2019–044. 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 website (*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 website 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 the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–NYSE–2019–044, and should be submitted on or before September 12, 2019.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[26]

Jill M. Peterson,

Assistant Secretary.

[FR Doc. 2019–18057 Filed 8–21–19; 8:45 am]

BILLING CODE 8011–01–P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–86692; File No. SR–DTC–2019–006]

Self-Regulatory Organizations; The Depository Trust Company; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Amend the Distributions Service Guide

August 16, 2019.

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 August 13, 2019, The Depository Trust Company (''DTC'') filed with the Securities and Exchange Commission (''Commission'') the proposed rule change as described in Items I, II and III below, which Items have been prepared by the clearing agency. DTC filed the proposed rule change pursuant to Section 19(b)(3)(A) of the Act[3] and Rule 19b–4(f)(4) thereunder.[4] The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

[25] 15 U.S.C. 78f(b)(6).

[26] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] 15 U.S.C. 78s(b)(3)(A).

[4] 17 CFR 240.19b–4(f)(4).

I. Clearing Agency's Statement of the Terms of Substance of the Proposed Rule Change

The proposed rule change [5] of DTC consists of amendments to the Distributions Guide to (i) update its U.S. tax withholding service (''UTW Service'') to transition functions related to the service from DTC's Participant Terminal System (''PTS'') and its Participant Brower Service (''PBS'') [6] to the Corporate Actions Web system (''CA Web'') and (ii) make ministerial and clarifying changes to text, as discussed below.

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the clearing agency 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. The clearing agency has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

(A) Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The proposed rule change would amend the Distributions Guide to (i) update the UTW Service to transition functions related to the service from PTS and PBS to CA Web and (ii) make ministerial and clarifying changes to text, as discussed below.

Transition of PTS/PBS Reorganizations Functions to CA Web

Beginning in 2012, DTC has filed a series of rule changes to update DTC's corporate action services by migrating the corporate action services for Distributions (as defined below) from PTS/PBS to CA Web, a then new browser user interface.[7] After a Participant testing phase, DTC retired PTS/PBS functions for Distributions in 2015, and the use of CA Web for processing Distributions became mandatory for all Participants.[8]

In 2016, DTC submitted a rule filing to transition PTS/PBS functions for redemptions to CA Web, and to update the Redemptions Service Guide [9] to add the appropriate references.[10] After a Participant testing phase, DTC retired PTS/PBS functions for redemptions in 2017, and the use of CA Web for processing redemptions became mandatory for all Participants.

Most recently, DTC submitted proposed changes to amend the Reorganizations Service Guide [11] for the further transition of corporate action functions to CA Web.[12]

Pursuant to the proposed rule change, DTC would transition PTS/PBS functions for the UTW Service to CA Web.

UTW Service Background

DTC offers services for processing corporate action events, including, but not limited to, the distributions service for the announcement and processing of cash and stock dividends, principal and interest, and capital gain distributions (collectively, ''Distributions'').

The U.S. Internal Revenue Code (''Code'') generally requires U.S. payors such as DTC to deduct and withhold 30 percent from U.S.-source income paid to a foreign payee, unless lower U.S. withholding tax rates or exemptions apply under provisions of the Code, regulations, or applicable tax treaties.[13]

In its role as a U.S. tax withholding agent, through the UTW Service, DTC (i) accepts from a foreign Participant instructions relevant to determining the withholding tax rates, (ii) pays dividends, interest and other securities distributions to the Participant net of appropriate taxes, if any, based on the applicable withholding rates, and (iii) reports and remits the taxes to the IRS. The UTW Service utilizes the PTS/PBS Elective Dividend Service (''EDS'') function to solicit and receive the instructions from foreign Participants.

Proposed Rule Change

While most EDS functions were moved to CA Web pursuant to the 2014 ruling, the EDS UTW Service functionality has continued to be offered through PTS and PBS. To enhance the end-to-end processing of corporate actions for Participants, DTC is proposing to move the EDS UTW Service functionality from PTS/PBS to CA Web and amend the section of the Distributions Guide titled ''U.S. Tax Withholding'' (''UTW Section'') to remove a reference that states that users of the UTW Service can access the menu item to use the service through the EDS function on PTS/PBS, and to instead state that Participants can access the UTW Service menu item on CA Web. The proposed rule change would simplify Participants' use of DTC's corporate actions by allowing foreign Participants to submit instructions relating to tax withholding within the same systemic platform as they use for other corporate action-related activity, CA Web.

Pursuant to the proposed rule change, DTC would also make the following ministerial and clarifying changes to the text of the UTW Section:

(1) DTC would delete the word ''non-withholding'' from text that states: ''To the extent allowable under U.S. federal income tax laws, UTW allows non-withholding qualified intermediaries [14] to submit withholding instructions to DTC on U.S. source income payments.'' This change would make the sentence consistent with existing U.S. tax practice where in certain circumstances a full-withholding qualified intermediary does not perform withholding and would instead instruct DTC to perform withholding on its behalf. Therefore, the distinction between a full-withholding and non-withholding qualified intermediary is no longer necessary.

(2) For the same reason cited in 1 immediately above, DTC would delete the word ''non-withholding'' from text that states: ''As a U.S. tax withholding agent, DTC: . . . Informs non-withholding QI users of the ''instruction window'' during which they must send withholding rate instructions to the depository; . . . .''

[5] Each capitalized term not otherwise defined herein has its respective meaning as set forth in the Rules, By-Laws and Organization Certificate of DTC (the ''Rules''), *available at http://www.dtcc.com/legal/rules-and-procedures.aspx,* and the Distributions Service Guide (the ''Distributions Guide''), *available at http://www.dtcc.com/~/media/Files/Downloads/legal/service-guides/Service%20Guide%20Distributions.pdf.*

[6] PTS and PBS are user interfaces for DTC's settlement and asset services functions. PTS is mainframe-based, and PBS is web-based with a mainframe back-end. Participants may use either PTS or PBS, as they are functionally equivalent. References to a particular PTS function in this rule filing include the corresponding PBS function.

[7] *See* Securities Exchange Act Release No. 68114 (October 26, 2012); 77 FR 66497 (November 5, 2012) (SR–DTC–2012–08).

[8] *See* Securities Exchange Act Release No. 73864 (December 17, 2014); 79 FR 77063 (December 23, 2014) (SR–DTC–2014–012) (''2014 Rule Filing'').

[9] *Available at http://www.dtcc.com/~/media/Files/Downloads/legal/service-guides/Redemptions.pdf.*

[10] *See* Securities Exchange Act Release No. 79746 (January 5, 2017), 82 FR 3372 (January 11, 2017) (SR–DTC–2016–014).

[11] *Available at http://www.dtcc.com/~/media/Files/Downloads/legal/service-guides/Reorganizations.pdf.*

[12] *See* Securities Exchange Act Release No. 85986 (May 31, 2019); 84 FR 26466 (June 6, 2019) (SR–DTC–2019–003).

[13] *See* Sections 1441, 1442 and 1443 of the Code and the regulations promulgated thereunder.

[14] A qualified intermediary (''QI'') is any non-U.S. intermediary (or non-U.S. branch of a U.S. intermediary) that has entered into a qualified intermediary withholding agreement with the IRS. *See* Distributions Guide, *supra* note 5.

DTC would also update the copyright date that is set forth in the ''Important Legal Information'' section of the Distributions Guide to change text that shows the copyright date as ''Copyright © 1999–2014'' to ''Copyright © 1999–2019.''

Implementation Timeframe

The proposed rule change would become effective upon filing with the Commission.

2. Statutory Basis

DTC believes that this proposal is consistent with the requirements of the Act [15] as described below.

Section 17A(b)(3)(F) of the Act requires, *inter alia,* that the Rules be designed to promote the prompt and accurate clearance and settlement of securities transactions.[16] DTC believes that the proposed rule change with respect to the migration of the processing functions described above from PTS/PBS to CA Web is consistent with this provision of the Act because it would migrate UTW Service processing to a more flexible interface that utilizes market standard language and incorporates the entire lifecycle of an event into one platform. By providing Participants with more efficient access to UTW Services, DTC believes that the proposed rule change is designed to promote the prompt and accurate clearance and settlement of securities transactions relating to Distributions, consistent with Section 17A(b)(3)(F) of the Act.[17]

DTC believes that the proposed rule change with respect to the clarification of the Distributions Guide is consistent with Section 17A(b)(3)(F) of the Act.[18] DTC believes that the proposed rule change would enhance the clarity and transparency of the Distributions Guide, which would allow a Participant to more efficiently conduct its business in connection with UTW Service processing. Therefore, DTC believes that the proposed rule change is designed to promote the prompt and accurate clearance and settlement of securities transactions related to Distributions, consistent with Section 17A(b)(3)(F) of the Act.[19]

(B) Clearing Agency's Statement on Burden on Competition

DTC believes that the proposed rule changes with respect to the migration of UTW Service processing functions from PTS/PBS to CA Web may have an impact on competition, because it would facilitate a more efficient process for communicating and processing UTW Service information. Having a more efficient process could promote competition by potentially reducing Participants' operating costs. In addition, CA Web is an existing DTC platform that all Participants are required to use to access other types of services, including other Distributions functions, reorganizations and redemptions processing, and so would not affect the rights and obligations of any Participant. Therefore, DTC believes that the proposed rule changes with respect to the migration of functions from PTS/PBS to CA Web may promote competition but would not create a burden on competition.[20]

DTC believes that the proposed rule changes with respect to clarifying the Distributions Guide would not have an impact on competition. The proposed rule changes would enhance the clarity and transparency of the Distributions Guide to better reflect DTC's UTW Services and practices. Improving the clarity and transparency of the Distributions Guide would help Participants to better understand their rights and obligations regarding DTC services, and so would not affect the rights and obligations of any Participant or other interested party.

(C) Clearing Agency's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

Written comments relating to this proposed rule change have not been solicited or received. DTC will notify the Commission of any written comments received by DTC.

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) of the Act [21] and paragraph (f) of Rule 19b–4 thereunder.[22] 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 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–DTC–2019–006 on the subject line.

Paper Comments

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549.

All submissions should refer to File Number SR–DTC–2019–006. 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 website (*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 website 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 the filing also will be available for inspection and copying at the principal office of DTC and on DTCC's website (*http://dtcc.com/legal/sec-rule-filings.aspx*). All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–DTC–2019–006 and should be submitted on or before September 12, 2019.

[15] 15 U.S.C. 78q–1.

[16] 15 U.S.C. 78q–1(b)(3)(F).

[17] *Id.*

[18] *Id.*

[19] *Id.*

[20] 15 U.S.C. 78q–1(b)(3)(I).

[21] 15 U.S.C. 78s(b)(3)(A).

[22] 17 CFR 240.19b–4(f).

[23] 17 CFR 200.30–3(a)(12).

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[23]

Jill M. Peterson,

Assistant Secretary.

[FR Doc. 2019–18056 Filed 8–21–19; 8:45 am]

BILLING CODE 8011–01–P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–86691; File No. SR–NYSEAMER–2019–31]

Self-Regulatory Organizations; NYSE American LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Amend Rule 928NY To Reduce the Minimum Allowable Parameter for the Transaction- and Volume-Based Settings in the Risk Limitation Mechanism

August 16, 2019.

Pursuant to Section 19(b)(1)[1] of the Securities Exchange Act of 1934 (the ''Act'')[2] and Rule 19b–4 thereunder,[3] notice is hereby given that on August 7, 2019, NYSE American LLC (''NYSE American'' or the ''Exchange'') 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 self-regulatory organization. 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 Rule 928NY (Risk Limitation Mechanism) to reduce the minimum allowable parameter for the transaction- and volume-based settings in the Risk Limitation Mechanism. The proposed rule change is available on the Exchange's website 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 928NY (Risk Limitation Mechanism) to reduce the minimum allowable parameter for the transaction- and volume-based settings in the Risk Limitation Mechanism. The filing would align the minimum allowable parameter for the transaction- and volume-based settings with the minimum allowable setting for the percentage-based setting, which the Exchange reduced earlier this year.[4] This proposal would allow the Exchange to (opt to) set uniform minimum exposure requirements, particularly for Market Makers who are obligated to utilize one of the three risk settings.[5]

Risk Limitation Mechanism

Rule 928NY sets forth the risk-limitation mechanism (the ''Mechanism''), which is designed to help Market Makers, as well as ATP Holders, better manage risk related to quoting and submitting orders, respectively, during periods of increased and significant trading activity.[6] The Exchange requires Market Makers to utilize a risk limitation mechanism for quotes, which automatically removes a Market Maker's quotes in all series of an options class when certain parameter settings are breached.[7] The Exchange permits, but does not require, ATP Holders (including Market Makers) to utilize its risk limitation mechanism for orders, which automatically cancels such orders when certain parameter settings are breached.[8]

Pursuant to Rule 928NY, the Exchange establishes a time period during which the Mechanism calculates for quotes and orders, respectively: (1) The number of trades executed by the Market Maker or ATP Holder in a particular options class (''transaction-based''); (2) the volume of contracts traded by the Market Maker or ATP Holder in a particular options class (''volume-based''); or (3) the aggregate percentage of the Market Maker's quoted size or ATP Holder's order size(s) executed in a particular options class (''percentage-based'') (each a ''risk setting''; collectively, the ''risk settings'').[9] If a risk setting is triggered, the Mechanism will cancel all of the Market Maker's quotes or the ATP Holder's open orders in that class until the Market Maker or ATP Holder notifies the Exchange it will resume submitting quotes or orders.[10] The temporary suspension of quotes or orders from the market that results when the risk settings are triggered is meant to operate as a safety valve that enables Market Makers and/or ATP Holders to re-evaluate their positions before requesting to re-enter the market.

Proposed Change to Minimum Parameter for Transaction- and Volume-Based Risk Settings

Per Commentary .03 to Rule 928NY, the Exchange establishes outside allowable parameters for each risk setting and announces by Trader Update ''any applicable minimum, maximum and/or default settings for the Risk Limitation Mechanisms'' that are at or within these outside parameters. ATP Holders, in turn, adjust their own risk

[1] 15 U.S.C. 78s(b)(1).

[2] 15 U.S.C. 78a.

[3] 17 CFR 240.19b–4.

[4] *See* Securities Exchange Act Release No. 85497 (April 3, 2019), 84 FR 14180 (April 9, 2019) (SR–NYSEAMER–2019–08) (lowering from 100% to one percent the minimum allowable parameter for the percentage-based risk setting). For consistency with the proposed textual changes, the Exchange proposes to modify ''1'' to ''one'' in regards to the minimum allowable percentage-based parameter. *See* proposed Commentary .03 to Rule 928NY.

[5] *See infra* note 6.

[6] Market Makers are included in the definition of ATP Holders and therefore, unless the Exchange is discussing the quoting activity of Market Makers, the Exchange does not distinguish Market Markers from ATP Holders when discussing the risk limitation mechanisms. *See* Rule 900.2NY(5) (defining ATP Holder as ''a natural person, sole proprietorship, partnership, corporation, limited liability company or other organization, in good standing, that has been issued an ATP,'' and requires that ''[a]n ATP Holder must be a registered broker or dealer pursuant to Section 15 of the Securities Exchange Act of 1934''). *See also* Rule 900.2NY(38) (providing that a Market Maker is ''an ATP Holder that acts as a Market Maker pursuant to Rule 920NY'').

[7] *See* Rule 928NY, Commentary .04(a) (providing that Market Makers are required to utilize one of the three risk settings for their quotes); and Commentary .01 (regarding the cancellation of quotes once the risk settings have been breached).

[8] *See* Rule 928NY, Commentary .04(b) (providing that ATP Holders may avail themselves of one of the three risk limitation mechanisms for certain of their orders) and Commentary .01 (regarding the cancellation of orders once the risk settings have been breached).

[9] *See* Rule 928NY(b)–(d) (setting forth the three risk limitation mechanisms available). A Market Maker may activate one Risk Limitation Mechanism for its quotes (which is required) and a different Risk Limitation Mechanism for its orders (which is optional), even if both are activated for the same class. *See also* Commentary .08 to Rule 928NY.

[10] *See* Commentaries .01 and .02 to Rule 928NY (requiring that a Market Maker or ATP Holder request that it be re-enabled after a breach of its risk settings).

settings within the Exchange-established parameters, based on risk tolerance, taking into account such factors as present and anticipated market conditions, news in an option, and/or sudden change in volatility of an option. Put another way, the rule sets forth the minimum/maximum for each risk setting and the Exchange may, but does not have to, use these settings. However, the Exchange may instead choose settings that are higher than the minimum and lower than the maximum settings (*i.e.,* if the rule allows a minimum of 1 and a maximum of 10, the Exchange could use these parameters or could instead establish a minimum of 3 and a maximum of 7). Once the Exchange determines and announces the applicable parameters for each risk setting, the ATP Holder, in turn, selects a setting within the Exchange announced parameters that suits their risk tolerance (*i.e.,* assuming the Exchange selected a minimum of 3 and a maximum of 7, the ATP Holder may select a setting of 3, 4, 5, 6 or 7).

Earlier this year—in April, the Exchange reduced from 100% to one percent the minimum allowable parameter for the percentage-based risk setting.[11] For consistency and uniformity, the Exchange now proposes to likewise adjust the minimum allowable parameter as established by Rule for the other two risk settings: transaction- and volume-based. Currently, the transaction-based risk setting has a minimum allowable parameter of three (trades) and the volume-based risk setting has a minimum allowable parameter of 20 (contracts). The Exchange proposes to reduce the minimum allowable parameter for both risk settings to one.[12] The following illustrates the potential impact should the Exchange reduce to one (1) the minimum allowable parameter for each of the transaction- and volume-based risk settings:

Examples of Impact of Reducing Transaction-Based Minimum Allowable Parameter

If a market participant utilizing the transaction-based risk setting has interest in three series of the same underlying (A, B and C), for 10 contracts each, and the market participant has set the exposure risk to three, a single execution of any size in each series (A, B and C) or a combination of three executions of any size in any series (A, B or C) would result in the remaining interest in the class being canceled. In this case, because the Mechanism is counting the number of executions, the participant can be at risk for any number of executions from 3 to thirty. However, if only two executions occur, no other interest would be canceled. If there is a subsequent execution within the applicable time period[13] for any number of contracts, the remaining interest in the class would be canceled.

If the same facts as above, but instead the participant's exposure risk is set to 1 transaction (as opposed to 3), a single execution in any series for any number of contracts, would result in the remaining interest in the class being canceled.

Examples of Impact of Reducing Volume-Based Minimum Allowable Parameter

If a market participant utilizing the volume-based risk setting has interest in three series of the same underlying (A, B and C), for 10 contracts each, and the market participant has set the exposure risk to 20 contracts, any combination of executions across the three series that total twenty or more contracts would result in the remaining interest in the class being canceled. In this case, because the Mechanism is counting the volume (or number) of contracts executed, the participant can be at risk for any number of contracts from 20 to 29 (executions of 10 contracts in series A and 9 contracts in series B would not cause cancelation, but a subsequent execution of any number of contracts in series C within the applicable time period[14] would result in the remaining interest in the class being canceled).

If the same facts as above, but instead the participant's exposure risk is set to 1 contract (as opposed to 20), an execution in any series for any number of contracts, will result in the remaining interest in the class being canceled.

* * * * *

The proposed reduction of the minimum parameter for each of the transaction- and volume-based risk settings was specifically requested by some ATP Holders and would inure to their benefit as it would allow the Exchange to offer more sensitive risk controls.

The Exchange notes that it is not modifying the maximum threshold for either of the transaction or volume-based settings, which provide ATP Holders, and Market Makers in particular, the ability to more finely calibrate their risk exposure.[15] The Exchange believes a modification to the minimum parameter for these risk settings would account for increased market volatility and fragmentation, as well as the ever-increasing automation, speed and volume transacted in today's electronic trading environment. In this regard, this proposed change would provide the Exchange with more flexibility within which to establish the lower bound risk parameter for ATP Holders that use this risk setting. To the extent this flexibility is utilized, the Exchange believes this should afford such ATP Holders the ability to better calibrate and manage risk.[16]

Implementation

The Exchange will announce by Trader Update the implementation date of the proposed rule change.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,[17] in general, and furthers the objectives of Section 6(b)(5) of the Act,[18] 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 regulating, clearing, settling, processing information with respect to, and 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.

ATP Holders are vulnerable to the risk from a system or other error or a market event that may cause them to send a large number of orders or receive multiple, automatic executions before they can adjust their exposure in the market. Without adequate risk

[11] *See supra* note 4.

[12] *See* proposed Commentary .03 to Rule 928NY. The manner in which Rule 928NY operates is not being amended in this rule change.

[13] *See* Commentary .03 to Rule 928NY (providing that the Exchange will specify via Trader Update "any applicable time period(s) for the Risk Limitation Mechanisms; provided, however, that the Exchange will not specify a time period of less than 100 milliseconds").

[14] *See id.*

[15] In 2016, the Exchange modified both the upper and lower bound of the transaction-based setting and only the upper bound of the volume-based (as well as the upper bound of the percentage-based) risk setting. *See* Securities Exchange Act Release No. 79468 (December 5, 2016), 81 FR 89160 (December 9, 2016) (SR–NYSEMKT–2016–110). *See also* Securities Exchange Act Release No. 67713 (August 22, 2012), 77 FR 52090 (August 28, 2012) (SR–NYSEMKT–2012–39) (immediate effective filing to introduce minimum and maximum parameters for the risk settings).

[16] The Exchange would still announce by Trader Update the actual minimum setting for the transaction- and volume-based risk settings, which may be the same as or greater than the proposed minimum parameter of one (1) (but no greater than the maximum allowable transaction- or volume-based setting, as applicable). *See* Commentary .03 to Rule 928NY.

[17] 15 U.S.C. 78f(b).

[18] 15 U.S.C. 78f(b)(5).

management tools, such as the available risk settings, ATP Holders may opt to reduce the amount of order flow and liquidity that they provide to the market, which could undermine the quality of the markets available to market participants. The Exchange believes that the proposed reduction of the minimum parameter for each of the transaction- and volume-based risk settings would remove impediments to and perfect the mechanism of a free and open market by providing the Exchange with more flexibility within which to establish the appropriate lower bound of these risk settings, in consideration of market conditions, which would enable this risk setting to operate in the manner intended to the benefit of all market participants. To the extent this flexibility is utilized, the Exchange believes this should afford ATP Holders that utilize this risk setting the ability to better calibrate and manage risk.

Further, this proposed change, which was specifically requested by some ATP Holders, would remove impediments to and perfect the mechanism of a free and open market because it would be available to all ATP Holders (if the Exchange chooses to reduce the minimum parameter—down to one (1)—for one or both of the transaction- and volume-based risk settings) and may encourage more ATP Holders to utilize the transaction- or volume-based risk settings, specifically, or the risk settings generally, which would benefit all market participants. The Exchange believes this proposal has the potential to help ATP Holders better manage their risk as it would allow for more precise customization of their risk settings which would, in turn, help ATP Holders avoid trading a number of contracts that exceeds the ATP Holder's risk tolerance level. In particular, this proposed reduction in the minimum allowable parameter would mean that the Exchange has the ability to set a minimum as low as one (1) for each of the three risk settings.[19]

The Exchange notes that other options exchanges offer risk settings for quotes and orders, including analogous transaction- and volume-based settings. For example, Rule 21.16, Risk Monitor Mechanism, on both Cboe BZX Exchange, Inc. (''BZX'') and Cboe EDGX Exchange, Inc. (''EDGX'') states that each BZX or EDGX Member may (but is not required to) configure a single counting program or multiple counting programs to govern its trading activity (*i.e.,* on a per port basis).[20] Just as with the Exchange's risk settings, both BZX and EDGX offer risk settings based on the number of contracts (or ''volume'') executed and the number of executions (or ''count'') within a time period designated by the BZX/EDGX member (collectively, the ''risk limits'').[21] These risk limits are calculated similarly to the risk setting on the Exchange: For each series of an option class, the number of executions or contracts traded (depending on the applicable risk setting) are counted and when they reach the applicable threshold, the risk protections are activated. Unlike the Exchange's rule, which establishes potential minimum and maximum settings to be determined by the Exchange, BZX/EDGX Rule 21.16 has no minimum equivalent, which would allow the Member (whether orders or market maker quotes) to set its risk settings for its trading activity as low as one contract or one execution. And unlike the Exchange, BZX/EDGX do not require its market makers to establish risk settings for quotes, nor does it impose a default setting for participants that do not establish such risk settings. The proposed change would authorize the Exchange to set the minimum parameters for the transaction- and volume-based to be as low as one trade or one contract, as applicable, which would thus allow the Exchange's rule to align with the minimum per the percentage-based risk setting as well as with the BZX/EDGX rule.[22] The Exchange believes that this proposal is consistent with the BXZ/EDGX rules that allow order senders (*i.e.,* including non-Market Makers) to use a transactional- or volume-based risk parameter that may be set as low as one execution or one contract.

Cboe Exchange Inc. (''Cboe'') Rule 8.18, Quote Risk Monitor (''QRM'') likewise requires risk settings that apply solely to quotes. For each such option class in which the Cboe market maker is engaged in trading, that market maker must establish ''a maximum number of contracts for such option class and ''the maximum number of series for which either side of the quote is fully traded.[23] While Cboe requires a maximum for each of these risk settings, it does not require or set a minimum. In addition, Nasdaq PHLX (''PHLX'')—like the Exchange and Cboe—also requires its market makers to utilize one of its risk settings (either volume-based or percentage-based) for quotes.[24] PHLX's volume-based risk setting operates similar to the Exchange's analogous setting, except that the PHLX market maker need only establish a maximum volume threshold that, when reached, will trigger PHLX to remove that market maker's quotes.[25] The Exchange believes that this proposal is consistent with the Cboe and PHLX rules that require market makers on those exchanges to use a risk parameter that may be set as low as one contract or one execution, given that those exchanges only require that a maximum threshold be selected.

Finally, the Exchange also believes that the proposed rule change would promote just and equitable principles of trade because Market Makers have the option to select any one of the three risk settings for quotes and non-Market Makers have this same option or may choose to utilize no risk settings at all. Thus, this proposal merely provides the Exchange additional latitude in establishing the potential minimum for the transaction- and volume-based risk settings and may encourage more ATP Holders to utilize these or the third (percentage-based) risk setting, which benefits all market participants.

The Exchange believes the technical change replacing ''one'' for ''1'' with regard to the minimum allowable percentage-based parameter change would promote just and equitable principles of trade because it would add internal consistency to Exchange rules.

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. The

[19] *See supra* note 4.

[20] *See* BZX and EDGX Rule 21.16(a)(i)–(iv) (providing optional risk control settings). On each market (BZX and EDGX), risk setting limits have been reached, the Risk Monitor Mechanism cancels or rejects such Member's orders or quotes in all underlying securities and cancels or rejects any additional orders or quotes. *See* BZX and EDGX Rule 21.16(b)(i)–(iii).

[21] *See* BZX and EDGX Rule 21.16(a)(i), (iii) (setting forth volume and count risk settings). *See also* BZX and EDGX Rule 21.16(a)(iv) (setting forth percentage-based setting).

[22] The Exchange notes that other options in exchanges in the Cboe family offer a similar Risk Monitor Mechanism. *See, e.g.,* Cboe C2 Exchange, Inc. (''C2'') Rule 6.14(c)(5)(A)(i)–(v) (setting forth risk settings, with paragraphs (i) and (iii) setting forth the volume- and count (or transaction)-based setting, each of which mirror those offered by BZX and EDGX). *See also* Securities Exchange Act Release No. 84778 (December 10, 2018), 83 FR 64384 (December 14, 2018) (SR–CboeEDGX–2018–058) (immediately effective EDGX filing to harmonize risk mechanism to that of its affiliated exchange, C2 in Rule 21.16).

[23] The Exchange notes that the QRM also allows Cboe market makers to establish ''a maximum cumulative percentage'' that the market maker is willing to trade, where the cumulative percentage is the sum of the percentages of the original quoted size of each side of each series that traded, and a Measurement Interval.'' *See* Cboe Rule 8.18.

[24] *See* PHLX Rule 1099(c)(2)(A),(B).

[25] *See* PHLX Rule 1099(c)(2)(B).

Exchange is proposing a minimum parameter for two of its risk settings that would provide the Exchange with greater flexibility in establishing the appropriate lower bound of the transaction and volume-based settings, which may in turn provide ATP Holders that utilize this setting with greater control and flexibility over setting their risk tolerance and, potentially, more protection over risk exposure. The proposal is structured to offer the same enhancement to all ATP Holders, regardless of size, and would not impose a competitive burden on any participant. The proposal may foster competition among Market Makers by providing them with the ability to enhance and customize their settings in order to compete for executions and order flow.

The Exchange does not believe that the proposed enhancement to the existing risk limitation mechanism would impose a burden on competing options exchanges. Rather, it provides ATP Holders with the opportunity to avail themselves of risk settings for quotes and orders that are consistent with such tools currently available on BZX, EDGX, Cboe and PHLX.[26]

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, it has become effective pursuant to Section 19(b)(3)(A) of the Act[27] and Rule 19b–4(f)(6) thereunder.[28]

A proposed rule change filed pursuant to Rule 19b–4(f)(6) under the Act[29] normally does not become operative for 30 days after the date of its filing. However, Rule 19b–4(f)(6)(iii)[30] 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 requested that the Commission waive the 30-day operative delay so that the proposed rule change may become operative upon filing. The Exchange states that such waiver would allow the Exchange to implement without delay the proposed functionality and compete more evenly with other exchanges that offer similar functionality for quotes and orders. Therefore, the Commission believes that waiver of the 30-day operative delay is consistent with the protection of investors and the public interest. Accordingly, the Commission hereby waives the operative delay and designates the proposed rule change operative upon filing.[31]

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. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule change should be approved or disapproved.

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–NYSEAMER–2019–31 on the subject line.

Paper Comments

• Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090.

All submissions should refer to File Number SR–NYSEAMER–2019–31. 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 website (*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 website 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 the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–NYSEAMER–2019–31 and should be submitted on or before September 12, 2019.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[32]

Jill M. Peterson,

Assistant Secretary.

[FR Doc. 2019–18055 Filed 8–21–19; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–86697; File No. SR–NYSEArca–2019–59]

Self-Regulatory Organizations; NYSE Arca, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Amend Rule 6.40–O To Reduce the Minimum Allowable Parameter for the Transaction- and Volume-Based Settings in the Risk Limitation Mechanism

August 16, 2019.

Pursuant to Section 19(b)(1)[1] of the Securities Exchange Act of 1934 (the

[26] *See supra* notes 20–25.

[27] 15 U.S.C. 78s(b)(3)(A).

[28] 17 CFR 240.19b–4(f)(6). In addition, Rule 19b–4(f)(6)(iii) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change, along with a brief description and 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. The Exchange has satisfied this requirement.

[29] 17 CFR 240.19b–4(f)(6).

[30] 17 CFR 240.19b–4(f)(6)(iii).

[31] For purposes only of waiving the 30-day operative delay, the Commission also has considered the proposed rule's impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

[32] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

''Act'')[2] and Rule 19b–4 thereunder,[3] notice is hereby given that, on August 7, 2019, NYSE Arca, Inc. (''NYSE Arca'' or the ''Exchange'') 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 self-regulatory organization. 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 Rule 6.40–O (Risk Limitation Mechanism) to reduce the minimum allowable parameter for the transaction- and volume-based settings in the Risk Limitation Mechanism. The proposed rule change is available on the Exchange's website 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 6.40–O (Risk Limitation Mechanism) to reduce the minimum allowable parameter for the transaction- and volume-based settings in the Risk Limitation Mechanism. The filing would align the minimum allowable parameter for the transaction- and volume-based settings with the minimum allowable setting for the percentage-based setting, which the Exchange reduced earlier this year.[4] This proposal would allow the Exchange to (opt to) set uniform minimum exposure requirements, particularly for Market Makers who are obligated to utilize one of the three risk settings.[5]

Risk Limitation Mechanism

Rule 6.40–O sets forth the risk-limitation mechanism (the ''Mechanism''), which is designed to help Market Makers, as well as OTP Holder and OTP Firms (collectively, ''OTPs''), better manage risk related to quoting and submitting orders, respectively, during periods of increased and significant trading activity.[6] The Exchange requires Market Makers to utilize a risk limitation mechanism for quotes, which automatically removes a Market Maker's quotes in all series of an options class when certain parameter settings are breached.[7] The Exchange permits, but does not require, OTPs (including Market Makers) to utilize its risk limitation mechanism for orders, which automatically cancels such orders when certain parameter settings are breached.[8]

Pursuant to Rule 6.40–O, the Exchange establishes a time period during which the Mechanism calculates for quotes and orders, respectively: (1) The number of trades executed by the Market Maker or OTP in a particular options class (''transaction-based''); (2) the volume of contracts traded by the Market Maker or OTP in a particular options class (''volume-based''); or (3) the aggregate percentage of the Market Maker's quoted size or OTP's order size(s) executed in a particular options class (''percentage-based'') (each a ''risk setting''; collectively, the ''risk settings'').[9] If a risk setting is triggered, the Mechanism will cancel all of the Market Maker's quotes or the OTP's open orders in that class until the Market Maker or OTP notifies the Exchange it will resume submitting quotes or orders.[10] The temporary suspension of quotes or orders from the market that results when the risk settings are triggered is meant to operate as a safety valve that enables Market Makers and/or OTPs to re-evaluate their positions before requesting to re-enter the market.

Proposed Change to Minimum Parameter for Transaction- and Volume-Based Risk Settings

Per Commentary .03 to Rule 6.40–O, the Exchange establishes outside allowable parameters for each risk setting and announces by Trader Update ''any applicable minimum, maximum and/or default settings for the Risk Limitation Mechanisms'' that are at or within these outside parameters. OTPs, in turn, adjust their own risk settings within the Exchange-established parameters, based on risk tolerance, taking into account such factors as present and anticipated market conditions, news in an option, and/or sudden change in volatility of an option. Put another way, the rule sets forth the minimum/maximum for each risk setting and the Exchange may, but does not have to, use these settings. However, the Exchange may instead choose settings that are higher than the minimum and lower than the maximum settings (*i.e.,* if the rule allows a minimum of 1 and a maximum of 10, the Exchange could use these parameters or could instead establish a minimum of 3 and a maximum of 7). Once the Exchange determines and announces the applicable parameters for each risk setting, the OTP, in turn, selects a setting within the Exchange announced parameters that suits their risk tolerance (*i.e.,* assuming the Exchange selected a minimum of 3 and

[2] 15 U.S.C. 78a.

[3] 17 CFR 240.19b–4.

[4] *See* Securities Exchange Act Release No. 85494 (April 3, 2019), 84 FR 14166 (April 9, 2019) (SR–NYSEArca–2019–18) (lowering from 100% to one percent the minimum allowable parameter for the percentage-based risk setting). For consistency with the proposed textual changes, the Exchange proposes to modify ''1'' to ''one'' in regards to the minimum allowable percentage-based parameter. *See* proposed Commentary .03 to Rule 6.40–O.

[5] *See infra* note 6.

[6] Market Makers are included in the definition of OTPs and therefore, unless the Exchange is discussing the quoting activity of Market Makers, the Exchange does not distinguish Market Markers from OTPs when discussing the risk limitation mechanisms. *See* Rule 1.1(nn) (defining OTP Holder as ''a natural person, in good standing, who has been issued an OTP, or has been named as a Nominee'' that is ''a registered broker or dealer pursuant to Section 15 of the Securities Exchange Act of 1934, or a nominee or an associated person of a registered broker or dealer that has been approved by the Exchange to conduct business on the Exchange's Trading Facilities''). *See also* Rule 6.32–O(a) (defining a Market Maker as an individual ''registered with the Exchange for the purpose of making transactions as a dealer-specialist on the Floor of the Exchange or for the purpose of submitting quotes electronically and making transactions as a dealer-specialist through the NYSE Arca OX electronic trading system'').

[7] *See* Rule 6.40–O, Commentary .04(a) (providing that Market Makers are required to utilize one of the three risk settings for their quotes); and Commentary .01 (regarding the cancellation of quotes once the risk settings have been breached).

[8] *See* Rule 6.40–O, Commentary .04(b) (providing that OTPs may avail themselves of one of the three risk limitation mechanisms for certain of their orders) and Commentary .01 (regarding the cancellation of orders once the risk settings have been breached).

[9] *See* Rule 6.40–O (b)–(d) (setting forth the three risk limitation mechanisms available). A Market Maker may activate one Risk Limitation Mechanism for its quotes (which is required) and a different Risk Limitation Mechanism for its orders (which is optional), even if both are activated for the same class. *See also* Commentary .08 to Rule 6.40–O.

[10] *See* Commentaries .01 and .02 to Rule 6.40–O (requiring that a Market Maker or OTP Holder request that it be re-enabled after a breach of its risk settings).

a maximum of 7, the OTP may select a setting of 3, 4, 5, 6 or 7).

Earlier this year—in April, the Exchange reduced from 100% to one percent the minimum allowable parameter for the percentage-based risk setting.[11] For consistency and uniformity, the Exchange now proposes to likewise adjust the minimum allowable parameter as established by Rule for the other two risk settings: Transaction- and volume-based. Currently, the transaction-based risk setting has a minimum allowable parameter of three (trades) and the volume-based risk setting has a minimum allowable parameter of 20 (contracts). The Exchange proposes to reduce the minimum allowable parameter for both risk settings to one.[12] The following illustrates the potential impact should the Exchange reduce to one (1) the minimum allowable parameter for each of the transaction- and volume-based risk settings:

Examples of Impact of Reducing Transaction-Based Minimum Allowable Parameter

If a market participant utilizing the transaction-based risk setting has interest in three series of the same underlying (A, B and C), for 10 contracts each, and the market participant has set the exposure risk to three, a single execution of any size in each series (A, B and C) or a combination of three executions of any size in any series (A, B or C) would result in the remaining interest in the class being canceled. In this case, because the Mechanism is counting the number of executions, the participant can be at risk for any number of executions from 3 to thirty. However, if only two executions occur, no other interest would be canceled. If there is a subsequent execution within the applicable time period[13] for any number of contracts, the remaining interest in the class would be canceled.

If the same facts as above, but instead the participant's exposure risk is set to 1 transaction (as opposed to 3), a single execution in any series for any number of contracts, would result in the remaining interest in the class being canceled.

Examples of Impact of Reducing Volume-Based Minimum Allowable Parameter

If a market participant utilizing the volume-based risk setting has interest in three series of the same underlying (A, B and C), for 10 contracts each, and the market participant has set the exposure risk to 20 contracts, any combination of executions across the three series that total twenty or more contracts would result in the remaining interest in the class being canceled. In this case, because the Mechanism is counting the volume (or number) of contracts executed, the participant can be at risk for any number of contracts from 20 to 29 (executions of 10 contracts in series A and 9 contracts in series B would not cause cancelation, but a subsequent execution of any number of contracts in series C within the applicable time period[14] would result in the remaining interest in the class being canceled).

If the same facts as above, but instead the participant's exposure risk is set to 1 contract (as opposed to 20), an execution in any series for any number of contracts, will result in the remaining interest in the class being canceled.

* * * * *

The proposed reduction of the minimum parameter for each of the transaction- and volume-based risk settings was specifically requested by some OTPs and would inure to their benefit as it would allow the Exchange to offer more sensitive risk controls. The Exchange notes that it is not modifying the maximum threshold for either of the transaction or volume-based settings, which provide OTPs, and Market Makers in particular, the ability to more finely calibrate their risk exposure.[15] The Exchange believes a modification to the minimum parameter for these risk settings would account for increased market volatility and fragmentation, as well as the ever-increasing automation, speed and volume transacted in today's electronic trading environment. In this regard, this proposed change would provide the Exchange with more flexibility within which to establish the lower bound risk parameter for OTPs that use this risk setting. To the extent this flexibility is utilized, the Exchange believes this should afford such OTPs the ability to better calibrate and manage risk.[16]

Implementation

The Exchange will announce by Trader Update the implementation date of the proposed rule change.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,[17] in general, and furthers the objectives of Section 6(b)(5) of the Act,[18] 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 regulating, clearing, settling, processing information with respect to, and 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.

OTPs are vulnerable to the risk from a system or other error or a market event that may cause them to send a large number of orders or receive multiple, automatic executions before they can adjust their exposure in the market. Without adequate risk management tools, such as the available risk settings, OTPs may opt to reduce the amount of order flow and liquidity that they provide to the market, which could undermine the quality of the markets available to market participants. The Exchange believes that the proposed reduction of the minimum parameter for each of the transaction- and volume-based risk settings would remove impediments to and perfect the mechanism of a free and open market by providing the Exchange with more flexibility within which to establish the appropriate lower bound of these risk settings, in consideration of market conditions, which would enable this risk setting to operate in the manner intended to the benefit of all market participants. To the extent this flexibility is utilized, the Exchange believes this should afford OTPs that utilize this risk setting the ability to better calibrate and manage risk.

[11] *See supra* note 4.

[12] *See* proposed Commentary .03 to Rule 6.40–O. The manner in which Rule 6.40–O operates is not being amended in this rule change.

[13] *See* Commentary .03 to Rule 6.40–O (providing that the Exchange will specify via Trader Update "any applicable time period(s) for the Risk Limitation Mechanisms; provided, however, that the Exchange will not specify a time period of less than 100 milliseconds").

[14] *See id.*

[15] In 2016, the Exchange modified both the upper and lower bound of the transaction-based setting and only the upper bound of the volume-based (as well as the upper bound of the percentage-based) risk setting. *See* Securities Exchange Act Release No. 79469 (December 5, 2016), 81 FR 89171 (December 9, 2016) (NYSEArca–2016–155). *See also* Securities Exchange Act Release No. 67714 (August 22, 2012), 77 FR 52104 (August 28, 2012) (NYSEArca–2012–87) (immediate effective filing to introduce minimum and maximum parameters for the risk settings).

[16] The Exchange would still announce by Trader Update the actual minimum setting for the transaction- and volume-based risk settings, which may be the same as or greater than the proposed minimum parameter of one (1) (but no greater than the maximum allowable transaction- or volume-based setting, as applicable). *See* Commentary .03 to Rule 6.40–O.

[17] 15 U.S.C. 78f(b).

[18] 15 U.S.C. 78f(b)(5).

Further, this proposed change, which was specifically requested by some OTPs, would remove impediments to and perfect the mechanism of a free and open market because it would be available to all OTPs (if the Exchange chooses to reduce the minimum parameter—down to one (1)—for one or both of the transaction- and volume-based risk settings) and may encourage more OTPs to utilize the transaction- or volume-based risk settings, specifically, or the risk settings generally, which would benefit all market participants. The Exchange believes this proposal has the potential to help OTPs better manage their risk as it would allow for more precise customization of their risk settings which would, in turn, help OTPs avoid trading a number of contracts that exceeds the OTP's risk tolerance level. In particular, this proposed reduction in the minimum allowable parameter would mean that the Exchange has the ability to set a minimum as low as one (1) for each of the three risk settings.[19]

The Exchange notes that other options exchanges offer risk settings for quotes and orders, including analogous transaction- and volume-based settings. For example, Rule 21.16, Risk Monitor Mechanism, on both Cboe BZX Exchange, Inc. (''BZX'') and Cboe EDGX Exchange, Inc. (''EDGX'') states that each BZX or EDGX Member may (but is not required to) configure a single counting program or multiple counting programs to govern its trading activity (*i.e.,* on a per port basis).[20] Just as with the Exchange's risk settings, both BZX and EDGX offer risk settings based on the number of contracts (or ''volume'') executed and the number of executions (or ''count'') within a time period designated by the BZX/EDGX member (collectively, the ''risk limits'').[21] These risk limits are calculated similarly to the risk setting on the Exchange: For each series of an option class, the number of executions or contracts traded (depending on the applicable risk setting) are counted and when they reach the applicable threshold, the risk protections are activated. Unlike the Exchange's rule, which establishes potential minimum and maximum settings to be determined by the Exchange, BZX/EDGX Rule 21.16 has no minimum equivalent, which would allow the Member (whether orders or market maker quotes) to set its risk settings for its trading activity as low as one contract or one execution. And unlike the Exchange, BZX/EDGX do not require its market makers to establish risk settings for quotes, nor does it impose a default setting for participants that do not establish such risk settings. The proposed change would authorize the Exchange to set the minimum parameters for the transaction- and volume-based to be as low as one trade or one contract, as applicable, which would thus allow the Exchange's rule to align with the minimum per the percentage-based risk setting as well as with the BZX/EDGX rule.[22] The Exchange believes that this proposal is consistent with the BXZ/EDGX rules that allow order senders (*i.e.,* including non-Market Makers) to use a transactional- or volume-based risk parameter that may be set as low as one execution or one contract.

Cboe Exchange Inc. (''Cboe'') Rule 8.18, Quote Risk Monitor (''QRM'') likewise requires risk settings that apply solely to quotes. For each such option class in which the Cboe market maker is engaged in trading, that market maker must establish ''a maximum number of contracts for such option class and ''the maximum number of series for which either side of the quote is fully traded.[23] While Cboe requires a maximum for each of these risk settings, it does not require or set a minimum. In addition, Nasdaq PHLX (''PHLX'')—like the Exchange and Cboe—also requires its market makers to utilize one of its risk settings (either volume-based or percentage-based) for quotes.[24] PHLX's volume-based risk setting operates similar to the Exchange's analogous setting, except that the PHLX market maker need only establish a maximum volume threshold that, when reached, will trigger PHLX to remove that market maker's quotes.[25] The Exchange believes that this proposal is consistent with the Cboe and PHLX rules that require market makers on those exchanges to use a risk parameter that may be set as low as one contract or one execution, given that those exchanges only require that a maximum threshold be selected.

Finally, the Exchange also believes that the proposed rule change would promote just and equitable principles of trade because Market Makers have the option to select any one of the three risk settings for quotes and non-Market Makers have this same option or may choose to utilize no risk settings at all. Thus, this proposal merely provides the Exchange additional latitude in establishing the potential minimum for the transaction- and volume-based risk settings and may encourage more OTPs to utilize these or the third (percentage-based) risk setting, which benefits all market participants.

The Exchange believes the technical change replacing ''one'' for ''1'' with regard to the minimum allowable percentage-based parameter change would promote just and equitable principles of trade because it would add internal consistency to Exchange rules.

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. The Exchange is proposing a minimum parameter for two of its risk settings that would provide the Exchange with greater flexibility in establishing the appropriate lower bound of the transaction and volume-based settings, which may in turn provide OTPs that utilize this setting with greater control and flexibility over setting their risk tolerance and, potentially, more protection over risk exposure. The proposal is structured to offer the same enhancement to all OTPs, regardless of size, and would not impose a competitive burden on any participant. The proposal may foster competition among Market Makers by providing them with the ability to enhance and customize their settings in order to compete for executions and order flow.

The Exchange does not believe that the proposed enhancement to the existing risk limitation mechanism would impose a burden on competing options exchanges. Rather, it provides OTPs with the opportunity to avail

[19] *See supra* note 4.

[20] *See* BZX and EDGX Rule 21.16(a)(i)–(iv) (providing optional risk control settings). On each market (BZX and EDGX), risk setting limits have been reached, the Risk Monitor Mechanism cancels or rejects such Member's orders or quotes in all underlying securities and cancels or rejects any additional orders or quotes. *See* BZX and EDGX Rule 21.16(b)(i)–(iii).

[21] *See* BZX and EDGX Rule 21.16(a)(i), (iii) (setting forth volume and count risk settings). *See also* BZX and EDGX Rule 21.16(a)(iv) (setting forth percentage-based setting).

[22] The Exchange notes that other options in exchanges in the Cboe family offer a similar Risk Monitor Mechanism. *See, e.g.,* Cboe C2 Exchange, Inc. (''C2'') Rule 6.14(c)(5)(A)(i)–(v) (setting forth risk settings, with paragraphs (i) and (iii) setting forth the volume- and count (or transaction)-based setting, each of which mirror those offered by BZX and EDGX). *See also* Securities Exchange Act Release No. 84778 (December 10, 2018), 83 FR 64384 (December 14, 2018) (SR–CboeEDGX–2018–058) (immediately effective EDGX filing to harmonize risk mechanism to that of its affiliated exchange, C2 in Rule 21.16).

[23] The Exchange notes that the QRM also allows Cboe market makers to establish ''a maximum cumulative percentage'' that the market maker is willing to trade, where the cumulative percentage is the sum of the percentages of the original quoted size of each side of each series that traded, and a Measurement Interval.'' *See* Cboe Rule 8.18.

[24] *See* PHLX Rule 1099(c)(2)(A),(B).

[25] *See* PHLX Rule 1099(c)(2)(B).

themselves of risk settings for quotes and orders that are consistent with such tools currently available on BZX, EDGX, Cboe and PHLX.[26]

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, it has become effective pursuant to Section 19(b)(3)(A) of the Act[27] and Rule 19b–4(f)(6) thereunder.[28]

A proposed rule change filed pursuant to Rule 19b–4(f)(6) under the Act[29] normally does not become operative for 30 days after the date of its filing. However, Rule 19b–4(f)(6)(iii)[30] 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 requested that the Commission waive the 30-day operative delay so that the proposed rule change may become operative upon filing. The Exchange states that such waiver would allow the Exchange to implement without delay the proposed functionality and compete more evenly with other exchanges that offer similar functionality for quotes and orders. Therefore, the Commission believes that waiver of the 30-day operative delay is consistent with the protection of investors and the public interest. Accordingly, the Commission hereby waives the operative delay and designates the proposed rule change operative upon filing.[31]

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. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule change should be approved or disapproved.

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–NYSEArca–2019–59 on the subject line.

Paper Comments

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090.

All submissions should refer to File Number SR–NYSEArca–2019–59. 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 website (*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 website 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 the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–NYSEArca–2019–59 and should be submitted on or before September 12, 2019.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[32]

Jill M. Peterson,

Assistant Secretary.

[FR Doc. 2019–18058 Filed 8–21–19; 8:45 am]

BILLING CODE 8011–01–P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–86695; File No. SR–Phlx–2019–28]

Self-Regulatory Organizations; Nasdaq PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Amend Exchange Rules 605 and 1049

August 16, 2019.

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 August 5, 2019, Nasdaq PHLX LLC (''Phlx'' or ''Exchange'') filed with the Securities and Exchange Commission (''SEC'' or ''Commission'') the proposed rule change as described in Items I, II, and III, 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 Substance of the Proposed Rule Change

The Exchange proposes to amend Exchange Rules 605 and 1049, titled ''Advertisements, Market Letters, Research Reports and Sales Literature'' and ''Options Communications.

The text of the proposed rule change is available on the Exchange's website at *http://nasdaqphlx.cchwallstreet.com/*, at the principal office of the Exchange, and at the Commission's Public Reference Room.

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[26] *See supra* notes 20–25.

[27] 15 U.S.C. 78s(b)(3)(A).

[28] 17 CFR 240.19b–4(f)(6). In addition, Rule 19b–4(f)(6)(iii) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change, along with a brief description and 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. The Exchange has satisfied this requirement.

[29] 17 CFR 240.19b–4(f)(6).

[30] 17 CFR 240.19b–4(f)(6)(iii).

[31] For purposes only of waiving the 30-day operative delay, the Commission also has considered the proposed rule's impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

[32] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

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 these 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 aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The purpose of this rule change is to adopt advertising requirements within Rules 605 and 1049, titled, ''Advertisements, Market Letters, Research Reports and Sales Literature'' and ''Options Communications''. The changes are described in more detail below.

Definitions

The Exchange proposes to amend Rules 605 and 1049 to incorporate by reference Financial Industry Regulatory Authority (''FINRA'') Rules 2210 (''FINRA 2210'') and 2220 (''FINRA 2220''), respectively, as rules of Phlx. These proposed rule changes will apply the same advertising requirements applicable to members of Nasdaq Stock Market LLC (''Nasdaq'') and Nasdaq Options Market (''NOM'') to Phlx. Nasdaq incorporated FINRA 2210 by reference in 2006.[3] Similarly, Section 22 of Chapter XI of NOM Rules incorporated FINRA rules regarding communications with the public in 2008.[4] The proposed rule changes will require members of Phlx to comply with FINRA 2210 and FINRA 2220 when issuing any communication to the public. Specifically, Phlx Rule 605 would require a Phlx member to comply with FINRA 2210 as if it were a rule of Phlx itself.[5] Likewise, Phlx Rule 1049 would require a Phlx member to comply with FINRA 2220 as if it were a rule of Phlx itself.[6]

The Exchange believes that requiring Phlx members to comply with FINRA 2210 and FINRA 2220 will provide consistency of marketing materials used by members of Nasdaq, NOM and Phlx as well as harness the knowledge and expertise of FINRA in their review of marketing materials.[7] Furthermore, the proposed rule change will impose a heightened standard on Phlx members in comparison to existing Phlx Rule 605 which simply calls for either the Phlx member, a general partner or holder of voting stock in the member to have endorsed their approval of the communication prior to publication or distribution.[8]

FINRA 2210(b)(1)(A) requires an appropriately qualified registered principal to approve each retail communication before the earlier of its use or filing with FINRA's Advertising Regulation Department. The requirements of FINRA 2210(b)(1)(A) may be satisfied by a Supervisory Analyst approved pursuant to FINRA Rule 1220(a)(14) [9] with respect to (i) research reports on debt and equity securities as described in FINRA Rule 2241(a)(11) and FINRA Rule 2242(a)(3); (ii) retail communications as described in FINRA Rule 2241(a)(11)(A) and FINRA Rule 2242(a)(3)(A); and (iii) other research communications, provided that the Supervisory Analyst has technical expertise in the particular product area. A Supervisory Analyst may not approve a retail communication that requires a separate registration unless the Supervisory Analyst also has such other registration.

The Exchange believes the application of FINRA 2210 to the Exchange's membership will benefit the broader marketplace by adopting FINRA's requirement that marketing materials be reviewed by appropriately qualified registered principals of a member. This will promote the public interest by helping to prevent inaccurate or misleading information going to investors. We note that Phlx Rule 1049 is similar in substance to FINRA Rule 2220.[10]

The proposed rule change will not create a burdensome compliance obligation for Phlx members. Of the existing one hundred sixteen members of Phlx, ninety-one are also members of Nasdaq. In light of the overlap in membership of the two exchanges, the proposed rule changes will allow for easier compliance with rules of both exchanges since members of both exchanges will now have identical compliance obligations with respect to communications with the public.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,[11] in general, and furthers the objectives of Section 6(b)(5) of the Act,[12] in particular, in that it is designed to promote just and equitable

[3] *See* Securities Exchange Act Release No. 53128, (January 13, 2006), 71 FR 3550 (January 23, 2006) (In the Matter of the Application of the Nasdaq Stock Market LLC for Registration as a National Securities Exchange; Findings, Opinion, and Order of the Commission), which approved the incorporation by reference of NASD Rule 2210, among others, into the Nasdaq rulebook. *See also* Securities Exchange Act Release No. 85188 (February 25, 2019), 84 FR 7138 (March 1, 2019) (SR–NASDAQ–2019–008), approving Nasdaq rule change updating references to NASD Rule 2210 to FINRA Rule 2210.

[4] *See* Securities Exchange Act Release No. 57478, (March 12, 2008), 73 FR 14521 (March 18, 2008) (SR–NASDAQ–2007–004 and SR–NASDAQ–2007–080), which approved, among other changes, the incorporation by reference of certain FINRA rules as NOM rules.

[5] We note that Phlx members will not be required to comply with FINRA 2210(c). This is consistent with Nasdaq Rule 2210 which excludes FINRA 2210(c) from the public communications rules applicable to Nasdaq members.

[6] The Exchange notes that the proposed rule change would not subject Phlx members to compliance with FINRA 2210c. As most Phlx members are currently members of FINRA, those members have already been subject to FINRA 2210 in its entirety, including sub-part (c). Only those Phlx members that are not FINRA members, and as a result do not conduct securities transactions and business with the investing public, will be relieved of the obligation to comply with FINRA 2210c (the portion of the rule requiring submission of communications for review prior to publication). The proposed rule change will not relieve any existing FINRA member of the obligation to comply with rules regarding communications with the public.

[7] The Nasdaq OMX Group and FINRA entered into a Regulatory Services Agreement (RSA) dated January 1, 2013. Pursuant to this agreement, FINRA has performed member regulation for all Nasdaq exchanges. As a result of the proposed rule change, FINRA will now review all public marketing materials produced by Phlx members.

[8] Phlx Rule 605 also calls for retention of a copy of the communication for a period of three years. Rule 605 also imposes obligations on firms for whom Phlx serves as the designated examining authority. Continued application of these requirements would be superfluous once FINRA Rule 2210 becomes effective.

[9] FINRA Rule 1220(a)(14) lists the Principal Registration Category of Supervisory Analyst. Each principal as defined in paragraph (a)(1) of Rule 1220 may register with FINRA as a Supervisory Analyst if his or her activities are limited to approving the following: (i) The content of a member's research reports on equity securities; (ii) the content of a member's research reports on debt securities; (iii) the content of third-party research reports; (iv) retail communications as described in Rule 2241(a)(11)(A); or (v) other research communications that do not meet the definition of ''research report'' under Rule 2241, provided that the Supervisory Analyst has technical expertise in the particular product area. The activities of a Supervisory Analyst engaged in equity research shall be supervised by a Research Principal registered pursuant to paragraph (a)(6) of Rule 1220.

[10] While Phlx Rule 1049 and FINRA 2220 are substantively similar, there are differences in the rules regarding review of communications by members found to have departed from the standards of FINRA 2220. In the event FINRA finds a member to have departed from the standards of FINRA 2220, FINRA may require the member to file some or all options communications with the Advertising Regulation Department at least ten calendar days prior to first use.

[11] 15 U.S.C. 78f(b).

[12] 15 U.S.C. 78f(b)(5).

principles of trade and to protect investors and the public interest by bringing greater transparency and consistency to its rules. Requiring Phlx members to comply with FINRA 2210 and FINRA 2220 will add conformity to the advertising requirements for members of Nasdaq, NOM and Phlx exchanges. Conformity in marketing rules will aide member firms as they will have a uniform set of rules to adhere to when issuing communications to their customers across multiple markets. This will reduce the likelihood of confusion as to compliance obligations and promote compliance with Exchange rules and the delivery of clear, accurate information to the public. Both outcomes are in the public interest and further the objectives of Section 6(b)(5) of the Act. Compliance with FINRA 2210 and FINRA 2220 will also provide greater protection to the public as FINRA has significant experience in reviewing marketing and advertising material having done so for various Nasdaq exchanges and FINRA's own membership. FINRA review of marketing materials will help protect investors, further meeting the goals of Section 6(b)(5) of the Act.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange believes that the proposed rule changes will not impose an undue burden on competition because the requirement to comply with FINRA Rules 2210 and FINRA 2220 will apply to all Phlx members equally.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

No written comments were either solicited or 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)(iii) of the Act [13] and subparagraph (f)(6) of Rule 19b–4 thereunder.[14]

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. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

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–Phlx–2019–28 on the subject line.

Paper Comments

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090.

All submissions should refer to File Number SR–Phlx–2019–28. 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 website (*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 website 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 the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SRhlx–2019–28 and should be submitted on or before September 12, 2019.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[15]

Jill M. Peterson,

Assistant Secretary.

[FR Doc. 2019–18077 Filed 8–21–19; 8:45 am]

BILLING CODE 8011–01–P

DEPARTMENT OF STATE

[Public Notice: 10861]

Notice of Determinations; Culturally Significant Objects Imported for Exhibition—Determinations: "J.M.W. Turner: Watercolors From Tate" Exhibition

SUMMARY: Notice is hereby given of the following determinations: I hereby determine that certain objects to be included in the exhibition "J.M.W. Turner: Watercolors from Tate," imported from abroad for temporary exhibition within the United States, are of cultural significance. The objects are imported pursuant to a loan agreement with the foreign owner or custodian. I also determine that the exhibition or display of the exhibit objects at the Mystic Seaport Museum, Mystic, Connecticut, from on or about October 5, 2019, until on or about February 23, 2020, and at possible additional exhibitions or venues yet to be determined, is in the national interest. I have ordered that Public Notice of these determinations be published in the **Federal Register**.

FOR FURTHER INFORMATION CONTACT: Chi Tran, Paralegal Specialist, Office of the Legal Adviser, U.S. Department of State (telephone: 202–632–6471; email: *section2459@state.gov*). The mailing address is U.S. Department of State, L/PD, SA–5, Suite 5H03, Washington, DC 20522–0505.

SUPPLEMENTARY INFORMATION: The foregoing determinations were made pursuant to the authority vested in me by the Act of October 19, 1965 (79 Stat. 985; 22 U.S.C. 2459), Executive Order 12047 of March 27, 1978, the Foreign Affairs Reform and Restructuring Act of

[13] 15 U.S.C. 78s(b)(3)(A)(iii).

[14] 17 CFR 240.19b–4(f)(6). 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 filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

[15] 17 CFR 200.30–3(a)(12).

1998 (112 Stat. 2681, *et seq.;* 22 U.S.C. 6501 note, *et seq.*), Delegation of Authority No. 234 of October 1, 1999, and Delegation of Authority No. 236–3 of August 28, 2000.

Marie Therese Porter Royce,

Assistant Secretary, Educational and Cultural Affairs, Department of State.

[FR Doc. 2019–18083 Filed 8–21–19; 8:45 am]

BILLING CODE 4710–05–P

DEPARTMENT OF STATE

[Public Notice: 10856]

Notice of Determinations; Culturally Significant Objects Imported for Exhibition—Determinations: "Bertoldo di Giovanni: The Renaissance of Sculpture in Medici Florence" Exhibition

SUMMARY: Notice is hereby given of the following determinations: I hereby determine that certain objects to be included in the exhibition ''Bertoldo di Giovanni: The Renaissance of Sculpture in Medici Florence,'' imported from abroad for temporary exhibition within the United States, are of cultural significance. The objects are imported pursuant to loan agreements with the foreign owners or custodians. I also determine that the exhibition or display of the exhibit objects at The Frick Collection, New York, New York, from on or about September 18, 2019, until on or about January 12, 2020, and at possible additional exhibitions or venues yet to be determined, is in the national interest. I have ordered that Public Notice of these determinations be published in the **Federal Register**.

FOR FURTHER INFORMATION CONTACT: Chi D. Tran, Paralegal Specialist, Office of the Legal Adviser, U.S. Department of State (telephone: 202–632–6471; email: *section2459@state.gov*). The mailing address is U.S. Department of State, L/PD, SA–5, Suite 5H03, Washington, DC 20522–0505.

SUPPLEMENTARY INFORMATION: The foregoing determinations were made pursuant to the authority vested in me by the Act of October 19, 1965 (79 Stat. 985; 22 U.S.C. 2459), Executive Order 12047 of March 27, 1978, the Foreign Affairs Reform and Restructuring Act of 1998 (112 Stat. 2681, *et seq.;* 22 U.S.C. 6501 note, *et seq.*), Delegation of Authority No. 234 of October 1, 1999, and Delegation of Authority No. 236–3 of August 28, 2000.

Marie Therese Porter Royce,

Assistant Secretary, Bureau of Educational and Cultural Affairs, Department of State.

[FR Doc. 2019–18084 Filed 8–21–19; 8:45 am]

BILLING CODE 4710–05–P

DEPARTMENT OF STATE

[Public Notice: 10860]

Notice of Determinations; Culturally Significant Objects Imported for Exhibition—Determinations: "John Singer Sargent: Portraits in Charcoal" Exhibition

SUMMARY: Notice is hereby given of the following determinations: I hereby determine that certain objects to be included in the exhibition ''John Singer Sargent: Portraits in Charcoal,'' imported from abroad for temporary exhibition within the United States, are of cultural significance. The objects are imported pursuant to loan agreements with the foreign owners or custodians. I also determine that the exhibition or display of the exhibit objects at The Morgan Library & Museum, New York, New York, from on or about October 4, 2019, until on or about January 12, 2020, at the National Portrait Gallery, Smithsonian Institution, Washington, District of Columbia, from on or about February 28, 2020, until on or about May 31, 2020, and at possible additional exhibitions or venues yet to be determined, is in the national interest. I have ordered that Public Notice of these determinations be published in the **Federal Register**.

FOR FURTHER INFORMATION CONTACT: Chi Tran, Paralegal Specialist, Office of the Legal Adviser, U.S. Department of State (telephone: 202–632–6471; email: *section2459@state.gov*). The mailing address is U.S. Department of State, L/PD, SA–5, Suite 5H03, Washington, DC 20522–0505.

SUPPLEMENTARY INFORMATION: The foregoing determinations were made pursuant to the authority vested in me by the Act of October 19, 1965 (79 Stat. 985; 22 U.S.C. 2459), Executive Order 12047 of March 27, 1978, the Foreign Affairs Reform and Restructuring Act of 1998 (112 Stat. 2681, *et seq.;* 22 U.S.C. 6501 note, *et seq.*), Delegation of Authority No. 234 of October 1, 1999, and Delegation of Authority No. 236–3 of August 28, 2000.

Marie Therese Porter Royce,

Assistant Secretary, Educational and Cultural Affairs, Department of State.

[FR Doc. 2019–18085 Filed 8–21–19; 8:45 am]

BILLING CODE 4710–05–P

SURFACE TRANSPORTATION BOARD

[Docket No. FD 36338]

OmniTRAX Holdings Combined, Inc., and HGS Railway Holdings, Inc.—Control Exemption—The Winchester and Western Railroad Company

OmniTRAX Holdings Combined, Inc. (OmniTRAX), and HGS Railway Holdings, Inc. (HGS) (collectively, Applicants), both noncarriers, filed a verified notice of exemption under 49 CFR 1180.2(d)(2) to acquire control of the Winchester and Western Railroad Company (WWRR), a Class III rail carrier.

According to Applicants, OmniTRAX and HGS are under joint managerial and operational control.[1] Applicants state that OmniTRAX currently controls 18 Class III railroads.[2] Applicants further state that HGS currently controls two Class III railroads.[3]

Applicants also note that they filed a notice of exemption in *OmniTRAX Holdings Combined, Inc.—Continuance in Control Exemption—Cleveland & Cuyahoga Railway,* FD 36288, in which Applicants seek to continue in control of Cleveland & Cuyahoga Railway, LLC (CCR), upon CCR's becoming a Class III rail carrier.[4]

Attached to the verified notice is an executed agreement to effectuate Applicants' control of WWRR.

[1] *See also HGS Ry. Holdings, Inc.—Continuance in Control Exemption—HGS–FCR, LLC,* FD 36180, slip op. at 2–3 n.3 (STB served May 23, 2018).

[2] According to Applicants, OmniTRAX controls the following railroads: Alabama & Tennessee River Railway, LLC; Brownsville & Rio Grande International Railway, LLC; Chicago Rail Link, LLC; Fulton County Railway, LLC; Georgia & Florida Railway, LLC; Georgia Woodlands Railroad, LLC; Great Western Railway of Colorado, LLC; Illinois Railway, LLC; Kettle Falls International Railway, LLC; Manufacturers' Junction Railway, LLC; Nebraska, Kansas & Colorado Railway, LLC; Newburgh & South Shore Railroad, LLC; Northern Ohio & Western Railway, LLC; Panhandle Northern Railway, LLC; Peru Industrial Railroad, LLC; Sand Springs Railway Company; Stockton Terminal and Eastern Railroad; and Central Texas & Colorado River Railway LLC.

[3] According to Applicants, HGS controls HGS–ATN, LLC, and HGS–FCR, LLC.

[4] The notice of exemption in Docket No. FD 36288 was served and published in the **Federal Register** on August 15, 2019 (84 FR 41804), and the exemption is scheduled to become effective on August 30, 2019.

The earliest this transaction may be consummated is September 5, 2019, the effective date of the exemption (30 days after the verified notice was filed).

The verified notice states that: (i) The rail lines operated by the OmniTRAX carriers and the HGS carriers, as well as the rail lines to be operated by CCR, do not connect with the rail lines to be operated by WWRR; (ii) the proposed transaction is not part of a series of anticipated transactions that would connect the rail lines that will be operated by WWRR with any railroad in the OmniTRAX and HGS corporate families, or with any rail line to be operated by CCR; and (iii) neither WWRR nor any of the carriers controlled by OmniTRAX or HGS, nor CCR, is a Class I rail carrier. Therefore, the transaction is exempt from the prior approval requirements of 49 U.S.C. 11323. *See* 49 CFR 1180.2(d)(2).

Under 49 U.S.C. 10502(g), the Board may not use its exemption authority to relieve a rail carrier of its statutory obligation to protect the interests of its employees. However, 49 U.S.C. 11326(c) does not provide for labor protection for transactions under 49 U.S.C. 11324 and 11325 that involve only Class III rail carriers. Because this transaction involves Class III rail carriers only, the Board, under the statute, may not impose labor protective conditions for this transaction.

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 August 29, 2019 (at least seven days before the exemption becomes effective).

All pleadings, referring to Docket No. FD 36338, must be filed with the Surface Transportation Board via e-filing or in writing addressed to 395 E Street SW, Washington, DC 20423–0001. In addition, a copy of each pleading must be served on Applicants' representative, Karl Morell, Karl Morell & Associates, 440 1st Street NW, Suite 440, Washington, DC 20001.

According to Applicants, this action is excluded from environmental review under 49 CFR 1105.6(c) and from historic preservation reporting requirements under 49 CFR 1105.8(b)(1).

Board decisions and notices are available at *www.stb.gov.*

Decided: August 16, 2019.

By the Board, Allison C. Davis, Director, Office of Proceedings.

Jeffrey Herzig,

Clearance Clerk.

[FR Doc. 2019–18206 Filed 8–21–19; 8:45 am]

BILLING CODE 4915–01–P

OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE

[Docket Number USTR–2019–0014]

Agency Information Collection Activities; Request for Comments—Renewal of the Collection of Information Titled '301 Exclusion Requests'

AGENCY: Office of the United States Trade Representative.

ACTION: Notice and request for comments.

SUMMARY: The Office of the United States Trade Representative (USTR) invites comments on an existing information collection request (ICR) titled *301 Exclusion Requests.* USTR plans to ask the Office of Management and Budget (OMB) to renew approval of the ICR for three years under the Paperwork Reduction Act of 1995 (PRA) and its implementing regulations.

DATES: Submit comments no later than October 21, 2019.

ADDRESSES: USTR strongly prefers electronic submissions made through the Federal eRulemaking Portal: *http://www.regulations.gov.* See the submission instructions below. The Docket Number is USTR–2019–0014. For alternatives to on-line submissions, please contact the Section 301 hotline at (202) 395–5725 before transmitting a comment and in advance of the deadline.

FOR FURTHER INFORMATION CONTACT: Assistant General Counsels Philip Butler or Megan Grimball, or Director of Industrial Goods Justin Hoffmann at (202) 395–5725.

SUPPLEMENTARY INFORMATION:

A. Comments

Submit written comments and suggestions addressing one or more of the following four points:

(1) Whether the ICR is necessary for the proper performance of USTR's functions, including whether the information will have practical utility.

(2) The accuracy of USTR's estimate of the burden of the ICR, including the validity of the methodology and assumptions used.

(3) Ways to enhance the quality, utility, and clarity of the ICR.

(4) Ways to minimize the burden of the ICR on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology.

B. Overview of This Information Collection

Title: 301 Exclusion Requests.

OMB Control Number: 0350–0015, which expires on December 31, 2019.

Form Number(s): 301 Exclusion Request/Response/Reply Form.

Description: Following a comprehensive investigation, the U.S. Trade Representative determined that the Government of China's acts, policies, and practices related to technology transfer, intellectual property, and innovation were actionable under section 301(b) of the Trade Act of 1974 (19 U.S.C. 2411(b)). The U.S. Trade Representative determined that appropriate action to obtain the elimination of these acts, policies, and practices included the imposition of additional *ad valorem* duties on products from China classified in certain enumerated subheadings of the Harmonized Tariff Schedule of the United States (HTSUS). For background on the proceedings in this investigation, please see the prior notices issued in the investigation, including 82 FR 40213 (August 23, 2017), 83 FR 14906 (April 6, 2018), 83 FR 28710 (June 20, 2018), 83 FR 33608 (July 17, 2018), 83 FR 38760 (August 7, 2018), 83 FR 40823 (August 16, 2018), 83 FR 47974 (September 21, 2018), and 83 FR 49152 (September 28, 2018), 83 FR 65198 (December 19, 2018), 84 FR 7966 (March 5, 2019), 84 FR 20459 (May 9, 2019), and 84 FR 21389 (May 9, 2019).

On May 15, 2019, USTR submitted a request to OMB for emergency processing of this ICR. USTR reviewed the six submissions in response to the notice requesting comments (84 FR 23145). Five comments expressed concerns regarding the ability to designate and protect business confidential information (BCI); three requested that the ICR provide additional guidance or clarification; two asked for an expedited review process; two requested that the ICR take into account additional information; two commented with respect to the burden estimate; two requested certain questions be removed; and one indicated the ICR should better indicate whether a particular field was required.

In light of the comments and in further consideration of the issues, USTR published FAQs covering a wide range of topics pertaining to the exclusions process and made changes to the ICR. The changes included updates to section one—'Submitter Information'—to include 'country' as a field, and to add a question to determine if the requestor meets the size standards for a small business established by the Small Business Administration. Other changes included designations to each field of the ICR to indicate whether the field is required and if the field is for BCI or public information.

OMB approved the emergency processing request on June 20, 2019, and assigned Control Number 0350–0015, which expires on December 31, 2019.

On June 24, 2019 (84 FR 29576), the U.S. Trade Representative established a process by which U.S. stakeholders could request the exclusion of particular products classified within a covered tariff subheading from the additional duties that went into effect on September 24, 2018, and May 10, 2019. Requests for exclusion have to identify a particular product and provide supporting data and the rationale for the requested exclusion. Within 14 days after USTR posts a request for exclusion, interested persons can provide a response with the reasons they support or oppose the request. Interested persons can reply to the response within seven days after it is posted.

On June 30, 2019, USTR opened an electronic portal for submission of exclusion requests—*http://exclusions.ustr.gov*—using the approved ICR. The deadline for submitting requests is September 30, 2019. A reproduction of the form used on the portal is attached as an annex to this notice.

Affected Public: U.S. stakeholders who want to request, or comment on a request, to exclude particular products from the additional duties on products from China classified in certain enumerated subheadings of the HTSUS.

Frequency of Submission: One submission per request, response, or reply.

Respondent Universe: U.S. stakeholders.

Reporting Burden:

Total Estimated Responses: 60,000 requests to exclude a particular product; 7,000 responses to a product exclusion request; and 3,000 replies to a response.

Total Estimated Annual Burden: USTR has revised this burden estimate in accordance with comments received in response to the emergency processing notice. USTR estimates that preparing and submitting a request to exclude a particular product will take approximately 120 minutes and will cost about $200 per submission. The total time burden for requests is 120,000 hours and the estimated total cost is $12,000,000.

USTR estimates that preparing and submitting a response to a product exclusion request will take approximately 60 minutes, and will cost about $100 per submission. The total time burden for responses is approximately 7,000 hours at an estimated total cost of $700,000.

USTR estimates that preparing and submitting a reply will take approximately 30 minutes, and will cost about $50 per submission. The total time burden for replies is approximately 1,500 hours and the estimated total cost is $150,000.

USTR estimates that the cost to the Federal government to evaluate each request, and response or reply, if any, is 2.5 hours, for a total time burden of 175,000 hours at an estimated total cost of $9,700,000. The $9.7 million total cost estimate includes the average annual salary plus benefits, for the federal employees and contractors expected to work on the exclusion process. USTR estimates that it will take approximately one year to complete the process.

Status: After reviewing comments received in response to this notice, under the PRA and its implementing regulations, USTR plans to submit a request to OMB to renew approval of the ICR for three years.

C. Requirements for Submissions

You must submit written comments by the deadline set forth in this notice. You must make all submissions in English via *http://www.regulations.gov,* using Docket Number USTR–2019–0014. USTR will not accept hand-delivered submissions. To make a submission using *http://www.regulations.gov,* enter the appropriate docket number in the 'search for' field on the home page and click 'search.' The site will provide a search-results page listing all documents associated with this docket. Find a reference to this notice by selecting 'notice' under 'document type' in the 'filter results by' section on the left side of the screen and click on the link entitled 'comment now.' The *regulations.gov* website offers the option of providing comments by filling in a 'type comment' field or by attaching a document using the 'upload file(s)' field. USTR prefers that you provide submissions in an attached document and note 'see attached' in the 'type comment' field on the online submission form. Include any data attachments to the submission in the same file as the submission itself, and not as separate files.

You will receive a tracking number upon completion of the submission procedure at *http://www.regulations.gov.* The tracking number is confirmation that *regulations.gov* received the submission. Keep the confirmation for your records. USTR is not able to provide technical assistance for the website. USTR may not consider documents you do not submit in accordance with these instructions. If you are unable to provide submissions as requested, please contact the Section 301 hotline at (202) 395–5725 before transmitting a comment and in advance of the deadline. General information concerning USTR is available at *www.ustr.gov.*

Janice Kaye,

Chief Counsel for Administrative Law.

BILLING CODE 3290–F9–P

Annex

Exclusion Request Form

1. Submitter Information

Full Organization Legal Name * **(Public)**

Requestor First Name * **(BCI)**

Requestor Last Name * **(BCI)**

Requestor Mailing Address

Street Address Line 1 * **(BCI)**

Street Address Line 2 **(BCI)**

City * **(BCI)**

State * **(BCI)**

Zip Code * **(BCI)**

Country * **(BCI)**

Requestor E-mail Address * **(BCI)**

Requestor Phone Number * **(BCI)**

Does your business meet the size standards for a small business as established by the Small Business Administration? * **(Public)** YES/NO

Are you a third party, such as a law firm, trade association, or customs broker, submitting on behalf of an organization or industry? * **(Public)** YES/NO

*Note: If you are submitting on behalf of an organization/industry, the information below is required.

Third Party Firm/Association Name **(Public)**

Third Party First Name **(BCI)**

Third Party Last Name (BCI)

Third Party Mailing Address

Street Address Line 1 (BCI)

Street Address Line 2 (BCI)

City (BCI)

State (BCI)

Zip Code (BCI)

Country (BCI)

Third Party E-mail Address (BCI)

Third Party Phone Number (BCI)

Who is your importer of record? (BCI)

Who will be the primary point of contact? (Select One) * (BCI)

- ○ Requestor
- ○ Third Party Submitter
- ○ Requestor and Third Party Submitter

2. **Please provide the 10-digit HTSUS item number* for the product you wish to address in this product exclusion request.** ***A 10-digit HTSUS number is required.*** * (Public)
*Use numerical characters only with no special characters (Example: 1023456789). For help with finding the HTSUS item number associated with your product, see https://hts.usitc.gov/.

3. **Please provide a complete and detailed description of the particular product of concern.*** (A detailed description of the product includes, but is not limited to, its physical characteristics (e.g., dimensions, weight, material composition, etc.), whether product is designed to function in or with a particular machine (application), and any unique physical features that distinguish it from other products within the covered 8-digit HTSUS subheading. If needed, please attach images and specification sheets, CBP rulings, court decisions, and previous import documentation below.) **Please also describe the product's principal use.**

*USTR will not consider requests that identify the product using criteria that cannot be made available to the public. USTR will not consider requests in which more than one unique product is identified.

Product Name * (Public)

Product Description (e.g. dimensions, weight, material composition, etc.) * (Public)

Product Function, Application, and Principal Use (Public)

Please upload any relevant attachments that will help identify and distinguish your product (e.g. CBP rulings, photos and specification sheets, and previous import documentation) (Public)

4. **Requestor's relationship to the product (select all that apply)** * (Public)

   - o Importer
   - o U.S. Producer
   - o Purchaser
   - o Industry Association
   - o Other

5. **Is this product, or a comparable product, available from sources in the United States? (If you indicate "NO" or "NOT SURE," in the box below, you must explain why the product is unavailable or why you are unsure of the product's availability.)** * (Public)

   - o YES
   - o NO
   - o NOT SURE

   Please explain why the product is unavailable or why you are unsure of the product's availability. (Submitter Determines BCI or Public)

6. **Is this product, or a comparable product, available from sources in third countries? (If you indicate "NO" or "NOT SURE," in the box below, you must explain why the product is unavailable or why you are unsure of the product's availability.)** * (Public)

   - o YES
   - o NO
   - o NOT SURE

   Please explain why the product is unavailable or why you are unsure of the product's availability. (Submitter Determines BCI or Public)

7. **Please discuss any attempts to source this product from United States or third countries.** * (Public)

8. **Please provide the value in USD and quantity (with units) of the <u>Chinese-origin</u> product of concern that you purchased in 2017, 2018, and the first quarter of 2019. Limit this figure to the products purchased by your firm (or by members of your**

trade association). Please provide estimates if precise figures are unavailable. * (BCI)

2017 Value: 2017 Quantity:

2018 Value: 2018 Quantity:

2019 Q1 Value: 2019 Q1 Quantity:

Are the provided figures estimates?: * (BCI) YES/NO

Are any of these purchases from a related company? * (BCI) YES/NO

Please list the name and relationship of the related company. (BCI)

9. **Please provide the value in USD and quantity (with units) of the product of concern that you purchased from any <u>third-country</u> source in 2017, 2018, and the first quarter of 2019. Limit this figure to the products purchased by your firm (or by members of your trade association). Please provide estimates if precise figures are unavailable.** * (BCI)

2017 Value: 2017 Quantity:

2018 Value: 2018 Quantity:

2019 Q1 Value: 2019 Q1 Quantity:

Are the provided figures estimates?: * (BCI) YES/NO

10. **Please provide the value in USD and quantity (with units) of the product of concern that you purchased from <u>domestic sources</u> in 2017, 2018, and the first quarter of 2019. Limit this figure to the products purchased by your firm (or by members of your trade association). Please provide estimates if precise figures are unavailable.** * (BCI)

2017 Value: 2017 Quantity:

2018 Value: 2018 Quantity:

2019 Q1 Value: 2019 Q1 Quantity:

Are the provided figures estimates?: * (BCI) YES/NO

11. **Please provide information regarding your company's gross revenue in USD for 2018, the first quarter of 2018, and the first quarter of 2019.** * (BCI)

Fiscal Year 2018:

First Quarter 2018:

First Quarter 2019:

Are the provided figures estimates?: * (BCI) YES/NO

12. **Is the Chinese-origin product of concern sold as a <u>final product</u> or as an <u>input</u> used in the production of a final product or products?** * (Public)

a) For imports sold as final products, please provide: (BCI)

% of your company's total, U.S. gross sales in 2018 that the Chinese-origin product accounted for.

b) For imports of inputs used in the production of final products, please provide: (BCI)

% of the total cost of producing the final product(s) the Chinese-origin input accounts for.

% of your company's total, U.S. gross sales in 2018 that sales of the final product(s) incorporating the input accounts for.

13. **Please comment on whether the imposition of additional duties (since September 2018) on the product you are seeking to exclude has resulted in severe economic harm to your company or other U.S. interests.** * (BCI)

14. **Please provide any additional information in support of your request, taking account of the instructions provided in Section [B] of the Federal Register notice.** (Submitter Determines BCI or Public)

15. **Did you submit exclusion requests for the Section 301 $34 billion** (Docket ID: USTR-2018-0025) **and/or the $16 billion** (Docket ID: USTR-2018-0032) **tariff actions?** * (Public) YES/NO

Please enter the total value of your company's imports applicable to the tariff action for which you submitted one or more exclusion request: (BCI)

Initial $34 Billion Tariff Action:

Additional $16 Billion Tariff Action:

16. **Please comment on whether the particular product of concern is strategically important or related to "Made in China 2025" or other Chinese industrial programs. You must explain in the box below why you believe the product of concern is or is not strategically important or related to "Made in China 2025" or other Chinese industrial programs.** * (Public)

17. **Include any additional attachments that should be considered along with this exclusion request (e.g., customs rulings, court decisions, previous import documentation, etc.). Please do not include attachments that contain your written argument.** (Submitter Determines BCI or Public)

[FR Doc. 2019–18094 Filed 8–21–19; 8:45 am]

BILLING CODE 3290–F9–C

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

[Summary Notice No. 52]

Petition for Exemption; Summary of Petition Received; UPS Flight Forward, Inc.

AGENCY: Federal Aviation Administration (FAA), Department of Transportation (DOT).

ACTION: Notice.

SUMMARY: This notice contains a summary of a petition seeking relief from specified requirements of Federal Aviation Regulations. The purpose of this notice is to improve the public's awareness of, and participation in, the FAA's exemption process. Neither publication of this notice nor the inclusion or omission of information in the summary is intended to affect the legal status of the petition or its final disposition.

DATES: Comments on this petition must identify the petition docket number and must be received on or before September 11, 2019.

ADDRESSES: Send comments identified by docket number FAA–2019–0628 using any of the following methods:

- *Federal eRulemaking Portal:* Go to *http://www.regulations.gov* and follow the online instructions for sending your comments electronically.
- *Mail:* Send comments to Docket Operations, M–30; U.S. Department of Transportation, 1200 New Jersey Avenue SE, Room W12–140, West Building Ground Floor, Washington, DC 20590–0001.
- *Hand Delivery or Courier:* Take comments to Docket Operations in Room W12–140 of the West Building Ground Floor at 1200 New Jersey Avenue SE, Washington, DC 20590–0001, between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays.
- *Fax:* Fax comments to Docket Operations at (202) 493–2251.

Privacy: In accordance with 5 U.S.C. 553(c), DOT solicits comments from the public to better inform its rulemaking process. DOT posts these comments, without edit, including any personal information the commenter provides, to *http://www.regulations.gov,* as described in the system of records notice (DOT/ALL–14 FDMS), which can be reviewed at *http://www.dot.gov/privacy.*

Docket: Background documents or comments received may be read at *http://www.regulations.gov* at any time. Follow the online instructions for accessing the docket or go to the Docket Operations in Room W12–140 of the West Building Ground Floor at 1200 New Jersey Avenue SE, Washington, DC 20590–0001, between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays.

FOR FURTHER INFORMATION CONTACT: Nia Daniels, (202) 267–7626, Office of Rulemaking, Federal Aviation Administration, 800 Independence Avenue SW, Washington, DC 20591.

This notice is published pursuant to 14 CFR 11.85.

Issued in Washington, DC, on August 16, 2019.

John Linsenmeyer,

Acting Deputy Director, Office of Rulemaking.

Petition for Exemption

Docket No.: FAA–2019–0628.

Petitioner: UPS Flight Forward, Inc.

Sections of 14 CFR Affected: 91.7; 91.9(b); 91.119(b) and (c); 91.121(a)(1); 91.151(b); 91.203(a)(1); 135.21(f); 135.25(a)(1) and (2); 135.63(c) and (d); 135.65(a) and (d); 135.143(c); 135.161(a); 135.203(a)(1) and (b); 135.209(b); and 135.243(b)(1) and (2).

Description of Relief Sought: UPS Flight Forward, Inc. seeks an exemption from federal regulations to allow it to conduct part 135 air carrier operations for commercial package delivery using an unmanned aircraft system (UAS).

[FR Doc. 2019–18051 Filed 8–21–19; 8:45 am]

BILLING CODE 4910–13–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

[Docket No. FAA–2019–0630]

Agency Information Collection Activities: Requests for Comments; Clearance of New Approval of Information Collection: Privacy International Civil Aviation Organization (ICAO) Address Program

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Notice and request for comments.

SUMMARY: In accordance with the Paperwork Reduction Act of 1995, FAA invites public comments about our intention to request the Office of Management and Budget (OMB) approval for a new information collection. The collection involves an aircraft operator's request for a privacy ICAO address through a web-based application process. The information to be collected is necessary to qualify for the authorized use of the privacy ICAO address services and for monitoring to support continued airworthiness and enforcement activities.

DATES: Written comments should be submitted by October 21, 2019.

ADDRESSES: Please send written comments:

By electronic docket: www.regulations.gov (Enter docket number into search field)

By mail: Syed Tahmid, Project Lead, Surveillance and Broadcast Services, AJM–422, Air Traffic Organization, Federal Aviation Administration, 600 Independence Ave. SW, Wilbur Wright Building, Washington, DC 20597.

By fax: 202–267–1277 (Attention: Mr. Syed Tahmid, Project Lead, Surveillance and Broadcast Services, AJM–422, Air Traffic Organization, Federal Aviation Administration).

FOR FURTHER INFORMATION CONTACT: For technical questions concerning this action, contact Syed Tahmid by email at: *syed.tahmid@faa.gov* or +1.202.267.8784.

SUPPLEMENTARY INFORMATION:

Public Comments Invited: You are asked to comment on any aspect of this information collection, including (a) Whether the proposed collection of information is necessary for FAA's performance; (b) the accuracy of the estimated burden; (c) ways for FAA to enhance the quality, utility, and clarity of the information collection; and (d) ways that the burden could be minimized 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.

OMB Control Number: 2120–XXXX.

Title: Privacy International Civil Aviation Organization (ICAO) Address Program.

Form Numbers: Not applicable.

Type of Review: New information collection.

Background: In 2010, the FAA issued a final rule mandating equipage requirements and performance standards for Automatic Dependent Surveillance-Broadcast (ADS–B) Out avionics on aircraft operating in certain airspace after December 31, 2019. Aircraft operators must be equipped with ADS–B Out to fly in most controlled airspace. Federal Regulations 14 CFR 91.225 and 14 CFR 91.227 contain requirement details. Each registered aircraft is assigned an aircraft registration number and an ICAO 24-bit aircraft address. This is also referred to as a ''Mode S Code'' in some FAA documents and websites, including the FAA Aircraft Registry. Where a 1090-MHz Extended Squitter (1090ES) transponder is required for ADS–B Out compliance, this ICAO 24-bit aircraft address, based on current transponder avionics standards, is openly broadcasted on the 1090 MHz frequency in transponder replies and ADS–B messages. Subsequently, the nature of openly broadcasting makes the identity of the aircraft publicly available.

Industry stakeholders have long suggested that FAA develop a process for aircraft operators who seek anonymity such that their aircraft movements and identity cannot be traced or seen by privately owned sensors that monitor the 1090 MHz frequency and combine this with other downlinked ADS–B and Mode S data being disseminated using the internet. The FAA intends to develop a process for operators who wish to mask their aircraft movements and identity for a period of time while flying within the sovereign airspace of the United States.

Participation in the assignment of privacy ICAO Code addresses is voluntary. However, the FAA must collect the operator's information in order to assign privacy ICAO addresses. It is envisioned that required data collected will be:

- Aircraft registration number
- Permanent ICAO address
- Aircraft owner's information to include:
  - Phone number
  - Email address
  - Home/business (physical) address

Only U.S. registered aircraft can be assigned a privacy ICAO aircraft address. No operator can use a privacy ICAO aircraft address for a U.S.-registered aircraft unless that operator is authorized to use a third-party flight identification for that same aircraft. No unique privacy ICAO address will be assigned to more than one U.S.-registered aircraft at any given time. Once approved, the operator will be assigned a privacy ICAO address.

The operator will be required to notify the FAA when their avionics have been loaded with the assigned temporary ICAO 24-bit aircraft address. Owners and operators must verify that the ICAO 24-bit aircraft address (Mode S code) broadcast by their ADS–B equipment matches the assigned privacy ICAO address for their aircraft. Operators can verify what ICAO 24-bit aircraft address is being broadcast by their aircraft by visiting: *https://adsbperformance.faa.gov/PAPRRequest.aspx.*

For monitoring privacy ICAO address use, the information will be downloaded by the FAA and entered into the FAA's ADS–B Performance Monitor [Docket No. FAA–2017–1194 published in **Federal Register**, December 20, 2017, as Document Number: 2017–27202].

Respondents: Intended for operators who seek anonymity such that their aircraft movements and identity cannot be easily traced or seen by privately owned sensors that monitor the 1090 MHz frequency. FAA estimates up to 15,000 respondents.

Frequency: On occasion. An operator can change privacy ICAO aircraft addresses, but no more often than once every 30 days.

Estimated Average Burden per Response: Approximately 20–25 minutes per application.

Estimated Total Annual Burden: Approximately 14,583 hours.

Issued in Washington, DC, on August 15, 2019.

David Gray,

Manager, Surveillance and Broadcast Services Group (AJM–42), Program Management Organization, Air Traffic Organization, Federal Aviation Administration.

[FR Doc. 2019–18052 Filed 8–21–19; 8:45 am]

BILLING CODE 4910–13–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

[Docket No. FAA–2019–0631]

Agency Information Collection Activities: Requests for Comments; Clearance of a New Approval of Information Collection: Service Availability Prediction Tool (SAPT)

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Notice and request for comments.

SUMMARY: In accordance with the Paperwork Reduction Act of 1995, FAA invites public comments about their intention to request Office of Management and Budget (OMB) approval of a new web-based tool to assist aircraft operators in achieving regulatory compliance. Depending on the specific nature of the operator's route of flight, varying levels of information are necessary for the FAA to process pre-flight availability predictions for navigation and surveillance, and, if needed, an ATC authorization request via this web-based tool. This collection involves planned routes of flight, aircraft avionics equipment, and may require identifying information about the requester. The information collected will be used to predict whether an aircraft flying the proposed route of flight will have sufficient position accuracy and integrity for:

(1) Navigation, via the Receiver Autonomous Integrity Monitoring (RAIM) SAPT

(2) Surveillance, via the Automatic Dependent Surveillance-Broadcast (ADS–B) SAPT

In addition, the website will allow operators to request authorization from ATC to operate aircraft that do not fully meet ADS–B Out requirements in rule airspace (per 14 CFR 91.225 and 91.227), which requires ADS–B Out via:

(3) ADS–B Deviation Authorization Preflight Tool (ADAPT)

DATES: Written comments should be submitted by October 21, 2019.

ADDRESSES: Please send written comments:

By Electronic Docket: www.regulations.gov (Enter docket number into search field).

By mail: Send comments to FAA at following address: Mr. David Gray, Manager, Surveillance and Broadcast Services, AJM–42, Air Traffic Organization, Federal Aviation Administration, 600 Independence Ave. SW, Wilbur Wright Building, Washington, DC 20597.

By fax: 202–267–1277 (Attention: Mr. David Gray, Manager, Surveillance and Broadcast Services, AJM–42, Air Traffic Organization, Federal Aviation Administration).

FOR FURTHER INFORMATION CONTACT: For technical questions concerning this action, contact Mr. Paul Von Hoene, Aviation Safety, Aviation Safety Inspector (AC/OPS) at *paul.vonhoene@faa.gov* or 202–267–8916.

SUPPLEMENTARY INFORMATION:

Public Comments Invited: You are asked to comment on any aspect of this information collection, including (a) whether the proposed collection of information is necessary for FAA's performance; (b) the accuracy of the estimated burden; (c) ways for FAA to enhance the quality, utility and clarity of the information collection; and (d) ways that the burden could be minimized 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.

OMB Control Number: 2120–XXXX.

Title: Service Availability Prediction Tool (SAPT).

Form Numbers: None—Operators will access website at *https://sapt.faa.gov*.

Type of Review: New information collection.

Background: Under 14 CFR 91.103, pilots and operators must use all available information in planning their flight to ensure that they will meet the performance requirements for the duration of the flight. Operators may use the FAA-provided pre-flight Service Availability Prediction Tool (SAPT) for determining predicted navigation or surveillance availability before a flight. The SAPT has three main components: Receiver Autonomous Integrity Monitoring (RAIM) SAPT, Automatic Dependent Surveillance-Broadcast (ADS–B) SAPT, and ADS–B Deviation Authorization Pre-Flight Tool (ADAPT).

The RAIM SAPT is voluntary and is intended mainly for pilots, dispatchers, and commercial service providers using Technical Standard Order (TSO)-C129 equipment to check predicted navigation horizontal protection level (HPL) for a proposed route of flight. RAIM SAPT incorporates TSO–C129 Global Positioning System (GPS) RAIM predictions to check the availability of GPS RAIM for satisfying the area navigation (RNAV) requirements of AC 90–100A Change 2, Paragraph 10(5). RAIM SAPT users can view RAIM outage predictions on RAIM Summary Displays to graphically view RAIM outage predictions for specific equipment configurations. Additionally, RAIM SAPT users can also use an XML-based web service, most commonly used by flight planning software, to enter specific route of flight information by the operator checking RAIM outage predictions.

The ADS–B SAPT is provided to help operators comply with 14 CFR 91.225 and 91.227 by predicting whether operators will meet regulatory requirements and to advise holders of FAA Exemption No. 12555 whether back-up surveillance will be available where installed aircraft avionics are not predicted to meet the requirements of 14 CFR 91.227(c)(1)(i) and (iii). For operators of aircraft equipped with TSO–C129 (SA–On) GPS receivers, the operator may run a preflight prediction using ADS–B SAPT as one option to meet their requirements. Information collected via ADS–B SAPT is comparable to that already provided in flight plans, with the addition of some information about the aircraft position source's TSO and related capabilities. Operators using an ADS–B SAPT flight plan form must enter aircraft identification. The ADS–B SAPT flight plan form does not collect other personally identifiable information details about the operator.

When an operator performs a preflight availability prediction using the FAA's SAPT, the SAPT retains a record of each transaction enabling the FAA to confirm that an operator took preflight action. The FAA recommends that operators using an alternate tool retain documentation that verifies the completion of the satisfactory preflight availability prediction for each intended route of flight. 84 FR 31713 (July 3, 2019).

ADAPT is mandatory for operators desiring to fly in ADS–B Out rule airspace without meeting the ADS–B equipage requirements. ADAPT allows operators to create an air traffic authorization request to operate in ADS–B Out rule airspace per 14 CFR 91.225(g). As precursor to using ADAPT, operators must first complete the ADS–B SAPT Flight Plan Form to determine if there is sufficient backup surveillance coverage throughout their planned flight. Operators must enter their personal contact information to enable an FAA ATC Authorization Authority (AAA) to reply with either an approval, rejection, or pending decision. ADAPT does collect personal identifying information to include name, telephone number, and email address.

Respondents: These prediction tools are primarily intended for pilots and dispatchers; anyone who is planning a flight which passes through U.S. sovereign airspace using an aircraft whose GPS receiver(s) is/are not guaranteed to meet certain performance requirements or whose aircraft is not equipped to meet requirements of 14 CFR 91.225.

Frequency: On occasion as part of flight planning, as required by FAA policy.

Estimated Average Burden per Response:

RAIM SAPT—3 minutes or less.

ADS–B SAPT—5 minutes or less.

(It is anticipated that RAIM SAPT and ADS–B SAPT will be automated into eXtensible Markup Language (XML) that operators may use to plan flights, eliminating manual data-entry).

ADAPT—7 minutes or less (includes up to 2 minutes for FAA email response).

Estimated Total Annual Burden:

RAIM SAPT—Approximately 673,425 minutes.

ADS–B SAPT—Approximately 11,062,128 minutes.

ADAPT—Approximately 15,330,000 minutes.

Issued in Washington, DC, on August 15, 2019.

David E. Gray,

Group Manager, Surveillance and Broadcast Services (AJM–42), Program Management Office, Air Traffic Organization, Federal Aviation Administration.

[FR Doc. 2019–18120 Filed 8–21–19; 8:45 am]

BILLING CODE 4910–13–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

[Docket No. FAA–2019–0333]

Agency Information Collection Activities: Requests for Comments; Clearance of Renewed Approval of Information Collection: Small Unmanned Aircraft Registration System (sUAS)

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Notice and request for comments.

SUMMARY: In accordance with the Paperwork Reduction Act of 1995, FAA invites public comments about our intention to request Office of Management and Budget (OMB) renewal approval for information collection 2120–0765. Aircraft registration is necessary to ensure personal accountability among all users of the national airspace system. Aircraft registration also allows the FAA and law enforcement agencies to address non-compliance by providing the means for identifying an aircraft's owner and operator. This collection also permits individuals to de-register or update their record in the registration database.

DATES: Written comments should be submitted by September 23, 2019.

ADDRESSES: Interested persons are invited to submit written comments on the proposed information collection to the Office of Information and Regulatory Affairs, Office of Management and Budget. Comments should be addressed to the attention of the Desk Officer, Department of Transportation/FAA, and sent via electronic mail to *oira_submission@omb.eop.gov,* or faxed to (202)395–6974, or mailed to the Office of Information and Regulatory Affairs, Office of Management and Budget, Docket Library, Room 10102, 725 17th Street NW, Washington, DC 20503.

Public Comments Invited: You are asked to comment on any aspect of this information collection, including (a) Whether the proposed collection of information is necessary for FAA's performance; (b) the accuracy of the estimated burden; (c) ways for FAA to enhance the quality, utility and clarity of the information collection; and (d) ways that the burden could be minimized 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.

FOR FURTHER INFORMATION CONTACT: Bonnie Lefko at: *bonnie.lefko@faa.gov;* or by phone: 405–954–7461.

SUPPLEMENTARY INFORMATION:

OMB Control Number: 2120–0765.

Title: Small Unmanned Aircraft Registration System (sUAS).

Form Numbers: None.

Type of Review: Renewal of existing collection.

Background: The **Federal Register** Notice with a 60-day comment period soliciting comments on the following collection of information was published on May 9, 2019 (84 FR 20460). There were three comments received. The FAA received two comments in support from EPIC and A4A. EPIC's further recommendations related to broadcasting location are beyond the scope and authority of what is proposed in this information collection. Another comment was received correcting the FAA's statutory citation, which the FAA acknowledges and has updated in the 30 day notice. The Secretary of the Department of Transportation (DOT) and the Administrator of the Federal Aviation Administration (FAA) affirmed that all unmanned aircraft, including model aircraft, are aircraft. As such, in accordance with 49 U.S.C. 44101(a) and as further prescribed in 14 CFR part 48, registration is required prior to operation. *See* 80 FR 63912, 63913 (October 22, 2015). Aircraft registration is necessary to ensure personal accountability among all users of the national airspace system. Aircraft registration also allows the FAA and law enforcement agencies to address non-compliance by providing the means for identifying an aircraft's owner and operator.

Subject to certain exceptions discussed below, aircraft must be registered prior to operation. See 49 U.S.C. 44101–44103. Upon registration, the Administrator must issue a certificate of registration to the aircraft owner. See 49 U.S.C. 44103.

Registration, however, does not provide the authority to operate. Persons intending to operate a small unmanned aircraft must operate in accordance with section the FAA Reauthorization Act of 2018 Section 349 (49 U.S.C. 44809), part 107 or part 91, in accordance with a waiver issued under part 107, in accordance with an exemption issued under 14 CFR part 11 (including those persons operating under an exemption issued pursuant to 49 U.S.C. 44807), or in conjunction with the issuance of a special airworthiness certificate, and are required to register. In the agency's 60 day notice, the number of minutes required to register was inadvertently stated as 10 minutes. The number, consistent with our past information collection supporting statements, is 5 minutes, which is reflected in this notice. There is no change to the annual burden.

Respondents: Approximately 300,000 affected sUAS registrations and 14,000 de-registrations annually.

Frequency: Information is collected on occasion.

Estimated Average Burden per Response: 5 minutes per response to register and 3 minutes per response to de-register.

Estimated Total Annual Burden: Approximately 51,000 hours.

Issued in Oklahoma City, OK, on August 19, 2019.

Bonnie Lefko,

Program Analyst, FAA, Civil Aviation Registry, AFB–700.

[FR Doc. 2019–18139 Filed 8–21–19; 8:45 am]

BILLING CODE 4910–13–P

DEPARTMENT OF TRANSPORTATION

Federal Highway Administration

[FHWA Docket No. FHWA–2019–0012]

Surface Transportation Project Delivery Program; Florida DOT Audit #2 Report

AGENCY: Federal Highway Administration (FHWA), U.S. Department of Transportation (DOT).

ACTION: Notice, request for comment.

SUMMARY: The Surface Transportation Project Delivery Program allows a State to assume FHWA's environmental responsibilities for review, consultation, and compliance for Federal highway projects. When a State assumes these Federal responsibilities, the State becomes solely responsible and liable for the responsibilities it has assumed, in lieu of FHWA. This program mandates annual audits during each of the first 4 years to ensure the State's compliance with program requirements. This is the second audit of the Florida Department of Transportation's (FDOT) performance of its responsibilities under the Surface Transportation Project Delivery Program (National Environmental Policy Act (NEPA) Assignment Program). This notice announces and solicits comments on the second audit report for the FDOT.

DATES: Comments must be received on or before September 23, 2019.

ADDRESSES: Mail or hand deliver comments to Docket Management Facility: U.S. Department of Transportation, 1200 New Jersey Avenue SE, Room W12–140, Washington, DC 20590. You may also submit comments electronically at *www.regulations.gov.* All comments should include the docket number that appears in the heading of this document. All comments received will be available for examination and copying at the above address from 9 a.m. to 5 p.m., e.t., Monday through Friday, except Federal holidays. Those desiring notification of receipt of comments must include a self-addressed, stamped postcard or you may print the acknowledgment page that appears after submitting comments electronically. Anyone can search the electronic form of all comments in any one of our dockets by the name of the individual submitting the comment (or signing the comment, if submitted on behalf of an association, business, or labor union). The DOT posts these comments, without edits, including any personal information the commenter provides, to *www.regulations.gov,* as described in the system of records notice (DOT/ALL–14 FDMS), which can be reviewed at *www.dot.gov/privacy.*

FOR FURTHER INFORMATION CONTACT: Ms. Marisel Lopez Cruz, Office of Project Development and Environmental Review, (407) 867–6402, *marisel.lopez-cruz@dot.gov,* Federal Highway Administration, U.S. Department of Transportation, 1200 New Jersey Avenue SE, Washington, DC 20590, or Mr. David Sett, Office of the Chief Counsel, (404) 562–3676, *david.sett@dot.gov,* Federal Highway Administration, Department of Transportation, 60 Forsyth Street 8M5, Atlanta, GA 30303. Office hours are from 8:00 a.m. to 4:30 p.m., e.t., Monday through Friday, except Federal holidays.

SUPPLEMENTARY INFORMATION:

Electronic Access

An electronic copy of this notice may be downloaded from the specific docket page at *www.regulations.gov.*

Background

The Surface Transportation Project Delivery Program, codified at 23 U.S.C. 327, commonly known as the NEPA Assignment Program, allows a State to assume FHWA's responsibilities for environmental review, consultation, and compliance for Federal highway projects. When a State assumes these Federal responsibilities, the State becomes solely liable for carrying out the responsibilities it has assumed, in lieu of FHWA. Effective December 14, 2016, FDOT assumed FHWA's responsibilities for environmental review and the responsibilities for reviews under other Federal environmental requirements.

Section 327(g) of Title 23, U.S.C., requires the Secretary to conduct annual audits to ensure compliance with the memorandum of understanding during each of the first 4 years of State participation and, after the fourth year, monitor compliance. The results of each audit must be made available for public comment. A final version of the first audit report was published in the **Federal Register** on August 27, 2018, at 83 FR 43726. This notice announces the availability of the second audit report for the FDOT and solicits comments on the same.

Authority: Section 1313 of Public Law 112–141; Section 6005 of Public Law 109–59; 23 U.S.C. 327; 23 CFR 773.

Issued on: August 15, 2019.

Nicole R. Nason,

Administrator, Federal Highway Administration.

Surface Transportation Project Delivery Program

Draft FHWA Audit #2 of the Florida Department of Transportation

May 2017 to April 2018

Executive Summary

This is the second audit of the Florida Department of Transportation's (FDOT) assumption of National Environmental Policy Act (NEPA) responsibilities under the Surface Transportation Project Delivery Program. Under the authority of 23 U.S.C. 327, FDOT and the Federal Highway Administration (FHWA) executed a memorandum of understanding (MOU) on December 14, 2016, whereby FHWA assigned, and FDOT assumed, FHWA's NEPA responsibilities and liabilities for Federal-aid highway projects and other related environmental reviews for transportation projects in Florida.

The FHWA formed a team in January 2018 to conduct an audit of FDOT's performance according to the terms of the MOU. The team held internal meetings to prepare for an on-site visit to the Florida Division and FDOT offices. Prior to the on-site visit, the team reviewed FDOT's NEPA project files, FDOT's response to FHWA's pre-audit information request (PAIR), and FDOT's NEPA Assignment Self-Assessment Summary Report. The team conducted interviews with FDOT and resource Agency staff and prepared preliminary audit results from September 24–28, 2018. The team presented these preliminary observations to FDOT Office of Environmental Management (OEM) leadership on September 28, 2018.

The FDOT continues to develop, revise, and implement procedures and processes required to carry out the NEPA Assignment Program. Overall, the team found that FDOT is committed to delivering a successful NEPA Program. This report describes numerous successful practices, two observations, and one non-compliance observation. The FDOT has carried out the responsibilities it has assumed in keeping with the intent of the MOU and FDOT's application. Through this report, FHWA is notifying FDOT of the one non-compliance observation that require FDOT to take corrective action. By addressing the observations in this report, FDOT will continue to assure a successful program. The report concludes with the status of FHWA's non-compliance observation from the first audit review (Audit #1), including any FDOT self-imposed corrective actions.

Background

The purpose of the audits performed under the authority of 23 U.S.C. 327 is to assess a State's compliance with the provisions of the MOU as well as all applicable Federal statutes, regulations, policies, and guidance. The FHWA's review and oversight obligation entails the need to collect information to evaluate the success of the NEPA Assignment Program; to evaluate a State's progress toward achieving its performance measures as specified in the MOU; and to collect information for the administration of the NEPA Assignment Program. This report summarizes the results of the second audit in Florida. Following this audit, FHWA will conduct two annual audits. This second audit report includes a summary discussion that describes progress since the last audit.

Scope and Methodology

The overall scope of this audit review is defined both in statute (23 U.S.C. 327) and the MOU (Part 11). An audit generally is defined as an official and careful examination and verification of accounts and records, especially of financial accounts, by an independent unbiased body. With regard to accounts or financial records, audits may follow a prescribed process or methodology and be conducted by ''auditors'' who have special training in those processes or methods. The FHWA considers this review to meet the definition of an audit because it is an unbiased, independent, official, and careful examination and verification of records and information about FDOT's assumption of environmental responsibilities.

The team consisted of NEPA subject matter experts from FHWA offices in Arizona, Nebraska, Ohio, Texas, Georgia, and the District of Columbia, as well as staff from FHWA's Florida Division. The diverse composition of the team, as well as the process of developing the review report and publishing it in the **Federal Register**, are intended to make this audit an unbiased official action taken by FHWA.

The team conducted a careful examination of FDOT policies, guidance, and manuals pertaining to NEPA responsibilities, as well as a representative sample of FDOT's project files. Other documents, such as the August 2018 PAIR responses, and FDOT's August 2018 Self-Assessment Summary Report, informed this review. The team interviewed FDOT staff and resource agency staff. This review is organized around six NEPA Assignment Program elements: Program management; documentation and records management; quality assurance/quality control (QA/QC); legal sufficiency; performance measurement; and training program. In addition, the team considered two cross-cutting focus areas: (1) Consistency between the NEPA documents and planning documents; and (2) Section 4(f) implementation and documentation.

The team defined the timeframe for highway project environmental approvals subject to this second audit to be between May 2017 and April 2018, when 898 projects were approved. The team drew both representative and judgmental samples totaling 105 projects from data in FDOT's online file system, Statewide Environmental Project Tracker (SWEPT). In the context of this report, descriptions of Type 1 Categorical Exclusions (CE) and Type 2 CEs are consistent with FDOT's Project Development and Environment Manual. The FHWA judgmentally selected all Type 2 CEs (11 projects), all Environmental Assessments (EA) with Findings of No Significant Impacts (1 project), and all Environmental Impact Statements (EIS) with Records of Decision (no projects fell into this category). The FHWA determined the sample size applying a 90 percent confidence level, a 10 percent margin of error to the Type 1 CEs, and then separately to the reevaluations. For the Type 1 CEs (64 projects), FHWA applied a judgmental distribution of the sample based on the percentage of each type of Type 1 CE in the sample universe. For the re-evaluations (29 projects), FHWA applied a judgmental distribution of the sample based on the percentage of each class of action in the sample universe. The FHWA also ensured each district office was reasonably represented for both Type 1 CEs and re-evaluations. The team reviewed projects in all of FDOT's seven districts.

The team submitted a PAIR to FDOT that contained 35 questions covering all 6 NEPA Assignment Program elements. The FDOT responses to the PAIR were used to develop specific follow-up questions for the on-site interviews with FDOT staff.

The team conducted a total of 31 interviews. Interview participants included staff from three of FDOT's seven district offices that were not interviewed in the first audit, District 3 (Chipley), District 4 (Ft. Lauderdale), and District 6 (Miami), and FDOT Central Office. The team interviewed FDOT environmental staff, middle management and executive management, regional representatives from the National Oceanic and Atmospheric Administration (NOAA)—National Marine Fisheries Service (NMFS), the U.S. Coast Guard (USCG), the U.S. Fish and Wildlife Service (USFWS), and the State Historic Preservation Officer (SHPO) from the Florida Department of State, Division of Historic Resources.

The team compared FDOT policies and procedures (including the published 2017 Project Development & Environment (PD&E) Manual) to the information obtained during interviews and project file reviews to determine if FDOT's performance of its MOU responsibilities are in accordance with FDOT policies and procedures and Federal requirements. Individual observations were documented during interviews and reviews and combined under the six NEPA Assignment Program elements. The audit results are described below by program element.

Overall Audit Opinion

The team recognizes that FDOT's efforts have been focused on implementing the requirements of the MOU by: Processing and approving projects; refining policies, procedures, and guidance documents; refining the SWEPT tracking system for ''official project files''; training staff; implementing a QA/QC Plan; and conducting a self-assessment for monitoring compliance with the assumed responsibilities. The team found evidence of FDOT's continuing efforts to train staff in clarifying the roles and responsibilities of FDOT staff, and in educating staff in an effort to assure compliance with all of the assigned responsibilities.

During the second audit, the team identified numerous successful practices, two observations, and one non-compliance observation that FDOT will need to address through corrective actions. These results came from a review of FDOT procedures, project file documentation, and interviews with FDOT and resource agencies.

The FDOT has carried out the responsibilities it has assumed consistent with the intent of the MOU and FDOT's application. By addressing the observations in this report, FDOT will continue to assure a successful program.

Successful Practices and Observations

Successful practices are practices that the team believes are positive, and encourages FDOT to consider continuing or expanding those programs in the future. The team identified numerous successful practices in this report. Observations are items the team would like to draw FDOT's attention to, which may improve processes, procedures, and/or outcomes. The team identified two observations in this report.

A non-compliance observation is an instance where the team finds the State is not in compliance or is deficient with regard to a Federal regulation, statute, guidance, policy, State procedure, or the MOU. Non-compliance may also include instances where the State has failed to secure or maintain adequate personnel and/or financial resources to carry out the responsibilities they have assumed. The FHWA expects the State to develop and implement corrective actions to address all non-compliance observations. The team identified one non-compliance observation during this second audit.

The team acknowledges that sharing initial results during the site visit closeout and sharing the draft audit report with FDOT provides them the opportunity to begin implementing corrective actions to improve the program. The FHWA will also consider actions taken by FDOT to address these observations as part of the scope of Audit #3.

The Audit Report addresses all six MOU program elements as separate discussions.

Program Management

Successful Practices

The team learned that FDOT has maintained its good working relationship with the two new resource agency staff interviewed—USCG and NOAA–NMFS. They stated that FDOT coordinated any changes in their program with the Agency to ensure satisfaction with their regulatory requirements and were very pleased with the coordination by FDOT at the district and OEM level. The USCG stated that the Florida Efficient Transportation Decision Making System facilitates their early involvement and coordination. The FHWA applauds this practice.

During interviews, FHWA learned of good internal communication between OEM and the districts regarding SWEPT assistance. This includes the assistance provided by OEM with the SWEPT hotline and one district uses a successful single SWEPT point of contact for internal consistency purposes. In addition, OEM continues to promote training on environmental and NEPA Assignment topics, and annual PD&E Manual updates on all topics, as needed.

The FDOT/OEM uses a spreadsheet for internal purposes to track policy updates and procedures received from FHWA and the actions they took to address. This practice reflects transparency and awareness by FDOT on changes to keep current with FHWA requirements under the MOU.

The team learned through interviews, in some instances, that the District Director and/or Environmental Manager review NEPA documents as an additional level of QA/QC on projects of interest. This practice shows local ownership and pride in districts wanting to do the best job they can do under NEPA Assignment, beyond what OEM may require.

Observation #1: FDOT's identification and documentation of commitments may result in mitigation required by Federal regulation.

There are several program elements that lead to this observation. The provisions on ''Commitment'' in the FDOT PD&E Manual (*e.g.,* Section 22.1.1) do not fully implement FHWA requirements to include in the environmental document all mitigation measures stated as commitments (23 CFR 771.105(a) and 771.109(b)). The identification of project impacts and the documentation of commitments must demonstrate that FDOT has reasonably considered the significance of a project's impacts within a NEPA approval appropriate to the project's class of action.

The team also found some of the NEPA documents reviewed make a general commitment regarding intent to obtain a permit, but do not address the project impacts associated with the permit or the commitments to avoid, mitigate, or minimize the impacts. Citing the need for a permit does not fully meet the requirement to document commitments to address project impacts at the time of a NEPA approval. In addition, some FDOT project files referenced standard specifications in lieu of identifying project specific commitments to address project impacts in the NEPA document, which does not align with FHWA policy. The FHWA Audit interviews and project file review confirm these findings (8 projects).

Observation #2: Endangered Species Act (ESA) finding was unsupported on certain projects.

The team identified 18 project files with a ''no effect'' ESA finding based solely on a description of the project's scope. The FHWA policy and guidance (February 2002 FHWA Management of the Endangered Species Act (ESA) Environmental Analysis and Consultation Process guidance memorandum (*https://www.environment.fhwa.dot.gov/legislation/other_legislation/natural/laws_esaguide.aspx*)) states that the ESA evaluation of impacts is dependent on the scope of the project, as well as ecological importance and distribution of the affected species, and intensity of potential impacts of the project.

The team identified four project files with a ''no effect'' ESA finding which referenced a Programmatic Biological Opinion between USFWS and other entities, to which FDOT is not a signatory, including some that provide species-specific consultation ''keys'' to support a ''no effect'' finding. The team learned from an interview with USFWS staff that FDOT should not specifically reference such ''keys'' as part of their informal and/or formal Section 7 ESA processes unless and until FDOT becomes a party to those programmatic agreements. Also, the team found that FDOT used ''keys'' as support for project impact decisions for species which do not have ''keys.'' Finally, FDOT's PD&E Manual does not include a procedure providing for use of the ''keys'' and does not address how the ''keys'' should be applied when making ESA findings.

Since receiving the draft audit report, FDOT reported to FHWA that it has coordinated with USFWS in order to address this observation, developed training and updated its guidance addressing this observation.

Quality Assurance/Quality Control

Successful Practices

From the PAIR and during the interviews, FDOT staff provided evidence of many new QA/QC tools using directions, forms, and procedures that will improve documentation and record keeping and may address many of the projects contained within the non-compliance observation of the 2017 Audit and FDOT's 2017 Self-Assessment. These new tools are likely to reduce the risk of future non-compliant projects through enhanced QA/QC. Examples of these QA/QC improved tools include a Consultant QC Plan, a Natural Resource Evaluation template, and a Section 106 Memorandum of Agreement for Adverse Impacts.

The FDOT has continued to update its PD&E Manual to ensure that it encompasses all new applicable laws, regulations, and guidance. The FDOT has a dedicated person responsible for coordinating an annual PD&E Manual update. The FDOT has an intense vetting process for the PD&E Manual update. The draft changes are shared with subject matter experts and then undergo peer, District, and management reviews. Resource agencies may also review changes as needed. The update will include new direction to document preparers that specifies when additional project documentation is needed. Many of these additions stem from the 2017 Audit findings and FDOTs 2017 Self-Assessment. The PD&E Manual update process is likely to eliminate many of the documentation issues found by FHWA in the 2017 and 2018 Audits.

Legal Sufficiency

The team's review of FDOT's legal sufficiency program found that FDOT has structured the legal sufficiency process for the NEPA Assignment Program by having in-house counsel, as well as outside counsel with NEPA experience, available. We appreciate that FDOT has chosen to house their Special Counsel for Environmental Affairs and two staff attorneys under the direct supervision of the FDOT Deputy General Counsel.

While no legal sufficiency determinations have been made by FDOT during the audit time frame, FDOT's Office of General Counsel (OGC) participates in monthly coordination meetings and topic-specific meetings with OEM and the districts. They also review other documents when requested for legal input. There is close collaboration throughout the process amongst and between OGC, OEM, and the district attorneys.

Training Program

Through interviews with the OEM leadership the team learned that rather than preparing an annual training plan, they have a training program that is constantly being assessed, revised, and updated as an on-line program. The program includes training on a wide variety of subjects, and training is delivered both face-to-face and virtually. The FDOT staff said that training is a common topic of discussion of leadership as well as staff, including frequently asking about needed training.

Successful Practices

The team learned through interviews FDOT closely tracks training rosters and registrations that evidence a broad number of training events to a high number of people. Over the past 12–14 months, FDOT trained over 2,000 people through 36 courses.

The team learned that OEM is always looking at the training program to find ways to augment it. For example, FDOT is now working with the SHPO staff to develop topic-specific Webinars on how information for the SHPO is to be organized and projects documented. The FDOT also has worked with NOAA–NMFS on their concerns in developing training. These trainings, along with a new short Web-based training module on producing environmental documents, are waiting to be uploaded to the OEM website.

The OEM leadership indicated in an interview that they have a number of staff that are new to FDOT, and, in general, have less than 5 years of experience. These new staff members were mentored by seasoned staff to serve as a resource to help them understand FDOT's procedures and the key issues in NEPA. By monitoring the performance measures on compliance, OEM leadership indicate the mentoring is a successful practice.

Performance Measures

The FDOT Self-Assessment Summary Report contained the results of FDOT's second report of its assessment of the NEPA Assignment Program and FDOT procedures compliance. This assessment, for the period between May 1, 2017, and April 30, 2018, entailed review of project files as well as results from a survey of Agency satisfaction. The report also included a discussion of FDOT's progress in meeting the performance measures. During the report period, there were no qualifying projects for Legal Sufficiency, NEPA Issue Resolution, and NEPA Approval Time Savings measures.

Successful Practices

The FDOT has 14 performance metrics to monitor and assess accomplishment of the 4 performance measures in the MOU, Section 10.2.1. The FDOT is actively monitoring these performance measures. Data for the performance metrics are generated and reported quarterly and annually in SWEPT. If FDOT identifies indicators that could affect their performance measures they can promptly take actions to address them.

The OEM leadership stated in interviews that the FDOT timeliness measure is used both as a way to streamline their review process and to understand it better. For example, they told the team that FDOT has changed some of the time reporting measures for environmental review staff. Project review duration includes a need for every project to go through the electronic review comments (ERC) process first and then a formal review and approval period in SWEPT. When in SWEPT, there is a review process with a number of days assigned. The FDOT realized for certain projects, ones that have minor impacts, no ERC review was necessary which further streamlined the project review process. The OEM leadership also stated in an interview that the 30-day review period is being constantly monitored in order to ensure if a modification to procedure is needed, it can be made. It was also stated that during the first two rating periods no modification to the review period has been needed.

Documentation and Records Management

The FDOT continues to use SWEPT as the NEPA file of record for federally funded projects. The FDOT has implemented several process improvements within SWEPT. Communication during the second audit cycle allowed staff to clarify many project level observations within the Audit process. The FDOT and FHWA have committed to continue communications to resolve issues identified within the audit process.

Non-Compliance Observation #1: Some FDOT project files contain insufficient documentation to support the environmental analysis or decision.

Both the MOU (subpart 10.2.1) and FDOT's PD&E Manual specify that documentation is needed to support compliance. The SWEPT has been identified as FDOT's project file of record, in which FDOT maintains approved reevaluations, CEs, EAs, and EISs. The team reviewed 105 projects for the 2018 Audit #2 that constituted a statistically valid sample. As part of the initial project file review, the team observed that 54 of the 105 project files reviewed lacked documentation in SWEPT to support the environmental analysis or the basis for an FDOT decision. In some cases, there were multiple observations for one project.

For example, one project file did not contain documentation of coordination with FHWA or USCG for the required (23 CFR 650.805 and 23 CFR 650.807) navigability assessment in order to support a permit determination. Additional examples, where the team observed documentation deficiencies included commitments, planning consistency, and mitigation. The team also observed that some commitments to address project impacts through mitigation, avoidance, and minimization were not documented at the time of NEPA approval. When the environmental document lacks commitments for important project impacts, the project record does not reflect a complete consideration of the significance of a project's impacts. Another consequence is that some commitments are added after the NEPA decision, are not tracked, or get dropped, which is not in accordance with Federal regulations. (23 CFR 771.105(a), 23 CFR 771.105(d), and 23 CFR 771.109(d)). Finally, project files were observed that did not include the Project Commitment Record for documenting commitments as required by the 2017 PD&E Manual.

The team's comments on these projects were shared with FDOT for their consideration and the team received responses from FDOT. The FHWA and FDOT have productively worked together to successfully resolve insufficient documentation for 23 projects and uploaded existing documentation in SWEPT for 18 projects. The FDOT indicated that they have implemented or committed to implementing process improvements to address the deficiencies. The FDOT is expected to continue implementation of corrective actions that would address these issues.

Update from 2017 Audit #1 Non-Compliance Observation #1: Some FDOT project files contain insufficient documentation to support the environmental analysis or decision.

The FHWA reported a non-compliance observation related to some FDOT project files that lacked documentation to support the environmental analysis or decision as part of Audit #1. This non-compliance observation is based on a review that resulted in observations on 47 projects, several of which had deficient documentation for more than one issue. The FDOT and FHWA have met over the past year and have productively worked together to resolve documentation issues from the previous audit. The FHWA shared comments on these projects with FDOT and they provided written responses. Based on these responses, FHWA and FDOT were able to successfully address many documentation issues through resolving a project observation (22 projects), FDOT uploading missing documentation in SWEPT (5 projects), or FDOT implementing or committed to implementing process improvements to address procedural deficiencies (39 projects). For example, FDOT updated their electronic Type 1 CE form in SWEPT to require certain supporting documentation be uploaded, which was confirmed through the Audit #2 FDOT staff interviews and project file reviews. The FDOT also included a direct link to the State Transportation Improvement Plan or Transportation Improvement Plan to ensure adequate documentation of planning consistency for all classes of action. The FDOT has made commendable strides to document planning consistency at NEPA approval. However, documentation of consistency with the metropolitan long-range transportation plans was missing for several projects and for a variety of classes of action. In addition, the 2018 FDOT Self-Assessment Summary states that FDOT initiated and completed a number of SWEPT system and programmatic enhancements to address the missing documentation noted during Audit #1. The FDOT is expected to continue implementation of corrective actions that would address these issues.

Finalizing This Report

The FHWA provided a draft of the audit report to FDOT for a 14-day review and comment period. The team considered FDOT's comments in this draft audit report. The FHWA is publishing this notice in the **Federal Register** for a 30-day comment period in accordance with 23 U.S.C. 327(g). No later than 60 days after the close of the comment period, FHWA will address all comments submitted to finalize this draft audit report pursuant to 23 U.S.C. 327(g)(B). Subsequently, FHWA will publish the final audit report in the **Federal Register**.

The FHWA will consider the results of this audit in preparing the scope of the next annual audit. The next audit report will include a summary that describes the status of FDOT's corrective and other actions taken in response to this audit's conclusions.

[FR Doc. 2019–18092 Filed 8–21–19; 8:45 am]

BILLING CODE 4910–22–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

Proposed Extension of Information Collection Request Submitted for Public Comment; Comment Request for Form 1097–BTC

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice and request for comments.

SUMMARY: The Internal Revenue Service, as part of its continuing effort to reduce paperwork and respondent burden, invites the public and other Federal agencies to take this opportunity to comment on proposed and/or continuing information collections, as required by the Paperwork Reduction Act of 1995. Currently, the IRS is soliciting comments concerning Form 1097–BTC, Bond Tax Credit.

DATES: Written comments should be received on or before October 21, 2019 to be assured of consideration.

ADDRESSES: Direct all written comments to Laurie Brimmer, Internal Revenue Service, Room 6129, 1111 Constitution Avenue NW, Washington, DC 20224. Requests for additional information or copies of the regulations should be directed to R. Joseph Durbala, at Internal Revenue Service, Room 6129, 1111 Constitution Avenue NW, Washington DC 20224, or through the internet, at *RJoseph.Durbala@irs.gov.*

SUPPLEMENTARY INFORMATION: *Title:* Election to Expense Certain Depreciable Assets.

OMB Number: 1545–2197.

Form Number: 1097–BTC.

Abstract: Form 1097–BTC, Bond Tax Credit, is an information return used to report tax credit bond credits distributed to shareholders. Shareholders of the RIC include in income, their proportionate share of the interest income attributable to the credits and are allowed the proportionate share of credits. (Code section 853A(b)(3)). A RIC must report the shareholder's proportionate share of credits and gross income after the close of the RIC's tax year. Form 1097–BTC, Bond Tax Credit, has been designed to report to the taxpayers and the IRS the tax credit distributed.

Current Actions: There is no change to the burden previously approved by OMB. This form is being submitted for renewal purposes only.

Type of Review: Extension of a currently approved collection.

Affected Public: Businesses and other for-profit organizations, and not-for-profit institutions.

Estimated Number of Respondents: 212.

Estimated Time per Respondent: 19 mins.

Estimated Total Annual Burden Hours: 67.

The following paragraph applies to all the collections of information covered by this notice:

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

Books or records relating to a collection of information must be retained if their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Desired Focus of Comments: The Internal Revenue Service (IRS) is particularly interested in comments that:

- 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;
- Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used;
- Enhance the quality, utility, and clarity of the information to be collected; and
- Minimize the burden of the collection of information on those who are to respond, including using appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology, *e.g.,* by permitting electronic submissions of responses.

Comments submitted in response to this notice will be summarized and/or included in the ICR for OMB approval of the extension of the information collection; they will also become a matter of public record.

Approved: August 15, 2019.

R. Joseph Durbala,

IRS Tax Analyst.

[FR Doc. 2019–18098 Filed 8–21–19; 8:45 am]

BILLING CODE 4830–01–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

Open Meeting of the Taxpayer Advocacy Panel Taxpayer Communications Project Committee

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of meeting.

SUMMARY: An open meeting of the Taxpayer Advocacy Panel's Taxpayer Communications Project Committee will be conducted. The Taxpayer Advocacy Panel is soliciting public comments, ideas, and suggestions on improving customer service at the Internal Revenue Service.

DATES: The meeting will be held Tuesday, September 17, 2019.

FOR FURTHER INFORMATION CONTACT: Carolyn Duckworth at 1–888–912–1227 or (314) 339–1670.

SUPPLEMENTARY INFORMATION: Notice is hereby given pursuant to Section 10(a)(2) of the Federal Advisory Committee Act, 5 U.S.C. App. (1988) that a meeting of the Taxpayer Advocacy Panel's Taxpayer Communications Project Committee will be held Tuesday, September 17, 2019, at 2:00 p.m. Eastern Time. The public is invited to make oral comments or submit written statements for consideration. Due to limited time and structure of meeting, notification of intent to participate must be made with Carolyn Duckworth. For more information please contact Carolyn Duckworth at 1–888–912–1227 or (314) 339–1670, or write TAP Office, 1222 Spruce, St. Louis, MO 63103 or contact us at the website: *http://www.improveirs.org.* The agenda will include various IRS issues.

Dated: August 19, 2019.

Kevin Brown,

Acting Director, Taxpayer Advocacy Panel.

[FR Doc. 2019–18086 Filed 8–21–19; 8:45 am]

BILLING CODE 4830–01–P

DEPARTMENT OF THE TREASURY

Periodic Meeting of the U.S. Department of the Treasury Tribal Advisory Committee

AGENCY: Department of the Treasury.

ACTION: Notice of meeting.

SUMMARY: This notice announces that the U.S. Department of the Treasury Tribal Advisory Committee (TTAC) will convene for a public meeting on Wednesday, September 18, 2019, from 9:00 a.m.–4:30 p.m. Eastern Time in the

Cash Room of the Treasury Building located at 1500 Pennsylvania Avenue NW, Washington, DC 20220. The meeting is open to the public, and the site is accessible to individuals with differing abilities.

DATES: The meeting will be held on Wednesday, September 18, 2019, from 9:00 a.m.–4:30 p.m. Eastern Time.

ADDRESSES: The meeting will be held in the Cash Room (Room 2121) at the Treasury Building located at 1500 Pennsylvania Avenue NW, Washington, DC 20220. The meeting will be open to the public. Because the meeting will be held in a secured facility, members of the public who plan to attend the meeting must register online or by telephone by 5:00 p.m. Eastern Time on Tuesday, September 10, 2019. Attendees with a valid email address may visit *http://www.cvent.com/d/4yqd09* or for mobile registration at *http://www.cvent.com/d/4yqd09?dvce=2* to complete a secure online registration form. All other attendees may contact Marie Vazquez-Lopez at *Marie.VazquezLopez@treasury.gov.*

If you require a reasonable accommodation, please contact Andre Faulk at *Andre.Faulk@treasury.gov* or 202–622–1278, or Lisa Jones at *lisa.jones@treasury.gov* or 202–622–0315. To request a sign language interpreter, please make your request five days prior to the event, if possible by contacting Lillian Wright at *Lillian.Wright@treasury.gov.* For all other inquiries concerning the TTAC meeting, please contact *Tribal.Consult@treasury.gov.*

FOR FURTHER INFORMATION CONTACT: Nancy Montoya, Policy Analyst, Department of the Treasury, 1500 Pennsylvania Avenue NW, Room 1426G, Washington, DC 20220, at (202) 622–2031 (this is not a toll-free number). Persons who have difficulty hearing or speaking may access this number via TTY by calling the toll-free Federal Relay Service at (800) 877–8339.

SUPPLEMENTARY INFORMATION:

Background

Section 3 of the Tribal General Welfare Exclusion Act of 2014, Public Law 113–68, 128 Stat. 1883, enacted on September 26, 2014 (TGWEA), directs the Secretary of the Treasury (Secretary) to establish a seven member Tribal Advisory Committee to advise the Secretary on matters related to the taxation of Indians, the training of Internal Revenue Service field agents, and the provision of training and technical assistance to Native American financial officers.

Pursuant to Section 3 of the TGWEA and in accordance with the provisions of the Federal Advisory Committee Act (FACA), 5 U.S.C. App. 1 *et seq.,* the TTAC was established on February 10, 2015, as the ''U.S. Department of the Treasury Tribal Advisory Committee.'' The TTAC's Charter provides that it shall operate under the provisions of the FACA and shall advise and report to the Secretary on:

(1) Matters related to the taxation of Indians;

(2) The establishment of training and education for internal revenue field agents who administer and enforce internal revenue laws with respect to Indian tribes of Federal Indian law and the Federal Government's unique legal treaty and trust relationship with Indian tribal governments; and

(3) The establishment of training of such internal revenue field agents, and provisions of training and technical assistance to tribal financial officers, about implementation of the TGWEA and any amendments.

Second Periodic Meeting

In accordance with section 10(a)(2) of the FACA and implementing regulations at 41 CFR 102–3.150, Krishna P. Vallabhaneni, the Designated Federal Officer of the TTAC, has ordered publication of this notice to inform the public that the TTAC will convene a public meeting on Wednesday, September 18, 2019, from 9:00 a.m.–4:30 p.m. Eastern Time in the Cash Room of the Treasury Building located at 1500 Pennsylvania Avenue NW, Washington, DC.

Summary of Agenda and Topics to be Discussed

During this meeting, the seven members will adopt bylaws for the TTAC and discuss the progress of the priority issue matrix and work plan, including the work of the three subcommittees. In addition, the TTAC will provide updates on priority issues, read any public comments submitted, and take other actions necessary to fulfill the Committee's mandate.

Public Comment

Members of the public wishing to comment on the business of the TTAC are invited to submit written statements by any of the following methods:

Electronic Statements

- Send electronic comments to *Tribal.Consult@treasury.gov.*

Paper Statements

- Send paper statements in triplicate to the Treasury Tribal Advisory Committee, Department of the Treasury, 1500 Pennsylvania Avenue NW, Room 1426G, Washington, DC 20220.

The Department of the Treasury will post all statements on its website *https://www.treasury.gov/resource-center/economic-policy/tribal-policy/Pages/Tribal-Policy.aspx* without change, including any business or personal information provided such as names, addresses, email addresses, or telephone numbers. The Department of the Treasury will also make such statements available for public inspection and copying in the Department of the Treasury's Library, 720 Madison Place NW, Room 1020, Washington, DC 20220, on official business days between the hours of 10:00 a.m. and 5:00 p.m. Eastern Time. You can make an appointment to inspect statements by telephoning (202) 622–2000. All statements received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. You should submit only information that you wish to make available publicly.

Dated: August 14, 2019.

Krishna P. Vallabhaneni,

Tax Legislative Counsel.

[FR Doc. 2019–18102 Filed 8–21–19; 8:45 am]

BILLING CODE 4810–25–P

FEDERAL REGISTER

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Part II

Securities and Exchange Commission

17 CFR Parts 200 and 240

Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital and Segregation Requirements for Broker-Dealers; Final Rule

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 200 and 240

[Release No. 34–86175; 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 and Segregation Requirements for Broker-Dealers

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: In accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act (''Dodd-Frank Act''), the Securities and Exchange Commission (''Commission''), pursuant to the Securities Exchange Act of 1934 (''Exchange Act''), is adopting 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 increasing the minimum net capital requirements for broker-dealers authorized to use internal models to compute net capital (''ANC broker-dealers''), and prescribing certain capital and segregation requirements for broker-dealers that are not SBSDs to the extent they engage in security-based swap and swap activity. The Commission also is making substituted compliance available with respect to capital and margin requirements under Section 15F of the Exchange Act and the rules thereunder and adopting a rule that specifies when a foreign SBSD or foreign MSBSP need not comply with the segregation requirements of Section 3E of the Exchange Act and the rules thereunder.

DATES:

Effective date: October 21, 2019.

Compliance date: The compliance date is discussed in section III.B of this release.

FOR FURTHER INFORMATION CONTACT: Michael A. Macchiaroli, Associate Director, at (202) 551–5525; Thomas K. McGowan, Associate Director, at (202) 551–5521; Randall W. Roy, Deputy Associate Director, at (202) 551–5522; Raymond Lombardo, Assistant Director, at 202–551–5755; Sheila Dombal Swartz, Senior Special Counsel, at (202) 551–5545; Timothy C. Fox, Branch Chief, at (202) 551–5687; Valentina Minak Deng, Special Counsel, at (202) 551–5778; Rose Russo Wells, Senior Counsel, at (202) 551–5527; or Nina Kostyukovsky, Special Counsel, at (202) 551–8833, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–7010.

SUPPLEMENTARY INFORMATION:

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I. Introduction

A. Background

Title VII of the Dodd-Frank Act (''Title VII'') established a new regulatory framework for the U.S. over-the-counter (''OTC'') derivatives markets.[1] Section 764 of the Dodd-Frank Act added Section 15F to the Exchange Act.[2] Section 15F(e)(1)(B) of the Exchange Act provides that the Commission shall prescribe capital and margin requirements for SBSDs and

[1] *See* Public Law 111–203, 701 through 774. The Dodd-Frank Act assigns primary responsibility for the oversight of the U.S. OTC derivatives markets to the Commission and the Commodity Futures Trading Commission (''CFTC''). 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 those terms. *See 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) (''*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. 66868 (Apr. 27, 2012), 77 FR 30596 (May 23, 2012) (''*Entity Definitions Adopting Release*'').

[2] 15 U.S.C. 78*o*-10 (''Section 15F of the Exchange Act'' or ''Section 15F'').

MSBSPs that do not have a prudential regulator (respectively, ''nonbank SBSDs'' and ''nonbank MSBSPs'').[3] Section 763 of the Dodd-Frank Act added Section 3E to the Exchange Act.[4] Section 3E provides the Commission with the authority to establish segregation requirements for SBSDs and MSBSPs.[5] The Commission also has separate and independent authority under Section 15 of the Exchange Act to prescribe capital and segregation requirements for broker-dealers.[6]

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'').[7] Section 15F(e)(1)(A) of the Exchange Act provides that the prudential regulators shall prescribe capital and margin requirements for SBSDs and MSBSPs that have a prudential regulator (respectively, ''bank SBSDs'' and ''bank MSBSPs''). 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 (respectively, ''bank swap dealers'' and ''bank swap participants'').[8] The prudential regulators have adopted capital and margin requirements for bank SBSDs and MSBSPs and for bank swap dealers and major swap participants.[9] The CFTC has adopted margin requirements and proposed capital requirements for nonbank swap dealers and major swap participants.[10] The CFTC also has adopted segregation requirements for cleared and non-cleared swaps.[11]

In October 2012, the Commission proposed: (1) Capital and margin requirements for nonbank SBSDs and MSBSPs, segregation requirements for SBSDs, and notification requirements relating to segregation for SBSDs and MSBSPs; and (2) raising the minimum net capital requirements and establishing liquidity requirements for ANC broker-dealers.[12] The Commission received a number of comment letters in response to the 2012 proposals.[13] In May 2013, the Commission proposed provisions regarding the cross-border treatment of security-based swap capital, margin, and segregation requirements.[14] The Commission received comments on these proposals as well.[15] In 2014, the Commission proposed an additional capital requirement for nonbank SBSDs that was inadvertently omitted from the 2012 proposals.[16]

Finally, in 2018, the Commission reopened the comment period and requested additional comment on the proposed rules and amendments (including potential modifications to proposed rule language).[17] Some commenters supported the reopening of the comment period as a means to help ensure that the final rules reflect current market conditions.[18] One commenter stated that the publication of the potential modifications to the proposed rule language provided important transparency in the development of this rulemaking.[19] Other commenters stated that the Commission did not provide them with an adequate basis upon which to comment, and argued that it was not possible to fully assess the potential modifications to the proposed rules without a full re-proposal.[20] The Commission disagrees. The potential modifications to the proposed rule language published in the release described how the rule text proposed in 2012 could be changed, including specific potential rule language. This approach provided the public with a meaningful opportunity to comment on potential modifications to the proposed rule text.

Today, the Commission is amending existing rules and adopting new rules. In particular, the Commission is amending existing rules 17 CFR 240.15c3–1 (''Rule 15c3–1''), 17 CFR

[3] 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. 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.

[4] 15 U.S.C. 78c–5 (''Section 3E of the Exchange Act'' or ''Section 3E'').

[5] Section 3E of the Exchange Act does not distinguish between bank and nonbank SBSDs and 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).

[6] 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 market 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. 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).''

[7] *See* 7 U.S.C. 6s(e)(1)(B).

[8] *See* 7 U.S.C. 6s(e)(1)(A).

[9] *See Margin and Capital Requirements for Covered Swap Entities,* 80 FR 74840 (Nov. 30, 2015) (''*Prudential Regulator Margin and Capital Adopting Release*''). The prudential regulators, as part of their margin requirements for non-cleared security-based swaps, adopted a segregation requirement for collateral received as margin.

[10] *See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants,* 81 FR 636 (Jan. 6, 2016) (''*CFTC Margin Adopting Release*''); *Capital Requirements of Swap Dealers and Major Swap Participants,* 81 FR 91252 (Dec. 16, 2016) (''*CFTC Capital Proposing Release*'').

[11] *See Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions,* 77 FR 6336 (Feb. 7, 2012); *Protection of Collateral of Counterparties to Uncleared Swaps; Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy,* 78 FR 66621 (Nov. 6, 2013); *Segregation of Assets Held as Collateral in Uncleared Swap Transactions,* 84 FR 12894 (Apr. 3, 2019).

[12] *See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers,* Exchange Act Release No. 68071, (Oct. 18, 2012), 77 FR 70214 (Nov. 23, 2012) (''*Capital, Margin, and Segregation Proposing Release*'').

[13] The comment letters are available at *https://www.sec.gov/comments/s7-08-12/s70812.shtml.*

[14] *See Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants,* Exchange Act Release No. 69490 (May 1, 2013), 78 FR 30968 (May 23, 2013) (''*Cross-Border Proposing Release*'').

[15] The comment letters are available at *https://www.sec.gov/comments/s7-02-13/s70213.shtml.*

[16] *See Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers; Capital Rule for Certain Security-Based Swap Dealers,* Exchange Act Release No. 71958 (Apr. 17, 2014), 79 FR 25194, 25254 (May 2, 2014). The Commission received one comment addressing this proposal. *See* Letter from Suzanne H. Shatto (July 9, 2014) (''Shatto Letter''), *available at https://www.sec.gov/comments/s7-05-14/s70514.shtml.*

[17] *See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers,* Exchange Act Release No. 84409 (Oct. 11, 2018), 83 FR 53007 (Oct. 19, 2018) (''*Capital, Margin, and Segregation Comment Reopening*'').

[18] *See* Letter from Stephen John Berger, Managing Director, Government & Regulatory Policy, Citadel Securities (Nov. 19, 2018) (''Citadel 11/19/2018 Letter''); Letter from Bridget Polichene, Chief Executive Officer, Institute of International Bankers (Nov. 19, 2018) (''IIB 11/19/2018 Letter'').

[19] *See* Letter from Sebastian Crapanzano and Soo-Mi Lee, Managing Directors, Morgan Stanley (Nov. 19, 2018) (''Morgan Stanley 11/19/2018 Letter'').

[20] *See, e.g.,* Letter from Carl B. Wilkerson, Vice President and Chief Counsel, Securities, American Council of Life Insurers (Nov. 19, 2018) (''American Council of Life Insurers 11/19/18 Letter''); Letter from Dennis M. Kelleher, President and Chief Executive Officer, Better Markets, Inc. (Nov. 19, 2018) (''Better Markets 11/19/2018 Letter''); Letter from Susan M. Olson, General Counsel, Investment Company Institute (Nov. 19, 2018) (''ICI 11/19/2018 Letter'').

240.15c3–1a (''Rule 15c3–1a''), 17 CFR 240.15c3–1b (''Rule 15c3–1b''), 17 CFR 240.15c3–1d (''Rule 15c3–1d''), 17 CFR 240.15c3–1e (''Rule 15c3–1e''), 17 CFR 240.15c3–3 (''Rule 15c3–3'') and adopting new Rules 15c3–3b, 18a–1, 18a–1a, 18a1b, 18a1c, 18a–1d, 18a–2, 18a–3, 18a–4, 18a–4a, and 18a–10. The amendments and new rules establish capital and margin requirements for nonbank SBSDs, including for: (1) Broker-dealers that are registered as SBSDs (''broker-dealer SBSDs''); [21] (2) broker-dealers that are registered as MSBSPs (''broker-dealer MSBSPs''); (3) nonbank SBSDs that are not registered as broker-dealers (''stand-alone SBSDs''); and (4) nonbank MSBSPs that are not registered as broker-dealers (''stand-alone MSBSPs''). They also establish segregation requirements for SBSDs and notification requirements with respect to segregation for SBSDs and MSBSPs. Further, the amendments provide that a nonbank SBSD that is also registered as an OTC derivatives dealer is subject to Rules 18a–1, 18a–1a, 18a–1b, 18a–1c, and 18a–1d rather than Rule 15c3–1 and its appendices.

The rule amendments also increase the minimum tentative net capital and net capital requirements for ANC broker-dealers. In addition to the new requirements for ANC broker-dealers, some of the amendments to Rules 15c3–1 and 15c3–3 apply to broker-dealers that are not registered as an SBSD or MSBSP (''stand-alone broker-dealers'') to the extent they engage in security-based swap activities.

Additionally, the Commission is amending its existing cross-border rule to provide a mechanism to seek substituted compliance with respect to the capital and margin requirements for foreign nonbank SBSDs and MSBSPs and providing guidance on how it will evaluate requests for substituted compliance.[22] The Commission is adopting rule-based requirements that address the application of the segregation requirements to cross-border security-based swap transactions.

The Commission also is amending its rules governing the delegation of authority to provide the staff with delegated authority to take certain actions with respect to some of the requirements.

The Commission is not adopting the proposed liquidity stress test requirements at this time.[23] Instead, the Commission continues to consider the comments received on those proposals.

The Commission staff consulted with the CFTC and the prudential regulators in drafting the final rules and amendments.

Finally, the Commission recognizes that the firms subject to the requirements being adopted today are operating in a market that continues to experience significant changes in response to market and regulatory developments. Given the global nature of the security-based swap and swap markets, the regulatory landscape will continue to shift as U.S. and foreign regulators continue to implement and/or modify relevant regulatory frameworks that apply to participants in these markets and to their transactions. For example, the CFTC has proposed but not yet finalized its own capital requirements that will apply to swap dealers, some of which will also likely be registered with the Commission as SBSDs. The Commission intends to monitor these developments during the period before the compliance date for these rules and may consider modifications to the requirements that it is adopting today as circumstances dictate, such as the need to further harmonize with other regulators to minimize the risk of unnecessary market fragmentation, or to address other market developments.[24]

In addition, the Commission intends to monitor the impact of the capital, margin, and segregation requirements being adopted today using data about the security-based swap and swap activities of stand-alone broker-dealers and SBSDs once they are subject to these requirements. The data will include the capital they maintain, the liquidity they maintain, the leverage they employ, the scale of their security-based swap and swap activities, the types and amounts of collateral they hold to address credit exposures, and the risk management controls they establish. The Commission may consider modifications to the requirements in light of these data.

B. Overview of the New Requirements

1. Capital Requirements

a. SBSDs

Broker-dealer SBSDs will be subject to the pre-existing requirements of Rule 15c3–1, as amended, to account for security-based swap and swap activities. Stand-alone SBSDs (including firms also registered as OTC derivatives dealers) will be subject to Rule 18a–1. Rule 18a–1 is structured similarly to Rule 15c3–1 and contains many provisions that correspond to those in Rule 15c3–1, as amended.

These rules prescribe minimum net capital requirements for nonbank SBSDs that are the greater of a fixed-dollar amount and an amount derived by applying a financial ratio. A broker-dealer SBSD must be an ANC broker-dealer (''ANC broker-dealer SBSD'') in order to use models to calculate market and credit risk charges in lieu of applying standardized deductions (also known as haircuts) for certain approved positions. An ANC broker-dealer, including an ANC broker-dealer SBSD, will be subject to a minimum fixed-dollar tentative net capital requirement of $5 billion and a minimum fixed-dollar net capital requirement of $1 billion. Stand-alone SBSDs that use models will be subject to a minimum fixed-dollar tentative net capital requirement of $100 million and a minimum fixed-dollar net capital requirement of $20 million. Broker-dealer and stand-alone SBSDs not authorized to use models will be subject to a fixed-dollar minimum net capital requirement of $20 million but will not be subject to a fixed-dollar tentative net capital requirement.

The financial ratio-derived minimum net capital requirement applicable to an ANC broker-dealer, including an ANC broker-dealer SBSD, and a broker-dealer SBSD not authorized to use models will be the amount computed using one of the two pre-existing (*i.e.,* were part of the rule before today's amendments) financial ratios in Rule 15c3–1 plus an amount computed using a new financial ratio tailored specifically to the firm's security-based swap activities. This new financial ratio requirement is 2% of an amount determined by calculating the firm's exposures to its security-based swap customers (''2% margin factor''). A stand-alone SBSD will be subject to the 2% margin factor but will not be subject to either of the pre-existing financial ratios in Rule 15c3–1. The 2% margin factor multiplier will remain at 2% for 3 years after the compliance date of the

[21] The term ''broker-dealer'' when used in this release generally does not refer to an OTC derivatives dealer *See* 17 CFR 240.3b–12 (''Rule 3b–12'') (defining the term ''OTC derivatives dealer''). Instead, this class of dealer is referred to as an ''OTC derivatives dealer'' and, except when discussing the alternative compliance mechanism of Rule 18a–10, the term ''stand-alone SBSD'' includes a nonbank SBSD that is also registered as an OTC derivatives dealer. The alternative compliance mechanism is discussed below in sections I.B.4., II.D., IV.A.6., IV.D.6., and VI.B.1. of this release, among other sections. As discussed below, the alternative compliance mechanism is not available to nonbank SBSDs that are registered as either a broker-dealer or an OTC derivatives dealer. Consequently, the term ''stand-alone SBSD,'' in the context of discussing the alternative compliance mechanism, refers to a stand-alone SBSD that is not also registered as an OTC derivatives dealer.

[22] 17 CFR 240.3a71–6 (''Rule 3a71–6'').

[23] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70252–54.

[24] The compliance date for the amendments and rules being adopted today is discussed below in section III.B. of this release.

rule. After 3 years, the multiplier could increase to not more than 4% by Commission order, and after 5 years the multiplier could increase to not more than 8% by Commission order if the Commission had previously issued an order raising the multiplier to 4% or less. The final rules further provide that the Commission will consider the capital and leverage levels of the firms subject to these requirements as well as the risks of their security-based swap positions and will provide notice before issuing an order raising the multiplier. This approach will enable the Commission to analyze the impact of the new requirement.

The following table summarizes the minimum net capital requirements applicable to nonbank SBSDs as of the compliance date of the rule.

Type of registrant	Rule	Tentative net capital	Net capital	
			Fixed-dollar	Financial ratio
Stand-alone SBSD (not using internal models).	18a–1	N/A	$20 million	2% margin factor.
Stand-alone SBSD (using internal models)[1]	18a–1	$100 million	20 million	2% margin factor.
Broker-dealer SBSD (not using internal models)	15c3–1	N/A	20 million	2% margin factor + Rule 15c3–1 ratio.
Broker-dealer SBSD (using internal models)	15c3–1	$5 billion	1 billion	2% margin factor + Rule 15c3–1 ratio.

[1] Includes a stand-alone SBSD that also is an OTC derivatives dealer.

Nonbank SBSDs will compute net capital by first determining their net worth under U.S. generally accepted accounting principles (''GAAP''). Next, the firms will need to deduct illiquid assets and take other deductions from net worth, and may add qualified subordinated loans. The deductions will be the same as required under the pre-existing requirements of Rule 15c3–1.

In addition, the Commission is prescribing new deductions tailored specifically to security-based swaps and swaps. For example, stand-alone broker-dealers and nonbank SBSDs will be required to take a deduction for under-margined accounts because of a failure to collect margin required under Commission, CFTC, clearing agency, derivatives clearing organization (''DCO''), or designated examining authority (''DEA'') rules (*i.e.,* a failure to collect margin when there is no exception from collecting margin). Nonbank SBSDs also will be required to take deductions when they elect not to collect margin pursuant to exceptions in the margin rules of the Commission and the CFTC for non-cleared security-based swaps and swaps, respectively. These deductions for electing not to collect margin must equal 100% of the amount of margin that would have been required to be collected from the security-based swap or swap counterparty in the absence of an exception (*i.e.,* the size of the deduction will be computed using the standardized or model-based approach prescribed in the margin rules of the Commission or the CFTC, as applicable). These deductions can be reduced by the value of collateral held in the account after applying applicable haircuts to the value of the collateral. In addition, as discussed below, nonbank SBSDs authorized to use models may take credit risk charges instead of these deductions for electing not to collect margin under exceptions in the margin rules of the Commission and the CFTC for non-cleared security-based swaps and swaps.

After taking these deductions and making other adjustments to net worth, the amount remaining is defined as ''tentative net capital.'' The final steps a stand-alone broker-dealer or nonbank SBSD will need to take in computing net capital are: (1) To deduct haircuts (standardized or model-based) on their proprietary securities and commodity positions; and (2) for firms authorized to use models, to deduct credit risk charges computed using credit risk models.

The haircuts for proprietary securities and commodity positions will be determined using standardized or model-based haircuts. The standardized haircuts for positions—other than security-based swaps and swaps—generally are the pre-existing standardized haircuts required by Rule 15c3–1. With respect to security-based swaps and swaps, the Commission is prescribing standardized haircuts tailored to those instruments. In the case of a cleared security-based swap or swap, the standardized haircut is the applicable clearing agency or DCO margin requirement. For a non-cleared credit default swap (''CDS''), the standardized haircut is set forth in two grids (one for security-based swaps and one for swaps) in which the amount of the deduction is based on two variables: the length of time to maturity of the CDS contract and the amount of the current offered basis point spread on the CDS. For other types of non-cleared security-based swaps and swaps, the standardized haircut generally is the percentage deduction of the standardized haircut that applies to the underlying or referenced position multiplied by the notional amount of the security-based swap or swap.

Instead of applying these standardized haircuts, stand-alone broker-dealers and nonbank SBSDs may apply to the Commission to use a model to calculate market and credit risk charges (model-based haircuts) for their positions, including derivatives instruments such as security-based swaps and swaps. The application and approval process will be similar to the process used for stand-alone broker-dealers applying to the Commission for authorization to use models under the pre-existing provisions of Rules 15c3–1 and 15c3–1e (*i.e.,* stand-alone broker-dealers applying to become ANC broker-dealers). If approved, the firm may compute market risk charges for certain of its proprietary positions using a model.

In addition, an ANC broker-dealer (including an ANC broker-dealer SBSD) and a stand-alone SBSD approved to use models for capital purposes can apply a credit risk charge with respect to uncollateralized exposures arising from derivatives instruments, including exposures arising from not collecting variation and/or initial margin pursuant to exceptions in the non-cleared security-based swap and swap margin rules of the Commission and CFTC, respectively. Consequently, these credit risk charges may be taken instead of the deductions described above when a nonbank SBSD does not collect variation and/or initial margin pursuant to exceptions in these margin rules.

In applying the credit risk charges, an ANC broker-dealer (including an ANC broker-dealer SBSD) is subject to a portfolio concentration charge that has a threshold equal to 10% of the firm's tentative net capital. Under the portfolio concentration charge, the application of the credit risk charges to uncollateralized *current* exposure across all counterparties arising from derivatives transactions is limited to an amount of the current exposure equal to no more than 10% of the firm's tentative net capital. The firm must take a charge equal to 100% of the amount of the firm's aggregate current exposure in excess of 10% of its tentative net capital. Uncollateralized *potential* future exposures arising from electing not to collect initial margin pursuant to exceptions in the margin rules of the Commission and the CFTC are not subject to this portfolio concentration charge. In addition, a stand-alone SBSD, including an SBSD operating as an OTC derivatives dealer, is not subject to a portfolio concentration charge with respect to uncollateralized current exposure. However, all these entities (*i.e.,* ANC broker-dealers, ANC broker-dealer SBSDs, stand-alone SBSDs, and stand-alone SBSDs that also are registered as OTC derivatives dealers) are subject to a concentration charge for large exposures to single a counterparty that is calculated using the existing methodology in Rule 15c3–1e.[25]

The following table summarizes the entities that are subject to the portfolio concentration charge and/or the counterparty concentration charge.

Entity type (must be approved to use models)	10% TNC portfolio concentration charge	Counterparty concentration charge
ANC broker-dealer	Yes	Yes.
ANC broker-dealer SBSD	Yes	Yes.
Stand-alone SBSD	No	Yes.
Stand-alone SBSD/OTC derivatives dealer	No	Yes.

Nonbank SBSDs also must comply with Rule 15c3–4. This rule will require them 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.

b. MSBSPs

Rule 18a–2 prescribes the capital requirements for stand-alone MSBSPs.[26] Under this rule, stand-alone MSBSPs must at all times have and maintain positive tangible net worth. The term ''tangible net worth'' is defined to mean the stand-alone MSBSP's net worth as determined in accordance with GAAP, excluding goodwill and other intangible assets. All MSBSPs must comply with Rule 15c3–4 with respect to their security-based swap and swap activities.

2. Margin Requirements for Non-Cleared Security-Based Swaps

a. SBSDs

Rule 18a–3 prescribes margin requirements for nonbank SBSDs with respect to non-cleared security-based swaps. The rule requires a nonbank SBSD to perform two calculations with respect to each account of a counterparty as of the close of business each day: (1) The amount of current exposure in the account of the counterparty (also known as variation margin); and (2) the initial margin amount for the account of the counterparty (also known as potential future exposure or initial margin). Variation margin is calculated by marking the position to market. Initial margin must be calculated by applying the standardized haircuts prescribed in Rule 15c3–1 or 18a–1 (as applicable). However, a nonbank SBSD may apply to the Commission for authorization to use a model (including an industry standard model) to calculate initial margin. Broker-dealer SBSDs must use the standardized haircuts (which include the option to use the more risk sensitive methodology in Rule 15c3–1a) to compute initial margin for non-cleared equity security-based swaps (even if the firm is approved to use a model to calculate initial margin). Stand-alone SBSDs (including firms registered as OTC derivatives dealers) may use a model to calculate initial margin for non-cleared equity security-based swaps (and potentially equity swaps if portfolio margining is implemented by the Commission and the CFTC), provided the account of the counterparty does not hold equity security positions other than equity security-based swaps (and potentially equity swaps).

Rule 18a–3 requires a nonbank SBSD to collect collateral from a counterparty to cover a variation and/or initial margin requirement. The rule also requires the nonbank SBSD to deliver collateral to the counterparty to cover a variation margin requirement. The collateral must be collected or delivered by the close of business on the next business day following the day of the calculation, except that the collateral can be collected or delivered by the close of business on the second business day following the day of the calculation if the counterparty is located in another country and more than 4 time zones away. Further, collateral to meet a margin requirement must consist of cash, securities, money market instruments, a major foreign currency, the settlement currency of the non-cleared security-based swap, or gold. The fair market value of collateral used to meet a margin requirement must be reduced by the standardized haircuts in Rule 15c3–1 or 18a–1 (as applicable), or the nonbank SBSD can elect to apply the standardized haircuts prescribed in the CFTC's margin rules. The value of the collateral must meet or exceed the margin requirement after applying the standardized haircuts. In addition, collateral being used to meet a margin requirement must meet conditions specified in the rule, including, for example, that it must have a ready market, be readily transferable, and not consist of securities issued by the nonbank SBSD or the counterparty.

There are exceptions in Rule 18a–3 to the requirements to collect initial and/or variation margin and to deliver variation margin. A nonbank SBSD need not collect variation or initial margin from (or deliver variation margin to) a counterparty that is a commercial end user, the Bank for International Settlements (''BIS''), the European Stability Mechanism, or a multilateral development bank identified in the rule. Similarly, a nonbank SBSD need not collect variation or initial margin (or deliver variation margin) with respect to a legacy account (*i.e.,* an account holding security-based swaps entered into prior to the compliance date of the rule). Further, a nonbank SBSD need not collect initial margin from a

[25] Stand-alone SBSDs (including firms that also are registered as OTC derivatives dealers) are subject to Rule 18a–1, which includes a counterparty concentration charge that parallels the existing charge in Rule 15c3–1e.

[26] A broker-dealer MSBSP will be subject to Rule 15c3–1.

counterparty that is a financial market intermediary (*i.e.,* an SBSD, a swap dealer, a broker-dealer, a futures commission merchant (''FCM''), a bank, a foreign broker-dealer, or a foreign bank) or an affiliate. A nonbank SBSD also need not hold initial margin directly if the counterparty delivers the initial margin to an independent third-party custodian. Further, a nonbank SBSD need not collect initial margin from a counterparty that is a sovereign entity if the nonbank SBSD has determined that the counterparty has only a minimal amount of credit risk.

The rule also has a threshold exception to the initial margin requirement. Under this exception, a nonbank SBSD need not collect initial margin to the extent that the initial margin amount when aggregated with other security-based swap and swap exposures of the nonbank SBSD and its affiliates to the counterparty and its affiliates does not exceed $50 million. The rule also would permit a nonbank SBSD to defer collecting initial margin from a counterparty for two months after the month in which the counterparty does not qualify for the $50 million threshold exception for the first time. Finally, the rule has a minimum transfer amount exception of $500,000. Under this exception, if the combined amount of margin required to be collected from or delivered to a counterparty is equal to or less than $500,000, the nonbank SBSD need not collect or deliver the margin. If the initial and variation margin requirements collectively or individually exceed $500,000, collateral equal to the full amount of the margin requirement must be collected or delivered.

The following table summarizes the exceptions in Rule 18a–3 from collecting initial and/or variation margin and from delivering variation margin.

Exception	Status of exception to collecting margin		Status of exception to delivering VM
	VM	IM	
Commercial End User	Need Not Collect	Need Not Collect	Need Not Deliver.
BIS or European Stability Mechanism	Need Not Collect	Need Not Collect	Need Not Deliver.
Multilateral Development Bank	Need Not Collect	Need Not Collect	Need Not Deliver.
Financial Market Intermediary	Must Collect	Need Not Collect	Must Deliver.
Affiliate	Must Collect	Need Not Collect	Must Deliver.
Sovereign with Minimal Credit Risk	Must Collect	Need Not Collect	Must Deliver.
Legacy Account	Need Not Collect	Need Not Collect	Need Not Deliver.
IM Below $50 Million Threshold	Must Collect	Need Not Collect	Must Deliver.
Minimum Transfer Amount	Need Not Collect	Need Not Collect	Need Not Deliver.

Finally, nonbank SBSDs must monitor the risk of each account, and establish, maintain, and document procedures and guidelines for monitoring the risk.

MSBSPs

Rule 18a–3 also prescribes margin requirements for nonbank MSBSPs with respect to non-cleared security-based swaps. The rule requires a nonbank MSBSP to calculate variation margin for the account of each counterparty as of the close of each business day. The rule requires the nonbank MSBSP to collect collateral from (or deliver collateral to) a counterparty to cover a variation margin requirement. The collateral must be collected or delivered by the close of business on the next business day following the day of the calculation, except that the collateral can be collected or delivered by the close of business on the second business day following the day of the calculation if the counterparty is located in another country and more than 4 time zones away. Further, the variation margin must consist of cash, securities, money market instruments, a major foreign currency, the security of settlement of the non-cleared security-based swap, or gold. The rule has an exception pursuant to which the nonbank MSBSP need not collect variation margin if the counterparty is a commercial end user, the BIS, the European Stability Mechanism, or one of the multilateral development banks identified in the rule (there is no exception from delivering variation margin to these types of counterparties). The rule also has an exception pursuant to which the nonbank MSBSP need not collect or deliver variation margin with respect to a legacy account. Finally, there is a $500,000 minimum transfer amount exception to the collection and delivery requirements for nonbank MSBSPs.

3. Segregation Requirements

Section 3E(b) of the Exchange Act provides that, for cleared security-based swaps, the money, securities, and property of a security-based swap customer 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. However, Section 3E(c)(1) of the Exchange Act also provides, that for cleared security-based swaps, customers' money, securities, and property may, for convenience, be commingled and deposited in the same one or more accounts with any bank, trust company, or clearing agency. Section 3E(c)(2) further provides that, notwithstanding Section 3E(b), in accordance with such terms and conditions as the Commission may prescribe by rule, regulation, or order, any money, securities, or property of the security-based swaps customer of a broker, dealer, or security-based swap dealer described in Section 3E(b) may be commingled and deposited as provided in Section 3E with any other money, securities, or property received by the broker, dealer, or security-based swap dealer and required by the Commission to be separately accounted for and treated and dealt with as belonging to the security-based swaps customer of the broker, dealer, or security-based swap dealer.

Section 3E(f) of the Exchange Act establishes a program by which a counterparty to non-cleared security-based swaps with an SBSD or MSBSP can elect to have initial margin held at an independent third-party custodian (''individual segregation''). Section 3E(f)(4) provides that if the counterparty does not choose to require segregation of funds or other property (*i.e.,* waives segregation), the SBSD or MSBSP shall send a report to the counterparty on a quarterly basis stating that the firm's back office procedures relating to margin and collateral requirements are in compliance with the agreement of the counterparties. The statutory provisions of Sections 3E(b) and (f) are self-executing.

The Commission is adopting segregation rules pursuant to which money, securities, and property of a security-based swap customer relating to cleared and non-cleared security-based swaps must be segregated but can be commingled with money, securities, or property of other customers (''omnibus segregation''). The omnibus segregation requirements for stand-alone broker-dealers and broker-dealer SBSDs are codified in amendments to Rule 15c3–3. The omnibus segregation requirements for stand-alone SBSDs (including firms registered as OTC derivatives dealers) and bank SBSDs are codified in Rule 18a–4.

The omnibus segregation requirements are mandatory with respect to money, securities, or other property relating to *cleared* security-based swaps that is held by a stand-alone broker-dealer or SBSD (*i.e.,* customers cannot waive segregation). With respect to non-cleared security-based swap transactions, the omnibus segregation requirements are an alternative to the statutory provisions discussed above pursuant to which a counterparty can elect to have initial margin individually segregated or to waive segregation. However, under the final omnibus segregation rules for stand-alone broker-dealers and broker-dealer SBSDs codified in Rule 15c3–3, counterparties that are not an affiliate of the firm cannot waive segregation. Affiliated counterparties of a stand-alone broker-dealer or broker-dealer SBSD can waive segregation. Under Section 3E(f) of the Exchange Act and Rule 18a–4, all counterparties (affiliated and non-affiliated) to a non-cleared security-based swap transaction with a stand-alone or bank SBSD can waive segregation. The omnibus segregation requirements are the ''default'' requirement if the counterparty does not elect individual segregation or to waive segregation (in the cases where a counterparty is permitted to waive segregation). Rule 18a–4 also has exceptions pursuant to which a foreign stand-alone or bank SBSD or MSBSP need not comply with the segregation requirements (including the omnibus segregation requirements) for certain transactions.

Under the omnibus segregation requirements, an SBSD or stand-alone broker-dealer must maintain possession or control over excess securities collateral carried for the accounts of security-based swap customers. Generally, excess securities collateral means securities and money market instruments that are not being used to meet a variation margin requirement of the counterparty. In the context of security-based swap transactions, excess securities collateral means collateral delivered to the SBSD or stand-alone broker-dealer to meet an initial margin requirement of the counterparty as well as collateral held by the SBSD or stand-alone broker-dealer in excess of any applicable initial margin requirement (and that is not being used to meet a variation margin requirement). There are two exceptions under which excess securities collateral can be held in a manner that is not in the possession or control of the SBSD or stand-alone broker-dealer: (1) It is being used to meet a margin requirement of a clearing agency resulting from a cleared security-based swap transaction of the security-based swap customer; or (2) it is being used to meet a margin requirement of an SBSD resulting from the first SBSD or stand-alone broker-dealer entering into a non-cleared security-based swap transaction with the SBSD to offset the risk of a non-cleared security-based swap transaction between the first SBSD or broker-dealer and the security-based swap customer.

Under the omnibus segregation requirements, an SBSD or stand-alone broker-dealer must maintain a security-based swap customer reserve account to segregate cash and/or qualified securities in an amount equal to the net cash owed to security-based swap customers. The SBSD or stand-alone broker-dealer must at all times maintain, through deposits into the account, cash and/or qualified securities in amounts computed weekly in accordance with the formula set forth in Rules 15c3–3b or 18a–4a. In the case of a broker-dealer SBSD or stand-alone broker-dealer, this account must be separate from the reserve accounts the firm maintains for ''traditional'' securities customers and other broker-dealers under pre-existing requirements of Rule 15c3–3.

The formula in Rules 15c3–3b and 18a–4a is modeled on the pre-existing reserve formula in Exhibit A to Rule 15c3–3 (''Rule 15c3–3a''). The security-based swap customer reserve formula requires the SBSD or stand-alone broker-dealer to add up various credit items (amounts owed to security-based swap customers) and debit items (amounts owed by security-based swap customers). If, under the formula, credit items exceed debit items, the SBSD or stand-alone broker-dealer must maintain cash and/or qualified securities in that net amount in the security-based swap customer reserve account. For purposes of the security-based swap reserve account requirement, qualified securities are: (1) Obligations of the United States; (2) obligations fully guaranteed as to principal and interest by the United States; and (3) subject to certain conditions and limitations, general obligations of any state or a political subdivision of a state that are not traded flat and are not in default, are part of an initial offering of $500 million or greater, and are issued by an issuer that has published audited financial statements within 120 days of its most recent fiscal year end.

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. SBSDs and MSBSPs must provide this notice in writing to a duly authorized individual prior to the execution of the first non-cleared security-based swap transaction with the counterparty occurring after the compliance date of the rule. SBSDs also must obtain subordination agreements from a counterparty that affirmatively elects to have initial margin held at a third-party custodian or that waives segregation. Finally, a stand-alone or bank SBSD will be exempt from the requirements of Rule 18a–4 if the firm meets certain conditions, including that the firm: (1) Does not clear security-based swap transactions for other persons; (2) provides notice to the counterparty regarding the right to segregate initial margin at an independent third-party custodian; (3) discloses to the counterparty in writing that any collateral received by the SBSD will not be subject to a segregation requirement; and (4) discloses to the counterparty how a claim of the counterparty for the collateral would be treated in a bankruptcy or other formal liquidation proceeding of the SBSD.

4. Alternative Compliance Mechanism

The Commission is adopting an alternative compliance mechanism in Rule 18a–10 pursuant to which a stand-alone SBSD that is registered as a swap dealer and predominantly engages in a swaps business may elect to comply with the capital, margin, and segregation requirements of the CEA and the CFTC's rules in lieu of complying with Rules 18a–1, 18a–3, and 18a–4. In order to qualify to operate pursuant to Rule 18a–10, the stand-alone SBSD cannot be registered as a broker-dealer or an OTC derivatives dealer. Moreover, in addition to other conditions, the aggregate gross notional amount of the firm's security-based swap positions must not exceed the lesser of a maximum fixed-dollar amount or 10% of the combined aggregate gross notional amount of the firm's security-based swap and swap positions. The maximum fixed-dollar amount is set at a transitional level of $250 billion for the first 3 years after the compliance date of the rule and then drops to $50 billion thereafter unless the Commission issues an order: (1) Maintaining the $250 billion maximum fixed-dollar amount for an additional period of time or indefinitely; or (2) lowering the maximum fixed-dollar amount to an amount between $250 billion and $50 billion. The final rule further provides that the Commission will consider the levels of security-based swap activity of the stand-alone SBSDs operating under the alternative compliance mechanism and provide notice before issuing such an order.

5. Cross-Border Application

As adopted, the Commission is treating capital and margin requirements under Section 15F(e) of the Exchange Act and Rules 18a–1, 18a–2, and 18a–3 thereunder as entity-level requirements that are applicable to the entirety of the business of an SBSD or MSBSP. Foreign SBSDs and MSBSPs have the potential to avail themselves of substituted compliance to satisfy the capital and margin requirements under Section 15F of the Exchange Act and Rules 18a–1 and 18a–2, and 18a–3 thereunder. The segregation requirements are deemed transaction-level requirements and substituted compliance is not available for them. However, Rule 18a–4 has exceptions pursuant to which a foreign stand-alone or bank SBSD or MSBSP need not comply with the segregation requirements for certain transactions. There are no exceptions from the segregation requirements for cross-border transactions of a stand-alone broker-dealer or a broker-dealer SBSD or MSBSP.

II. Final Rules and Rule Amendments

A. Capital

1. Introduction

The Commission is adopting capital requirements for nonbank SBSDs and MSBSPs pursuant to Sections 15 and 15F of the Exchange Act. More specifically, the Commission is adopting amendments to Rule 15c3–1 and certain of its appendices to address broker-dealer SBSDs and the security-based swap activities of stand-alone broker-dealers. In addition, the Commission is adopting Rule 18a–1, Rules 18a–1a, 18a–1b, 18a–1c and 18a–1d to establish capital requirements for stand-alone SBSDs, including for stand-alone SBSDs that are also registered as OTC derivatives dealers. Rule 18a–1 and its related rules are structured similarly to Rule 15c3–1 and its appendices and contain many provisions that correspond to those in Rule 15c3–1 and its appendices.[27]

As discussed in the proposing release, Rule 15c3–1 imposes a net liquid assets test that is designed to promote liquidity within broker-dealers.[28] For example, paragraph (c)(2)(iv) of Rule 15c3–1 does not permit most unsecured receivables to count as allowable net capital. This aspect of the rule severely limits the ability of broker-dealers to engage in activities that generate unsecured receivables (*e.g.,* as unsecured lending). 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 permits a broker-dealer to engage in activities that are part of conducting a securities business (*e.g.,* taking securities positions) but in a manner that leaves the firm 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). The objective of Rule 15c3–1 is to require a broker-dealer to maintain sufficient liquid assets to meet all liabilities, including obligations to customers, counterparties, and other creditors and to have adequate additional resources to wind-down its business in an orderly manner without the need for a formal proceeding if the firm fails financially.[29] The business of trading securities is one in which success, both for the firms and the investing public, is strongly dependent upon confidence, continuity, and commitment.[30] Generally, almost all trading-related liabilities are payable upon demand and represent a major portion of the firm's liabilities. Emphasis on liquidity helps to ensure that the liquidation of a firm will not result in excessive delay in repayment of the firm's obligations to customers, broker-dealers, and other creditors and therefore assures the continued liquidity of the securities markets. Rule 15c3–1 has been the capital standard for broker-dealers since 1975. Generally, the rule has promoted the maintenance of prudent levels of capital.[31]

Some commenters supported the Commission's proposal to model the nonbank SBSD capital requirements on the broker-dealer capital requirements. A commenter stated that separate standards for stand-alone broker-dealers and nonbank SBSDs would complicate the regulatory framework.[32] A second commenter argued that there should be no difference in the manner in which capital standards are applied to nonbank SBSDs, regardless of whether they are registered as broker-dealers or are affiliated with a bank holding company.[33] A third commenter expressed general support for the approach.[34]

Other commenters expressed concerns with regard to the proposed

[27] Rule 18a–1a, Rule18a–1b, Rule 18a–1c, and Rule 18a–1d correspond to the following appendices to Rule 15c3–1: Rule 15c3–1a (Options); Rule 15c3–1b (Adjustments to net worth and aggregate indebtedness for certain commodities transactions); 17 CFR 240.15c3–1c (''Rule 15c3–1c'') (Consolidated computations of net capital and aggregate indebtedness for certain subsidiaries and affiliates); and Rule 15c3–1d (Satisfactory subordination agreements).

[28] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70217–20.

[29] *See Net Capital Rule,* Exchange Act Release No. 38248 (Feb. 6, 1997), 62 FR 6474, 6475 (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.'').

[30] *See Net Capital Rule,* Exchange Act Release No. 27249 (Sept. 15, 1989), 54 FR 40395, 40396 (Oct. 2, 1989).

[31] *See* Securities Investor Protection Corporation (''SIPC''), *Annual Report* (2018), *available at https://www.sipc.org/media/annual-reports/2018-annual-report.pdf.* SIPC's 2018 annual report states that the annual average of new broker-dealer liquidations under the Securities Investor Protection Act of 1970 (''SIPA'') for the last 10-year period was 0.8 firms per year. It also states that there have been 330 broker-dealers liquidated in a SIPA proceeding since SIPC's inception in 1970, which amounts to less than 1% of approximately 40,000 broker-dealers that have been SIPC members during that time period. Moreover, it states that over that time period the value of cash and securities of SIPA liquidated broker-dealers returned to customers totaled approximately $139.8 billion and, of that amount, approximately $138.9 billion came from the estates of the failed broker-dealers, and approximately $1 billion came from the SIPC fund. It further states that, of the approximately 770,400 claims satisfied in completed or substantially completed cases as of December 31, 2018, a total of 356 were for cash and securities whose value was greater than limits of protection afforded by SIPA.

[32] *See* Letter from Dennis M. Kelleher, President and Chief Executive Officer, Better Markets, Inc. (Feb. 22, 2013) (''Better Markets 2/22/2013 Letter''); Letter from Dennis M. Kelleher, President and Chief Executive Officer, Better Markets, Inc. (July 22, 2013) (''Better Markets 7/22/2013 Letter'').

[33] *See* Letter from Kurt N. Schacht, Managing Director, and Beth Kaiser, Director, CFA Institute (Feb. 22, 2013) (''CFA Institute Letter'').

[34] *See* Letter from Thomas G. McCabe, Chief Operating Officer, OneChicago, LLC (Feb. 19, 2013) (''OneChicago 2/19/2013 Letter'').

approach or encouraged the Commission to harmonize its final rules with those of international standard setters and domestic regulators that have finalized capital and margin requirements.[35] A commenter stated that the Commission's proposed approach would result in very different capital requirements for nonbank SBSDs as compared to nonbank swap dealers subject to CFTC oversight, and that this could potentially prevent entities from dually registering as nonbank SBSDs and swap dealers.[36] The commenter also stated that requiring a multi-registered entity—such as an entity registered as a broker-dealer, FCM, SBSD, and swap dealer—to calculate regulatory capital under the rules of both the Commission and the CFTC and adhere to the greater minimum requirement would provide a strong disincentive to seeking the operational and risk management efficiencies of a consolidated business entity, and would be anticompetitive.

Several commenters encouraged the Commission and CFTC to harmonize their proposed capital rules.[37] A commenter suggested that the Commission coordinate with the CFTC and, as appropriate, the prudential regulators to assure that each agency's respective capital rules are harmonized and do not have the unintended effect of impairing the ability of broker-dealers that are dually registered as FCMs to provide clearing services for security-based swaps and swaps.[38] Another commenter was concerned that the proposed capital requirements for nonbank SBSDs were not comparable to those proposed by other U.S. regulators and that modeling the proposed rules on the broker-dealer capital standard was not appropriate.[39] This commenter argued that the bank capital standard is risk-based, whereas the broker-dealer capital standard is transaction volume-based, and that SBSDs and swap dealers operate in the same markets with the same counterparties and should be subject to comparable capital requirements. Commenters also referenced Section 15F(e)(3)(D)(ii) of the Exchange Act, which provides that the Commission, the prudential regulators, and the CFTC ''shall, to the maximum extent practicable, establish and maintain comparable minimum capital requirements. . . .'' [40] One commenter argued that divergence of bank and nonbank regulation is leading to some migration of risk to nonbank broker-dealers.[41] A commenter suggested that to avoid undermining the *de minimis* exception for SBSDs or inhibiting hedging activities by broker-dealers not registered as SBSDs, the Commission should limit the application of the proposed amendments to Rule 15c3–1 to broker-dealers that register as SBSDs.[42] Another commenter stated that a positive tangible net worth test would be more appropriate for nonbank SBSDs.[43]

The Commission has made two significant modifications to the final capital rules for nonbank SBSDs that should mitigate some of these concerns raised by commenters. First, as discussed below in section II.A.2.b.v. of this release, the Commission has modified Rule 18a–1 so that it no longer contains a portfolio concentration charge that is triggered when the aggregate current exposure of the stand-alone SBSD to its derivatives counterparties exceeds 50% of the firm's tentative net capital.[44] This means that stand-alone SBSDs that have been authorized to use models will not be subject to this limit on applying the credit risk charges to uncollateralized current exposures related to derivatives transactions. This includes uncollateralized current exposures arising from electing not to collect variation margin for non-cleared security-based swap and swap transactions under exceptions in the margin rules of the Commission and the CFTC. The credit risk charges are based on the creditworthiness of the counterparty and can result in charges that are substantially lower than deducting 100% of the amount of the uncollateralized current exposure.[45] This approach to addressing credit risk arising from uncollateralized current exposures related to derivatives transactions is generally consistent with the treatment of such exposures under the capital rules for banking institutions.[46]

The second significant modification is an alternative compliance mechanism. As discussed below in section II.D. of this release, the alternative compliance mechanism will permit a stand-alone SBSD that is registered as a swap dealer and that predominantly engages in a swaps business to comply with the capital, margin, and segregation requirements of the CEA and the CFTC's rules in lieu of complying with the Commission's capital, margin, and segregation requirements.[47] The CFTC's proposed capital rules for swap dealers that are FCMs would retain the existing capital framework for FCMs, which imposes a net liquid assets test similar to the existing capital requirements for stand-alone broker-dealers.[48] However, under the CFTC's proposed capital rules, swap dealers that are not FCMs would have the option of complying with: (1) A capital standard based on the capital rules for banks; (2) a capital standard based on the Commission's capital requirements in Rule 18a–1; or

[35] *See* Letter from Tom Quaadman, Executive Vice President, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce (Nov. 19, 2018) (''Center for Capital Markets Competitiveness, Chamber of Commerce 11/19/2018 Letter''); Citadel 11/19/2018 Letter; Letter from Walt L. Lukken, President and Chief Executive Officer, Futures Industry Association (Nov. 19, 2018) (''FIA 11/19/2018 Letter''); ICI 11/19/2018 Letter; Letter from Laura Harper Powell, Associate General Counsel, Managed Funds Association, and Adam Jacobs-Dean, Managing Director, Global Head of Markets Regulation, Alternative Investment Management Association (Nov. 19, 2018) (''MFA/AIMA 11/19/2018 Letter''); Adam Hopkins, Managing Director, Legal Department, Mizuho Capital Markets LLC, Marcy S. Cohen, General Counsel and Managing Director, ING Capital Markets LLC, and Michael Baudo, President and CEO, ING Capital Markets LLC (Nov. 16, 2018) (''Mizuho/ING Letter''); Letter from Sebastian Crapanzano and Soo-Mi Lee, Managing Directors, Morgan Stanley (Feb. 22, 2013) (''Morgan Stanley 2/22/2013 Letter'').

[36] *See* Letter from Richard M. Whiting, Executive Director and General Counsel, The Financial Services Roundtable (Feb. 22, 2013) (''Financial Services Roundtable Letter'').

[37] *See* Citadel 11/19/18 Letter; Financial Services Roundtable Letter; FIA 11/19/2018 Letter; Morgan Stanley 11/19/2018 Letter.

[38] *See* FIA 11/19/2018 Letter.

[39] *See* Morgan Stanley 2/22/2013 Letter.

[40] *See* Letter from Robert Pickel, Chief Executive Officer, International Swaps and Derivatives Association (''ISDA'') (Feb. 5, 2014) (''ISDA 2/5/2014 Letter''); Morgan Stanley 2/22/2013 Letter.

[41] *See* Letter from Robert Rutkowski (Nov. 20, 2018) (''Rutkowski 11/20/2018 Letter'').

[42] *See* Letter from Kenneth E. Bentsen, Jr., President and CEO, Securities Industry and Financial Markets Association (Nov. 19, 2018) (''SIFMA 11/19/2018 Letter''); Morgan Stanley 11/19/2018 Letter.

[43] *See* Letter from David T. McIndoe, Alexander S. Holtan, and Cheryl I. Aaron, Counsels, Sutherland Asbill & Brennan LLP on behalf of The Commercial Energy Working Group (Feb. 14, 2013) (''Sutherland Letter'').

[44] *See* paragraph (e)(2) of Rule 18a–1, as adopted. *See also Capital, Margin, and Segregation Proposing Release,* 77 FR at 70244 (proposing a portfolio concentration charge in Rule 18a–1 for stand-alone SBSDs).

[45] *See* paragraph (e)(2) of Rule 18a–1, as adopted.

[46] *See OTC Derivatives Dealers,* Exchange Act Release No. 40594 (Oct. 23, 1998), 63 FR 59362, 59384–87 (Nov. 3, 1998) (''[T]he Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively, the ''U.S. Banking Agencies'') have adopted rules implementing the Capital Accord for U.S. banks and bank holding companies. Appendix F is generally consistent with the U.S. Banking Agencies' rules, and incorporates the qualitative and quantitative conditions imposed on-banking institutions.''). The use of models to compute market risk charges in lieu of the standardized haircuts (as nonbank SBSDs will be permitted to do under Rules 15c3–1 and 18a–1) also is generally consistent with the capital rules for banking institutions. *Id. See also* section VI.A.4.b. of this release (discussing bank capital regulations).

[47] *See* Rule 18a–10, as adopted.

[48] *See CFTC Capital Proposing Release,* 81 FR 91252.

(3) if the swap dealer is predominantly engaged in non-financial activities, a capital standard based on a tangible net worth requirement.

The Commission acknowledges that under these two modifications a stand-alone SBSD will be subject to: (1) A capital standard that is less rigid than Rule 15c3–1 in terms of imposing a net liquid assets test (in the case of firms that will comply with Rule 18a–1); or (2) a capital standard that potentially does not impose a net liquid assets test (in the case of firms that will operate under the alternative compliance mechanism and, therefore, comply with the CFTC's capital rules). This will decrease the liquidity of these firms and therefore decrease their self-sufficiency. As a result, the risk that a stand-alone SBSD may not be able to self-liquidate in an orderly manner will be increased.

However, stand-alone SBSDs will engage in a more limited business than stand-alone broker-dealers and broker-dealer SBSDs. Thus, they will be less significant participants in the overall securities markets. For example, they will not be dealers in the cash securities markets or the markets for listed options and they will not maintain custody of cash or securities for retail investors in those markets. Given their limited role, the Commission believes that it is appropriate to more closely align the requirements for stand-alone SBSDs with the requirements of the CFTC and the prudential regulators. These modifications to more closely harmonize the rules are designed to address the concerns of commenters noted above about the potential consequences of imposing different capital standards. They also take into account Section 15F(e)(3)(D)(ii) of the Exchange Act, which provides that the Commission, the prudential regulators, and the CFTC ''shall, to the maximum extent practicable, establish and maintain comparable minimum capital requirements . . .''

Notwithstanding the modification to Rule 18a–1 described above, the rule continues to be modeled in large part on the broker-dealer capital rule. For example, as is the case with Rule 15c3–1, most unsecured receivables (aside from uncollateralized current exposures relating to derivatives transactions) will not count as allowable capital. Moreover, fixed assets and other illiquid assets will not count as allowable capital. Consequently, stand-alone SBSDs subject to Rule 18a–1 (*i.e.,* firms that do not operate under the alternative compliance mechanism) will remain subject to certain requirements modeled on requirements of Rule 15c3–1 that are designed to promote their liquidity.

Additionally, broker-dealer SBSDs will be subject to Rule 15c3–1 and the stricter (as compared to Rule 18a–1) net liquid assets test it imposes. For example, as discussed below in section II.A.2.b.v. of this release, Rule 15c3–1e, as amended, modifies the existing portfolio concentration charge so that it equals 10% of an ANC broker-dealer's tentative net capital (a reduction from 50% of the firm's tentative net capital).[49] Thus, the ability of these firms to apply the credit risk charges to uncollateralized current exposures arising from derivatives transactions will be more restricted. In addition, as discussed below, broker-dealer and stand-alone SBSDs will be subject to a 100% capital charge for initial margin they post to counterparties because, for example, the counterparty is subject to the margin rules of the CFTC or the prudential regulators.

Consequently, while the two modifications discussed above with respect to stand-alone SBSDs should mitigate commenters' concerns, there likely will be significant differences between the capital requirements for nonbank SBSDs and the capital requirements for bank SBSDs and bank and nonbank swap dealers. In this regard, the Commission has balanced the concerns raised by commenters about inconsistent requirements with the objective of promoting the liquidity of nonbank SBSDs. The Commission believes that the broker-dealer capital standard is the most appropriate alternative for nonbank SBSDs, given the nature of their business activities and the Commission's experience administering the standard with respect to broker-dealers. The objective of the broker-dealer capital standard is to protect customers and counterparties and to mitigate the consequences of a firm's failure by promoting the ability of these entities to absorb financial shocks and, if necessary, to self-liquidate in an orderly manner.

Moreover, certain operational, policy, and legal differences support the distinction between nonbank SBSDs and bank SBSDs. First, based on the Commission staff's understanding of the activities of nonbank dealers in the OTC derivatives markets, 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, which—unlike broker-dealers—are in the business of making loans and taking deposits. Similar to stand-alone broker-dealers, nonbank SBSDs will not be lending or deposit-taking institutions and will focus their activities on dealing in securities (*i.e.,* security-based swaps).

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. Those same differences also will exist between bank SBSDs and nonbank SBSDs. For example, in general, banks obtain much of their funding through customer deposits (a relatively inexpensive source of funding) and can obtain liquidity through the Federal Reserve's discount window. Broker-dealers do not—and nonbank SBSDs will not—have access to these sources of funding and liquidity. Consequently, in the Commission's judgment, the broker-dealer capital standard is the appropriate standard for nonbank SBSDs because it is designed to promote a firm's liquidity and self-sufficiency (in other words, to account for the lack of inexpensive funding sources that are available to banks, such as deposits and central bank support).

The rules governing ANC broker-dealers and OTC derivatives dealers currently contain provisions designed to address dealing in OTC derivatives by broker-dealers and, therefore, to some extent are tailored to address security-based swap activities of broker-dealers. However, as discussed below, the amendments to Rule 15c3–1 are designed to more specifically address the risks of security-based swaps and swaps and the potential for the increased involvement of broker-dealers in these markets.[50] Moreover, most stand-alone broker-dealers are not subject to Rules 15c3–1e and 15c3–1f and thus will need to take standardized haircuts in calculating their net capital. Therefore, in response to comments, the Commission believes it is appropriate for the amendments to Rule 15c3–1 to apply to broker-dealers irrespective of whether they are registered as SBSDs. This approach will establish requirements (such as standardized haircuts for security-based swaps) that are specifically tailored to security-based swap activities across all broker-dealers (*i.e.,* broker-dealer SBSDs and stand-alone broker-dealers that engage in a *de minimis* level of security-based swap activities).

The Commission disagrees with the comment that the broker-dealer capital standard is not risk-based. The ratio-

[49] *See* paragraph (c)(3) of Rule 15c3–1e, as adopted.

[50] *See 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); *OTC Derivatives Dealers,* 63 FR 59362.

based minimum net capital requirement being adopted today is tied directly to the risk of the firm's customer exposures. Further, the standardized and model-based haircuts that will be used by nonbank SBSDs are tied directly to the market and credit risk of the firm's positions.

For these reasons, Rules 15c3–1, as amended, and 18a–1, as adopted, establish capital requirements for nonbank SBSDs that differ from the capital requirements adopted by the prudential regulators and certain of the capital requirements the CFTC proposed for nonbank swap dealers.[51] The Commission considered these alternative approaches in light of Section 15F(e)(3)(D)(ii) of the Exchange Act, which provides—as discussed above—that the Commission, prudential regulators, and the CFTC to the maximum extent practicable, establish and maintain comparable minimum capital requirements. However, as discussed above, the Commission believes that the capital requirements for nonbank SBSDs should take into account key differences between banks (which are lending institutions) and nonbank SBSDs (which will focus primarily on securities activities). Therefore, the Commission does not believe it would be appropriate to model the Commission's capital requirements for nonbank SBSDs on the bank capital standard.[52]

Further, the Commission does not believe it is necessary to apply a tangible net worth test to nonbank SBSDs, as suggested by a commenter. The CFTC proposed a tangible net worth requirement for swap dealers that are predominately engaged in non-financial activities (*e.g.,* agriculture or energy) because of the potential that some of these entities may need to register as swap dealers due to their use of swaps as part of their non-financial activities.[53] The application of a broker-dealer-based or a bank-based capital approach to entities engaged in non-financial activities could result in inappropriate capital requirements that would not be proportionate to the risk associated with these types of firms. The Commission does not believe that entities predominantly engaged in non-financial activities are likely to deal in security-based swaps to an extent that would trigger registration with the Commission because, for example, the swap market is significantly larger than the security-based swap market and has many more active participants that are non-financial entities.[54] Moreover, a tangible net worth standard would not promote liquidity, as it treats all tangible assets equally, and therefore could incentivize a firm to hold illiquid but higher yielding assets.

Based on staff experience, it is expected that financial institutions will comprise a large segment of the security-based swap 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. Consequently, these affiliates—because their capital structures are geared towards securities trading or because they already are broker-dealers—will not face the types of practical issues that non-financial entities would face if they had to adhere to a capital standard modeled on the broker-dealer capital standard. In addition, many broker-dealers currently are affiliates of bank holding companies. Consequently, these broker-dealers are subject to Rule 15c3–1, while their parent and bank affiliates are subject to bank capital standards. For these reasons, the Commission does not believe it is necessary to adopt a different capital standard to accommodate entities that are predominantly engaged in non-financial activities as was proposed by the CFTC.[55]

The Commission acknowledges that not adopting the CFTC's proposed alternative-capital-standards approach could require nonbank SBSDs that are also registered with the CFTC as swap dealers to, in some cases, perform two different capital calculations. This could cause some firms to separate their nonbank SBSDs and their nonbank swap dealers into separate entities. For nonbank SBSDs that are predominantly swap dealers, the alternative compliance mechanism will avoid this outcome. In addition, the modification to Rule 18a–1 more closely aligns the treatment of uncollateralized current exposures arising from derivatives transactions with the treatment of such exposures under the bank capital rules. The Commission, however, does not believe it would be appropriate to further address this potential consequence by modifying its proposed capital requirements for nonbank SBSDs to permit firms to apply a bank capital standard or tangible net worth test for the reasons discussed above.

In response to commenters' requests that the Commission and CFTC work together and harmonize their respective capital rules, as appropriate, Commission staff has consulted with the CFTC, among others, in drafting the proposals and the amendments and rules being adopted today, and as discussed further below, has sought to make the Commission's capital rule more consistent with the CFTC's proposed capital rules, as appropriate.

For these reasons, the Commission is modeling the capital requirements for nonbank SBSDs on the broker-dealer capital standard in Rule 15c3–1, as

[51] As noted above, the prudential regulators similarly adopted capital standards for bank SBSDs based on the capital standards for banks. *See Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74889. As discussed above, the CFTC has proposed different capital standards for nonbank swap dealers depending on whether the registrant is an FCM and whether the registrant is predominantly engaged in non-financial activities. *See CFTC Capital Proposing Release,* 81 FR 91252.

[52] As discussed above and in section II.D. of this release, stand-alone SBSDs (excluding firms registered as OTC derivatives dealers) will be able to operate pursuant to the alternative compliance mechanism of Rule 18a–10 if they meet the conditions in the rule. Stand-alone SBSDs operating pursuant to this mechanism will be permitted to comply with the capital, margin, and segregation requirements of the CEA and the CFTC's rules instead of the capital, margin, and segregation requirements of Rules 18a–1, 18a–3, and 18a–4. As noted above, the CFTC's proposed capital rule for swap dealers included an option for certain firms to adhere to a bank-like capital standard. As discussed below in section II.D. of this release, the Commission believes stand-alone SBSDs that meet the conditions of Rule 18a–10 should be permitted to adhere to capital, margin, and segregation requirements of the CEA and the CFTC's rules (which, potentially, could include a bank-like capital standard) because, among other reasons, they will be predominantly engaging in a swaps business and, therefore, the CFTC will have a heightened regulatory interest in these firms as compared to the Commission's regulatory interest.

[53] *See CFTC Capital Proposing Release,* 81 FR at 91264–65.

[54] *See* BIS, *OTC derivatives statistics at end December 2018* (May 2019). The BIS statistical releases cited in this release are available at *https://www.bis.org/list/statistics/index.htm.*

[55] As discussed above and in section II.D. of this release, stand-alone SBSDs (excluding firms registered as OTC derivatives dealers) will be able to adhere to the capital, margin, and segregation requirements of the CEA and the CFTC's rules instead of Rules 18a–1, 18a–3, and 18a–4 if they meet the conditions in Rule 18a–10. As noted above, the CFTC's proposed capital rule for swap dealers included an option for certain firms to adhere to a tangible net worth capital standard. As also noted above, the Commission does not expect that entities predominantly engaged in non-financial activities are likely to register as SBSDs. Accordingly, it is unlikely that stand-alone SBSDs adhering to CFTC requirements in accordance with Rule 18a–10 will be subject to the CFTC's tangible net worth capital standard. To the extent that they are, however, the Commission believes stand-alone SBSDs that meet the conditions of Rule 18a–10 should be permitted to adhere to capital, margin, and segregation requirements of the CEA and the CFTC's rules (which, potentially, could include a tangible net worth capital standard) because, among other reasons, they will be predominantly engaging in a swaps business and, therefore, the CFTC will have a heightened regulatory interest in these firms as compared to the Commission's regulatory interest.

proposed, but with the two significant modifications discussed above with respect to the capital requirements for stand-alone SBSDs.

The Commission is adopting a positive tangible net worth capital standard for stand-alone MSBSPs pursuant to Section 15F of the Exchange Act. As discussed in more detail below, the Commission did not receive comments that specifically objected to this standard for these entities.

2. Capital Rules for Nonbank SBSDs

a. Computing Required Minimum Net Capital

Rule 15c3–1 requires a broker-dealer to maintain a minimum level of net capital (meaning highly liquid capital) at all times. Paragraph (a) of the rule requires the broker-dealer to perform two calculations: (1) A computation of the minimum amount of net capital the broker-dealer must maintain; and (2) a computation of the amount of net capital the broker-dealer is maintaining. 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 (''15-to-1 ratio'') or the 2% of aggregate debit items ratio (''2% debit item ratio''). The Commission proposed that nonbank SBSDs be subject to similarly structured minimum net capital requirements that varied depending on the type of entity. More specifically, proposed Rule 18a–1 required a stand-alone SBSD not authorized to use internal models when computing net capital to maintain minimum net capital of not less than the greater of $20 million or 8% of the firm's ''risk margin amount'' as that term was defined in the rule.[56] The risk margin amount was calculated as the sum of:

• The greater of: (1) 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 (2) the amount of the deductions that would apply to the cleared security-based swap positions of the security-based swap customers pursuant to proposed Rule 18a–1; and

• The total initial margin calculated by the stand-alone SBSD with respect to non-cleared security-based swaps pursuant to proposed Rule 18a–3.

The total of these two amounts—*i.e.,* the risk margin amount—would be multiplied by 8% to determine the ratio-based minimum net capital requirement (''8% margin factor''). In the 2018 comment reopening, the Commission asked whether the input to the risk margin amount for cleared security-based swaps should be determined solely by the total initial margin required to be delivered by the nonbank SBSD with respect to transactions cleared for security-based swap customers at a clearing agency.[57]

Proposed Rule 18a–1 permitted a stand-alone SBSD to apply to the Commission to use model-based haircuts.[58] The rule required a stand-alone SBSD authorized to use models to maintain: (1) Minimum tentative net capital of not less than $100 million; and (2) minimum net capital of not less than the greater of $20 million or the 8% margin factor.[59] The proposed rule defined ''tentative net capital'' to mean, in pertinent part, the amount of net capital maintained by the nonbank SBSD before deducting haircuts (standardized or model-based) with respect to the firm's proprietary positions and, for firms authorized to use models, before deducting the credit risk charges discussed below in section II.A.2.b.v. of this release. The minimum tentative net capital requirement was designed to account for the fact that model-based haircuts, 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. It also was designed to account for the fact that models may miscalculate risks or not capture all risks (*e.g.,* extraordinary losses or decreases in liquidity during times of stress that are not incorporated into the models).

The proposed amendments to Rule 15c3–1 established minimum net capital requirements for a broker-dealer SBSD not authorized to use model-based haircuts.[60] The proposed amendments required these entities to maintain minimum net capital equal of the greater of $20 million or the sum of: (1) The 8% margin factor; and (2) the amount of the financial ratio requirement that applied to the broker-dealer under pre-existing requirements in Rule 15c3–1 (*i.e.,* either the 15-to-1 ratio or 2% debit item ratio).

Under Rule 15c3–1e, a broker-dealer must apply to the Commission for authorization to use the alternative net capital (ANC) computation that permits models to be used to compute haircuts and credit risk charges. Broker-dealers with that authorization—ANC broker-dealers—are subject to minimum net capital requirements specific to these entities. In particular, before today's amendments, paragraph (a)(7)(i) of Rule 15c3–1 required an ANC broker-dealer to maintain minimum tentative net capital of at least $1 billion and minimum net capital of at least $500 million. In addition, paragraph (a)(7)(ii) of Rule 15c3–1 required an ANC broker-dealer to provide the Commission with an ''early warning'' notice when its tentative net capital fell below $5 billion.

As proposed, a broker-dealer SBSD authorized to use models was subject to the minimum net capital requirements for an ANC broker-dealer, which the Commission proposed increasing.[61] Consequently, under the proposed amendments to Rule 15c3–1, an ANC broker-dealer, including an ANC broker-dealer SBSD, was 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 amount of the 15-to-1 ratio or 2% debit item ratio (as applicable) plus the 8% margin factor. The Commission also proposed increasing the early warning notification requirement for ANC broker-dealers from $5 billion to $6 billion.

The Commission explained in the proposing release that 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 was $5 billion.[62] This $5 billion ''early warning'' threshold acted 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 was not to require the existing ANC broker-dealers to increase their current capital levels (as they already maintained tentative net capital in excess of $5 billion).[63] Rather, the goal

[56] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70221–24.

[57] *See Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53009. The release also sought comment and supporting data on the potential minimum net capital amounts that would be required of nonbank SBSDs. *Id.*

[58] *Capital, Margin, and Segregation Proposing Release,* 77 FR at 70226–27, 70237–40.

[59] 77 FR at 70221–24.

[60] 77 FR at 70225–26.

[61] 77 FR at 70227–29.

[62] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70228.

[63] The ANC broker-dealers continue to maintain tentative net capital in excess of the proposed $6 billion early warning level. *See also* section VI of this release (discussing costs and benefits of the

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was 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.

Comments and Final Fixed-Dollar Minimum Net Capital Requirements

Some commenters expressed support for the proposed fixed-dollar minimum tentative net capital and net capital requirements. A commenter stated that the requirements were consistent with pre-existing requirements and practices for OTC derivatives dealers and ANC broker-dealers that have not proven to produce significant disparities with other capital regimes.[64] A second commenter stated that the proposal to require an ANC broker-dealer to provide notification to the Commission if the firm's tentative net capital fell below $6 billion would improve the Commission's monitoring of these key market participants.[65]

One commenter asked the Commission to reconsider the proposed $100 million minimum fixed-dollar tentative net capital requirement for stand-alone SBSDs authorized to use models, particularly for a nonbank SBSD that trades only in cleared security-based swaps.[66] The commenter stated that dealing in cleared security-based swaps should not implicate the same concerns about the use of models that led to the establishment of a higher threshold for other Commission registrants. The Commission believes that the same risks exist with respect to the use of models whether an SBSD is trading cleared or non-cleared security-based swaps. In particular, the minimum tentative net capital requirement is designed to address the possibility that the model might miscalculate risk irrespective of the relative level of risk of the positions (*e.g.,* cleared versus non-cleared security-based swaps) being input into the model.

For these reasons, the Commission is adopting the proposed minimum fixed-dollar tentative net capital and net capital requirements as proposed as well as the $6 billion early warning notification requirement as proposed.[67] Consequently, under the final rules: (1) A stand-alone SBSD not approved to use internal models has a $20 million fixed-dollar minimum net capital requirement; [68] (2) a stand-alone SBSD authorized to use internal models (including a firm registered as an OTC derivatives dealer) has a $100 million fixed-dollar minimum tentative net capital requirement and a $20 million fixed-dollar minimum net capital requirement; [69] (3) a broker-dealer SBSD not authorized to use internal models has a $20 million fixed-dollar minimum net capital requirement; [70] and (4) an ANC broker-dealer, including an ANC broker-dealer SBSD, has a $6 billion fixed-dollar early warning notification requirement, a $5 billion fixed-dollar minimum tentative net capital requirement, and a $1 billion fixed-dollar minimum net capital requirement.[71]

Comments and Final Ratio-Based Minimum Net Capital Requirements

As noted above, the Commission proposed a ratio-based minimum net capital requirement that for a broker-dealer SBSD was the 15-to-1 ratio or 2% debit item ratio (as applicable) plus the proposed 8% margin factor, and for a stand-alone SBSD was only the proposed 8% margin factor.[72] Commenters raised concerns about the proposed 8% margin factor. One commenter suggested that the Commission require broker-dealer SBSDs to comply with a ratio that is modeled on the 2% debit item ratio in Rule 15c3–1.[73] Another commenter stated that a minimum capital requirement that is scalable to the volume, size, and risk of a nonbank SBSD's activities would be consistent with the safety and soundness standards mandated by the Dodd-Frank Act and the Basel Accords and would be comparable to the requirements established by the CFTC and the prudential regulators.[74] The commenter, however, expressed concerns that the proposed 8% margin factor was not appropriately risk-based.[75]

A commenter suggested that, if the proposed 8% margin factor is adopted, the Commission should exclude security-based swaps that are portfolio margined with swaps or futures in a CFTC-supervised account.[76] Another commenter believed that a broker-dealer dually registered as an FCM should be subject to a single risk margin amount calculated pursuant to the CFTC's rules, since the CFTC's proposed calculation incorporates both security-based swaps and swaps.[77] A commenter suggested modifying the proposed definition of ''risk margin amount'' to reflect the lower risk associated with central clearing by ensuring that capital requirements for cleared security-based swaps are lower than the requirements for equivalent non-cleared security-based swaps.[78]

Commenters also addressed the modifications to the proposed rule text in the 2018 comment reopening pursuant to which the input for cleared security-based swaps in the risk margin amount would be determined solely by reference to the amount of initial margin required by clearing agencies (*i.e.,* not be the greater of those amounts or the amount of the haircuts that would apply to the cleared security-based swap positions). Some commenters supported the potential rule language modifications.[79] Other commenters

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increases in the capital requirements for ANC broker-dealers).

[64] *See* Letter from Kenneth E. Bentsen, Jr., Executive Vice President, Securities Industry and Financial Markets Association (Feb. 22, 2013) (''SIFMA 2/22/2013 Letter'').

[65] *See* Letter from Stuart J. Kaswell, Executive Vice President, Managing Director, and General Counsel, Managed Funds Association (Feb. 22, 2013) (''MFA 2/22/2013 Letter'').

[66] *See* Letter from Stephen John Berger, Managing Director, Government & Regulatory Policy, Citadel Securities (May 15, 2017) (''Citadel 5/15/2017 Letter'').

[67] *See* paragraphs (a)(7)(i) and (a)(10)(i) of Rule 15c3–1, as amended; paragraphs (a)(1) and (2) of Rule 18a–1, as adopted. In the final rule, the Commission made non-substantive amendments to the term of ''tentative net capital'' in Rule 18a–1, as adopted, to align the language more closely to the definition in Rule 15c3–1. *See* paragraph (c)(5) of Rule 18a–1, as adopted.

[68] *See* paragraph (a)(1) of Rule 18a–1, as adopted.

[69] *See* paragraph (a)(2) of Rule 18a–1, as adopted.

[70] *See* paragraph (a)(10)(i) of Rule 15c3–1, as amended.

[71] *See* paragraph (a)(7)(i) and (ii) of Rule 15c3–1, as amended.

[72] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70225–26.

[73] *See* SIFMA 11/19/18 Letter. This commenter suggested that the Commission not apply the proposed 8% margin factor to full-purpose broker-dealers, and modify the customer reserve requirements to include security-based swap credits and debits, thereby covering security-based swaps in the existing 2% debit item ratio, under existing Rule 15c3–1. For stand-alone SBSDs, the commenter recommended replacing the proposed 8% margin factor with a 2% minimum capital requirement, based on a calculation consistent with the proposed risk margin amount.

[74] *See* SIFMA 2/22/2013 Letter.

[75] The commenter suggested two approaches: one for nonbank SBSDs authorized to use models and one for nonbank SBSDs not authorized to use models. Under the first approach, the risk margin amount would be a percent of the firm's aggregate model-based haircuts. The second approach was a credit quality adjusted version of the proposed 8% margin factor.

[76] *See* SIFMA 11/19/18 Letter.

[77] *See* Morgan Stanley 11/19/2018 Letter. This commenter also argued that a stand-alone broker-dealer should not be subject to the proposed 8% margin factor minimum ratio requirement. Stand-alone broker-dealers—other than ANC broker-dealers—do not have to incorporate the 2% margin factor into their net capital calculation under Rule 15c3–1, as amended.

[78] *See* MFA 2/22/2013 Letter. *See also* Letter from Thomas G. McCabe, Chief Regulatory Officer, OneChicago (Nov. 19, 2018) (''OneChicago 11/19/2018 Letter'').

[79] *See* ICI 11/19/18 Letter; MFA/AIMA 11/19/2019 Letter; SIFMA 11/19/2018 Letter.

opposed them.[80] One commenter opposing the modifications stated that the ''greater of'' provision creates a backstop to protect against the possibility that varying margin requirements across clearing agencies and over time could be insufficient to reflect the true risk to a nonbank SBSD arising from its customers' positions.[81] Another commenter stated that eliminating the haircut requirement may incentivize clearing agencies to compete on the basis of margin requirements.[82]

The Commission continues to believe a margin factor ratio is the right approach to setting a scalable minimum net capital requirement. The calculation is based on the initial margin required to be posted by an ANC broker-dealer or nonbank SBSD to a clearing agency for cleared security-based swaps and on the initial margin calculated by a nonbank SBSD for a counterparty for non-cleared security-based swaps.[83] Margin requirements generally are scaled to the risk of the positions, with riskier positions requiring higher levels of margin. Therefore, the amount of the ratio-based minimum net capital requirement will be linked to the volume, size, and risk of the firm's cleared and non-cleared security-based swap transactions.

However, in response to comments raising concerns about the potential impact of the proposed 8% margin factor, the Commission believes it would be appropriate to adopt, at least initially, a lower margin factor and create a process through which the percent multiplier can potentially (but not necessarily) be increased over time (*i.e.,* starting at 2% and potentially transitioning from 2% to 8% or less over the course of at least 5 years). Initially using a 2% multiplier could provide ANC broker-dealers and nonbank SBSDs with time to adjust to the requirement if it incrementally increases. The final rule sets strict limits in terms of how quickly the multiplier can be raised and the amount by which it can be raised through the process in the rule because market participants should know when a potential increase in the multiplier using the process could first occur and how much the multiplier could be increased at that time or thereafter. The Commission's objective is to establish an efficient and flexible process, while providing market participants with notice about the potential timing and magnitude of an increase so that they can make informed decisions about how to structure their businesses.

Consequently, under the process set forth in the final rules, the percent multiplier will be 2% for at least 3 years after the compliance date of the rule.[84] After 3 years, the multiplier could increase to not more than 4% by Commission order, and after 5 years the multiplier could increase to not more than 8% by Commission order if the Commission had previously issued an order raising the multiplier to 4% or less. The process sets an upper limit for the multiplier of 8% (the day-1 multiplier under the proposed rules) and requires the issuance of two successive orders to raise the multiplier to as much as 8% (or an amount between 4% and 8%). The first order can be issued no earlier than 3 years after the compliance date of the rules, and the second order can be issued no earlier than 5 years after the compliance date.

The process in the final rules provides that, before issuing an order to raise the multiplier, the Commission will consider the capital and leverage levels of the firms subject to the ratio-based minimum net capital requirement as well as the risks of their security-based swap positions. After the rule is adopted, the Commission will gather data on how the ratio-based minimum net capital requirement using the 2% multiplier (''2% margin factor'') compares to the levels of excess net capital these firms maintain, the risks of their security-based swap positions, and the leverage they employ.[85] This information will assist the Commission in analyzing whether the ratio-based minimum net capital requirement is operating in practice as the Commission intends (*i.e.,* a requirement that sets a prudent level of minimum net capital given the volume, size, and risk of the firm's security-based swap positions). In determining whether to issue an order raising the multiplier, the Commission may also consider, for example, whether further data is necessary to analyze the appropriate level of the ratio-based minimum net capital requirement.

Finally, the process in the final rules provides that the Commission will publish notice of the potential change to the multiplier and subsequently issue an order regarding the change. The Commission intends to provide such notice sufficiently in advance of the order for the public to be aware of the potential change.

As discussed above, a commenter suggested that broker-dealer SBSDs should be subject to a ratio that is modeled on the 2% debit item ratio in Rule 15c3–1. The Commission does not believe there is a compelling reason to adopt a different standard for broker-dealer SBSDs. The standard being adopted today is based on initial margin calculations for cleared and non-cleared security-based swaps. Modeling a requirement on the 2% debit item ratio would require a calculation based on the segregation requirements for security-based swaps. This could result in firms with similar risk profiles in terms of their customers' security-based swap positions having different minimum net capital requirements because for stand-alone SBSDs the requirement would be based on margin calculations and for ANC broker-dealers and broker-dealer SBSDs the requirement would be based on segregation requirements. The Commission believes the more prudent approach is to require all firms subject to this requirement to comply with the same standard in order to avoid the potential competitive impacts of imposing different standards, particularly when the rationale for applying the different standard advocated by the commenter is not grounded in promoting the safety and soundness of the firms.

Similarly, the Commission is not establishing two alternative methods for calculating the 2% margin factor—one for firms that use models and the other for firms that do not use models—as suggested by the commenter. To a certain extent, the 2% margin factor calculation by a nonbank SBSD authorized to use models to calculate initial margin requirements for non-cleared security-based swap transactions will be more risk sensitive than the calculation by nonbank SBSDs that will use the standardized approach to calculate initial margin (*i.e.,* the standardized haircuts). Models generally are more risk sensitive and therefore will result in lower initial

[80] *See* Letter from Americans for Financial Reform (Nov. 19, 2018) (''Americans for Financial Reform Education Fund Letter''); Better Markets 11/19/2018 Letter; Rutkowski 11/20/2018 Letter.

[81] *See* Better Markets 11/19/2018 Letter.

[82] *See* Americans for Financial Reform Education Fund Letter. *See also* Rutkowski 11/20/2018 Letter.

[83] An ANC broker-dealer will not be subject to the final margin rule for non-cleared security-based swaps if it is not also registered as an SBSD. Therefore, its calculation of the 2% margin factor will only account for cleared security-based swaps.

[84] As discussed below in section II.D. of this release, Rule 18a–10 contains a process through which the maximum fixed-dollar amount is set at a transitional level of $250 billion for the first 3 years after the compliance date of the rule and then drops to $50 billion thereafter unless the Commission issues an order: (1) Maintaining the $250 billion maximum fixed-dollar amount for an additional period of time or indefinitely; or (2) lowering the maximum fixed-dollar amount to an amount between $250 billion and $50 billion.

[85] *See* section VI of this release (providing analysis of initial margin estimated for inter-dealer CDS positions, and using this to provide a range of estimates for the potential costs of complying with the 2% margin factor requirement, under certain assumptions).

margin requirements than approaches using standardized haircuts. Thus, the firms that use models to calculate initial margin for non-cleared security-based swaps generally will employ a more risk-sensitive approach when calculating the 2% margin factor than firms that do not use models. Further, the Commission believes that most nonbank SBSDs will use models to calculate initial margin to the extent permitted under the final margin rules.

Moreover, a standard based on a firm's aggregate model-based haircuts—the commenter's first suggested alternative—could result in a substantially lower minimum net capital requirement. The Commission's approach requires the firm to calculate the risk margin amount using the initial margin amount calculated for each counterparty's cleared and non-cleared security-based swap positions. The commenter's alternative of using the model-based haircut calculations would net proprietary positions resulting in a lower minimum net capital requirement. The Commission believes the more prudent approach is to base the minimum net capital requirement on the margin calculations for each counterparty's security-based swap positions. For similar reasons, the Commission believes nonbank SBSDs not authorized to use models should base the calculation of the risk margin amount on the standardized margin calculations for their counterparties (rather than the standardized haircut calculation that can be taken for proprietary positions, which permits certain netting of long and short positions). This will be simpler and more consistent with the requirements of Rule 18a–3, as adopted, than the commenter's suggested credit quality approach for nonbank SBSDs that do not use models.

Moreover, as discussed below in section II.A.2.b.v. of this release, the final capital rules for ANC broker-dealers and nonbank SBSDs broaden the application of the credit risk charges as compared to the proposed rules. This should significantly reduce the amount of net capital an ANC broker-dealer or nonbank SBSD will need to maintain with respect to its security-based swap positions (as compared to the treatment of these positions under the proposed rules).[86] Therefore, the Commission believes that largely retaining the proposed approaches to calculating the risk margin amount (and, therefore, the 2% margin factor) is an appropriate trade-off to reducing the application of the capital deductions in lieu of margin.

In response to comments that the Commission exclude security-based swaps that are being portfolio margined under a CFTC-supervised account, the Commission will need to coordinate with the CFTC to implement portfolio margining.[87] A part of any such coordination would be to resolve the question of how to incorporate accounts that are portfolio margined into the minimum net capital requirements under the capital rules of the Commission and the CFTC.

In response to comments, the Commission does not believe it would be appropriate to treat cleared security-based swaps more favorably than non-cleared security-based swaps for purposes of calculating the 2% margin factor. The 2% margin factor is consistent with an existing requirement in the CFTC's net capital rule for FCMs.[88] Currently, FCMs must maintain adjusted net capital in excess of 8% of the risk margin on futures, foreign futures, and cleared swaps positions carried in customer and noncustomer accounts. Moreover, the CFTC has proposed a similar requirement for swap dealers and major swap participants registered as FCMs.[89] The CFTC's proposed minimum capital requirement is 8% of the initial margin for non-cleared swap and security-based swap positions, and the total initial margin the firm is required to post to a clearing agency or broker-dealer for cleared swap and security-based swap positions. Thus, the CFTC's proposed rule does not treat cleared positions more favorably than non-cleared positions (both are based on initial margin calculations).

However, in response to comments, the Commission has modified the final rule so that for cleared security-based swaps the calculation of the risk margin amount is based on the initial margin required to be posted to a clearing agency rather than the greater of that amount or the haircuts that would apply to the positions (as was proposed).[90] Thus, for purposes of the 2% margin factor, the risk of cleared security-based swaps is measured by the amount of initial margin the clearing agency's margin rule requires. This more closely aligns the Commission's rule with the CFTC's proposed rule (as requested by commenters).

In response to commenters who opposed this modification, the Commission recognizes that it will eliminate a component of the proposed rule that was designed to address the potential that clearing agencies might set margin requirements that were lower than the applicable haircuts that would apply to the positions. However, retaining the requirement could have created a disincentive to clear security-based swap transactions. Moreover, eliminating it will simplify the calculation and more closely align the requirement with the CFTC's proposed capital rule. The Commission has weighed these competing considerations and believes that the modification is appropriate.

The Commission does not believe further modifications to distinguish the risk of cleared security-based swaps from non-cleared security-based swaps are necessary. Cleared security-based swaps generally will be less complex than non-cleared security-based swaps. Further, cleared security-based swaps will be more liquid than non-cleared security-based swaps in terms of how long it will take to close them out. These attributes may factor into the margin calculations of the clearing agencies and, consequently, into the risk margin amount. Therefore, the potentially lower risk characteristics of cleared security-based swaps as compared to non-cleared security-based swaps could be incorporated into the 2% margin factor by virtue of relying solely on the clearing agency margin requirements.

For these reasons, the Commission is adopting the 2% margin factor with modifications to the term ''risk margin amount'' and the potential phase-in of the percent multiplier, as discussed above.[91] Stand-alone SBSDs will need to calculate the 2% margin factor to determine their ratio-based minimum net capital requirement. ANC broker-dealers and broker-dealer SBSDs will need to calculate the 2% margin factor and the 15-to-1 ratio or 2% debit item ratio (as applicable) to determine their ratio-based minimum net capital requirement.

b. Computing Net Capital

The Commission proposed the net liquid assets test embodied in Rule 15c3–1 as the regulatory capital

[86] *See* SIFMA 2/22/2013 Letter (raising concerns that the proposed 8% margin factor and the capital charges in lieu of margin could result in duplicative charges).

[87] *See, e.g., Order Granting Conditional Exemption Under the Securities Exchange Act of 1934 in Connection with Portfolio Margining of Swaps and Security-Based Swaps,* Exchange Act Release No. 68433 (Dec. 14, 2012), 77 FR 75211 (Dec. 19, 2012).

[88] *See* 17 CFR 1.17(a)(1)(i)(B) and (b)(8).

[89] *See CFTC Capital Proposing Release,* 81 FR at 91266.

[90] *See* paragraph (c)(17) of Rule 15c3–1, as amended; paragraph (c)(6) of Rule 18a–1, as adopted.

[91] *See* paragraphs (a)(7)(i) and (a)(10)(i) of Rule 15c3–1, as amended; paragraphs (a)(1) and (2) of Rule 18a–1, as adopted.

standard for all nonbank SBSDs. The standard (maintaining net liquid assets) is imposed through the computation requirements set forth in paragraph (c)(2) of Rule 15c3–1, which defines the term ''net capital.'' The first step in a net capital calculation is to compute the broker-dealer's net worth under GAAP. Next, the broker-dealer must make certain adjustments to its net worth. These adjustments are designed to leave the firm in a position in which each dollar of unsubordinated liabilities is matched by more than a dollar of highly liquid assets.[92] There are fourteen categories of net worth adjustments, including adjustments resulting from the application of standardized or model-based haircuts.[93] The Commission proposed that a broker-dealer SBSD compute net capital pursuant to the pre-existing provisions in paragraph (c)(2) of Rule 15c3–1, as proposed to be amended, to account for security-based swap and swap activities, and that stand-alone SBSDs compute net capital in a similar manner pursuant to proposed Rule 18a–1.[94]

i. Deduction for Posting Initial Margin

If a stand-alone broker-dealer or nonbank SBSD delivers initial margin to a counterparty, it must take a deduction from net worth in the amount of the posted collateral.[95] The Commission recognizes that the imposition of this deduction could increase transaction costs for stand-alone broker-dealers and nonbank SBSDs.[96] Consequently, the Commission sought comment on whether it should provide a means for a firm to post initial margin to counterparties without incurring the deduction with respect to Rules 15c3–1 and 18a–1, under specified conditions. The potential conditions included that the initial margin requirement is funded by a fully executed written loan agreement with an affiliate of the firm and that the lender waives re-payment of the loan until the initial margin is returned to the firm.[97]

Several commenters expressed support for this general approach but suggested modifications. A commenter supported requiring no deduction if the posted initial margin is: (1) Subject to an agreement that satisfies the specified conditions, or (2) maintained at a third-party custodian in accordance with the recommendations the Basel Committee on Banking Supervision (''BCBS'') and the Board of the International Organization of Securities Commissions (''IOSCO'') made with respect to margin requirements for non-cleared derivatives (''BCBS/IOSCO Paper'').[98] Another commenter supported the policy behind the Commission's approach recognizing the role of an SBSD as a subsidiary of a larger banking organization, but recommended that the Commission evaluate whether inter-company liquidity and funding arrangements and loss absorbing capacity mandated by resolution planning guidance should be recognized as a second alternative to deductions for initial margin posted away.[99] This commenter also encouraged the Commission to reconcile its guidance with the CFTC's proposed capital rules, which do not require initial margin posted to a third-party custodian to be deducted from net worth in computing capital.[100] Finally, a commenter raised concerns regarding the potential guidance suggesting that the effect of the conditions would be to reduce the amount of capital SBSDs are required to hold, increasing risk.[101]

The Commission is providing the following interpretive guidance as to how a stand-alone broker-dealer or nonbank SBSD can avoid taking a deduction from net worth when it posts initial margin to a third party. Under the guidance, initial margin provided by a stand-alone broker-dealer or nonbank SBSD to a counterparty need not be deducted from net worth when computing net capital if:

- The initial margin requirement is funded by a fully executed written loan agreement with an affiliate of the stand-alone broker-dealer or nonbank SBSD;
- The loan agreement provides that the lender waives re-payment of the loan until the initial margin is returned to the stand-alone broker-dealer or nonbank SBSD; and
- The liability of the stand-alone broker-dealer or the nonbank SBSD to the lender can be fully satisfied by delivering the collateral serving as initial margin to the lender.[102]

Stand-alone broker-dealers and nonbank SBSDs may apply this guidance to security-based swap and swap transactions.[103] In response to comments, the Commission does not believe this interpretive guidance will increase risk to a stand-alone broker-dealer or nonbank SBSD because the conditions require that an affiliate fund the initial margin requirement, resulting in no decrease to the capital of the broker-dealer or nonbank SBSD. In contrast, these conditions may decrease risks to a stand-alone broker-dealer or nonbank SBSD by making additional capital available to the firm for liquidity or other purposes, given that it will not need to use its own capital to fund the initial margin requirement of the counterparty. Further, the Commission does not believe that initial margin posted by a stand-alone broker-dealer or nonbank SBSD with respect to a swap transaction should be exempt from the firm's net capital requirements, since collateral posted away from the firm would not be available for other purposes, and, therefore, the firm's liquidity would be reduced. Finally, in response to comments, the Commission does not believe it would be appropriate at this time to permit a stand-alone broker-dealer or nonbank SBSD to look to collateral held by an affiliate as part of resolution planning as a means for the firm to avoid taking a deduction for initial margin posted to a counterparty. The collateral held by the affiliate may not be available to the stand-alone

[92] *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).

[93] *See* paragraphs (c)(2)(i) through (xiv) of Rule 15c3–1.

[94] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70230–56.

[95] 17 CFR 15c3–1(c)(2)(iv).

[96] *See* section VI of this release (discussing costs and benefits of the rules and amendments).

[97] *See Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53012.

[98] *See* SIFMA 11/19/2018 Letter. *See also* BCBS and IOSCO, *Margin Requirements for Non-centrally Cleared Derivatives* (Mar. 2015), *available at http://www.bis.org/bcbs/publ/d317.pdf.*

[99] *See* Morgan Stanley 11/19/2018 Letter.

[100] *See* Morgan Stanley 11/19/2018 Letter. In the case of a dually-registered SBSD/swap dealer, the commenter encouraged the Commission to defer to the CFTC's proposed treatment for swap initial margin.

[101] *See* Better Markets 11/19/2018 Letter.

[102] Although not binding, the staff of the Division of Trading and Markets issued a no-action letter (in the context of margin collateral posted by a stand-alone broker-dealer to a swap dealer or other counterparty for a non-cleared swap) that stated that the staff would not recommend enforcement action to the Commission if the stand-alone broker-dealer did not deduct from net worth when computing net capital initial margin provided to a counterparty, if certain conditions were met. *See* Letter from Michael A. Macchiaroli, Associate Director, Division of Trading and Markets, Commission, to Kris Dailey, Vice President, Risk Oversight and Regulation, FINRA (Aug. 19, 2016) (''Staff Letter''). *See also Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53012, n.38 (discussing the conditions in the Staff Letter).

[103] This guidance is not relevant to margin collateral posted to a clearing agency for a cleared security-based swap or a DCO for a cleared swap. Under the final capital rules, stand-alone broker-dealers and nonbank SBSDs may treat margin collateral posted to a clearing agency for cleared security-based swaps or to a DCO for cleared swaps as a ''clearing deposit'' and, therefore, not deduct the value of the collateral from net worth when computing net capital. *See* paragraph (c)(2)(iv)(E)(*3*) of Rule 15c3–1, as amended; paragraph (c)(1)(iii) of Rule 18a–1, as adopted.

broker-dealer or nonbank SBSD, particularly in a time of market stress when it is most needed.

ii. Deductions for not Collecting Margin

The pre-existing provisions of paragraph (c)(2)(xii) of Rule 15c3–1 require a broker-dealer to take a deduction from net worth for under-margined accounts. The Commission proposed to amend Rule 15c3–1 to require a stand-alone broker-dealer or broker-dealer SBSD to take a deduction from net worth for the amount of cash required in the account of each security-based swap customer to meet a margin requirement of a clearing agency, DEA (such as FINRA), or the Commission to which the firm was subject, after application of calls for margin, marks to the market, or other required deposits which are outstanding one business day or less.[104] Proposed Rule 18a–1 had an analogous provision, although it did not refer to margin requirements of DEAs because stand-alone SBSDs will not be members of self-regulatory organizations (''SROs'') and therefore will not have a DEA.

These proposed under-margined account provisions required a stand-alone broker-dealer or nonbank SBSD to take a deduction from net worth when a customer or security-based swap customer did not meet a margin requirement of a clearing agency, DEA, or the Commission pursuant to a rule that applied to the stand-alone broker-dealer or nonbank SBSD after one business day from the date the margin requirement arises. The proposed deductions were designed to address the risk to stand-alone broker-dealers and nonbank SBSDs that arises from not collecting collateral to cover their exposures to counterparties. The Commission asked whether the deductions should also be extended to failing to collect margin required under margin rules for swap transactions that apply to a stand-alone broker-dealer or nonbank SBSD.[105]

The Commission also proposed deductions from net worth to address situations in which an account of a security-based swap customer is meeting all applicable margin requirements, but the margin requirements result in the collection of an amount of collateral that is insufficient to address the risk of the positions in the account.[106] The proposals separately addressed cleared and non-cleared security-based swaps.

For cleared security-based swaps, the Commission proposed a deduction that applied if a nonbank SBSD collects margin 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 the nonbank SBSD (*i.e.,* the collected margin was less than the amount of the standardized or model-based haircuts, as applicable). This proposed requirement was designed to account for the risk of the counterparty defaulting by requiring the nonbank SBSD to maintain capital in the place of collateral in an amount that is no less than required for a proprietary position. It also was designed 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. In the 2018 comment reopening, the Commission asked whether this proposed rule should be modified to include a risk-based threshold under which the deduction need not be taken, and provided modified rule text to apply the deduction to cleared swap transactions.[107]

For non-cleared security-based swaps, the Commission proposed requirements that imposed deductions to address 3 exceptions in the nonbank SBSD margin requirements of proposed Rule 18a–3. Under these 3 exceptions, a nonbank SBSD would not be required to collect (or, in one case, hold) variation and/or initial margin from certain types of counterparties. Consequently, the Commission proposed deductions to serve as an alternative to collecting margin.

The first proposed deduction applied when a nonbank SBSD does not collect sufficient margin under an exception in proposed Rule 18a–3 for counterparties that are commercial end users. The second proposed deduction applied when the nonbank SBSD does not hold initial margin under an exception in proposed Rule 18a–3 for counterparties requiring that the collateral be segregated pursuant to Section 3E(f) of the Exchange Act. Section 3E(f) of the Exchange Act, among other things, provides that the collateral must be carried by an independent third-party custodian. Collateral held in this manner would not be in the physical possession or control of the nonbank SBSD, nor would it be capable of being liquidated promptly by the nonbank SBSD without the intervention of another party. Consequently, it would not meet the collateral requirements in proposed Rule 18a–3. The third proposed deduction applied when a nonbank SBSD does not collect sufficient margin under an exception in proposed Rule 18a–3 for legacy accounts (*i.e.,* accounts holding security-based swap transactions entered into prior to the effective date of the rule). The Commission also sought comment on whether there should be deductions in lieu of margin for non-cleared swaps with commercial end users and counterparties that elect to have initial margin held at a third-party custodian as well as for non-cleared swaps in legacy accounts.[108]

In the 2018 comment reopening, the Commission provided potential rule language that would establish deductions in lieu of margin for non-cleared security-based swaps and swaps.[109] The amount of the deduction for non-cleared security-based swaps would be the initial margin calculated pursuant to proposed Rule 18a–3 (*i.e.,* using the standardized haircuts in the nonbank SBSD capital rules or a margin model). The amount of the deduction for non-cleared swaps would be the standardized haircuts in the nonbank SBSD capital rules or the amount calculated using a margin model approved for purposes of proposed Rule 18a–3.

The Commission also asked in the 2018 comment reopening whether there should be an exception to taking the deduction for initial margin collateral held by an independent third-party custodian pursuant to Section 3E(f) of the Exchange Act or Section 4s(l) of the CEA under conditions that promote the SBSD's ability to promptly access the collateral if needed.[110] Specifically, the Commission sought comment on whether there should be such an exception under the following conditions: (1) The custodian is a bank; (2) the nonbank SBSD enters into an agreement with the custodian and the counterparty that provides the nonbank

[104] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70245, 70331.

[105] *See* 77 FR at 70247.

[106] *See* 77 FR at 7045–47.

[107] *See Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53009. More specifically, the Commission requested comment on whether the rule should provide that the deduction need not be taken if the difference between the clearing agency margin amount and the haircut is less than 1% (or some other amount) of the SBSD's tentative net capital, and less than 10% (or some other amount) of the counterparty's net worth, and the aggregate difference across all counterparties is less than 25% (or some other amount) of the counterparty's tentative net capital.

[108] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70247–48.

[109] *See Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53012.

[110] *See Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53011–12.

SBSD with the same control over the collateral as would be the case if the nonbank SBSD controlled the collateral directly; and (3) an opinion of counsel deems the agreement enforceable. In addition, the Commission stated it was considering providing guidance on ways a nonbank SBSD could structure the account control agreement to meet a requirement that the nonbank SBSD have the same control over the collateral as would be the case if the nonbank SBSD controlled the collateral directly.[111]

Comments and Final Requirements for Deductions for Under-Margined Accounts

As noted above, the Commission proposed a deduction from net worth for failing to collect margin required by a rule of a clearing agency, DEA, or the Commission that applied to the stand-alone broker-dealer or nonbank SBSD.[112] A commenter urged the Commission to permit firms a one-day grace period before the deduction would apply in the case of an under-margined account of an affiliate if the affiliate is subject to U.S. or comparable non-U.S. prudential regulation.[113] The commenter stated that applying an immediate deduction with respect to a security-based swap transaction with a regulated affiliate before there is operationally a means for transferring collateral to the SBSD would only serve to undermine beneficial risk management activities within a corporate group.

In response to the comment, the final margin rule being adopted today provides a nonbank SBSD or MSBSP an additional day (*i.e.,* two business days) to collect required margin from a counterparty (including variation margin due from an affiliate) if the counterparty is located in a different country and more than 4 time zones away.[114] In addition, the exceptions for when nonbank SBSDs need not collect initial margin from a counterparty have been expanded.[115] For example, the financial market intermediary exception has been expanded so that it not only applies to counterparties that are SBSDs but also to other types of financial market intermediaries, including foreign and domestic banks and broker-dealers.[116] There also is an exception from collecting initial margin from affiliates.[117] In addition, the final margin rule includes an initial margin exception when the aggregate credit exposure of the nonbank SBSD and its affiliates to the counterparty and its affiliates is $50 million or less.[118] These modifications to the final margin rule should substantially mitigate the commenter's concerns, given that in many instances there will be no requirement to collect initial margin, and the timeframe for collecting margin has been lengthened for counterparties located in other countries when they are more than 4 time zones away.

Nonetheless, when margin is required by a rule that applies to an entity, it should be collected promptly.[119] Margin is designed to protect the stand-alone broker-dealer or nonbank SBSD from the consequences of the counterparty defaulting on its obligations. This deduction for failing to collect required margin will serve as an incentive for stand-alone broker-dealers and nonbank SBSDs to have a well-functioning margin collection system, and the capital needed to take the deduction will protect them from the consequences of the counterparty's default.

For the foregoing reasons, the Commission is adopting the deduction for under-margined accounts with the modification to include a deduction for failing to collect required margin with respect to swap transactions.[120] In addition, as discussed above, the Commission has modified Rule 18a–3 to permit an extra business day to collect margin from a counterparty that is located in another country and more than 4 time zones away. Further, it is possible that other margin requirements for security-based swaps and swaps may provide more than one business day to collect required margin.[121] Therefore, the final rules have been modified to provide that the deduction for uncollected margin can be reduced by calls for margin, marks to the market, or other required deposits which are outstanding *within the required time frame* to collect the margin, mark to the market, or other required deposits.[122] As proposed, the rules provided that the deduction could be reduced by calls for margin, marks to the market, or other required deposits which are outstanding one business day or less. Consequently, under the final rules, if the firm has sent the counterparty a margin call within the required time frame for collecting the margin, a stand-alone broker-dealer or nonbank SBSD can reduce the deduction for required margin that has not been collected from a counterparty by the amount of that call. If the counterparty does not post the margin within that time frame, the deduction must be taken.

Comments and Final Requirements for Deductions In Lieu of Margin for Cleared Transactions

As noted above, the Commission proposed a deduction from net worth that applied if a nonbank SBSD collects margin from a counterparty for a cleared security-based swap in an amount that is less than the deduction that would apply to the security-based swap if it was a proprietary position of the nonbank SBSD.[123] In the 2018 comment reopening, the Commission asked whether this proposal should be modified to include a risk-based threshold under which the proposed deduction need not be taken.[124]

A commenter stated that the requirement to take a deduction in lieu

[111] The Commission asked commenters to address whether the agreement between the nonbank SBSD, counterparty, and third party should: (1) Provide that the collateral will be released promptly and directed in accordance with the instructions of the nonbank SBSD upon the receipt of an effective notice from the nonbank SBSD; (2) provide that when the counterparty provides an effective notice to access the collateral the nonbank SBSD will have sufficient time to challenge the notice in good faith and that the collateral will not be released until a prior agreed-upon condition among the three parties has occurred; and (3) give priority to an effective notice from the nonbank SBSD over an effective notice from the counterparty, as well as priority to the nonbank SBSD's instruction about how to transfer collateral in the event the custodian terminates the account control agreement.

[112] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70245.

[113] *See* SIFMA 2/22/2013 Letter.

[114] *See* paragraphs (c)(1)(iii) and (c)(2)(ii) of Rule 18a–3, as adopted. These and other provisions related to the margin rule are discussed in more detail in section II.B.2. below. In addition, a conforming change was made in paragraph (c)(1)(iii)(B) of Rule 18a–1, as adopted, to replace the phrase ''one business day'' with ''the required time frame to collect the margin, marks to the market, or other required deposit.'' *See* paragraph (c)(1)(iii)(B) of Rule 18a–1, as adopted.

[115] *See* paragraph (c)(1)(iii) of Rule 18a–3, as adopted.

[116] *See* paragraph (c)(1)(iii)(B) of Rule 18a–3, as adopted.

[117] *See* paragraph (c)(1)(iii)(G) of Rule 18a–3, as adopted.

[118] *See* paragraph (c)(1)(iii)(H) of Rule 18a–3, as adopted.

[119] A stand-alone broker-dealer will not be subject to the Commission's final margin rule for non-cleared security-based swaps (Rule 18a–3). Therefore, the firm will not be required to take a capital deduction for failing to collect margin under this rule.

[120] *See* paragraph (c)(2)(xii)(B) of Rule 15c3–1, as amended; paragraph (c)(1)(viii) of Rule 18a–1, as adopted.

[121] *See CFTC Margin Adopting Release,* 81 FR at 649–650; *Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74864–65 (discussing collection of margin timing requirements, including when counterparties are located in different time zones).

[122] *See* paragraph (c)(2)(xii)(B) of Rule 15c3–1, as amended; paragraph (c)(1)(viii) of Rule 18a–1, as adopted.

[123] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70245–46.

[124] *See Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53009.

of margin with respect to cleared security-based swaps would ''harm customers because it would provide an incentive for the collection of margin by SBSDs beyond the amount determined by the clearing agency.'' [125] The commenter recommended that the Commission eliminate this proposed deduction. Several commenters stated that the Commission should address any concerns regarding clearing agency minimum margin requirements directly through its regulation of clearing agencies.[126] One commenter stated that the deduction could drive business to firms willing to incur the deduction instead of collecting sufficient margin.[127] The commenter believed that this would provide an advantage to the largest clearing firms possessing the greatest amount of excess net capital, thereby exacerbating concentration in the market for clearing services. Another commenter stated that a low margin level for cleared swaps should not be viewed as a deficiency of clearing models but as an advantage of central clearing.[128] This commenter stated that a threshold such as the one described in the 2018 comment reopening would not address the commenter's concerns and that the proposed deduction should be eliminated. Another commenter recommended that the Commission impose the cleared security-based swap deduction only to the extent it exceeds 1% of the SBSD's tentative net capital, consistent with the Commission's CDS portfolio margin exemption.[129] One commenter opposed the inclusion of a potential threshold in the final rule, believing it would reduce capital requirements and increase risk.[130] Some commenters opposed applying the proposed deduction to cleared swaps, arguing it would interfere with the CFTC's comprehensive regulation of cleared swaps margin requirements.[131] A commenter noted that client clearing markets in the United States are, in their current composition, dominated by CFTC-regulated swaps and believed that integration of Commission net capital rules with CFTC net capital rules is particularly important in the case of client clearing.[132]

The Commission is persuaded by commenters that the proposed deduction could provide an unintended advantage to the largest clearing firms and that potential issues regarding clearing agency and DCO minimum margin requirements may be addressed through direct regulation of clearing agencies and DCOs. Therefore, the Commission is eliminating the proposed deduction from the final rules. The CFTC did not propose a similar deduction related to clearing agency margin requirements. Therefore, eliminating this deduction from the final rules may result in the two agencies having more closely aligned capital requirements.

In response to comments that elimination of the proposed deduction will decrease capital requirements and increase risk, the Commission believes that existing requirements for clearing agencies and DCOs as well as the risk management requirements for nonbank SBSDs being adopted today will address the potential risk of a counterparty defaulting on a requirement to post margin for a cleared security-based swap or swap transaction. For example, since the issuance of the proposing release in 2012, the Commission has enhanced its clearing agency standards. More specifically, in 2016, the Commission adopted final rules to establish enhanced standards for the operation and governance of registered clearing agencies that meet the definition of ''covered clearing agency.'' [133] Under these rules, a covered clearing agency that provides central clearing services must establish, implement, maintain, and enforce written policies and procedures reasonably designed to, as applicable, cover its credit exposures to its participants by establishing a risk-based margin system that meets certain minimum standards prescribed in the rule.[134] The CFTC also has adopted enhanced requirements for systemically important DCOs.[135] In addition, nonbank SBSDs must establish and maintain a risk management control system that complies with Rule 15c3–4. This rule requires that the system address various risks, including credit risk. Consequently, nonbank SBSDs will need to have risk management systems designed to mitigate the risk of a counterparty defaulting on a requirement to post margin for a cleared security-based swap or swap transaction.

For the foregoing reasons, the Commission believes it is appropriate to eliminate from the final rules the deductions related to the margin requirements for cleared security-based swap and swap transactions.

Comments and Final Requirements for Deductions In Lieu of Margin for Non-Cleared Transactions

As noted above, the Commission proposed deductions from net worth in lieu of margin for non-cleared security-based swaps, and sought comment on whether these proposed deductions should be expanded to include non-cleared swaps.[136] In the 2018 comment reopening, the Commission provided potential rule language that would establish deductions in lieu of margin for non-cleared security-based swaps and swaps.[137] The amount of the deduction for non-cleared security-based swaps would be the initial margin calculated pursuant to proposed Rule 18a–3 (*i.e.,* using the standardized haircuts in the nonbank SBSD capital rules or a margin model approved for the purposes of Rule 18a–3). The amount of the deduction for non-cleared swaps would be the standardized haircuts in the nonbank SBSD capital rules or the amount calculated using a margin model approved for the purposes of proposed Rule 18a–3.

Comments on these matters generally fell into one of 3 categories: (1) Comments requesting or supporting the ability to apply credit risk charges instead of these deductions for a broader range of counterparties than only commercial end users; (2) comments objecting to the deduction when counterparties elect to have initial margin held at a third-party custodian and suggesting modifications to the potential exception to avoid the deduction; and (3) comments objecting to the deduction for legacy accounts and requesting the ability to use credit risk charges for these accounts.

As discussed in more detail below, the Commission is adopting the proposed deductions in lieu of margin for non-cleared security-based swap and swap transactions, but with two significant modifications that are designed to address the concerns raised by commenters. First, as discussed

[125] *See* SIFMA 2/22/2013 Letter.

[126] *See* Morgan Stanley 11/19/2018 Letter; OneChicago 11/19/2018 Letter; SIFMA 2/22/2013 Letter; SIFMA 11/19/2018 Letter.

[127] *See* SIFMA 11/19/2018 Letter.

[128] *See* OneChicago 11/19/2018 Letter.

[129] *See* SIFMA 11/19/2018 Letter. This commenter argued that the 25% aggregate tentative net capital threshold is unnecessary.

[130] *See* Better Markets 11/19/2018 Letter.

[131] *See* Morgan Stanley 11/19/2018 Letter; SIFMA 11/19/2018 Letter.

[132] *See* Morgan Stanley 11/19/2018 Letter.

[133] *See Standards for Covered Clearing Agencies,* Exchange Act Release No. 78961 (Sept. 28, 2016), 81 FR 70786 (Oct. 13, 2016).

[134] 17 CFR 240.17Ad–22(e)(6).

[135] *See Enhanced Risk Management Standards for Systemically Important Derivatives Clearing Organizations,* 78 FR 49663 (Aug. 15, 2013); *Derivatives Clearing Organizations and International Standards,* 78 FR 72476 (Dec. 2, 2013).

[136] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70246–47.

[137] *See Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53012.

below in section II.A.2.b.v. of this release, the Commission has expanded the circumstances under which a nonbank SBSD authorized to use models may apply credit risk charges instead of taking the deduction in lieu of margin.[138] Under the final rules, the credit risk charges may be applied when the nonbank SBSD does not collect variation or initial margin subject to any exception in Rule 18a–3 or the margin rules of the CFTC with respect to non-cleared security-based swap and swap transactions, respectively. However, an ANC broker-dealer SBSD is subject to a portfolio concentration charge with respect to uncollateralized current exposure (including current exposure resulting from not collecting variation margin) equal to 10% of the firm's tentative net capital.[139] A stand-alone SBSD is not subject to a portfolio concentration charge.[140]

Second, the Commission has added a provision in the final rule that allows a nonbank SBSD to treat initial margin with respect to a non-cleared security-based swap or swap held at a third-party custodian as if the collateral were delivered to the nonbank SBSD and, thereby, avoid taking the deduction for failing to hold the collateral directly.[141] This modification should help mitigate concerns raised by commenters about the impact the deduction would have on nonbank SBSDs and their counterparties. Further, it responds to commenters who suggested that third-party custodial arrangements could be structured to provide the nonbank SBSD with sufficient control over the collateral to address the Commission's concern that the nonbank SBSD would not be able to promptly liquidate collateral in the event of the counterparty's default. As discussed in more detail below, the final rule is designed so that existing custodial agreements established pursuant to the margin rules of the CFTC and the prudential regulators should meet the conditions of the exception.

The Commission—as indicated above—has also modified the final requirements so that the deductions will apply to uncollected margin with respect to non-cleared swap transactions (in addition to non-cleared security-based swap transactions).[142] A commenter objected to applying the deductions in lieu of margin to non-cleared swaps transactions because, in the commenter's view, it would interfere with policy choices of the CFTC such as that agency's requirement that initial margin be held at a third-party custodian.[143] The commenter also objected to calculating the amount of the deduction using the standardized haircuts in the nonbank SBSD capital rules or a model approved for purposes of Rule 18a–3. The commenter recommended that the deduction be calculated using the methods for calculating initial margin prescribed in the CFTC's rules.

In response to the commenter's concerns about applying the deductions with respect to non-cleared swaps, the failure to collect sufficient margin from a counterparty with respect to a swap transaction exposes the nonbank SBSD to the same credit risk that arises from failing to collect sufficient margin with respect to a security-based swap transaction. The deduction in lieu of margin is designed to address this risk by requiring the nonbank SBSD to hold capital (instead of collateral) to protect itself from the consequences of the default of the counterparty. Applying the deduction in lieu of margin to non-cleared swap transactions is designed to promote the safety and soundness of the nonbank SBSD.[144] Moreover, as discussed below, the Commission has modified the exception from taking the deduction when a counterparty's initial margin is held at a third-party custodian (including initial margin for non-cleared swap transactions) in a manner that is designed to accommodate custodial arrangements entered into pursuant to the CFTC's margin rules. In addition, as discussed below in section II.A.2.b.v. of this release, the ability to use credit risk charges has been expanded to swap transactions.

The Commission is persuaded by the commenter's second point that the amount of the deduction should be calculated using the methods for calculating initial margin prescribed in the CFTC's margin rules. Consequently, unlike the potential rule language in the 2018 comment reopening, the amount of the deduction is calculated using the methodology required by the margin rules for non-cleared swaps adopted by the CFTC. For example, if the CFTC has approved the firm's use of a margin model, the firm can use the model to calculate the amount of the deduction in lieu of margin.

Under the final rules, a nonbank SBSD must deduct from net worth when computing net capital unsecured receivables, including receivables arising from not collecting variation margin under an exception in the margin rule for non-cleared security-based swaps.[145] The final rules also require a nonbank SBSD to deduct the initial margin amount for non-cleared security-based swaps calculated under Rule 18a–3 with respect to a counterparty or account, less the margin value of collateral held in the account.[146] Consequently, if the nonbank SBSD does not collect and hold variation and/or initial margin for an account pursuant to an exception in Rule 18a–3, the nonbank SBSD will be required to take a 100% deduction for the uncollateralized amount of the exposure. For uncollected variation margin, the amount of the exposure is the mark-to-market value of the security-based swap; for initial margin, the amount of the exposure is the initial margin amount calculated pursuant to Rule 18a–3. However, as discussed below in section II.A.2.b.v. of this release, an ANC broker-dealer SBSD and stand-alone SBSD authorized to use models can apply a credit risk model to

[138] *See* paragraph (a)(7) of Rule 15c3–1, as amended; paragraph (a)(2) of Rule 18a–1, as adopted. *See Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53010–11 (soliciting comment on potential rule language that would modify the proposal in this manner).

[139] ANC broker-dealers that are not registered as SBSDs and other types of stand-alone broker-dealers will not be subject to the capital deductions in lieu of margin for non-cleared security-based swaps resulting from electing not to collect margin under Rule 18a–3 because they are not subject to the rule (*i.e.,* the rule only applies to nonbank SBSDs). As discussed above, they will be subject to the capital deductions for under-margined accounts with respect to margin requirements for security-based swaps and swaps that apply to them (*e.g.,* margin requirements of DEAs, clearing agencies, or DCOs). While ANC broker-dealers (*i.e.,* firms not registered as SBSDs) are not subject to Rule 18a–3 and the associated capital deductions in lieu of collecting margin under that rule, they may engage in OTC derivatives transactions that result in uncollateralized credit exposures to the counterparties. If so, they can apply credit risk charges to the exposures rather than take a 100% deduction for the exposure as discussed below in section II.A.2.b.v. of this release. However, as discussed in that section of this release, they are subject to the portfolio concentration charge.

[140] As discussed below in section II.A.2.b.v. of this release, proposed Rule 18a–1 would have established a portfolio concentration charge for stand-alone SBSDs equal to 50% of their tentative net capital. The final rule does not include that provision.

[141] *See* paragraph (c)(2)(xv)(C) of Rule 15c3–1, as amended; paragraph (c)(1)(ix)(C) of Rule 18a–1, as adopted. *See also Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53011–12 (soliciting comment on potential rule language that would establish a means to avoid taking the deduction for failing to hold the collateral directly).

[142] *See* paragraph (c)(2)(xv)(B) of Rule 15c3–1, as amended; paragraph (c)(1)(ix)(B) of Rule 18a–1, as adopted.

[143] *See* SIFMA 11/19/18 Letter.

[144] *See* Section 15F(e)(3) of the Exchange Act (providing in pertinent part that the capital requirements shall ''help ensure the safety and soundness of'' nonbank SBSDs).

[145] *See* paragraph (c)(2)(iv) of Rule 15c3–1; paragraph (c)(1)(iii) of Rule 18a–1, as adopted.

[146] *See* paragraph (c)(2)(xv)(A) of Rule 15c3–1, as amended; paragraph (c)(1)(ix)(A) of Rule 18a–1, as adopted.

these exposures instead of taking these deductions.

With respect to swaps, the final rules provide that a nonbank SBSD must deduct from net worth when computing net capital unsecured receivables, including receivables arising from not collecting variation margin under an exception in the non-cleared swaps margin rules of the CFTC.[147] The final rules also require a nonbank SBSD to deduct initial margin amounts calculated pursuant to the margin rules of the CFTC, less the margin value of collateral held in the account of a swap counterparty at the SBSD.[148] Consequently, if the nonbank SBSD does not collect and hold variation and/or initial margin for an account pursuant to an exception in the CFTC's margin rules, the nonbank SBSD will be required to take a 100% deduction for the uncollateralized amount of the exposure. For uncollected variation margin, the amount of the exposure is the mark-to-market value of the swap; for uncollected initial margin, the amount of the exposure is the initial margin amount calculated pursuant to the CFTC's margin rules. However, as discussed below in section II.A.2.b.v. of this release, an ANC broker-dealer and nonbank SBSD authorized to use models can apply a credit risk model to these exposures instead of taking these deductions.

Deductions related to margin held at third-party custodians. In terms of the deductions related to counterparties that elect to have initial margin held at a third-party custodian, commenters stated that it would discourage the use of third-party custodians, which security-based swap customers have a right to elect under Section 3E(f) of the Exchange Act.[149] They also claimed that the deduction would result in substantial costs to the affected nonbank SBSD, which would be passed on to the security-based swap customer. A commenter noted that other regulators have finalized or proposed swap capital rules that do not include a special deduction for initial margin held at a third-party custodian.[150]

Various commenters stated that a nonbank SBSD will have legal ''control'' over collateral pledged to it and held at a third-party custodian when the parties properly structure a custodial agreement.[151] Some of these commenters also stated that properly structured tri-party account control agreements could address the Commission's concern about the nonbank SBSD's lack of control over initial margin held at a third-party custodian.[152] Some commenters argued that even though physical control is lacking under tri-party custodial arrangements, legal control of the securities collateral, under properly structured tri-party custodial arrangements, exists pursuant to Article 8 of the Uniform Commercial Code.[153] Commenters noted that pledgors, secured parties, and securities intermediaries typically memorialize the pledge of securities and grant ''control'' of the securities to the secured party through a tri-party account control agreement.[154] A commenter noted that courts have recognized the legitimacy of account control agreements and enforced them in accordance with their terms.[155] Finally, another commenter suggested that the account control agreement should provide the nonbank SBSD with legal control over, and access to, the counterparty's initial margin in the event of enforcement of the firm's rights against such initial margin.[156]

As noted above, the Commission asked in the 2018 comment reopening whether there should be an exception to the deduction when collateral is held by an independent third-party custodian as initial margin pursuant to Section 3E(f) of the Exchange Act or Section 4s(l) of the CEA.[157] The Commission asked whether the capital charge should be avoided in these circumstances if: (1) The independent third-party custodian is a bank as defined in Section 3(a)(6) of the Exchange Act that is not affiliated with the counterparty; (2) the firm, the independent third-party custodian, and the counterparty that delivered the collateral to the custodian have executed an account control agreement governing the terms under which the custodian holds and releases collateral pledged by the counterparty as initial margin that provides the firm with the same control over the collateral as would be the case if the firm controlled the collateral directly; and (3) the firm obtains a written opinion from outside counsel that the account control agreement is legally valid, binding, and enforceable in all material respects, including in the event of bankruptcy, insolvency, or a similar proceeding.

As a preliminary matter, two commenters addressed the potential rule language in the preface to the exception that stated that it could apply with respect to collateral held by an independent third-party custodian as initial margin pursuant to Section 3E(f) of the Exchange Act or Section 4s(l) of the CEA.[158] One of these commenters noted that the CFTC and the prudential regulators adopted their margin rules pursuant to Section 4s(e) of the CEA and Section 15F(e) of the Exchange Act, respectively.[159] The commenter further noted that the margin rules of the CFTC and the prudential regulators require that initial margin be segregated at a third-party custodian. Consequently, the commenter was concerned that initial margin held at a third-party custodian pursuant to those margin rules would not qualify for the exception. The commenter also noted that foreign regulators' rules could require that

[147] *See* paragraph (c)(2)(iv) of Rule 15c3–1; paragraph (c)(1)(iii) of Rule 18a–1, as adopted. In order to further harmonize the Commission's capital rules with the CFTC's proposed capital rules, stand-alone broker-dealers and nonbank SBSDs need not deduct unsecured receivables from registered FCMs resulting from cleared swap transactions in computing net capital. *See* paragraph (a)(3)(iii)(C) of Rule 15c3–1b, as amended; paragraph (a)(2)(iii)(C) of Rule 18a–1b, as adopted.

[148] *See* paragraph (c)(2)(xv)(B) of Rule 15c3–1, as amended; paragraph (c)(1)(ix)(B) of Rule 18a–1, as adopted.

[149] *See, e.g.,* Letter from American Benefits Council, Committee on Investment of Employee Benefit Assets, European Federation for Retirement Provision, the European Association of Paritarian Institutions, the National Coordinating Committee for Multiemployer Plans, and the Pension Investment Association of Canada (May 19, 2014) (''American Benefits Council, et al. 5/19/2014 Letter''); Letter from Karrie McMillan, General Counsel, Investment Company Institute (Feb. 4, 2013) (''ICI 2/4/2013 Letter''); Letter from David W. Blass, General Counsel, Investment Company Institute (Nov. 24, 2014) (''ICI 11/24/2014 Letter''); ICI 11/19/2018 Letter; Letter from Tim Buckley, Managing Director and Chief Investment Officer, and John Hollyer, Principal and Head of Risk Management and Strategy Analysis, Vanguard (May 27, 2014) (''Vanguard Letter'').

[150] *See* Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, Managed Funds Association (May 18, 2017) (''MFA 5/18/2017 Letter'').

[151] *See* Letter from Adam Jacobs, Director, Head of Markets Regulation, Alternative Investment Management Association (Mar. 17, 2014) (''AIMA 3/17/2014 Letter''); Letter from Karrie McMillan, General Counsel, Investment Company Institute (Dec. 5, 2013) (''ICI 12/5/2013 Letter''); ICI 11/19/2018 Letter; Letter from Institute of International Bankers and Securities Industry and Financial Markets Association (June 21, 2018) (''IIB/SIFMA Letter''); Letter from Stuart J. Kaswell, Executive Vice President, Managing Director, and General Counsel, Managed Funds Association (Feb. 24, 2013) (''MFA 2/24/2014 Letter'').

[152] *See* ICI 12/5/2013 Letter; MFA 2/22/2013 Letter; MFA 2/24/2014 Letter.

[153] *See* American Benefits Council, et al. 5/19/2014 Letter; ICI 12/5/2013 Letter; ICI 11/19/2018 Letter; MFA 2/22/2013 Letter.

[154] *See* ICI 12/5/2013 Letter; MFA 2/22/2013 Letter; MFA 2/24/2014 Letter.

[155] *See* ICI 12/5/2013 Letter (*citing Scher Law Firm* v. *DB Partners I LLC,* 27 Misc.3d 1230(A), 911 N.Y.S.2d 696 (Kings County 2010) and *SIPC* v. *Lehman Brothers, Inc.,* 433 B.R. 127 (Bankr. S.D.N.Y. 2010)).

[156] *See* MFA/AIMA 11/19/2018 Letter.

[157] *See Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53011.

[158] *See* Morgan Stanley 11/19/2018 Letter; SIFMA 11/19/2018 Letter.

[159] SIFMA 11/19/2018 Letter.

initial margin collateral be held at a third-party custodian.

The margin rules of the CFTC and the prudential regulators require initial margin to be held at a third-party custodian and prescribe specific requirements for the custodial arrangements as well as requirements to document agreements with counterparties governing the exchange of margin.[160] The margin rules of other jurisdictions could have similar requirements. In the specific context of this exception from taking a deduction, the reason why the collateral is held at a third-party custodian is less important than taking the necessary steps to enter into a custodial arrangement that meets the conditions discussed below for qualifying for the exception. The conditions are designed to provide the nonbank SBSD, as the secured party, with prompt access to the collateral held at the third-party custodian when the collateral is needed to protect the nonbank SBSD against the consequences of the counterparty's default. The fact that the collateral is held at the third-party custodian at the election of the counterparty or because a domestic or foreign law requires it to be held at the custodian should not be dispositive as to whether a given custodial arrangement can qualify for this exception.

Moreover, the second and third conditions discussed below are designed to ensure that the custodial agreement legally provides the nonbank SBSD with the right to promptly access the collateral if necessary. These conditions therefore will address any concerns regarding potential interference with that right. For these reasons, the Commission agrees with the commenters that the preface to the exception need not limit the legal bases for why the collateral is being held at a third-party custodian. Consequently, the final rules do not reference Section 3E(f) of the Exchange Act or Section 4s(l) of the CEA in the preface to the exception.[161]

Commenters addressed the first potential condition set forth in the 2018 comment reopening that the independent third-party custodian be a bank as defined in Section 3(a)(6) of the Exchange Act that is not affiliated with the counterparty. One commenter stated that the condition that the custodian be an unaffiliated bank is reasonable and practical.[162] Other commenters suggested that the Commission expand the range of permissible custodians to include U.S. securities depositories and clearing agencies, foreign banks, and foreign securities depositories.[163] The Commission also received comments prior to the 2018 comment reopening that are relevant to this potential condition. Two commenters supported allowing the collateral to be held at an affiliate of the nonbank SBSD.[164] One commenter suggested that the third-party custodian must be a legal entity that is separate from both the nonbank SBSD and the counterparty (but not necessarily unaffiliated with the nonbank SBSD or counterparty).[165] This commenter stated that this position would appropriately recognize well established, ordinary course custody and trading practices of market participants, including registered funds.

The Commission agrees with commenters that it would be appropriate to recognize third-party custodians that are not a bank. In the U.S., clearing organizations and depositories registered with the Commission or the CFTC could serve as custodians. As these entities are subject to oversight and regulation, the Commission does not believe the rule should exclude them from serving as custodians. In addition, if foreign securities or currencies are used as collateral to meet an initial margin requirement, it may be impractical to have them held at a U.S. custodian. Accordingly, the Commission believes it would be appropriate to recognize a foreign bank, clearing organization, or depository that is supervised (*i.e.,* subject to oversight by a government authority) if the collateral consists of foreign securities or currencies and the custodian customarily maintains custody of such foreign securities or currencies. For these reasons, the final rules recognize domestic and foreign banks, custodians, and depositories, subject to the conditions discussed above.

The Commission also agrees with commenters that the final rules should permit the third-party custodian to be an affiliate of the nonbank SBSD (but not the counterparty). In particular, an affiliate may be less likely to interfere with the legal right of the nonbank SBSD to exercise control over the collateral in the event of a default of the counterparty. Consequently, the final rules permit the custodian to be an affiliate of the nonbank SBSD but not the counterparty.[166]

Commenters addressed the second potential condition set forth in the 2018 comment reopening that the firm, the independent third-party custodian, and the counterparty that delivered the collateral to the custodian must have executed an account control agreement that provides the firm with the same control over the collateral as would be the case if the firm controlled the collateral directly. Commenters generally supported the view that a nonbank SBSD, as the secured party, should have prompt access to the collateral held at the third-party custodian.[167] However, a commenter objected to the ''same control'' language and argued it could be read to mean that nonbank SBSDs would be allowed to re-hypothecate and use collateral posted to a third-party custodian.[168] Another commenter argued that collateral covered by an agreement meeting the conditions of the exception would no longer be segregated in any meaningful sense, and may violate the plain language of the Dodd-Frank Act that initial margin be segregated for the benefit of the counterparty.[169] A commenter argued that this type of

[160] *See CFTC Margin Adopting Release,* 81 FR at 670–73, 702–3 (adopting 17 CFR 23.157 and 17 CFR 23.158); *Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74873–75, 74886–87, 74905, 74908–09.

[161] *See* paragraph (c)(2)(xv)(C) of Rule 15c3–1, as amended; paragraph (c)(1)(ix)(C) of Rule 18a–1, as adopted. The phrase ''pursuant to section 3E(f) of the Act or section 4s(l) of the Commodity Exchange Act'' in the preface to each paragraph included in the 2018 comment reopening is not included in the final rules.

[162] *See* MFA/AIMA 11/19/2018 Letter.

[163] *See* IIB 11/19/2018 Letter; SIFMA 11/19/2018 Letter.

[164] *See* MFA 2/22/2013 Letter; SIFMA 2/22/2013 Letter.

[165] *See* ICI 11/24/2014 Letter.

[166] *See* paragraph (c)(2)(xv)(C)(*1*) of Rule 15c3–1, as amended; paragraph (c)(1)(ix)(C)(*1*) of Rule 18a–1, as adopted.

[167] *See, e.g.,* Letter from Carl B. Wilkerson, Vice President and Chief Counsel, American Council of Life Insurers (Feb. 22, 2013) (''American Council of Life Insurers 2/22/2013 Letter''); Letter from Adam Jacobs, Director of Markets Regulation, Alternative Investment Management Association (Feb. 22, 2013) (''AIMA 2/22/2013 Letter''); ICI 12/5/2013 Letter; Letter from Robert Pickel, Chief Executive Officer, International Swaps and Derivatives Association (Jan. 23, 2013) (''ISDA 1/23/13 Letter''); MFA 2/24/2014 Letter; SIFMA 2/22/2013 Letter.

[168] *See* ICI 11/19/2018 Letter.

[169] *See* Better Markets 11/19/2018 Letter. In response to the ICI 11/19/2018 Letter and the Better Markets 11/19/2018 Letter, the potential rule language in the 2018 comment reopening with respect to a custodial arrangement that provided the nonbank SBSD with the ''same control'' over the collateral was not intended to interfere with the fundamental purpose of having collateral held at a third-party custodian: To keep it segregated and bankruptcy remote from the secured party. Instead, it was designed to promote the ability of the nonbank SBSD to access the collateral if the counterparty defaulted. Consequently, it was not intended to permit the nonbank SBSD to re-hypothecate the collateral or undermine the counterparty's statutory right to elect to have initial margin held at a third-party custodian. In any event, as discussed below, the Commission is not adopting the ''same control'' standard and, therefore, these commenters' concerns about that standard have been addressed.

provision would be costly, operationally burdensome, and inconsistent with current market practices for third-party custodial arrangements.[170]

The Commission agrees with commenters that the ''same control'' standard could create practical obstacles that would make it difficult to execute an account control agreement that would be sufficient to avoid the deduction when initial margin is held by a third-party custodian. Moreover, meeting the standard could have required the re-drafting of existing agreements that are in place in accordance with the third-party custodian and documentation requirements of the CFTC and the prudential regulators. Doing so would be a costly and burdensome process. At the same time, the Commission also agrees with commenters that the account control agreement should provide the nonbank SBSD, as the secured party, with the right to promptly access the collateral held at the third-party custodian if necessary.

The Commission has balanced these considerations in crafting final rules. In this regard, the Commission believes it would be appropriate to adopt final rules that align more closely with the third-party custodian requirements of the CFTC and the prudential regulators. Consequently, the final rules provide that the account control agreement must be a legal, valid, binding, and enforceable agreement under the laws of all relevant jurisdictions, including in the event of bankruptcy, insolvency, or a similar proceeding of any of the parties to the agreement.[171] The rules further provide that the agreement must provide the nonbank SBSD with the right to access the collateral to satisfy the counterparty's obligations to the nonbank arising from transactions in the account of the counterparty.[172] This is the fundamental purpose of the agreements and should not raise the same practical issues as the ''same control'' standard. At the same time, it is designed to require an agreement that achieves this fundamental purpose and by doing so will provide the nonbank SBSD, as the secured party, with prompt access to the collateral held at the third-party custodian when the collateral is needed to protect the nonbank SBSD against the consequences of the counterparty's default. While the provision requires an agreement, the Commission has crafted it with the objective that existing agreements with counterparties entered into for the purposes of the third-party custodian and documentation rules of the CFTC and the prudential regulators will suffice.

Commenters addressed the third potential condition set forth in the 2018 comment reopening that the firm obtain a written opinion from outside counsel that the account control agreement is legally valid, binding, and enforceable in all material respects, including in the event of bankruptcy, insolvency, or a similar proceeding. Some commenters opposed the requirement for an opinion of outside legal counsel on the basis of cost and impracticability, arguing it is inconsistent with market practice and operationally burdensome to implement.[173] One commenter stated that the requirement was unnecessary because existing account control agreements and laws provide substantial protections.[174] Another commenter suggested that the Commission consider alternatives to the requirement, such as permitting a nonbank SBSD to recognize initial margin so long as it has a well-founded basis to conclude that the collateral arrangement is enforceable.[175]

The Commission acknowledges that requiring a formal written legal opinion by outside counsel could be a costly burden and, on further consideration, may not be necessary. At the same time, the Commission believes the nonbank SBSD should take steps to analyze whether the custodial agreement will provide the firm, as the secured party, with the right to access the collateral to satisfy the counterparty's obligations to the firm arising from transactions in the account of the counterparty. In other words, the firm should analyze whether a tri-party custodial agreement intended to provide this right is a legal, valid, binding, and enforceable agreement under the laws of all relevant jurisdictions, including in the event of bankruptcy, insolvency, or a similar proceeding of any of the parties to the agreement. The Commission's view that this analysis should be performed is consistent with the views of the CFTC and the prudential regulators. In particular, those agencies, in explaining the requirements of their rules governing tri-party custodial agreements, stated that the secured party would need to conduct a sufficient legal review to conclude with a well-founded basis that, in the event of a legal challenge, including one resulting from the default or from the receivership, conservatorship, insolvency, liquidation, or similar proceedings of the custodian or counterparty, the relevant court or administrative authorities would find the custodial agreement to be legal, valid, binding, and enforceable under the law.[176]

The Commission has balanced the cost and potential practical difficulties in obtaining a written opinion of outside legal counsel with the need for the nonbank SBSD to enter into a tri-party custodial agreement that will operate as intended under the relevant laws. The Commission has concluded that a written legal opinion of outside counsel is not the only way to provide assurance that the tri-party custodial agreement will operate as intended. For example, the nonbank SBSD could perform its own legal analysis rather than pay outside counsel to provide the legal opinion or be a member of a competent industry association that makes legal analysis available to its members. Therefore, the final rules do not require the nonbank SBSD to obtain a legal opinion of outside counsel. Instead, the rules require the firm to maintain written documentation of its analysis that in the event of a legal challenge the relevant court or administrative authorities would find the account control agreement to be legal, valid, binding, and enforceable under the applicable law, including in the event of the receivership, conservatorship, insolvency, liquidation, or a similar proceeding of any of the parties to the agreement.[177] Among other things, the documentation could be a written

[170] *See* SIFMA 11/19/2018 Letter.

[171] *See* paragraph (c)(2)(xv)(C)(*2*) of Rule 15c3–1, as amended; paragraph (c)(1)(ix)(C)(*2*) of Rule 18a–1, as adopted. *See also CFTC Margin Adopting Release,* 81 FR at 670–71, 702–3 (adopting 17 CFR 23.157, which provides that the custodial agreement must be a legal, valid, binding, and enforceable agreement under the laws of all relevant jurisdictions including in the event of bankruptcy, insolvency, or a similar proceeding); *Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74873–75, 74905 (adopting rules requiring that a custodial agreement must be a legal, valid, binding, and enforceable agreement under the laws of all relevant jurisdictions, including in the event of bankruptcy, insolvency, or a similar proceeding).

[172] *See* paragraph (c)(2)(xv)(C)(*2*) of Rule 15c3–1, as amended; paragraph (c)(1)(ix)(C)(*2*) of Rule 18a–1, as adopted.

[173] *See* ICI 11/19/2018 Letter; MFA/AIMA 11/19/2018 Letter; Letter from Jason Silverstein, Esq., Managing Director, Asset Management Group & Associate General Counsel, Securities Industry and Financial Markets Association, and Andrew Ruggiero Senior Associate, Asset Management Group, Securities Industry and Financial Markets Association (Nov. 19, 2018) (''SIFMA AMG 11/19/2018 Letter'').

[174] *See* ICI 11/19/2018 Letter.

[175] *See* SIFMA 11/19/2018 Letter. This commenter also requested that the Commission clarify that industry opinions regarding classes of agreements would satisfy a potential requirement for an opinion.

[176] *See CFTC Margin Adopting Release,* 81 FR at 670–71; *Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74873–75.

[177] *See* paragraph (c)(2)(xv)(C)(*3*) of Rule 15c3–1, as amended; paragraph (c)(1)(ix)(C)(*3*) of Rule 18a-1, as adopted.

opinion of outside legal counsel, reflect the firm's own ''in-house'' legal research, or be the research of a competent industry association. The documentation will reflect how the firm analyzed the legality of the account control agreement.

Legacy accounts. In terms of the deductions related to legacy accounts, one commenter stated that ''the costs of this requirement will ultimately flow back to the counterparties, penalizing all counterparties who trade with any affected [nonbank SBSD]'' and that ''the retroactive effect of such a requirement—which effectively requires [nonbank SBSDs] to revise the price terms of pre-effective [security-based swaps]—is contrary to the prospective nature of the rest of Dodd-Frank's Title VII.'' [178] A second commenter argued that the deduction is inconsistent with how dealers currently do business, as they do not typically collect margin from certain credit-worthy counterparties.[179] Commenters stated that the legacy account deduction is inconsistent with the proposed capital regimes of the CFTC and the prudential regulators.[180] A commenter argued that this inconsistency could result in regulatory arbitrage.[181] Commenters indicated that the proposed legacy account deduction would unfairly penalize nonbank SBSDs and their customers.[182] A commenter stated that the deduction would negatively affect the pricing and liquidity of transactions with counterparties.[183] Commenters also argued that the proposed deduction could lead some market participants that cannot afford the costs to exit the market or cease engaging in new security-based swaps activity.[184]

In response to the comment that the deduction in lieu of margin related to legacy accounts is contrary to the prospective nature of Title VII of the Dodd-Frank Act and will require re-pricing of existing security-based swaps,[185] the legacy account exception is designed to address the impracticality of renegotiating contracts governing security-based swap transactions that predate the compliance date of Rule 18a–3.[186] Further, as discussed below in section II.A.2.b.v. of this release, the ability to apply the credit risk charges has been expanded to exposures arising from electing not to collect variation or initial margin with respect to legacy accounts. This should help to mitigate the concern of this commenter and others that the 100% deduction could cause nonbank SBSDs to pass the costs of the capital requirement to counterparties. This also should help to mitigate concerns of commenters who argued that the 100% deduction was inconsistent with the capital requirements of other regulators. As one commenter stated, applying a credit risk charge for a nonbank SBSD's legacy account positions would more closely align the Commission's capital standards with the approaches of the CFTC and the prudential regulators.[187]

The Commission acknowledges that, even with the modification expanding the application of the credit risk charge, the final rule will result in costs to nonbank SBSDs as well as to their security-based swap and swap counterparties. However, the Commission has sought to strike an appropriate balance between addressing the concerns of commenters and promulgating a final rule that promotes the safety and soundness of nonbank SBSDs.[188] The Commission believes it has achieved this objective by taking a measured approach to modifying the rule to reduce the impact of the deductions for uncollected variation and initial margin.

iii. Standardized Haircuts

The final step in the process of computing net capital under Rule 15c3–1 is to apply the standardized or model-based haircuts to the firm's proprietary positions, thereby reducing the firm's tentative net capital amount to an amount that constitutes the firm's net capital.[189] Most stand-alone broker-dealers use the standardized haircuts, which are prescribed in Rules 15c3–1, 15c3–1a, and 15c3–1b. ANC broker-dealers may apply model-based haircuts to positions for which they have been authorized to use models pursuant to Rule 15c3–1e. For all other types of positions, they must use the standardized haircuts.

The pre-existing provisions of paragraph (c)(2)(vi) of Rule 15c3–1 prescribe standardized haircuts for marketable securities and money market instruments. The amounts of the standardized haircuts 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. Broker-dealer SBSDs will be subject to these pre-existing standardized haircut provisions in paragraph (c)(2)(vi) of Rule 15c3–1. Proposed Rule 18a–1 required stand-alone SBSDs to apply the pre-existing standardized haircuts in paragraph (c)(2)(vi) of Rule 15c3–1 by cross-referencing that paragraph.[190] The pre-existing provisions of Rules 15c3–1a and 15c3–1b prescribe standardized haircuts for equity option positions and commodities positions, respectively. The provisions in Rule 15c3–1b incorporate deductions in the CFTC's capital rule for FCMs.[191] Broker-dealer SBSDs will be subject to the pre-existing standardized haircut provisions in Rules 15c3–1a and 15c3–1b. The Commission proposed Rules 18a–1a and 18a–1b to prescribe standardized haircuts for stand-alone SBSDs modeled on the pre-existing requirements in Rules 15c3–1a and 15c3–1b, respectively.[192]

However, the pre-existing provisions of Rule 15c3–1 and Rule 15c3–1b did not prescribe standardized haircuts tailored specifically for security-based swaps and swaps.[193] Consequently, the Commission proposed amending paragraph (c)(2)(vi) of Rule 15c3–1 and Rule 15c3–1b to establish standardized

[178] *See* Letter from Douglas M. Hodge, Managing Director and Chief Operating Officer, Pacific Investment Management Company LLC (Feb. 21, 2013) (''PIMCO Letter'').

[179] *See* Letter from Sebastian Crapanzano and Soo-Mi Lee, Managing Directors, Morgan Stanley (Oct. 29, 2014) (''Morgan Stanley 10/29/2014 Letter'').

[180] *See* Morgan Stanley 2/22/13 Letter; SIFMA 2/22/2013 Letter.

[181] *See* Financial Services Roundtable Letter.

[182] *See* PIMCO Letter; SIFMA 2/22/2013 Letter.

[183] *See* Morgan Stanley 2/22/13 Letter.

[184] *See* Financial Services Roundtable Letter; Morgan Stanley 2/22/13 Letter.

[185] *See* PIMCO Letter.

[186] *See* section II.B.2.b.i. of this release (discussing the legacy account exception).

[187] *See* Morgan Stanley 10/29/14 Letter; Morgan Stanley 11/19/2018 Letter.

[188] *See* Better Markets 11/19/2018 Letter. *See also* section VI of this release (discussing costs and benefits of final rules).

[189] *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,* 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).

[190] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70231, n.146.

[191] *See* 17 CFR 1.17 (prescribing standardized haircuts for commodities positions of FCMs) (''Rule 1.17'').

[192] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70231–37, 70248–50.

[193] Because there were no specific standardized haircuts for security-based swaps, a stand-alone broker-dealer was required to apply a deduction based on the existing provisions (*e.g.,* the catchall provisions in the rule). For certain types of OTC derivatives, the deduction has been the notional amount of the derivative multiplied by the deduction that would apply to the underlying instrument referenced by the derivative. *See Net Capital Rule,* Exchange Act Release No. 32256 (May 6, 1993), 58 FR 27486, 27490 (May 10, 1993).

haircuts for security-based swaps and swaps that would apply to stand-alone broker-dealers and broker-dealer SBSDs.[194] The Commission proposed parallel standardized deductions tailored for security-based swaps and swaps in proposed Rules 18a–1 and 18a–1b, respectively, that would apply to stand-alone SBSDs.

The proposed standardized haircut for a CDS was determined using one of two maturity grids: One for a CDS that is a security-based swap and the other for a CDS that is a swap.[195] The proposed grids prescribed standardized haircuts based on two variables: The length of time to maturity of the CDS and the amount of the current offered basis point spread on the CDS. The standardized haircut for an unhedged short position in a CDS (*i.e.,* selling protection) was the applicable percentage specified in the grid. The deduction for an unhedged long position in a CDS (*i.e.,* buying protection) was 50% of the applicable deduction specified in the grid. The amount of the deductions in the maturity grid for a CDS that was a swap were one-third less than the comparable deductions in the maturity grid for a CDS that was a security-based swap. The proposed rules provided for reduced grid-derived deductions based on netting positions.

For a security-based swap that is not a CDS, the proposed standardized haircuts required multiplying the notional amount of the security-based swap by the amount of the standardized haircut percent that applied to the underlying position pursuant to the pre-existing provisions of Rule 15c3–1.[196] For example, paragraph (c)(2)(vi)(J) of Rule 15c3–1 prescribes a standardized haircut for an exchange traded equity security equal to 15% of the mark-to-market value of the security. Consequently, the standardized haircut for a security-based swap referencing an exchange traded equity security was a deduction equal to the notional amount of the security-based swap multiplied by 15%. The same approach applied to a security-based swap (other than a CDS) referencing a debt instrument. For example, paragraph (c)(2)(vi)(F)(*1*)(*v*) of Rule 15c3–1 prescribes a 7% standardized haircut for a corporate bond that has a maturity of five years, is not traded flat or in default as to principal or interest, and has a minimal amount of credit risk. Therefore, the proposed standardized haircut for a security-based swap referencing such a bond was a deduction equal to the notional amount of the security-based swap multiplied by 7%.

For a swap that is not a CDS or interest rate swap, the Commission proposed a similar approach that required multiplying the notional amount of the swap by a certain percent.[197] To determine the applicable percent, the Commission proposed a hierarchy approach. Under this approach, if the pre-existing provisions of Rule 15c3–1 prescribed a standardized haircut for the type of asset, obligation, or event underlying the swap, the percent deduction of the Rule 15c3–1 standardized haircut applied. For example, if the swap referenced an equity security index, the pre-existing standardized haircut in Rule 15c3–1 applicable to baskets of securities and equity index exchange traded funds applied. If the pre-existing provisions of Rule 15c3–1 did not prescribe a standardized haircut for the type of asset, obligation, or event underlying the swap but the pre-existing provisions in Rule 15c3–1b did, the percent deduction in the Rule 15c3–1b standardized haircut applied. This would be the case if the swap referenced a type of commodity for which CFTC Rule 1.17 prescribes a standardized haircut, and the Rule 1.17 haircut is incorporated into Rule 15c3–1b. Finally, if neither Rules 15c3–1 nor 15c3–1b prescribed a standardized haircut for the type of asset, obligation, or event underlying the swap but Rule 1.17 did, the percent deduction in the Rule 1.17 standardized deduction applied. This could be the case, for example, if the swap was a type of swap for which the CFTC had prescribed a specific standardized haircut.

For interest rate swaps, the Commission proposed a similar standardized haircut approach that required multiplying the notional amount of the swap by a certain percent.[198] The percent was determined by referencing the standardized haircuts in Rule 15c3–1 for U.S. government securities with comparable maturities to the swap's maturity. However, the proposed haircut for interest rate swaps had a floor of 1% (whereas U.S. government securities with a maturity of less than 9 months are subject to haircuts of ¾ of 1%, ½ of 1%, or 0% depending on the time to maturity). This 1% floor was 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.

Under the proposed standardized haircuts for a security-based swap that is not a CDS, stand-alone broker-dealers and nonbank SBSDs were permitted to recognize portfolio offsets.[199] In particular, these entities were permitted to include an equity security-based swap in a portfolio of related equity positions (*e.g.,* long and short cash and options positions involving the same security) under the pre-existing provisions of Rule 15c3–1a, which produces a single haircut for a portfolio of equity options and related positions.[200] Similarly, they were permitted to treat a debt security-based swap and an interest rate swap in the same manner as debt instruments are treated in pre-existing debt-maturity grids in Rule 15c3–1 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.

Comments and Final Requirements for Standardized Haircuts

A commenter stated that, based on its estimates, the standardized haircuts in the proposed CDS maturity grids would be significantly greater than the capital charges that would apply to the same positions using an internal model.[201] The commenter stated that the Commission should conduct further review of empirical data regarding the historical market volatility and losses given default associated with CDS positions and modify the proposed standardized haircuts. This commenter argued that excessive standardized haircuts may disproportionately affect smaller and mid-size firms.[202] The commenter further stated that these types of firms may be limiting their security-based swaps business so they will not be required to register as a nonbank SBSD or may try to develop internal models to avoid having to use the standardized haircuts.

In response to these comments, the economic analysis performed for these

[194] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70231–37, 70248–50.

[195] *See* 77 FR at 70232–34, 70248–49.

[196] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70234–36.

[197] *See* 77 FR at 70249–50.

[198] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70249.

[199] *See* 77 FR at 70235–36, 70249.

[200] Specifically, the Commission proposed amending paragraph (a)(4) of Rule 15c3–1a to include equity security-based swaps within the definition of *underlying instrument.* This would allow these positions to be included in portfolios of equity positions involving the same equity security. In addition, the Commission proposed including security futures within the definition of the term *underlying instrument* to permit these positions to be included in portfolios of positions involving the same underlying security.

[201] *See* SIFMA 2/22/2013 Letter.

[202] *See* SIFMA 11/19/2018 Letter.

final rules determined that the standardized haircuts being adopted today generally were not set at the most conservative level. As stated in the analysis, the Commission believes that, in general, haircuts are intended to strike a balance between being sufficiently conservative to cover losses in most cases, including stressed market conditions, and being sufficiently nimble to allow nonbank SBSDs to operate efficiently in all market conditions. Based on the results of the analysis, the Commission believes the standardized haircuts in the final rules take into account this tradeoff.[203]

Nonetheless, the Commission recognizes that the standardized haircuts for non-cleared security-based swaps are less risk-sensitive than the model-based haircuts and, therefore, in many cases will be greater than the model-based haircuts. This difference in the deductions that result from applying standardized haircuts as opposed to model-based haircuts is part of the pre-existing provisions of Rule 15c3–1. The rule has permitted ANC broker-dealers and OTC derivatives dealers to apply model-based haircuts, whereas all other broker-dealers must apply the standardized haircuts. These differences are why broker-dealers applying the model-based haircuts are subject to higher capital standards, including minimum tentative net capital requirements.[204] These additional and higher capital requirements account for the generally lower deductions that result from applying model-based haircuts as opposed to standardized haircuts. Because nonbank SBSDs that do not use model-based haircuts will not be subject to these additional or higher capital requirements, the Commission believes that it is an appropriate trade-off that they will employ the less risk-sensitive standardized haircuts. Further, the Commission believes that most nonbank SBSDs will seek approval to use model-based haircuts.

The standardized haircuts are designed to account for more than just market and credit risk—they also are intended to address other risks such as operational, leverage, and liquidity risks.[205] The standardized haircuts are intended to account for more risks because the firms that will use them, as discussed above, are subject to lower minimum net capital requirements.

Commenters also recommended that for cleared security-based swaps, the Commission apply a standardized haircut based on the initial margin requirement of the clearing agency, similar to the treatment of futures in Rule 15c3–1b.[206] A commenter stated that the clearing agencies use risk-based models to calculate initial margin and, therefore, relying on their margin calculations would allow firms that do not use models to indirectly get the benefit of a more risk-sensitive approach.[207]

The Commission is persuaded that it would be appropriate to establish standardized haircuts for cleared security-based swaps and swaps that are determined using the margin requirements of the clearing agency or DCO where the position is cleared. Consequently, the Commission is modifying the proposed standardized haircut requirements for cleared security-based swaps and swaps to require that the amount of the deduction will be the amount of margin required by the clearing agency or DCO where the position is cleared.[208] This will align the treatment of these cleared products with the treatment of futures products. It also will establish standardized haircuts that potentially are more risk sensitive, as suggested by the commenter. This will benefit stand-alone broker-dealers and nonbank SBSDs that have not been authorized to use models to determine market risk charges for their security-based swap and swap positions.

A commenter supported the Commission's proposal to allow standardized haircuts for portfolios of equity security-based swaps and related equity positions using the methodology in Rule 15c3–1a.[209] The commenter believed this would allow stand-alone broker-dealers and nonbank SBSDs to employ a more risk-sensitive approach to computing net capital than if a position were treated in isolation. The Commission agrees with the commenter's reasoning and continues to believe that cleared equity security-based swaps should be permitted to be included in the portfolios of equity positions for purposes of Rules 15c3–1a and 18a–1a and that this treatment should be extended to cleared equity-based swaps. Therefore, the Commission is modifying the requirement to permit equity-based swaps (in addition to equity security-based swaps) to be included as related or underlying instruments for purposes of Rules 15c3–1a and 18a-1a.[210] Further, as discussed above, the standardized haircut for cleared security-based swaps and swaps being adopted today is determined using the margin requirements of the clearing agency or DCO where the position is cleared. However, as an alternative to that standardized haircut, a stand-alone broker-dealer and nonbank SBSD can use the methodology prescribed in Rules 15c3–1a and 18a–1a to derive a portfolio-based standardized haircut for cleared security-based swaps that reference an equity security or narrow-based equity index and swaps that reference a broad-based equity index.[211]

A commenter opposed the 1% minimum standardized haircut for interest rate swaps as being too severe.[212] Based on its analysis of sample positions, this commenter believed that the proposed standardized haircut calculations that include the 1% minimum haircut would result in market risk charges that are nearly 35 times higher than charges without the 1% minimum.[213] The Commission is persuaded that the proposed 1% minimum haircut was too conservative,

[203] *See* section VI of this release.

[204] *See OTC Derivatives Dealers,* 63 FR at 5938; *Alternative Net Capital Requirements for Broker-Dealers That Are Part of Consolidated Supervised Entities,* 69 FR at 34431.

[205] *See Alternative Net Capital Requirements for Broker-Dealers That Are Part of Consolidated Supervised Entities,* 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.'').

[206] *See* Citadel 5/15/2017 Letter; Citadel 11/19/2018 Letter; SIFMA 2/22/2013 Letter.

[207] *See* SIFMA 2/22/2013 Letter.

[208] *See* paragraph (c)(2)(vi)(O) of Rule 15c3–1, as amended; paragraph (b)(1) of Rule 15c3–1b, as amended; paragraph (c)(1)(vi)(A) of Rule 18a–1, as adopted; paragraph (b)(1) of Rule 18a–1b, as adopted. In the final rule, paragraph (c)(2)(vi)(O) of Rule 15c3–1, as proposed, is being re-designated paragraph (c)(2)(vi)(P) of Rule 15c3–1, as adopted. In addition, references to ''(c)(2)(vi)(O)'' have been replaced with references to ''(c)(2)(vi)(P)'' in paragraph (c)(2)(vi)(P) of Rule 15c3–1, as amended; the word ''non-cleared'' has been inserted before the term ''security-based swap''; and the title has been modified to read ''Non-cleared security-based swaps.'' Conforming changes have been made to Appendix B to Rule 15c3–1, as amended, Rule 18a–1, as adopted, and Rule 18a–1b, as adopted. Paragraph (c)(2)(vi)(O) of Rule 15c3–1, as amended, will state: ''*Cleared security-based swaps.* In the case of a cleared security-based swap held in a proprietary account of the broker or dealer, deducting the amount of the applicable margin requirement of the clearing agency or, if the security-based swap references an equity security, the broker or dealer may take a deduction using the method specified in § 240.15c3–1a.'' Conforming rule text modifications were made to Appendix B to Rule 15c3–1, as amended, Rule 18a–1, as adopted, and Rule 18a–1b, as adopted.

[209] *See* SIFMA 2/22/2013 Letter.

[210] *See* paragraphs (a)(3) and (4) of Rule 15c3–1a, as amended; paragraphs (a)(3) and (4) of Rule 18a–1a, as adopted.

[211] *See* paragraph (c)(2)(vi)(O) of Rule 15c3–1, as amended; paragraph (b)(1) of Rule 15c3–1b, as amended; paragraph (c)(1)(vi)(A) of Rule 18a–1, as adopted; paragraph (b)(1) of Rule 18a–1b, as adopted.

[212] *See* SIFMA 2/22/2013 Letter.

[213] *See* SIFMA 11/19/2018 Letter.

particularly when applied to tightly hedged positions such as those in the commenter's examples. As discussed above, the standardized haircut for cleared swaps, including interest rate swaps, being adopted today is determined by the margin required by the DCO where the position is cleared. Therefore, the 1% minimum standardized haircut for cleared security-based swaps is being eliminated.

However, the Commission continues to believe that a minimum haircut should be applied to non-cleared interest rate swaps. Under the final rules being adopted today, the standardized haircuts for non-cleared interest rate swaps are determined using the maturity grid for U.S. government securities in paragraph (c)(2)(vi)(A) of Rule 15c3–1.[214] Moreover, the standardized haircuts for non-cleared security-based swaps and swaps (other than CDS) being adopted today permit a stand-alone broker-dealer and nonbank SBSD to reduce the deduction by an amount equal to any reduction recognized for a comparable long or short position in the reference security under the standardized haircuts in Rule 15c3–1.[215] The standardized haircuts in paragraph (c)(2)(vi)(A) of Rule 15c3–1 permit a stand-alone broker-dealer to take a capital charge on the net long or short position in U.S. government securities that are in the same maturity categories in the rule. This treatment will apply to interest rate swaps. Therefore, if a stand-alone broker-dealer or nonbank SBSD has long and short positions in interest rate swaps, the amount of the standardized haircut applied to these positions could be greatly reduced and could potentially be 0% for positions that are tightly hedged. This could permit the firm to substantially leverage its interest rate swaps and hold little or no capital against them. Further, potential differences between the movement of interest rates on U.S. government securities and interest rates upon which swap payments are based could impose a level of additional risk even to tightly hedged interest rate positions.

For these reasons, the Commission believes that a minimum standardized haircut for non-cleared interest rate swaps is appropriate. However, the Commission is persuaded by the commenter that the proposed 1% minimum haircut was too conservative. Therefore, the Commission is modifying the standardized haircut for non-cleared interest rate swaps so that it can be no less than ⅛ of 1% of a long position that is netted against a short position in the case of a non-cleared swap with a maturity of 3 months or more.[216] The standardized haircuts in paragraph (c)(2)(vi)(A) of Rule 15c3–1 require a 0% haircut for the unhedged amount of U.S. government securities that have a maturity of less than 3 months. Therefore, the standardized haircuts for interest rate swaps will treat hedged and unhedged positions with maturities of less than 3 months identically in that there will be no haircut required to be applied to the positions.

The next lowest standardized haircut in paragraph (c)(2)(vi)(A) of Rule 15c3–1 applies to unhedged positions with a maturity of 3 months but less than 6 months. For these positions, the haircut is ½ of 1%. Therefore, the minimum standardized haircut for hedged interest rate swaps with a maturity of 3 months or more (*i.e.,* ⅛ of 1%) will be one-quarter of the standardized haircut for unhedged positions with a maturity 3 months but less than 6 months. The Commission believes this modified minimum haircut for interest rate swaps strikes an appropriate balance in terms of addressing commenters' concerns that the 1% minimum was too conservative and the prudential concern with permitting a stand-alone broker-dealer or nonbank SBSD to substantially leverage its non-cleared interest rate swaps positions.

Another commenter stated that the Commission appears to have proposed different and substantially higher haircuts for cleared swaps regulated by the CFTC, such as cleared interest rate swaps and cleared index CDS, than those proposed under the CFTC's rules.[217] This commenter stated that dual registrants should not be subject to conflicting requirements for the same instrument and urged the Commission to work with the CFTC to harmonize applicable requirements for cleared swaps that are regulated by the CFTC. The commenter also noted that increasing harmonization will promote the portfolio margining of cleared security-based swaps and swaps. The CFTC has not finalized its capital rules under Title VII of the Dodd-Frank Act; however, as discussed above, the Commission has modified the standardized haircuts for cleared CDS and interest rate swaps so that the deduction equals the margin requirement of the clearing agency or DCO where the positions are cleared. This should alleviate the commenter's concerns about the magnitude of the standardized haircuts for cleared swaps. In terms of harmonizing the Commission's standardized haircuts with the CFTC's standardized haircuts, the Commission intends to continue coordinating with the CFTC as that agency finalizes its capital requirements under Title VII of the Dodd-Frank Act.

For the foregoing reasons, the Commission is adopting the standardized haircuts for security-based swaps and swaps with the modifications discussed above and with certain non-substantive modifications to conform the final rule text in Rule 15c3–1, as amended, and Rule 18a–1, as adopted.[218]

iv. Model-Based Haircuts

The Commission proposed to allow nonbank SBSDs to apply model-based haircuts.[219] Broker-dealer SBSDs that were not already ANC broker-dealers needed Commission authorization to use model-based haircuts and were subject to the requirements governing the use of models by ANC broker-dealers (*i.e.,* they would need to operate as an ANC broker-dealer SBSD). Stand-alone SBSDs similarly needed Commission authorization to apply model-based haircuts and were subject to requirements governing the use of them modeled on the requirements for ANC broker-dealers.

Under the proposals, nonbank SBSDs seeking authorization to use model-based haircuts needed to submit an application to the Commission (''ANC application'').[220] The pre-existing provisions of paragraphs (a)(1) through (a)(3) of Rule 15c3–1e set forth in detail the information that must be submitted

[214] *See* paragraph (b)(2)(ii)(A)(*3*) of Rule 15c3–1b, as amended; paragraph (b)(2)(ii)(A)(*3*) of Rule 18a–1b, as adopted.

[215] *See* paragraph (c)(2)(vi)(P)(*2*) of Rule 15c3–1, as amended; paragraph (b)(2)(ii)(B) of Rule 15c3–1b, as amended; paragraph (c)(1)(vi)(B)(*2*) of Rule 18a–1, as adopted; paragraph (b)(2)(ii)(B) of Rule 18a–1b, as adopted.

[216] *See* paragraph (b)(2)(ii)(A)(*3*) of Rule 15c3–1b, as amended; paragraph (b)(2)(ii)(A)(*3*) of Rule 18a–1b, as adopted.

[217] *See* Citadel 5/15/2017 Letter.

[218] *See* paragraphs (c)(2)(vi)(O) and (P) of Rule 15c3–1, as amended; Rule 15c3–1a, as amended; Rule 15c3–1b as amended; paragraph (c)(1)(vi) of Rule 18a–1, as adopted; Rule 18a–1a, as adopted; Rule 18a–1b, as adopted. In addition to the changes discussed above, the Commission has made some non-substantive modifications to the final rule text for the standardized haircuts for non-cleared CDS that are security-based swaps or swaps in order to conform the final rule text in Rule 18a–1, as adopted, and Rule 18a–1b, as adopted, with the final rule text in Rule 15c3–1, as amended, and Rule 15c3–1b, as amended. The standardized haircuts for these positions were designed to be consistent in both rules. *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70233–34. In the proposing release, however, there were some inadvertent differences in the proposed rule texts which have been corrected in the final rules.

[219] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70237–40.

[220] *See* 77 FR at 70237–39.

by a stand-alone broker-dealer in an ANC application. The pre-existing provisions of paragraph (a)(4) provide that the Commission may request that the applicant supplement the ANC application with other information. The pre-existing provisions of paragraph (a)(5) prescribe when an ANC application is deemed filed with the Commission and provides that the application and all submissions in connection with it are accorded confidential treatment to the extent permitted by law. The pre-existing provisions of paragraph (a)(6) provide that if any information in an ANC application is found to be or becomes inaccurate before the Commission approves the application, the stand-alone 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. The pre-existing provisions of paragraph (a)(7) provide that the 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. A broker-dealer SBSD seeking authorization to use internal models would be subject to these pre-existing application requirements in paragraph (a) of Rule 15c3–1e. A stand-alone SBSD seeking authorization to use internal models would be subject to similar application requirements in proposed Rule 18a–1.

As part of the ANC application approval process, the Commission staff reviews the operation of the stand-alone broker-dealer's model, including a review of associated risk management controls and the use of stress tests, scenario analyses, and back-testing. As part of this process, the applicant provides information designed to demonstrate to the Commission staff that the model reliably accounts for the risks that are specific to the types of positions the firm intends to include in the model computations. During the review, the Commission staff assesses the quality, rigor, and adequacy of the technical components of the model and of related governance processes around the use of the model as well as the firm's risk management policies, procedures, and controls. Under the proposals, nonbank SBSDs seeking authorization to use internal models would be subject to similar reviews during the application process.[221]

The pre-existing provisions of paragraph (a)(8) of Rule 15c3–1e require an ANC broker-dealer to amend its ANC application and submit it to the Commission for approval before materially changing its model or its internal risk management control system. Further, the pre-existing provisions of paragraph (a)(10) require an ANC broker-dealer to notify the Commission 45 days before the firm ceases to use internal models to compute net capital. Finally, the pre-existing provisions of paragraph (a)(11) provide that the Commission, by order, can revoke an ANC broker-dealer's exemption that allows it to use internal models if the Commission finds that the ANC broker-dealer's use of models is no longer necessary or appropriate in the public interest or for the protection of investors. In this case, the firm would need to revert to applying the standardized haircuts for all positions. Under the proposal, an ANC broker-dealer SBSD would be subject to these pre-existing application requirements in paragraph (a) of Rule 15c3–1e. A stand-alone SBSD authorized to use internal models would have been subject to similar application requirements in proposed Rule 18a–1.[222]

The pre-existing provisions of paragraph (d)(1) of Rule 15c3–1e require an ANC broker-dealer to comply with qualitative requirements that specify among other things that: (1) The model must be integrated into the ANC broker-dealer's daily internal risk management system; (2) the model must be reviewed periodically by the firm's internal audit staff, and annually by an independent public accounting firm; and (3) the measure computed by the model must be multiplied by a factor of at least 3 but potentially a greater amount based on the number of exceptions to the measure resulting from quarterly back-testing exercises.[223] The pre-existing provisions of paragraph (d)(2) prescribe quantitative requirements that specify that the model must, among other things: (1) Use a 99%, one-tailed confidence level with price changes equivalent to a 10-business-day movement in rates and prices;[224] (2) use an effective historical observation period of at least one year; (3) use historical data sets that are updated at least monthly and are reassessed whenever market prices or volatilities change significantly; 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. An ANC broker-dealer SBSD would be subject to these pre-existing qualitative and quantitative requirements in paragraph (d) of Rule 15c3–1e. A stand-alone SBSD authorized to use internal models would have been subject to similar qualitative and quantitative requirements in proposed Rule 18a–1.[225]

The pre-existing provisions of paragraph (b) of Rule 15c3–1e prescribe the model-based haircuts an ANC broker-dealer must deduct from tentative net capital in lieu of the standardized haircuts. This deduction is an amount equal to the sum of four charges: (1) A portfolio market risk charge for all positions that are included in the ANC broker-dealer's models (*i.e.,* the amount measured by the model multiplied by a factor of at least 3);[226] (2) a ''specific risk'' charge for positions where specific risk was not captured in the model;[227] (3) a charge for positions not included in the model where the ANC broker-dealer is approved to use scenario analysis; and (4) a charge for all other positions that is determined using the standardized haircuts. An ANC broker-dealer SBSD would be subject to these pre-existing model-based haircut requirements in paragraph (b) of Rule 15c3–1e. A stand-alone SBSD authorized to use internal models would have been subject to similar requirements in proposed Rule 18a–1.[228]

Finally, ANC broker-dealers are subject to ongoing supervision with respect to their internal risk management, including their use of models. In this regard, the Commission staff meets regularly with senior risk managers at each ANC broker-dealer to

[221] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70239.

[222] *Id.*

[223] A back-testing exception occurs when the ANC broker-dealer's actual one-day loss exceeds the amount estimated by its model.

[224] This means the potential loss measure produced by the model is a loss that the portfolio could experience if it were held for 10 trading days and that this potential loss amount would be exceeded only once every 100 trading days.

[225] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70239.

[226] This 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.

[227] This 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.

[228] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70239–40.

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 (scheduled and *ad hoc*) focused on financial results, the management of the firm's balance sheet, and, in particular, the liquidity of the firm's balance sheet.[229] The Commission staff also monitors the performance of the ANC broker-dealer's internal models through regular submissions of reported model changes by the firms and quarterly discussions with the firm's quantitative modeling personnel. Material changes to the internal models used to determine regulatory capital require advance notification, Commission staff review, and pre-approval before implementation. Stand-alone SBSDs authorized to use model-based haircuts would be subject to similar monitoring and reviews.

Comments and Final Requirements for Model-Based Haircuts

A commenter expressed support for the Commission's proposal that nonbank SBSDs be authorized to use model-based haircuts for proprietary securities positions, including security-based swap positions, in lieu of standardized haircuts, subject to application to, and approval by, the Commission and satisfaction of the qualitative and quantitative requirements set forth in Rule 15c3–1e.[230] However, other commenters raised concerns about permitting nonbank SBSDs to use model-based haircuts. A commenter stated that model-based haircuts should be ''floored'' at a level set by a standardized approach.[231] This commenter also stated that the Commission's continued reliance on model-based haircuts would represent a step away from the evolving practice of prudential regulators. This commenter and others also generally argued that the failure by significant market participants to accurately measure risk using models in the run-up to and during the 2008 financial crisis demonstrated that such models do not successfully measure risk and do not enable firms to make optimal judgments about risk.[232] One of these commenters argued that the firms using models are the most systemically risky and have a financial incentive to keep the measures low.[233] Other commenters argued that models can be manipulated and create perverse incentives for risk management staff to minimize capital charges.[234] A commenter indicated that it will be difficult for Commission staff to examine, duplicate, and back-test model estimates.[235] A second commenter believed models tend to fail during volatile market conditions particularly during a crisis.[236] Another commenter, in light of various reforms by banking regulators, urged the Commission to place more limitations on ANC broker-dealers because they use internal models to determine capital charges.[237]

Commenters also argued that *allowing* the use of models for capital purposes can create competitive advantages for larger firms that are able to reduce their capital requirements through internal modeling relative to smaller firms that are engaged in similar activities but are subject to different capital requirements.[238] A commenter stated that allowing the use of models will incentivize firms to organize themselves in ways that reduce their capital requirements and increase their leverage in order to enhance return on capital.[239] This commenter also stated that capital requirements should be the same regardless of firms' activities and that the only reason for different treatment should be the aggregate exposures taken by individual firms.

The Commission continues to believe that the capital rules for ANC broker-dealers and nonbank SBSDs should permit these entities to use model-based haircuts. Models are used by financial institutions to manage risk and, therefore, permitting their use will allow firms to integrate their risk management processes with their capital computations.

The Commission, however, acknowledges the concerns raised by commenters about the efficacy of models, particularly in times of market stress. In response to these concerns and the comment that ANC broker-dealers should be subject to more limitations, ANC broker-dealers and nonbank SBSDs using models will be subject to higher minimum capital requirements as well as the Commission's ongoing monitoring of their use of models. In particular, the minimum tentative net capital requirements that apply to ANC broker-dealers (which are being substantially increased by today's amendments) and stand-alone SBSDs authorized to use model-based haircuts are designed to address the concerns raised by commenters that the models may fail to accurately measure risk, firms may calibrate the models to keep values low, firms might manipulate models, and models may fail during volatile market conditions. More specifically, tentative net capital is the amount of a firm's net capital *before* applying the haircuts.

Today's amendments and new rules will require ANC broker-dealers (including ANC broker-dealer SBSDs) to maintain at least $5 billion in tentative net capital and subject them to a minimum fixed-dollar net capital requirement of $1 billion. Stand-alone SBSDs authorized to use models will be required to maintain at least $100 million in tentative net capital and will be subject to a minimum fixed-dollar net capital requirement of $20 million. Consequently, for each type of nonbank SBSD, the fixed-dollar minimum tentative net capital requirement is five times the fixed-dollar minimum net capital requirement. Thus, nonbank SBSDs that use models will need to maintain minimum tentative net capital in an amount that far exceeds their minimum fixed-dollar net capital requirement. The larger tentative net capital requirement is designed to address the risk associated with using model-based haircuts. To the extent a nonbank SBSD's model fails to accurately calculate the risk of its positions, the tentative net capital requirement will serve as a buffer to account for the difference between the calculated haircut amount and the actual risk of the positions. Further, the Commission's ongoing supervision of the firms' use of models as well as the qualitative and quantitative requirements governing the use of models (*e.g.,* backtesting) provide additional checks on the use of models that are designed to address the risks

[229] 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.

[230] *See* SIFMA 2/22/2013 Letter.

[231] *See* Letter from Americans for Financial Reform (Feb. 22, 2013) (''Americans for Financial Reform Letter'').

[232] *See* Americans for Financial Reform Letter; Better Markets 7/22/2013 Letter; CFA Institute Letter; Letter from Sheila C. Bair, Systemic Risk Council (Jan. 24, 2013) (''Systemic Risk Council Letter''). *See also* Letter from Lisa A. Rutherford (Jan. 22, 2013) (''Rutherford Letter'').

[233] *See* Better Markets 7/22/2013 Letter.

[234] *See* CFA Institute Letter; Systemic Risk Council Letter.

[235] *See* Better Markets 7/22/2013 Letter.

[236] *See* Letter from Matthew Shaw (Feb. 22, 2013) (''Shaw Letter'').

[237] *See* Americans for Financial Reform Education Fund Letter.

[238] *See* CFA Institute Letter; Systemic Risk Council Letter.

[239] *See* CFA Institute Letter.

identified by the commenters. Finally, ANC broker-dealers and nonbank SBSDs are subject to Rule 15c3–4, which requires them 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.

Although one commenter stated that the Commission's continued reliance on internal models would represent a step away from the evolving practice of prudential regulators, this has not been the case. Financial supervisors and regulators, in the United States and elsewhere, have continued to permit the use of internal models as a component of establishing and measuring capital requirements for financial market participants, including with respect to bank SBSDs and bank swap dealers. Similarly, the CFTC has proposed to allow nonbank swap dealers to use models. The Commission's final rules and amendments will promote consistency with these other rules. For these reasons, the Commission is adopting the provisions relating to the use of model-based haircuts substantially as proposed.[240]

Finally, a commenter recommended that the Commission adopt an expedited review and approval process for models that have been approved and are subject to periodic assessment by the Federal Reserve or a qualifying foreign regulator.[241] This commenter suggested that if the Commission has previously approved a model for use by one registrant, the Commission should automatically approve the use of that model by an affiliate subject to the same risk management program as the affiliate whose model was previously approved. Other commenters recommended that the Commission permit a nonbank SBSD to use internal credit risk models approved by other regulators, and that the Commission generally defer to the other regulator's ongoing oversight of the model (including model governance).[242] Another commenter supported a provisional approval process for internal capital models.[243]

In response to these comments, the Commission encourages prospective registrants to reach out to the Commission staff as early as possible in advance of the registration compliance date to begin the model approval process. The staff will work diligently to review the models before the firm must register as an SBSD. However, the Commission acknowledges the possibility that it may not be able to make a determination regarding a firm's model before it is required to register as an SBSD. Consequently, the Commission is modifying Rule 15c3–1e and Rule 18a–1 to provide that the Commission may approve, subject to any condition or limitations that the Commission may require, the temporary use of a provisional model by an ANC broker-dealer, including an ANC broker-dealer SBSD, or a stand-alone SBSD for the purposes of computing net capital if the model had been approved by certain other supervisors.[244] Further, as discussed below in section II.B.2.a.i. of this release, the Commission also may approve, subject to any condition or limitations that the Commission may require, the temporary use of a provisional model by a nonbank SBSD for the purposes of calculating initial margin pursuant to the requirements of Rule 18a–3, as adopted.

To qualify, the firm must have a complete application pending for approval to use a model.[245] The requirement that a complete application be pending is designed to limit the amount of time that the firm uses the provisional model and incentivize firms to promptly file applications for model approval.

In addition, to be approved by the Commission, the use of the provisional model must have been approved by a prudential regulator, the CFTC, a CFTC-registered futures association, a foreign financial regulatory authority that administers capital and/or margin requirements that the Commission has found are eligible for substituted compliance, or any other foreign supervisory authority that the Commission finds has approved and monitored the use of the provisional model through a process comparable to the process set forth in the final rules.[246] This condition is designed to ensure that the provisional model has been approved by a financial regulator that is administering a program for approving and monitoring the use of models that is consistent with the Commission's program, including with respect to the qualitative and quantitative requirements for models in the final rules being adopted today.

v. Credit Risk Models

The pre-existing provisions of paragraph (a)(7) of Rule 15c3–1 and paragraph (c) of Rule 15c3–1e permit an ANC broker-dealer to treat uncollateralized current exposure to a counterparty arising from derivatives transactions as part of its tentative net capital instead of deducting 100% of the value of the unsecured receivable (as is required with respect to most unsecured receivables under Rule 15c3–1).[247] These provisions further require the ANC broker-dealer to take a credit risk charge to tentative net capital (along with the market risk charges—the model-based haircuts—discussed above in section II.A.2.b.iv. of this release) to compute its net capital. The credit risk charge typically will be significantly less than the 100% deduction to net worth that would have otherwise applied to the unsecured receivable since the credit risk charge is a percentage of the amount of the receivable. The pre-existing provisions of paragraph (c) of Rule 15c3–1e prescribe the method for calculating credit risk charges (''ANC credit risk model''). In particular, the credit risk charge is the sum of 3 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 the aggregate current exposure to all counterparties exceeds 50% of the firm's tentative net capital.

The capital rules governing OTC derivatives dealers similarly permit them to include uncollateralized current exposures to a counterparty arising from derivatives transactions in their tentative net capital, and require them to take a credit risk charge to tentative net capital with respect to these exposures to compute net capital.[248]

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[240] *See* paragraph (a)(7) of Rule 15c3–1, as amended; paragraph (a) of Rule 15c3–1e, as amended; paragraphs (a)(2), (d), and (e)(1) of Rule 18a–1, as adopted. The Commission also is modifying the credit risk charges in the final rule in paragraph (a)(7) of Rule 15c3–1, as amended and paragraph (a)(2) of Rule 18a–1, as adopted. These changes are discussed in the next section. The Commission also is making some non-substantive changes in paragraph (d)(9)(iii) of Rule 18a–1, as adopted.

[241] *See* SIFMA 2/22/2013 Letter; SIFMA 11/19/2018 Letter.

[242] *See* ING/Mizuho Letter; IIB 11/19/2018 Letter.

[243] *See* Citadel 5/15/2017 Letter.

[244] *See* paragraph (a)(7)(ii) of Rule 15c3–1e, as amended; paragraph (d)(5)(ii) of Rule 18a–1, as adopted. As a result of this modification, paragraph (a)(7) of Rule 15c3–1e has been re-designated paragraph (a)(7)(i) of Rule 15c3–1e, as amended, and paragraph (d)(5) of Rule 18a–1, as proposed, has been re-designated paragraph (d)(5)(i) of Rule 18a–1, as adopted.

[245] *See* paragraph (a)(7)(ii)(A) of Rule 15c3–1e, as amended; paragraph (d)(5)(ii)(A) of Rule 18a–1, as adopted.

[246] *See* paragraph (a)(7)(ii)(B) of Rule 15c3–1e, as amended; paragraph (d)(5)(ii)(B) of Rule 18a–1, as adopted.

[247] *See* paragraph (c)(15) of Rule 15c3–1 (defining the term ''tentative net capital'').

[248] *See* paragraphs (a)(5) and (c)(15) of Rule 15c3–1; 17 CFR 240.15c3–1f (''Rule 15c3–1f'').

Paragraph (d) of Rule 15c3–1f prescribes the method for computing the credit risk charges for OTC derivatives dealers (''OTCDD credit risk model''). The OTCDD credit risk model is similar to the ANC credit risk model except that the former does not include a portfolio concentration charge.[249]

Commission staff reviews an ANC broker-dealer's use of the ANC credit risk model as part of the overall review of the firm's ANC application and monitors the firm's use of the model thereafter. Moreover, the process is subject to the pre-existing provisions of paragraphs (a)(8), (a)(10), and (a)(11) of Rule 15c3–1e, which provide, respectively, that: (1) An ANC broker-dealer must amend and submit to the Commission for approval its ANC application before materially changing its ANC credit risk model; (2) an ANC broker-dealer must notify the Commission 45 days before it ceases using its ANC credit risk model; and (3) the Commission, by order, can revoke an ANC broker-dealer's ability to use the ANC credit risk model. Commission staff also reviews and monitors an OTC derivatives dealer's use of its OTCDD credit risk model.[250]

Under the pre-existing provisions of Rule 15c3–1e, an ANC broker-dealer approved to use an ANC credit risk model can apply the model to unsecured receivables arising from OTC derivatives instruments from all types of counterparties. The Commission proposed to narrow this treatment so that ANC broker-dealers could apply the ANC credit risk model to unsecured receivables arising exclusively from security-based swap transactions with commercial end users (*i.e.,* unsecured receivables arising from other types of derivative transactions were subject to the 100% deduction from net worth).[251]

The Commission proposed that stand-alone SBSDs authorized to use models also could apply a credit risk model to unsecured receivables arising from security-based swap transactions with commercial end users.[252] The proposed credit risk model for stand-alone SBSDs was modeled on the ANC credit risk model (as opposed to the OTCDD credit risk model). Consequently, the credit risk model for stand-alone SBSDs included a portfolio concentration charge if aggregate current exposures to all counterparties exceeded 50% of the firm's tentative net capital.

In the 2018 comment reopening, the Commission asked whether the final rules should cap the ability of ANC broker-dealers and stand-alone SBSDs authorized to use models to apply the credit risk models to uncollateralized *current exposures* arising from security-based swap and swap transactions with commercial end users. The Commission asked whether this cap should equal 10% of the firm's tentative net capital.[253] In addition, the Commission asked whether the use of the credit risk models by ANC broker-dealers and stand-alone SBSDs should be expanded to apply to uncollateralized *potential exposures* to counterparties arising from electing not to collect initial margin for non-cleared security-based swap and swap transactions pursuant to exceptions in the margin rules of the Commission and the CFTC. This treatment would be an alternative to taking the 100% deduction to net worth in lieu of collecting initial margin.

Comments and Final Requirements for Using Credit Risk Models

A commenter urged the Commission not to limit the circumstances in which the credit risk models could be used.[254] The commenter stated that uncollateralized receivables arising from a counterparty failing to post margin typically result from operational issues that are temporary in nature (*i.e.,* that are addressed in a matter of days) and are liquidated if they last for longer periods of time. The commenter stated that a credit risk charge adequately addresses the risks of under-collateralized positions during the interim period before margin is posted and that ''a punitive 100% deduction is unnecessary.'' The commenter also stated that requiring a nonbank SBSD to hold additional capital for each dollar of margin it did not collect from a non-financial entity for a swap would effectively undermine an exception proposed by the CFTC, which the commenter indicated would deter the dual registration of nonbank SBSDs as swap dealers. The commenter also requested that the Commission permit ANC broker-dealers and stand-alone SBSDs authorized to use models to apply a counterparty credit risk charge in lieu of a 100% deduction for security-based swaps and swaps with sovereigns, central banks, supranational institutions, and affiliates to the extent that an exception to applicable margin requirements applies. Similarly, another commenter recommended that the Commission calibrate the capital charges so that they do not make compliance with other regulators' margin rules punitive.[255]

A commenter stated that ANC broker-dealers and stand-alone SBSDs should be permitted to apply the credit risk models to uncollateralized exposures to multilateral development banks in which the U.S. is a member.[256] This commenter stated that the Commission's proposal to limit use of the models to commercial end users is unwarranted, on either risk-based or policy grounds. A commenter stated that requiring a 100% deduction for unsecured receivables from commercial end users with respect to swap transactions (as compared to security-based swap transactions for which the credit risk models would apply) will make it difficult, if not impossible, to maintain a dually-registered nonbank SBSD and swap dealer.[257] Another commenter urged the Commission to modify its proposal to avoid the pass-through of costs to commercial end users that the commenter argued would result if SBSDs are required to hold capital to cover unsecured credit exposures to them.[258] This commenter also recommended that the Commission allow nonbank SBSDs and nonbank MSBSPs that are not approved to use internal models to take the credit risk charge (*i.e.,* not limit its use to ANC broker-dealers and stand-alone SBSDs authorized to use models). One commenter suggested that the Commission substitute a credit risk charge or a credit concentration charge in place of the 100% charge for legacy accounts, with an exception permitting SBSDs to exclude any currently non-cleared positions for which a clearing agency has made an application to the Commission to accept for clearing.[259]

In response to the 2018 comment reopening, a commenter expressed support for expanding the use of credit risk models to uncollected initial margin from legacy accounts.[260] This commenter argued that this would be comparable to capital rules for bank SBSDs. Similarly, a commenter supported expanding the use of credit

[249] *See* paragraph (d) of Rule 15c3–1f.

[250] *See* paragraph (a) of Rule 15c3–1f.

[251] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70240–44.

[252] *See* 77 FR at 70240–44.

[253] *See Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53010–11.

[254] *See* SIFMA 2/22/2013 Letter.

[255] *See* Memorandum from Richard Gabbert, Counsel to Commissioner Hester M. Peirce, regarding an April 24, 2018 meeting with representatives of Citigroup (April 26, 2018) (''Citigroup 4/24/2018 Meeting'').

[256] *See* Letter from Anne-Marie Leroy, Senior Vice President and Group General Counsel, and David Harris, Acting Vice President and General Counsel, The World Bank (Feb. 21, 2013) (''World Bank Letter'').

[257] *See* Financial Services Roundtable Letter.

[258] *See* Sutherland Letter.

[259] *See* SIFMA 2/22/2013 Letter.

[260] *See* Morgan Stanley 11/19/2018 Letter.

risk models, noting that it would be consistent with the Basel capital standards as well as the manner in which the current net capital rule applies to ANC broker-dealers.[261] Conversely, a commenter opposed expanding the use of credit risk models.[262]

Finally, a commenter raised concerns about the potential rule language in the 2018 comment reopening because it narrowed the ability to use credit risk models for transactions in security-based swaps and swaps.[263] The commenter noted that the current capital rules permit ANC broker-dealers to use the ANC credit risk models with respect to derivatives instruments, which encompass—among other things—OTC options that are not security-based swaps or swaps.

In response to these comments, the Commission is persuaded that the ability to apply the credit risk models should not be narrowed as proposed in 2012 (*i.e.,* to exposures arising from uncollected variation and initial margin from commercial end users). The Commission believes the better approach is to maintain the existing provision in Rule 15c3–1 that permits an ANC broker-dealer to apply the ANC credit risk model to credit exposures arising from all derivatives transactions. The Commission further believes that Rule 18a–1 should permit stand-alone SBSDs authorized to use models to similarly apply the credit risk model. Consequently, under the final rules, the credit risk models can be applied to uncollateralized current exposures to counterparties arising from all derivatives instruments, including such exposures arising from not collecting variation margin from counterparties pursuant to exceptions in the margin rules of the Commission and the CFTC.[264]

The final rules also permit use of the credit risk models instead of taking the 100% deductions to net worth for electing not to collect initial margin for non-cleared security-based swaps and swaps pursuant to exceptions in the margin rules of the Commission and the CFTC, respectively. This broader application of the credit risk models with respect to security-based swap and swap transactions—which will reduce the amount of the capital charges—should mitigate concerns raised by commenters about the impact that the 100% deductions to net worth would have on nonbank SBSDs and their counterparties. It also responds to commenters who requested that the ability to use the credit risk models be expanded to a broader range of transactions. In addition, the broader application of credit risk models should mitigate the concerns raised by commenters that applying the 100% deduction to net worth with respect to swap transactions would make it difficult, if not impossible, to maintain an entity dually-registered as a nonbank SBSD and swap dealer.

As noted above, the 2018 comment reopening described a potential cap equal to 10% of the firm's tentative net capital that would limit the firm's ability to apply the credit risk models to uncollateralized current exposures arising from electing not to collect variation margin.[265] Under this potential threshold, a firm would need to take a capital charge equal to the aggregate amount of uncollateralized current exposures that exceeded 10% of the firm's tentative net capital.

Commenters addressed this potential cap. One commenter recommended that rather than an aggregate cap, the Commission adopt a counterparty-by-counterparty threshold equal to 1% of the firm's tentative net capital.[266] In the alternative, this commenter suggested using a 20% cap, if the Commission deemed it necessary to impose an aggregate limit. Another commenter suggested that the Commission not adopt the 10% cap and instead rely on the existing portfolio concentration charge in Rule 15c3–1e that is part of the credit risk model used to calculate the credit risk charges.[267]

In response to the comments, the 10% cap was designed to limit the amount of a firm's capital base that is comprised of unsecured receivables. These assets generally are illiquid and cannot be readily converted to cash, particularly in a time of market stress. Permitting additional unsecured receivables to be allowable assets for capital purposes (in the form of either a higher aggregate cap or alternative thresholds) could substantially impair the firm's liquidity and ability to withstand a financial shock. Moreover, as discussed above, the Commission is broadening the application of the credit risk models to all types of counterparties and transactions that are subject to exceptions in the margin rules for non-cleared security-based swaps and swaps.

For these reasons, the Commission believes it is an appropriate and prudent measure to adopt the 10% cap for ANC broker-dealers, including ANC broker-dealer SBSDs. These firms engage in a wide range of securities activities beyond dealing in security-based swaps, including maintaining custody of securities and cash for retail customers. They are significant participants in the securities markets and, accordingly, the Commission believes it is appropriate to adopt rules that promote their safety and soundness by limiting the amount of unsecured receivables that can be part of their regulatory capital. Thus, the Commission does not believe increasing the 10% cap to a 20% cap would be appropriate.

Consequently, under the final rule, these firms are subject to a portfolio concentration charge equal to 100% of the amount of the firm's aggregate *current exposure* to all counterparties in excess of 10% of the firm's tentative net capital.[268] Thus, unsecured receivables arising from electing not to collect variation margin are included in the portfolio concentration charge. The charge does not include *potential future exposure* arising from electing not to collect initial margin.

In response to comments, the Commission has reconsidered the proposed portfolio concentration charge for stand-alone SBSDs (including stand-alone SBSDs registered as OTC derivatives dealers).[269] These firms will engage in a much more limited securities business as compared to ANC broker-dealers, including ANC broker-dealer SBSDs. Consequently, they will be a less significant participant in the broader securities market. Moreover, under existing requirements, OTC derivatives dealers are not subject to a portfolio concentration charge.[270] Therefore, not including a portfolio concentration charge for stand-alone SBSDs will more closely align the credit risk model for these firms with the OTCDD credit risk model. The Commission believes this is appropriate as both types of entities are limited in the activities they can engage in as compared to ANC broker-dealers. Further, as discussed above in section II.A.4. of this release, a stand-alone SBSD that also is registered as an OTC derivatives dealer will be subject to

[261] *See* SIFMA 11/19/2018 Letter.

[262] *See* Better Markets 11/19/2018 Letter.

[263] *See* Morgan Stanley 11/19/2018 Letter.

[264] *See* paragraph (a)(7) of Rule 15c3–1, as amended; paragraph (a)(2) of Rule 18a–1, as adopted.

[265] *See Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53010.

[266] *See* Morgan Stanley 11/19/2018 Letter.

[267] *See* SIFMA 11/19/2018 Letter.

[268] *See* paragraph (c)(3) of Rule 15c3–1e, as amended.

[269] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70244 (proposing a portfolio concentration charge in Rule 18a–1 for stand-alone SBSDs).

[270] *See* paragraph (c) of Rule 15c3–1f.

Rules 18a–1, 18a–1a, 18a–1b, 18a–1c and 18a–1d rather than Rule 15c3–1 and its appendices (and, in particular, Rule 15c3–1f). Consequently, not including a portfolio concentration charge in Rule 18a–1 will avoid having two different standards: one for OTC derivatives dealers that also are SBSDs and the other for OTC derivatives dealers that are not SBSDs. For these reasons, the credit risk model for stand-alone SBSDs in Rule 18a–1 has been modified from the proposal to eliminate the portfolio concentration charge.[271]

In addition to the foregoing modifications to the credit risk models for ANC broker-dealers and stand-alone SBSDs, the Commission is making an additional modification to the term ''collateral'' as defined in the rules for purposes of the models.[272] In particular, the existing definition in Rule 15c3–1e and the proposed definition in Rule 18a–1 provided that in applying the credit risk model the fair market value of collateral pledged by the counterparty could be taken into account if, among other conditions, the firm maintains possession or control of the collateral.[273] Consequently, under the existing and proposed rules, collateral held at a third-party custodian could not be taken into account because it was not in the possession or control of the firm.

As discussed above in section II.A.2.b.ii. of this release, the Commission believes it would be appropriate to recognize a broader range of custodians for purposes of the exception to taking the deduction to net worth when initial margin is held at a third-party custodian. Consequently, the Commission modified that provision so that, for purposes of the exception, a stand-alone broker-dealer or nonbank SBSD could recognize collateral held at a bank as defined in Section 3(a)(6) of the Exchange Act or a registered U.S. clearing organization or depository that is not affiliated with the counterparty or, if the collateral consists of foreign securities or currencies, a supervised foreign bank, clearing organization, or depository that is not affiliated with the counterparty and that customarily maintains custody of such foreign securities or currencies.[274] The Commission believes the same types of custodians should be recognized for purposes of the credit risk models and accordingly is modifying the definitions of ''collateral'' in Rules 15c3–1e, as amended, and 18a–1, as adopted, to permit an ANC broker-dealer or nonbank SBSD to take into account collateral held at a third-party custodian that is one of these entities, subject to the same conditions with respect to foreign securities and currencies.[275]

A commenter urged the Commission to modify the proposed application of the credit risk models to avoid the pass-through of costs to commercial end users that the commenter argued would result if nonbank SBSDs are required to hold capital to cover unsecured credit exposures to these counterparties.[276] The commenter recommended that the Commission allow nonbank SBSDs not authorized to compute model-based haircuts to use the credit risk models (*i.e.,* not limit the use of credit risk models to ANC broker-dealers and stand-alone SBSDs authorized to use models). Another commenter suggested that nonbank SBSDs that have not been approved to use models for capital purposes also be allowed to compute credit risk charges for uncollected initial margin by multiplying the exposure by 8% and a credit-risk-weight factor.[277]

In response, the Commission does not believe it would be appropriate to permit stand-alone SBSDs that are not authorized to use models to apply model-derived credit risk charges. First, the credit risk models used by ANC broker-dealers and nonbank SBSDs require a calculation of maximum potential exposure to the counterparty multiplied by a back-testing-determined factor.[278] The maximum potential exposure amount is a charge to address potential future exposure and is calculated using the firm's market risk model (*i.e.,* the model to calculate model-based haircuts) 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. Second, ANC broker-dealers and stand-alone SBSDs authorized to use models are subject to higher minimum tentative net capital and net capital requirements. These enhanced minimum capital requirements are designed to account for the lower deductions that result from using models. Nonbank SBSDs that have not been authorized to use models will not be subject to these additional requirements. Moreover, as a practical matter, the Commission expects that most nonbank SBSDs will apply to use models.

A commenter argued that adopting an exception from collecting initial margin from another SBSD for a non-cleared security-based swap transaction without imposing a deduction from net worth would be inappropriate.[279] The commenter argued that these counterparties could default, which, in turn, could increase systemic risk. In response, as discussed above in section II.A.2.b.ii. of this release, the final rules require a nonbank SBSD to take a deduction in lieu of margin when it does not collect initial margin from a counterparty, including an SBSD. The capital charge is designed to achieve the same objective as collecting margin (*i.e.,* protect the nonbank SBSD from the consequences of the counterparty's default). Moreover, a nonbank SBSD will be required to collect variation margin from other financial market intermediaries such as SBSDs.

A commenter stated that uncollateralized receivables arising from a counterparty failing to post margin typically result from operational issues that are temporary in nature (*i.e.,* that are addressed in a matter of days) and are liquidated if they last for longer periods of time.[280] Consequently, the commenter requested that the Commission expand the use of credit risk models to instances when the nonbank SBSD does not collect *required* margin (*i.e.,* as distinct from when the SBSD elects not collect margin pursuant to an exception in the margin rules). As discussed above in section II.A.2.b.ii. of this release with respect to under-margined accounts, when margin is required it should be collected promptly, as it is designed to protect the nonbank SBSD from the consequences of the counterparty defaulting on its obligations. The 100% deduction from net worth for failing to collect required margin will serve as an incentive for nonbank SBSDs to have a well-

[271] *See* paragraph (e)(2) of Rule 18a–1, as adopted.

[272] *See* paragraph (c)(4)(v) of Rule 15c3–1e, as amended; paragraph (e)(2)(iii)(E) of Rule 18a–1, as adopted.

[273] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70243.

[274] *See* paragraph (c)(2)(xv)(C)(*1*) of Rule 15c3–1, as amended; paragraph (c)(1)(ix)(C)(*1*) of Rule 18a–1, as adopted.

[275] *See* paragraph (c)(4)(v)(B)(*2*) of Rule 15c3–1e, as amended; paragraph (e)(2)(iii)(E)(*2*) of Rule 18a–1, as adopted. As part of this modification, paragraph (c)(4)(v)(B) was re-designated paragraph (c)(4)(v)(B)(*1*) and the phrase ''and may be liquidated promptly by the firm without intervention by any other party'' was added before the semicolon. This rule text was moved from paragraph (c)(4)(v)(D) of Rule 15c3–1e, because this provision is not applicable to the third-party custodial provisions in paragraph (c)(4)(v)(B)(*2*). As a result, paragraph (c)(4)(v)(D) of Rule 15c3–1e was deleted and the remaining subparagraphs re-numbered. Conforming changes also were made to paragraph (e)(2)(iii) of Rule 18a–1, as amended.

[276] *See* Sutherland Letter.

[277] *See* SIFMA 11/19/2018 Letter.

[278] *See* paragraph (c)(4)(i) and Rule 15c3–1e, as amended; paragraph (e)(2)(iii)(A) of Rule 18a–1, as adopted.

[279] *See* OneChicago 2/19/2013 Letter.

[280] *See* SIFMA 2/22/2013 Letter.

functioning margin collection system and the capital needed to take the deduction will protect the nonbank SBSD from the consequences of the counterparty's default. However, the final margin rule being adopted today provides a nonbank SBSD or MSBSP an additional day to collect required margin from a counterparty (including variation margin due from an affiliate) if the counterparty is located in a different country and is more than 4 time zones away.[281] This should mitigate the commenter's concern about having to take a deduction when required margin is not collected in a timely manner.

Finally, a commenter requested that the Commission permit a nonbank SBSD to substitute the credit risk charge that would apply to a transaction with a counterparty with the credit risk charge that would apply to a transaction with a different counterparty that hedges the transaction with the first counterparty, as permitted under bank capital rules under certain conditions.[282] The commenter cited a bank regulation that permits this shifting of credit risk charges.[283] The bank regulation cited in support of this comment is integrated into the broader set of bank capital regulations. The commenter did not describe why such a provision would be appropriate for a nonbank or which bank regulations would need to be codified into the ANC broker-dealer and nonbank SBSD capital rules to prudently and effectively implement it. Consequently, the Commission is not incorporating such a provision into the ANC broker-dealer and nonbank SBSD capital rules.[284]

For the foregoing reasons, the Commission is adopting final rules that permit ANC broker-dealers and stand-alone SBSDs authorized to use credit risk models to apply the credit risk charges with the modifications discussed above.[285] The Commission also is adopting final rules regarding the operation of the credit risk models with the modifications discussed above.[286]

c. Risk Management

ANC broker-dealers and OTC derivatives dealers are subject to a risk management rule.[287] Rule 15c3–4 requires these firms to, among other things, 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. The Commission proposed that nonbank SBSDs be required to comply with Rule 15c3–4 to promote the establishment of effective risk management control systems by these firms.[288]

Commenters expressed support for the Commission's proposal.[289] A commenter stated that requiring nonbank SBSDs to comply with Rule 15c3–4 ''will better enable nonbank SBSDs to identify and mitigate and manage the risks they are facing.'' [290] A second commenter stated that Rule 15c3–4 should already contemplate the unique needs of a dealer in derivatives.[291] The Commission is adopting, as proposed, the requirement that nonbank SBSDs comply with Rule 15c3–4.[292]

d. Other Rule 15c3–1 Provisions Incorporated Into Rule 18a–1

i. Debt-Equity Ratio Requirements

Paragraph (d) of Rule 15c3–1 sets limits on the amount of a stand-alone broker-dealer's outstanding subordinated loans. The debt-to-equity limits are designed to ensure that a stand-alone 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. Paragraph (h) of proposed Rule 18a–1 contained parallel debt-to-equity limits.[293] The Commission did not receive comments concerning the debt-to-equity limits in proposed Rule 18a–1 and for the reasons discussed in the proposing release is adopting them as proposed.[294]

ii. Capital Withdrawal Requirements

Paragraph (e)(1) of Rule 15c3–1 requires that a stand-alone broker-dealer provide notice when it seeks to withdraw capital in an amount that exceeds certain thresholds. Paragraph (e)(2) of Rule 15c3–1 permits the Commission to issue an order temporarily restricting a stand-alone broker-dealer from withdrawing capital or making loans or advances to stockholders, insiders, and affiliates under certain circumstances. The Commission proposed parallel requirements for stand-alone SBSDs.[295] The Commission did not receive comments concerning the proposed capital withdrawal requirements for stand-alone SBSDs and for the reasons discussed in the proposing release is adopting them as proposed.[296]

iii. Appendix C

Appendix C to Rule 15c3–1 requires a stand-alone 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.[297] 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 stand-alone broker-dealer may also be consolidated. Subject to certain conditions in Appendix C to Rule 15c3–1, a stand-alone broker-dealer may receive flow-through net capital benefits because the consolidation may serve to increase the firm's net capital and thereby assist it in

[281] *See* paragraphs (c)(1)(iii) and (c)(2)(ii) of Rule 18a–3, as adopted. These and other provisions related to the margin rule are discussed in more detail in section II.B.2. of this release.

[282] *See* SIFMA 11/19/2018 Letter.

[283] 12 CFR 217.36.

[284] *See also* section II.A.1. of this release (discussing why the Commission does not believe it would be appropriate to apply a bank capital standard to a nonbank SBSD).

[285] *See* paragraph (a)(7) of Rule 15c3–1, as amended; paragraph (a)(2) of Rule 18a–1, as adopted.

[286] See paragraph (c) of Rule 15c3–1e, as amended; paragraph (e)(2) to Rule 18a–1, as adopted. The following non-substantive changes are being made. First, ''%'' is replaced with ''percent'' in paragraph (e)(2) of Rule 18a–1, as adopted, to improve internal consistency in the rule. Second, ''paragraphs (c)(1)(iv), (vi), and (vii) of this section'' are replaced with ''paragraphs (c)(1)(iv), (vi), and (vii) of this section, and § 240.18a–1b,'' in paragraph (d)(1) of Rule 18a–1, as adopted. Third, ''ten business day'' is replaced with ''ten-business day'' in paragraph (d)(9)(i)(C)(5)(i) of Rule 18a–1, as adopted. Fourth, ''paragraphs (c)(1)(iii), (iv), (vii), or (viii)'' is replaced with ''paragraphs (c)(1)(iii), (iv), (vi), (vii),'' in paragraph (d)(9)(iii) of Rule 18a–1, as adopted.

[287] *See* 17 CFR 240.15c3–4 (''Rule 15c3–4''); paragraph (a)(7)(iii) of Rule 15c3–1.

[288] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70250–70251.

[289] *See* Letter from Chris Barnard (Dec. 4, 2012) (''Barnard Letter''); Financial Services Roundtable Letter.

[290] *See* Barnard Letter.

[291] *See* Financial Services Roundtable Letter.

[292] *See* paragraph (a)(10)(ii) of Rule 15c3–1, as amended (which applies Rule 15c3–4 to broker-dealer SBSDs not authorized to use model-based haircuts); paragraph (f) of Rule 18a–1, as adopted (which applies Rule 15c3–4 to stand-alone SBSDs). In the final rule, paragraph (g) of Rule 18a–1, as proposed to be adopted, was re-designated paragraph (f). *See* paragraph (f) of Rule 18a–1, as adopted. *See also* paragraph (a)(7)(iii) of Rule 15c3–1 (which applies Rule 15c3–4 to ANC broker-dealers, including ANC broker-dealer SBSDs).

[293] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70254–55.

[294] *See* paragraph (g) of Rule 18a–1, as adopted. The debt-equity ratio requirements were set forth in re-designated paragraph (g) of Rule 18a–1, as adopted, and conforming changes were made to applicable cross-references in the rule.

[295] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70254–55.

[296] *See* paragraph (h) of Rule 18a–1, as adopted. The capital withdrawal requirements were set forth in re-designated paragraph (h) of Rule 18a–1, as adopted, and conforming changes were made to applicable cross-references in the rule.

[297] *See* Rule 15c3–1c.

meeting the minimum requirements of Rule 15c3–1. However, based on Commission staff experience and information from an SRO, very few stand-alone broker-dealers consolidate subsidiaries or affiliates to obtain the flow-through capital benefits permitted under Appendix C to Rule 15c3–1.

Consequently, the Commission proposed a parallel requirement for a stand-alone SBSD to 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, but the Commission did not propose parallel provisions permitting flow-through capital benefits.[298] The Commission did not receive comments on this proposed consolidation requirement and for the reasons discussed in the proposing release is adopting it as proposed.[299]

iv. Appendix D

Paragraph (c)(2)(ii) of Rule 15c3–1 permits a stand-alone broker-dealer when computing net capital to exclude liabilities that are subordinated to the claims of creditors pursuant to a satisfactory subordination agreement. Excluding these liabilities has the effect of increasing the firm's net capital. Appendix D to Rule 15c3–1 (Rule 15c3–1d) sets forth minimum and non-exclusive requirements for satisfactory subordination agreements.[300] There are two types of subordination agreements under Rule 15c3–1d: (1) A subordinated loan agreement, which is used when a third party lends cash to a stand-alone broker-dealer;[301] and (2) a secured demand note agreement, which is a promissory note in which a third party agrees to give cash to a stand-alone broker-dealer on demand during the term of the note and provides cash or securities to the broker-dealer as collateral.[302] Based on Commission staff experience, stand-alone broker-dealers infrequently utilize secured demand notes as a source of capital, and the amounts of these notes are relatively small in size.

Certain of the provisions in Rule 15c3–1d are tied to the minimum net capital requirements of stand-alone broker-dealers. Consequently, the Commission proposed amendments to the rule to reflect the proposed minimum net capital requirements of broker-dealer SBSDs so that they could realize the net capital benefits of qualified subordination agreements.[303] The Commission also included parallel provisions in proposed Rules 18a–1 and 18a–1d so that stand-alone SBSDs could realize the net capital benefits of qualified subordination agreements.[304] However, because stand-alone broker-dealers rarely use secured demand notes, the proposed provisions for stand-alone SBSDs did not include this option for entering into a qualified subordinated agreement. The Commission did not receive comments on the proposed amendments to Rule 15c3–1d or the proposed parallel provisions for stand-alone SBSDs and for the reasons discussed in the proposing release is adopting them with certain non-substantive modifications.[305]

v. Capital Charge for Unresolved Securities Differences

Paragraph (c)(2)(v) of Rule 15c3–1 requires a stand-alone broker-dealer to take a capital charge for short securities differences that are unresolved for seven days or longer and for long securities differences where the securities have been sold before they are adequately resolved. These capital charges were inadvertently omitted from the text of Rule 18a–1 when it was proposed and, consequently, the Commission proposed to include them in the rule when proposing the recordkeeping and reporting rules for SBSDs and MSBSPs.[306] The Commission received one comment, which addressed concerns regarding short sale buy-in requirements that are beyond the scope of this rulemaking.[307] For the reasons discussed in the proposing release, the Commission is adopting the capital charges as proposed with minor non-substantive changes.[308]

3. Capital Rules for Nonbank MSBSPs

The Commission proposed Rule 18a–2 to establish capital requirements for nonbank MSBSPs.[309] Under the proposal, nonbank MSBSPs were required at all times to have and maintain positive tangible net worth. The Commission proposed a tangible net worth standard, 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 stand-alone broker-dealers or SBSDs. As proposed, the term ''tangible net worth'' was defined to mean the nonbank MSBSP's net worth as determined in accordance with GAAP, excluding goodwill and other intangible assets. Consequently, the definition of ''tangible net worth'' allowed 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.

The Commission also proposed that nonbank MSBSPs must comply with Rule 15c3–4 with respect to their security-based swap and swap activities. Requiring nonbank MSBSPs to be subject to Rule 15c3–4 was intended to promote sound risk management practices with respect to the risks associated with OTC derivatives.

Commenters expressed support for the Commission's proposed requirements for nonbank MSBSPs.[310] A commenter stated that the positive tangible net worth test is more appropriate than the net liquid assets test particularly for entities that have never been prudentially regulated before.[311] Another commenter supported ''the proposed requirement

[298] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70255.

[299] *See* Rule 18a–1c, as adopted.

[300] *See* 17 CFR 240.15c3–1d (''Rule 15c3–1d'').

[301] *See* paragraph (a)(2)(ii) of Rule 15c3–1d.

[302] *See* paragraph (a)(2)(v)(A) of Rule 15c3–1d.

[303] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70256, n. 460.

[304] *See* 77 FR at 70255–70256.

[305] *See* Rule 15c3–1d, as amended; paragraph (c)(1)(ii) of Rule 18a–1, as adopted; Rule 18a–1d, as adopted. The final rules are modified in the following non-substantive ways. The proposed rule text in Rule 15c3–1d is modified to refer generically to minimum capital requirements, rather than specific numbers and percentages, to account for the additional financial ratios that broker-dealer SBSDs are subject to under Rule 15c3–1. The term ''%'' is replaced with ''percent'' to improve internal consistency in paragraphs (b)(7), (b)(8)(i), (b)(10)(ii)(B), and (c)(5)(B) of Rule 15c3–1d, as amended, and in paragraphs (b)(6), (b)(7), (b)(9)(ii)(A), (c)(2), and (c)(4) of Rule 18a–1, as adopted. The headers ''(i)'' and ''(ii)'' are removed in paragraph (b)(1) of Rule 18a–1d, as adopted. The semicolon at the end of paragraph is replaced with a period in paragraph (c)(2) of Rule 15c3–1d, as amended, and paragraph (b)(5) of Rule 18a–1d, as adopted. The phrase ''§ 240.18a–1 and § 240.18a–1d'' is replaced with ''§§ 18a–1 and 18a–1d'' in paragraphs (b)(8)(i) and (c)(1) of Rule 18a–1d, as adopted. Semicolons are added at the end of paragraphs (b)(9)(D) and (D)(*1*) of Rule 18a–1d, as adopted. The phrase ''[C]lause (i) of paragraph (b)(8)'' is replaced with ''paragraph (b)(8)(i) of this section'' in paragraph (b)(9)(ii)(D) of Rule 18a–1d, as adopted.

[306] *See Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers; Capital Rule for Certain Security-Based Swap Dealers,* 79 FR at 25254.

[307] *See* Shatto Letter.

[308] *See* paragraph (c)(1)(x)(A) through (C) of Rule 18a–1, as adopted. In the final rule, the Commission replaced the phrase ''broker or dealer'' with ''security-based swap dealer'' in paragraph (c)(1)(x)(B) and the term ''designated examining authority for a broker or dealer'' with ''Commission'' in paragraph (c)(1)(x)(C).

[309] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70256–57.

[310] *See* Barnard Letter; Sutherland Letter.

[311] *See* Sutherland Letter.

that MSBSPs maintain a positive tangible net worth.'' [312] However, the commenter also stated that the proposed rule ''should recognize and respect state insurance regulators' role in ensuring the capital adequacy of financial guaranty insurers, and should accordingly recognize that, in the case of a financial guaranty insurer, any positive tangible net worth requirement should be satisfied if an insurer maintains the minimum statutory capital and complies with the investment requirements under applicable insurance law.'' [313] This commenter also stated that, to the extent that financial guaranty insurers use affiliates to write CDS that they in turn insure, and insofar as such affiliates are designated as MSBSPs, the positive tangible net worth test should refer back to the financial guaranty insurer itself, as that is the entity that the CDS counterparties look to for paying the affiliates' obligations under the insured CDS.

With respect to the Commission's proposal that nonbank MSBSPs comply with Rule 15c3–4, the commenter stated that it recognized the need for nonbank MSBSPs to maintain strong internal risk controls, but cautioned the Commission against imposing unnecessarily burdensome, duplicative, and costly risk management controls on financial guaranty insurers. This commenter also stated that financial guaranty insurers that are determined to be MSBSPs should be able to establish compliance with Rule 15c3–4 by virtue of compliance with the New York Department of Financial Services Circular Letter No. 14, which calls for the establishment of comprehensive internal risk management controls.

The Commission has considered the comments on its proposed requirements for nonbank MSBSPs and is adopting the requirements substantially as proposed.[314] The requirement that nonbank MSBSPs at all times have and maintain positive tangible net worth is intended to be a less rigorous requirement than the net liquid assets test applicable to stand-alone broker-dealers and nonbank SBSDs. It will provide a workable standard for entities that engage in a diverse range of business activities that differ from, and are broader than, the securities activities conducted by stand-alone broker-dealers or SBSDs.

In response to the comment that the rule should recognize and respect existing state insurance law capital adequacy standards, the commenter supported the proposed tangible net worth requirement for nonbank MSBSPs.[315] The final rule imposes a relatively simple capital standard—the requirement to maintain positive tangible net worth (*i.e.,* positive net worth after deducting intangible assets). This should not impose a significant burden on nonbank MSBSPs, including firms that also are subject to capital requirements under state insurance laws. If it is possible that a nonbank MSBSP's capital position could drop below a positive tangible net worth but at the same time still comply with a state insurance law capital requirement, the Commission believes the rule's positive tangible net worth standard should be the binding constraint with respect to the nonbank MSBSP's activities as an MSBSP. The Commission does not believe it would be appropriate to permit a nonbank MSBSP to continue to operate as an MSBSP if it cannot meet the capital requirement of the positive tangible net worth test. In such a case, the firm's precarious capital position would pose a significant risk to its security-based swap counterparties.

In response to the comment about nonbank MSBSPs with CDS insured by an affiliate, the commenter did not identify an alternative capital standard that should apply to such nonbank MSBSPs. If the commenter was suggesting that these nonbank MSBSPs should be subject to a lesser requirement than the positive tangible net worth standard, the Commission disagrees. As discussed above, the Commission believes this standard will not impose a substantial burden on nonbank MSBSPs. Further, to the extent the affiliate insuring the CDS fails, the nonbank MSBSP will need to rely on its own financial resources.

The Commission also is adopting, as proposed, the requirement that MSBSPs comply with Rule 15c3–4.[316] Although a commenter cautioned the Commission against imposing unnecessarily burdensome, duplicative, and costly risk management controls on financial guaranty insurers, the Commission believes that establishing and maintaining a strong risk management control system that complies with Rule 15c3–4 is necessary for entities engaged in a security-based swaps business. Participants in the securities markets are exposed to various risks, including market, credit, leverage, liquidity, legal, and operational risk. Risk management controls 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. Moreover, to the extent an entity, such as a financial guaranty insurer, complies with existing risk management requirements applicable to its business, the entity will likely have in place some, if not many, of the required risk management controls. Thus, the incremental burdens and costs associated with complying with Rule 15c3–4 should not be great.

4. OTC Derivatives Dealers

OTC derivatives dealers are limited purpose broker-dealers that are authorized to trade in OTC derivatives (including a broader range of derivatives than security-based swaps) and to use models to calculate net capital. They are required to maintain minimum tentative net capital of $100 million and minimum net capital of $20 million.[317] OTC derivatives dealers also are subject to Rule 15c3–4.

A commenter stated that OTC derivatives dealers will register as nonbank SBSDs in order to conduct an integrated equity derivatives business (*i.e.,* trade in equity security-based swaps and equity OTC options).[318] The commenter requested that the Commission modify its framework for OTC derivatives dealers to allow them to register as nonbank SBSDs. The commenter further stated that the Commission should permit an OTC derivatives dealer that is dually registered as a nonbank SBSD to deal in OTC options and qualifying forward contracts, subject to the rules applicable to the nonbank SBSD.

The Commission agrees with the commenter that entities may seek to deal in a broader range of OTC derivatives that are securities other than dealing in just security-based swaps. In order to engage in this broader securities activity, the entity would need to register as a broker-dealer. The capital

[312] *See* Letter from Bruce E. Stern, Chairman, Association of Financial Guaranty Insurers (Feb. 15, 2013) (''AFGI 2/15/2013 Letter''). *See also* Letter from Bruce E. Stern, Chairman, Association of Financial Guaranty Insurers (July 22, 2013) (''AFGI 7/22/2013 Letter'').

[313] *See* AFGI 2/15/2013 Letter.

[314] *See* Rule 18a–2, as adopted. The Commission modified paragraph (a) of the rule to provide that the tangible net worth requirement does not apply to a broker-dealer MSBSP. However, a broker-dealer MSBSP will be required to comply with Rule 15c3–4. *See* paragraph (c) of Rule 18a–2, as adopted.

[315] *See* AFGI 2/15/2013 Letter (''We support the proposed requirement that MSBSPs maintain a positive tangible net worth.'').

[316] *See* paragraph (c) of Rule 18a–2, as adopted.

[317] *See* paragraph (a)(5) of Rule 15c3–1, as amended.

[318] *See* SIFMA 2/22/2013 Letter.

rules the Commission is adopting today address entities that will register as broker-dealer SBSDs. In response to the comments, the Commission believes it would be appropriate to also adopt final rules to address OTC derivatives dealers that will register as nonbank SBSDs. Accordingly, the final rules provide that an OTC derivatives dealer that is registered as a nonbank SBSD must comply with Rule 18a–1, as adopted, and Rules 18a–1a, 18a–1b, 18a–1c and 18a–1d instead of Rule 15c3–1 and its appendices.[319] This will simplify the capital rules for such an entity by requiring the firm to comply with a single set of requirements.

Moreover, the provisions of Rule 18a–1 and related rules are similar to the provisions of Rule 15c3–1 and its appendices. For example, the minimum fixed-dollar capital requirements in both sets of rules are $100 million in tentative net capital and $20 million in net capital. Both sets of rules permit the firms to compute net capital using models. In addition, as discussed above in section II.A.2.b.v. of this release, the methodology for computing the credit risk charges in Rule 18a–1 does not include the proposed portfolio concentration charge. As a result of this modification, both sets of rules are consistent in that they do not require this charge. Stand-alone SBSDs and OTC derivatives dealers also are both subject to Rule 15c3–4. For these reasons, the Commission believes a stand-alone SBSD should be able to efficiently incorporate its activities as an OTC derivatives dealer into its capital and risk management requirements under Rule 18a–1, as adopted.

B. Margin

1. Introduction

The Commission is adopting Rule 18a–3 pursuant to Section 15F of the Exchange Act to establish margin requirements for nonbank SBSDs and MSBSPs with respect to non-cleared security-based swaps. The Commission modeled Rule 18a–3 on the margin rules applicable to stand-alone broker-dealers (the ''broker-dealer margin rules'').[320] A commenter supported the Commission's decision to base its proposal on the existing margin rules for stand-alone broker-dealers, noting that it is critically important that the Commission maintain a level playing field for similar financial instruments.[321]

A number of commenters raised concerns about the Commission's decision to model proposed Rule 18a–3 on the broker-dealer margin rules to the extent that doing so resulted in inconsistencies with the margin rules of the CFTC and the prudential regulators as well as with the recommendations in the BCBS/IOSCO Paper.[322] A commenter argued that the broker-dealer margin rules are not consistent with the restrictions on re-hypothecation recommended by the BCBS/IOSCO Paper.[323] This commenter stated that the Commission needed to tailor its margin requirements to the realities of the security-based swap and swap markets.

Another commenter appreciated that the Commission largely modeled its proposed margin rules on the broker-dealer margin rules in an effort to promote consistency with existing rules, but suggested that the Commission more closely conform its final rules to the recommendations in the final BCBS/IOSCO Paper to promote the comparability of margin requirements among jurisdictions.[324] A second commenter noted that material differences and inconsistencies between the proposal and domestic and international standards could cause a need for separate documentation and tri-party arrangements for security-based swaps and swaps, which could lead to separate margin calls and different netting sets.[325]

A commenter suggested that the Commission coordinate its margin rules with the CFTC and the prudential regulators and raised a concern that the cumulative effects of multiple regulations potentially could tie up significant amounts of financial resources.[326] Other commenters recommended re-proposing the margin rule after publication of the final recommendations of the BCBS/IOSCO Paper, as well as coordinating and harmonizing with the margin rules of the CFTC and other foreign and domestic regulators.[327] A commenter argued that inconsistent rules potentially could be incompatible in practice and that international adoption of the recommended standards in the BCBS/IOSCO Paper will prevent regulatory arbitrage and lead to a more level playing field between competitors in different jurisdictions.[328] Other commenters argued that the Commission should more closely align its margin requirements to the recommended standards in the BCBS/IOSCO Paper to promote more comparable margin requirements across jurisdictions.[329] One commenter argued that several components of the proposed margin rules differ from the recommended framework in the BCBS/IOSCO Paper and would generally make nonbank SBSDs uncompetitive with bank SBSDs and foreign SBSDs.[330] The commenter argued that the Commission could best address these differences by permitting OTC derivatives dealers and stand-alone SBSDs to collect and maintain margin in a manner consistent with the recommendations in the BCBS/IOSCO Paper.

Section 15F(e)(3)(D) of the Exchange Act requires that, to the maximum extent practicable, the Commission, the CFTC, and the prudential regulators shall establish and maintain comparable minimum initial and variation margin requirements for SBSDs and MSBSPs. In response to the comments above, the Commission has modified the proposal to more closely align the final rule with the margin rules of the CFTC and the prudential regulators and, in doing so,

[319] *See* paragraph (a)(5)(ii) of Rule 15c3–1, as amended; undesignated introductory paragraph to Rule 18a–1, as adopted (stating that the rule applies to stand-alone SBSDs registered as OTC derivatives dealers).

[320] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70259.

[321] *See* OneChicago 2/19/2013 Letter.

[322] The CFTC and the prudential regulators incorporated the recommendations in the BCBS/IOSCO Paper into their final margin rules for non-cleared security-based swaps and/or swaps. *See CFTC Margin Adopting Release,* 81 FR 636; *Prudential Regulator Margin and Capital Adopting Release,* 80 FR 74840.

[323] *See* Letter from Paul Schott Stevens, President and CEO, Investment Company Institute (May 11, 2015) (''ICI 5/11/2015 Letter'').

[324] *See* MFA 2/22/2013 Letter.

[325] *See* SIFMA AMG 11/19/2018 Letter.

[326] *See* Financial Services Roundtable Letter.

[327] *See, e.g.,* Letter from William J. Harrington (Nov. 19, 2018) (''Harrington 11/19/2018 Letter''); ICI 1/23/2013 Letter; ICI 11/19/2018 Letter; ISDA 1/23/13 Letter; Morgan Stanley 10/29/2014 Letter; PIMCO Letter; SIFMA AMG 11/19/2018 Letter. The CFTC and the prudential regulators re-proposed their margin rules after publication of the BCBS/IOSCO Paper. *See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants,* 79 FR 59898 (Oct. 3, 2014); *Margin and Capital Requirements for Covered Swap Entities,* 79 FR 57348 (Sept. 24, 2014). As noted above, these agencies incorporated the recommendations of the BCBS/IOSCO Paper into their final margin rules. The Commission reopened the comment period for the proposed capital, margin, and segregation requirements in October 2018—well after the final recommendations of the BCBS/IOSCO Paper. In reopening the comment period, the Commission asked specific questions about potential rule language that would modify rule text in the proposed margin rule. *See Capital, Margin, and Segregation Comment Reopening.*

[328] *See* ISDA 2/5/2014 Letter.

[329] *See* American Council of Life Insurers 2/22/2013 Letter; American Council of Life Insurers 11/19/2018 Letter; Letter from Dan Waters, Managing Director, ICI Global (Nov. 24, 2014) (''ICI Global 11/24/2014 Letter''); MFA 2/22/2013 Letter; Letter from Christopher A. Klem, Leigh R. Fraser, and Molly Moore, Ropes & Gray LLP (Jan. 22, 2013) (''Ropes & Gray Letter''); SIFMA 11/19/2018 Letter.

[330] *See* SIFMA 11/19/2018 Letter.

the recommendations in the IOSCO/BCBS Paper. As discussed in more detail below, these modifications to harmonize the final rule include:

• An extra day to collect margin in the event a counterparty is located in a different country and more than 4 time zones away;

• A requirement that SBSDs post variation margin to most counterparties;

• An exception pursuant to which a nonbank SBSD need not collect initial margin to the extent that the initial margin amount when aggregated with other security-based swap and swap exposures of the nonbank SBSD and its affiliates to the counterparty and its affiliates does not exceed a fixed-dollar $50 million threshold;

• An exception pursuant to which a nonbank SBSD need not collect initial margin from a counterparty that is an affiliate of the nonbank SBSD;

• An exception pursuant to which a nonbank SBSD need not collect variation or initial margin from a counterparty that is the BIS, the European Stability Mechanism, or certain multilateral development banks;

• An exception pursuant to which a nonbank SBSD need not collect initial margin from a counterparty that is a sovereign entity with minimal credit risk;

• An option for nonbank SBSDs to use models to calculate initial margin that are different from the models they use to calculate capital charges;

• An option for nonbank SBSDs to use models developed by third parties (which will permit the use of an industry standard model such as ISDA's SIMM™ model); [331]

• An option for stand-alone SBSDs to use a model to calculate initial margin for equity security-based swaps subject to certain conditions;

• An option for nonbank SBSDs to collect and deliver collateral that is eligible under the CFTC's margin rules; and

• An option for nonbank SBSDs to use the standardized haircuts prescribed in the CFTC's margin rule to determine deductions for collateral received or delivered as margin.

While differences remain, the Commission believes the final nonbank SBSD margin rule for non-cleared security-based swaps is largely comparable to the margin rules of the CFTC and the prudential regulators. The main differences are that the Commission's rule:

• Does not require (but permits) nonbank SBSDs to collect initial margin from counterparties that are financial market intermediaries such as SBSDs, swap dealers, FCMs, and domestic and foreign broker-dealers and banks;

• Does not require (but permits) nonbank SBSDs to post initial margin to a counterparty;

• Does not contain the exceptions from the requirement to collect margin for counterparties such as financial end users that do not have material exposures to security-based swaps and swaps; and

• Does not require (but permits) initial margin to be held at a third-party custodian.

These differences between the Commission's final rule and the margin rules of the CFTC and the prudential regulators reflect the Commission's judgment of how ''to help ensure the safety and soundness'' of nonbank SBSDs and MSBSPs as required by Section 15F(e)(3)(i) of the Exchange Act. The Commission has sought to strike an appropriate balance between addressing the concerns of commenters and promulgating a final margin rule that promotes the safety and soundness of nonbank SBSDs.[332] For these reasons, the Commission is adopting a final rule—Rule 18a–3—that is modeled on the broker-dealer margin rule but with the significant modifications noted above. These modifications further harmonize the rule with the final margin rules of the CFTC and the prudential regulators. In particular, and as discussed in more detail below, these changes are intended, in part, to permit firms that are registered as SBSDs and swap dealers to collect initial margin and collect and deliver variation margin in a manner consistent with current practices under the CFTC's margin rules, which should in turn reduce operational burdens that would arise due to differences in these requirements.[333] Moreover, while paragraphs (c)(4) and (5) of Rule 18a–3, as adopted, respectively require netting and collateral agreements to be in place,[334] the rule does not impose a specific margin documentation requirement as do the margin rules of the CFTC and the prudential regulators.[335] Consequently, an existing netting or collateral agreement with a counterparty that was entered into by the nonbank SBSD in order to comply with the margin documentation requirements of the CFTC or the prudential regulators will suffice for the purposes of Rule 18a–3, as adopted, if the agreement meets the requirements of paragraph (c)(4) or (5), as applicable.

2. Margin Requirements for Nonbank SBSDs and Nonbank MSBSPs

a. Daily Calculations

i. Nonbank SBSDs

Proposed Rule 18a–3 required a nonbank SBSD to perform two calculations for the account of each counterparty: (1) The amount of equity in the account (variation margin); and (2) the initial margin amount for the account.[336] The term ''equity'' was 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 meeting the requirements of the rule. As indicated by the definition, the Commission proposed that the nonbank SBSD could offset payables and receivables relating to derivatives in the account by applying a qualifying netting agreement with the counterparty. Proposed Rule 18a–3 set forth the requirements for a netting agreement to qualify for this treatment. The equity in the account was the amount that resulted after

[331] Information about ISDA's SIMM™ model is available at *https://www.isda.org/category/margin/isda-simm/*.

[332] *See* Section VI of this release (discussing benefits and costs of the final margin requirements).

[333] Furthermore, although Rule 18a–3 does not mandate that SBSDs deliver initial margin to their counterparties (or to deliver or collect initial margin from financial market intermediaries) as the CFTC's margin rules do, nothing in Rule 18a–3 prohibits nonbank SBSDs from delivering initial margin to these counterparties or collecting initial margin from or posting initial margin to financial market intermediaries. In addition, as above in section II.A.2.b.i. of this release, the Commission is providing guidance that would permit nonbank SBSDs to post initial margin to counterparties without taking a capital charge pursuant to certain conditions.

[334] *See* paragraph (c)(4) of Rule 18a–3, as adopted (providing that a nonbank SBSD or MSBSP may take into account the fair market value of collateral delivered by a counterparty, provided the collateral is subject to an agreement between the SBSD or the MSBSP and the counterparty that is legally enforceable by the SBSD or MSBSP against the counterparty and any other parties to the agreement); paragraph (c)(5) of Rule 18a–3, as adopted (prescribing requirements for qualified netting agreements).

[335] *See* 17 CFR 23.159 (CFTC rule requiring that margin documentation: (1) Specify the methods, procedures, rules, inputs, and data sources to be used for determining the value of non-cleared swaps for purposes of calculating variation margin; (2) describe the methods, procedures, rules, inputs, and data sources to be used to calculate initial margin for non-cleared swaps entered into between the covered swap entity and the counterparty; and (3) specify the procedures by which any disputes concerning the valuation of non-cleared swaps, or the valuation of assets collected or posted as initial margin or variation margin may be resolved); *see also CFTC Margin Adopting Release,* 81 FR at 672–73, 702–3; *Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74886–87, 74908–909.

[336] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70260–62.

marking-to-market the securities positions and adding the credit balance or subtracting the debit balance (including giving effect to qualifying netting agreements). An account with negative equity was subject to a variation margin requirement unless an exception from collecting collateral to cover the negative equity (*i.e.,* the nonbank SBSD's current exposure) applied.

The proposed rule set forth a standardized and a model-based approach for calculating initial margin.[337] The rule divided security-based swaps into two classes for purposes of the standardized approach: (1) CDS; and (2) all other security-based swaps. In both cases, the initial margin amount was to be calculated using the standardized haircuts in the proposed capital rules for nonbank SBSDs.

Proposed Rule 18a–3 provided that, if the nonbank SBSD was authorized to use model-based haircuts, the firm could use them to calculate initial margin for security-based swaps for which the firm had been approved to apply such haircuts.[338] However, model-based haircuts could not be used to calculate initial margin for equity security-based swaps. Initial margin for equity security-based swaps needed to be calculated using standardized haircuts in order to be consistent with SRO margin rules for cash equity positions. Consequently, a nonbank SBSD authorized to use model-based haircuts for certain types of debt security-based swaps could use these haircuts to calculate initial margin for the same types of positions. For all other positions, a nonbank SBSD needed to use the standardized haircuts. Nonbank SBSDs not authorized to use model-based haircuts needed to use the standardized haircuts to calculate initial margin for all types of positions.

Finally, proposed Rule 18a–3 required a nonbank SBSD to increase the frequency of the variation and initial margin calculations (*i.e.,* perform intra-day calculations) during periods of extreme volatility and for accounts with concentrated positions.[339]

Comments and Final Requirements To Calculate Variation Margin

A commenter sought clarification as to whether the mark-to-market value of security-based swap positions would only be counted in the definition of ''equity'' as part of the credit balance or the debit balance, as appropriate.[340] This commenter believed the absence of credit and debit balance definitions created a potential issue that the mark-to-market value of non-cleared security-based swap positions would be double counted in the calculation of the equity in a counterparty's account. In response, a nonbank SBSD should only include the mark-to-market value of a security-based swap once when calculating equity in determining the variation margin requirement.

Another commenter stated that counterparties should be permitted to reference third parties for dispute resolution, valuations, and inputs in relation to their account equity variation margin calculations.[341] In response, the Commission agrees that price and valuation information from third parties can be useful in validating the nonbank SBSD's variation margin calculations and in the dispute resolution process.

The Commission is adopting the requirement to calculate variation margin for the account of a counterparty on a daily basis, with certain non-substantive modifications to the rule, in response to comments and to use terms that are more commonly used in the security-based swap market.[342] In the final rule, the Commission has deleted the term ''equity'' and the definitions of ''positive equity'' and ''negative equity'' and has included the phrase ''current exposure'' without defining it.[343] The phrase ''current exposure'' is used more commonly in the non-cleared security-based swap market when describing uncollateralized mark-to-market gains or losses.

Comments and Final Requirements To Calculate Initial Margin Using the Standardized Approach

Commenters argued that the standardized approach to calculating initial margin was too conservative and not sufficiently risk sensitive.[344] A commenter stated that the standardized approach would result in excessive margin requirements because the standardized haircuts in the capital rules were applied to gross notional amounts and only permitted limited netting.[345] This commenter also argued that it was unclear how the proposed grids applied to more complex products.

In response to these concerns, nonbank SBSDs may seek authorization to calculate initial margin using the model-based approach. Based on staff experience and the ongoing implementation of margin rules for non-cleared security-based swaps and swaps by other regulators and market participants, the Commission believes that most nonbank SBSDs will seek authorization to use a model. The availability of an initial margin model and the widespread use of initial margin models by industry participants should alleviate commenters' concerns that using standardized haircuts to calculate initial margin will lead to excessive initial margin requirements. While the Commission agrees that standardized haircuts likely will lead to more conservative requirements in contrast to the model-based initial margin calculations, the Commission does not believe these requirements will be excessive. The standardized haircuts have been used by stand-alone broker-dealers for many years. Moreover, as discussed below, the Commission is modifying the proposal to add a threshold under which initial margin need not be collected. This should mitigate the concern raised by the commenter with regard to using the standardized haircuts to calculate initial margin. Finally, the ability to use the simpler standardized haircuts for initial margin calculations may be preferable for nonbank SBSDs that occasionally trade in non-cleared security-based swaps but not in a substantial enough

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[337] *See* 77 FR at 70261.

[338] In the 2018 comment reopening, the Commission also sought comment on whether the margin rule should permit nonbank SBSDs to apply to use models other than proprietary capital models to compute initial margin, including applying to use an industry standard model. *Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53013.

[339] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70260.

[340] *See* SIFMA 2/22/13 Letter.

[341] *See* Letter from Kevin Gould, President, Markit (Feb. 22, 2013) (''Markit Letter'').

[342] *See* paragraph (c)(1)(i)(A) of Rule 18a–3, as adopted.

[343] *See* paragraph (c)(1)(i)(A) of Rule 18a–3, as adopted. The Commission also proposed to define the term ''positive equity'' to mean equity of greater than $0 and ''negative equity'' to mean equity of less than $0. The Commission received no comments on these proposed definitions. However, the Commission is deleting them in the final rule because the term equity is no longer being defined. In addition, paragraph (b)(1) of proposed Rule 18a–3 defined the term ''account'' for purposes of the daily calculations of variation and initial margin to mean an account carried by a nonbank SBSD or MSBSP for a counterparty that holds non-cleared security-based swaps. The Commission did not receive any comments on this definition. However, the Commission is modifying the definition to move the clause ''for a counterparty'' to the end of the definition to clarify that the nonbank SBSD holds non-cleared security-based swaps for a counterparty, and to add the term ''one or more'' before the phrase ''non-cleared security-based swaps.'' Furthermore, paragraph (b)(3) of proposed Rule 18a–3 defined the term ''counterparty'' to mean a person with whom the nonbank SBSD or MSBSP has entered into a non-cleared security-based swap transaction. The Commission received no comments on this definition and is adopting it as proposed.

[344] *See* ISDA 1/23/2013 Letter; Markit Letter.

[345] *See* ISDA 1/23/2013 Letter.

volume to justify the initial and ongoing systems and personnel costs that may be associated with the implementation and operation of an initial margin model.

Commenters argued that nonbank SBSDs should be permitted to use approaches other than the standardized approach to calculate initial margin for equity security-based swaps.[346] One commenter stated that the standardized haircuts in the capital rules that would be used to calculate initial margin for equity security-based swaps—including the more risk sensitive standardized haircut approach in Rule 15c3–1a and proposed Rule 18a–1a (''Appendix A methodology'')—are inadequate and inefficient for a proper initial margin calculation and do not sufficiently recognize portfolio margining. This commenter argued that the Appendix A methodology does not incorporate critical factors such as volatility, and, as a result, initial margin on equity security-based swaps would likely be insufficient in times of market stress (in contrast to a model-based approach). Finally, this commenter stated that requiring the Appendix A methodology for non-cleared equity security-based swaps would place U.S.-based nonbank SBSDs at a competitive disadvantage in the market because no other jurisdiction (or other U.S. regulator) has proposed to prohibit the use of models for specific asset classes.[347] Another commenter similarly raised concerns that applying the Appendix A methodology (as compared to a model) would result in initial margin requirements that are substantially less sensitive to the economic risks of a security-based swap portfolio, and suggested that the Commission permit a nonbank SBSD to use a model to calculate initial margin for equity security-based swaps.[348] Several other commenters endorsed the use of models to compute initial margin for equity security-based swaps.[349]

The Commission continues to believe it is important to maintain parity between the margin requirements in the cash equity markets and the margin requirements for equity security-based swaps. The only method currently available to portfolio margin positions in the cash equity markets is the Appendix A methodology.[350] Consequently, the Commission is adopting the requirement to use the standardized approach to calculate initial margin for non-cleared equity security-based swaps, but with a modification to address commenters' concerns.[351] In particular, the Commission is modifying the margin rule to permit a stand-alone SBSD to use a model to calculate initial margin for non-cleared equity security-based swaps, provided the account does not hold equity security positions other than equity security-based swaps and equity swaps (*e.g.,* the account cannot hold long and short positions, options, or single stock futures).[352] The Commission believes permitting the model-based approach under these limited circumstances strikes an appropriate balance in terms of addressing commenters' concerns and maintaining regulatory parity between the cash equity market and the equity security-based swap market. Moreover, a nonbank stand-alone SBSD could seek authorization to use a model to portfolio margin equity security-based swaps with equity swaps. Similarly, as discussed above in relation to the standardized haircuts, the Commission modified the Appendix A methodology from the proposal to permit equity swaps to be included in a portfolio of equity products. The ability to use the model-based approach for equity security-based swaps (and potentially equity swaps) and the modification to the Appendix A methodology will facilitate portfolio margining of equity security-based swaps and equity swaps, though the Commission and the CFTC will need to coordinate further to implement this type of portfolio margining.[353]

Comments and Final Requirements To Calculate Initial Margin Using the Model-Based Approach

Comments addressing the model-based approach to calculating initial margin generally fell into one of two broad categories: (1) Comments raising concerns about the risks of using models; and (2) comments supporting the use of models but suggesting modifications to the proposal or seeking clarifications as to how the proposal would work in practice.

In terms of concerns about the risks of models, one commenter argued that using models for capital and margin calculations likely will make capital and margin more pro-cyclical because market data used in the models will show less risk during strong periods of the economic cycle and more risk during downturns.[354] This commenter recommended, among other things, that if internal models continue to be used, they should be ''floored'' at the level set by standardized approaches (*e.g.,* those used in bank capital regimes), and that the Commission should continue with a review of the implications of the use of internal models. Another commenter stated that netting derivatives exposures (a component of model-based initial margin calculations) when calculating potential losses is an unsound risk management practice.[355] According to the commenter, even if two positions appear to offset one another, liquidity conditions, replacement costs, and counterparty credit risk may vary considerably.

The Commission acknowledges the concerns expressed by commenters about the efficacy of models, particularly in times of market stress. The Commission nonetheless believes it is appropriate to permit firms to employ a model to calculate initial margin. The Commission's supervision of the firms' use of models as well as the conditions that will be imposed governing their use will provide checks that are designed to address the risks identified by the

[346] *See* ISDA 1/23/2013 Letter; SIFMA 2/22/2013 Letter; SIFMA 11/19/2018 Letter.

[347] *See* ISDA 1/23/2013 Letter.

[348] *See* SIFMA 2/22/2013 Letter.

[349] *See* Center for Capital Markets Competitiveness, Chamber of Commerce 11/19/2018 Letter; Letter from Scott O'Malia, Chief Executive Officer, International Swaps and Derivatives Association (Nov. 19, 2018) (''ISDA 11/19/2018''); OneChicago 11/19/2018 Letter; SIFMA AMG 2/22/2013 Letter; SIFMA 11/19/2018 Letter. One commenter suggested that the Commission permit stand-alone SBSDs and SBSDs dually-registered as OTC derivatives dealers to calculate initial margin for equity security-based swaps using an industry standard model such as SIMM™. *See* SIFMA 11/19/2018 Letter.

[350] *See* FINRA Rule 4210(g).

[351] *See* paragraph (d)(1) of Rule 18a–3, as adopted. In the final rule, the Commission replaced the term ''margin'' with the term ''initial margin amount'' and replaced the phrase ''of positive equity in an account of a counterparty'' with the phrase ''calculated pursuant to paragraph (d) of this section.'' *See* paragraph (b)(4) of Rule 18a–3, as adopted. These are non-substantive changes to conform the rule text to changes made to other paragraphs of the final rule. In addition, in the final rule the Commission deleted the phrase ''calculated pursuant to paragraph (d)(2) of this section'' from paragraph (c)(1)(i)(B) of the rule, because the phrase, as modified, was moved to paragraph (b)(4) of the rule to define the term ''initial margin amount.''

[352] *See* paragraph (d)(2)(ii) of Rule 18a–3, as adopted. *See also Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53015–16. In the reopening, the potential modifications to the rule contained the phrase ''provided, however, the account of the counterparty subject to the requirements of this paragraph may not hold equity securities or listed options.'' 83 FR at 53016. The final rule contains the phrase ''provided, however, the account of the counterparty subject to the requirements of this paragraph may not hold equity security positions other than equity security-based swaps and equity swaps.'' The final rule clarifies that the account of a counterparty utilizing this paragraph may not hold equity security positions other than equity security-based swaps and equity swaps.

[353] *See, e.g., Order Granting Conditional Exemption Under the Securities Exchange Act of 1934 in Connection with Portfolio Margining of Swaps and Security-Based Swaps,* 77 FR 75211.

[354] *See* Americans for Financial Reform Letter.

[355] *See* Better Markets 1/22/2013 Letter; Better Markets 7/22/2013 Letter.

commenters, such as the potential for firms to manipulate their collateral needs. In addition, the CFTC, the prudential regulators, and foreign financial regulators permit the use of internal models to calculate initial margin. Permitting nonbank SBSDs to use models for this purpose will further harmonize the Commission's margin rule with the rules of domestic and foreign regulators and, therefore, minimize potential competitive impacts of imposing different requirements.

Commenters supporting the use of models commented on the proposed requirement that the initial margin model needed to be the same model used by the nonbank SBSD to calculate haircuts for purposes of the proposed capital rules. These commenters supported the Commission's potential modification to permit nonbank SBSDs to use models other than proprietary capital models to compute initial margin, including an industry standard model.[356] A commenter stated that the rule should provide a nonbank SBSD with the option to choose between internal and third-party models to avoid an uneven playing field among counterparties, noting that not all entities have sufficient resources to develop internal models.[357] This commenter argued that permitting a nonbank SBSD to use a third-party model would reduce the time and resources needed for the Commission to authorize the use of the model. A second commenter requested that nonbank SBSDs be permitted to use an industry standard model to compute initial margin and argued that such a model would result in efficiency, transparency, and consistency in the marketplace.[358] Other commenters generally supported the use of an industry standard model to compute initial margin.[359]

Making a similar point about the benefits of model transparency, a commenter suggested that internal models should be available to counterparties upon request.[360] Similarly, commenters suggested that the ability of a counterparty to replicate a firm's initial margin model should be a condition of the Commission's approval of the model, or that the calculation of initial margin should be independently verifiable.[361] A commenter argued that external models, in some cases, are preferable to internal models because there is less potential for firms to manipulate their collateral needs.[362] The commenter also supported the use of pre-approved clearing agency and DCO models as one input in the calculation of initial margin for non-cleared positions, but cautioned that additional inputs should be required. The commenter opposed the use of vendor-supplied models for the calculation of margin due to concerns that vendors may develop models that would help firms minimize required margin.

Commenters also addressed the potential offsets that could be permitted with respect to the model-based initial margin calculations. A commenter argued that netting should be limited to exactly offsetting positions and that positions that are potentially correlated due to, for example, long and short positions in the same broad industry should not be permitted to be offset.[363] On the other hand, another commenter requested that counterparties be permitted to use a broader product set to calculate initial margin than the set required by each counterparty's applicable regulation.[364] The commenter stated that this broader product set potentially could include a wide set of bilaterally traded products, even if such products are not swaps or derivatives. Other commenters asked the Commission to clarify whether cleared and non-cleared security-based swaps could be offset.[365] A commenter stated that if U.S. registrants must structure their activities so as to margin non-centrally cleared security-based swaps and swaps separately from other non-centrally cleared derivatives, they would be at a significant competitive disadvantage to foreign competitors.[366] Another commenter encouraged the Commission to consider allowing participants to calculate the risk of positions within broad asset classes and then sum the risk calculations for each asset class.[367] A commenter also stated that it is essential that national supervisors provide consistent and more comprehensive guidance regarding model inputs (including baseline stress scenarios) and the adjustment of model inputs.[368] Commenters supported the cross-margining of security-based swaps with other products under a single cross-product netting agreement, as well as the portfolio margining of cleared security-based swaps and swaps.[369]

Commenters also requested that the Commission facilitate portfolio margining.[370] A commenter supported the Commission's proposal to allow portfolio margining between cash market securities and security-based swaps, and encouraged the Commission to work with other regulators to make such an approach as expansive as possible.[371] Other commenters encouraged the Commission to permit a nonbank SBSD (including a broker-dealer SBSD) to portfolio margin non-cleared security-based swaps with non-cleared swaps in accordance with the CFTC's margin and segregation rules, subject to appropriate conditions (including appropriately calibrated capital charges and waiver of customer protection rules).[372] Another commenter argued that the CFTC, in turn, should expand its existing relief allowing a swap dealer to collect and post margin on a portfolio basis for swaps and security-based swaps under the CFTC's margin rules by reciprocally allowing a dually registered swap dealer and nonbank SBSD to portfolio margin security-based swaps and swaps under the Commission's margin rules.[373] One commenter suggested that the Commission clarify that the portfolio margining of cleared and non-cleared

[356] *See* Center for Capital Markets Competitiveness, Chamber of Commerce 11/19/2018 Letter; ISDA 11/19/2018 Letter; MFA/AIMA 11/19/2018 Letter; SIFMA 11/19/2018 Letter.

[357] *See* Markit Letter.

[358] *See* SIFMA 3/12/2014 Letter; SIFMA 11/19/2018 Letter.

[359] *See* Center for Capital Markets Competitiveness, Chamber of Commerce 11/19/2018 Letter; MFA/AIMA 11/19/2018 Letter; SIFMA 11/19/2018 Letter.

[360] *See* Sutherland Letter.

[361] *See* MFA 2/22/2013 Letter; MFA/AIMA 11/19/2018 Letter; Letter from Timothy W. Cameron, Managing Director, and Matthew J. Nevins, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association Asset Management Group (Feb. 22, 2013) (''SIFMA AMG 2/22/2013 Letter'').

[362] *See* CFA Institute Letter.

[363] *See* Americans for Financial Reform Letter.

[364] *See* Letter from Mary P. Johannes, Senior Director and Head of ISDA WGMR Initiative, International Swaps and Derivatives Association (May 15, 2015) (''ISDA 5/15/2015 Letter'').

[365] *See, e.g.,* AIMA 2/22/2013 Letter; Letter from American Benefits Council, Committee on Investment of Employee Benefit Assets, European Federation for Retirement Provision, the European Association of Paritarian Institutions, the National Coordinating Committee for Multiemployer Plans, and the Pension Investment Association of Canada (Jan. 29, 2013) (''American Benefits Council, et al. 1/29/2013 Letter''); ISDA 2/5/2014 Letter; MFA 2/22/2013 Letter; Ropes & Gray Letter; SIFMA 2/22/2013 Letter.

[366] *See* Letter from Kenneth E. Bentsen, Jr., President and Chief Executive Officer, Securities Industry and Financial Markets Association (Mar. 12, 2014) (''SIFMA 3/12/2014 Letter'').

[367] *See* ISDA 2/5/2014 Letter.

[368] *See* SIFMA 3/12/14 Letter.

[369] *See* FIA 11/19/2018 Letter; MFA/AIMA 11/19/20178 Letter; OneChicago 11/19/2018 Letter; SIFMA 11/19/2018 Letter.

[370] *See Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53014–16. *See also* Center for Capital Markets Competitiveness, Chamber of Commerce 11/19/2018 Letter; ICI 11/19/2018 Letter; ISDA 11/19/2018 Letter; SIFMA 11/19/2018 Letter.

[371] *See* Financial Services Roundtable Letter.

[372] *See* Citigroup 4/24/2018 Meeting; IIB/SIFMA Letter.

[373] *See* IIB/SIFMA Letter; *see also* CFTC Letter 16–71 (Aug. 23, 2016).

security-based swaps and swaps should be permitted and encouraged the Commission to coordinate with the CFTC to determine appropriate conditions for enhanced portfolio margining.[374]

To expedite the approval process, some commenters suggested that the Commission permit the use of initial margin models approved by other domestic and foreign regulators, or a model already approved for a firm's parent company.[375] One commenter suggested that the Commission provisionally approve proprietary models used by nonbank SBSDs when the margin rules first become effective subject to further Commission review.[376] The commenter argued that such a process would prevent those firms whose models were reviewed earlier from having an unfair market advantage over those firms that are positioned later in the Commission's review schedule.

Other commenters argued that the Commission should restrict the use of portfolio margining to ensure greater security for market participants, or stated that the Commission did not provide an explanation as to how the Commission would oversee portfolio margin models.[377]

In response to comments, the Commission made the following modifications to the proposed model-based approach to calculating initial margin: (1) Nonbank SBSDs may use a model other than their capital model; (2) the final rule provides more clarity as to the offsets permitted of an initial margin model; (3) the final rule permits stand-alone SBSDs to use a model to portfolio margin equity security-based swaps and will permit these entities to include equity swaps in the portfolio, subject to further coordination with the CFTC; and (4) as discussed above in section II.A.2.b.iv. of this release, the final capital rule provides that the Commission may approve the temporary use of a provisional model by a nonbank SBSD for the purposes of calculating initial margin if the model had been approved by certain other supervisors.

As indicated, the final rule does not limit a nonbank SBSD to using its capital model to calculate initial margin.[378] For example, after the Commission proposed Rule 18a–3, the CFTC and the prudential regulators adopted final margin rules permitting the use of a model to calculate initial margin subject to the approval of the CFTC or a firm's prudential regulator.[379] The first compliance date for these rules for both variation and initial margin was September 1, 2016 for the largest firms.[380] The Commission understands that the firms subject to these final rules have widely adopted the use of an industry standard model to compute initial margin.[381] Based on these developments, the Commission believes that most nonbank SBSDs likely will apply to the Commission to use the industry standard model to compute initial margin. The final rule permits the use of such a model, subject to approval by the Commission.

The Commission believes that the ability to use an initial margin model (other than the firm's capital model)—including the industry standard model that has been widely adopted by market participants—will mitigate many of the concerns raised by commenters. Counterparties will be better able to replicate the initial margin calculations of the nonbank SBSDs with whom they transact. Giving counterparties the ability to meaningfully estimate potential future initial margin calls will allow them to prepare for contingencies and minimize the risk of their failure to meet a margin call. This increased transparency will benefit the nonbank SBSD and the counterparty. Consequently, widespread use of an industry standard model to calculate initial margin may increase transparency and decrease margin disputes. This should mitigate commenters' concerns regarding the transparency of a nonbank SBSD's proprietary model used to calculate initial margin, as the Commission believes that most nonbank SBSDs likely will apply to the Commission to use the industry standard model to compute initial margin.

The Commission acknowledges that some nonbank SBSDs may choose to use models other than the industry standard model. However, the anticipated widespread use of the industry standard model will provide counterparties with the option of taking their business to nonbank SBSDs that use this model to the extent they are concerned about a lack of transparency with respect to other models used by nonbank SBSDs. Moreover, this could incentivize firms that use other models to make them more transparent to market participants.

The final rule also provides that the initial margin model must use a 99%, one-tailed confidence level with price changes equivalent to a 10 business-day movement in rates and prices, and must use risk factors sufficient to cover all the material price risks inherent in the positions for which the initial margin amount is being calculated, including foreign exchange or interest rate risk, credit risk, equity risk, and commodity risk, as appropriate.[382] Several commenters opposed a 10 business-day movement in rates and prices as part of the quantitative requirements for using a model and recommended that the Commission reduce the close-out period to 3 or 5 days.[383] One of these commenters argued that a 10-day period substantially overstates the risk of many non-cleared security-based swaps and will create unnecessarily high initial margin requirements.[384] Other commenters recommended that the Commission establish a more flexible, risk-specific approach to determine and adjust the appropriate liquidation time horizon by product type or asset class.[385]

The Commission believes the prudent approach is to retain the proposed 10 business-day period in the final requirements governing the use of models to calculate initial margin.[386] The 10-day standard has been part of the quantitative requirements for broker-dealers in calculating model-based haircuts under the net capital rule since

[374] *See* MFA/AIMA 11/19/2018 Letter.

[375] *See* IIB11/19/2018 Letter; ISDA 1/23/2013 Letter; SIFMA 3/12/2014 Letter.

[376] *See* ISDA 1/23/2013 Letter.

[377] *See* Americans for Financial Reform Education Fund Letter; Better Markets 11/19/2018 Letter; Rutkowski 11/20/2018 Letter. Another commenter opposed the portfolio margining of swaps with flip clauses, walkaway clauses, or similar provisions. *See* Harrington 11/19/2018 Letter.

[378] *See* paragraph (d)(2) of Rule 18a–3, as adopted. *See Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53012–13 (soliciting comment on potential rule language that would modify the proposal in this manner).

[379] *See Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74876; *CFTC Margin Adopting Release,* 81 FR at 654.

[380] *See, e.g., Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74849–74851; *CFTC Margin Adopting Release,* 81 FR at 674–677. Variation margin requirements have been implemented pursuant to these rules, while initial margin requirements are being phased in through September 1, 2020.

[381] *See, e.g.,* ISDA, *ISDA SIMM™ Deployed Today; New Industry Standard for Calculating Initial Margin Widely Adopted by Market Participants* (Sept. 1, 2016), *available at https://www.isda.org/2016/09/01/isda-simm-deployed-today-new-industry-standard-for-calculating-initial-margin-widely-adopted-by-market-participants/.*

[382] *See* paragraph (d)(2) of Rule 18a–3, as adopted. This approach is consistent with the final margin rules of the CFTC and the prudential regulators. *See Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74906; *CFTC Margin Adopting Release,* 81 FR at 699.

[383] *See* American Benefits Council, et al. 1/29/2013 Letter; MFA 2/22/2013 Letter; PIMCO Letter; SIFMA AMG 2/22/2013 Letter.

[384] *See* American Benefits Council, et al. 1/29/2013 Letter.

[385] *See* MFA 2/22/2013 Letter; MFA/AIMA 11/19/2018 Letter.

[386] *See* paragraph (d)(2) of Rule 18a–3, as adopted.

the rule permitted the use of models. The Commission does not believe it would be appropriate to have a less conservative standard for calculating initial margin (which is designed to account for the risk of the counterparty's positions) than for calculating model-based haircuts under Rule 15c3–1e, as amended, and Rule 18a–1, as adopted (which is designed to account for the risk of the nonbank SBSD's own positions). Further, the Commission does not believe that a period of less than 10 business days—such as the 3 to 5 business-day period typically used by clearing agencies and DCOs—would be appropriate given that non-cleared security-based swaps may be, in some cases, less liquid than cleared security-based swaps in terms of how long it would take to close them out. Moreover, the initial margin model requirements of the CFTC and the prudential regulators mandate a 10-day standard and, therefore, the Commission's rule is harmonized with their rules.[387]

The final rule provides more clarity as to the offsets permitted in calculating initial margin using a model. In particular, it provides that an initial margin model must use risk factors sufficient to cover all the material price risks inherent in the positions for which the initial margin is being calculated, including foreign exchange or interest rate risk, credit risk, equity risk, and commodity risk, as appropriate.[388] The final rule also provides that empirical correlations may be recognized by the model within each broad risk category, but not across broad risk categories. This means that each non-cleared security-based swap and related position must be assigned to a single risk category for purposes of calculating initial margin. Thus, the initial margin calculation can offset cleared and non-cleared security-based swaps (in answer to the question raised by some commenters) to the extent they are within the same asset class.[389]

The presence of any common risks or risk factors across asset classes (*e.g.,* credit, commodity, and interest rate risks) cannot be recognized for initial margin purposes. This approach is designed to help ensure a conservative and robust margin regime that potentially reduces counterparty exposures to offset the greater risk to the nonbank SBSD and the financial system arising from the use of non-cleared security-based swaps.[390] Margin calculations that limit correlations to asset classes generally will result in more conservative initial margin amounts than calculations that permit offsets across different asset classes. Finally, this approach is consistent with the final margin rules adopted by the CFTC and the prudential regulators, and with the industry standard model being used today to comply with the margin rules of the CFTC and the prudential regulators.[391]

The final rule permits stand-alone SBSDs to use a model to calculate initial margin for equity security-based swaps and will permit these entities to include equity swaps in the portfolio, subject to further coordination with the CFTC.[392] Under the final rule, these entities are not required to use the standardized approach to calculate initial margin for equity security-based swaps. However, the account of a counterparty for which the stand-alone SBSD provides model-based portfolio margining may not hold equity security positions other than equity security-based swaps and equity swaps. Therefore, cash market positions such as long and short equity positions, listed options positions, and single stock futures positions cannot be held in the accounts or otherwise included in the portfolio margin calculations. This is designed to ensure that a stand-alone SBSD cannot provide more favorable treatment for these types of equity positions than a stand-alone or ANC broker-dealer that is subject to the margin requirements of the Federal Reserve's Regulation T and the margin rules of the SROs.

A commenter requested that qualified netting agreements be permitted in calculating initial margin.[393] Other commenters argued that effective netting agreements lower systemic risk by reducing both the aggregate requirement to deliver margin and trading costs for market participants.[394] A commenter stated that netting, among other things, is an important tool for the reduction of counterparty credit risk.[395] Another commenter supported the Commission's proposal to permit certain netting under a qualified netting agreement to determine margin requirements, stating that netting obligations under derivatives and other trading positions reduces counterparty credit risk and allows market participants to make the most efficient use of their capital.[396] Finally, a commenter stated that differences in the security-based swap and swap margin rules may fragment the market by causing firms to engage only in a security-based swaps business through a Commission-regulated nonbank SBSD.[397] The commenter stated that, upon the insolvency of a nonbank SBSD and an affiliated swap dealer, a counterparty would likely be unable to close out and net security-based swaps entered into with the nonbank SBSD with swaps entered into with the swap dealer because the entities are not the same. This commenter also believed that the Commission's proposals may undermine the mutuality of obligations for close-out netting, stating that the Commission appeared to treat a nonbank SBSD as an agent of the counterparty rather than a direct counterparty, which may cause a bankruptcy court to reject attempts by a counterparty to close out derivatives positions with the debtor.

In response, the Commission has modified the rule to clarify that qualified netting agreements may be used in the calculation of initial margin (in addition to variation margin).[398] Generally, industry practice is to use netting in variation and initial margin calculations. Further, the Commission believes that in most cases a counterparty entering into a non-cleared security-based swap transaction with a nonbank SBSD will be a direct counterparty of the nonbank SBSD. In response to the comment regarding potential fragmentation of the market

[387] *See Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74875; *CFTC Margin Adopting Release,* 81 FR at 653. *See also* BCBS/IOSCO Paper at 12.

[388] *See* paragraph (d)(2) of Rule 18a–3, as adopted. Although the final rule uses the term "risk factors," the approach of assigning each non-cleared security-based swap to a specific risk factor category is sometimes referred to by market participants as the "asset class approach."

[389] However, the clearing agency's margin requirement for the cleared security-based swaps in a portfolio likely will permit offsets only for positions it clears.

[390] *See* Section 15F(e)(3)(A) of the Exchange Act.

[391] *See Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74876 ("Each derivative contract must be assigned to a single asset class in accordance with the classifications in the final rule (*i.e.,* foreign exchange or interest rate, commodity, credit, and equity)"); *CFTC Margin Adopting Release,* 81 FR at 657–58 ("The final rule does not permit an initial margin model to reflect offsetting exposures, diversification, or other hedging benefits across broad risk categories. Hence, the margin calculations for derivatives in distinct product-based asset classes, such as equity and credit, must be performed separately without regard to derivatives contracts in other asset classes. Each derivatives contract must be assigned to a single asset class. . . ."). *See also* BCBS/IOSCO Paper at 12–13.

[392] *See* paragraph (d)(2) of Rule 18a–3, as adopted.

[393] *See* MFA 2/22/2013 Letter.

[394] *See* AIMA 2/22/2013 Letter; MFA 2/22/2013 Letter.

[395] *See* MFA 2/22/2013 Letter.

[396] *See* Sutherland Letter.

[397] *See* ICI 11/19/2018 Letter.

[398] Specifically, the Commission has modified paragraph (c)(5) in the final rule to delete the "(A)" from the reference to paragraph (c)(1)(i)(A) (as a result, paragraph (c)(5), governing the use of netting agreements, now refers to the variation and initiation margin calculations as opposed to just the variation margin calculation).

and the proposed rule's effects on close-out netting, as discussed above, the Commission believes the final margin rule for non-cleared security-based swaps is largely comparable to the final margin rules of the CFTC and the prudential regulators.[399] In addition, as discussed above, the Commission has modified the final rules to facilitate the portfolio margining of security-based swaps and swaps, subject to further coordination with the CFTC.[400] For example, the Commission modified Rules 15c3–1a and 18a–1a to permit swaps to be included in the Appendix A methodology, which can be used by broker-dealer SBSDs to calculate initial margin.[401] Moreover, the Commission modified paragraph (d)(2) of Rule 18a–3 to permit stand-alone SBSDs to use a model to portfolio margin equity security-based swaps with equity swaps, subject to certain conditions. The Commission believes that these modifications will provide a means for market participants to conduct security-based swap and swap activity in the same legal entity without incurring significant additional operational or compliance costs.

A commenter stated that the Commission's potential modification of the proposed rules to permit the use of an industry standard model provides too little information concerning the parameters that would be required for such models and the process for nonbank SBSDs to approve, establish, maintain, review, and validate margin models.[402] In response, the final rule provides that a nonbank SBSD seeking approval to use a model (including an industry standard model) to calculate initial margin will be subject to the application process in Rule 15c3–1e, as amended, or paragraph (d) of Rule 18a–1, as adopted, as applicable, governing the use of model-based haircuts.[403] As part of the application process, the Commission staff will review whether the model meets the qualitative and quantitative requirements of Rule 18a–3. Therefore, a nonbank SBSD will need to submit sufficient information to allow the Commission to make a determination regarding the performance of the nonbank SBSD's initial margin model. The use of internal models, industry standard models, or other models to calculate initial margin by nonbank SBSDs will be subject to the same application and approval process under the final rule. The application process and any condition imposed in connection with Commission approval of the use of the model should mitigate the risk that nonbank SBSDs will compete by implementing lower initial margin levels and should also help ensure that initial margin levels are set at sufficiently prudent levels to reduce risk to the firm and, more generally, systemic risk.

If an industry standard model is widely used by nonbank SBSDs, concerns about competing through lower margin requirements should be further mitigated. However, the Commission reiterates that each nonbank SBSD individually must receive approval from the Commission to use an initial margin model, including an industry standard model, because, among other things, each firm must submit a comprehensive description of its internal risk management control system and how that system satisfies the requirements set forth in Rule 15c3–4. Thus, any approval by the Commission for a particular nonbank SBSD to use a specific model to calculate initial margin will not be deemed approval for another nonbank SBSD to use the same model.

As noted above, some commenters made suggestions about how to expedite the model approval process.[404] In response to these comments, the Commission recognizes that the timing of such approvals could raise competitive issues if one nonbank SBSD is authorized to use a model before one or more other firms. Timing issues may also arise with respect to the review and approval process if multiple firms simultaneously apply to the Commission for approval to use a model. The Commission is sensitive to these issues and, similar to the capital model approval process, encourages all firms that intend to register as nonbank SBSDs and seek model approval to begin working with the staff as far in advance of their targeted registration date as is feasible. However, as discussed above with respect to capital models, the Commission acknowledges the possibility that it may not be able to make a determination regarding a firm's margin model before it is required to register as an SBSD. Consequently, the Commission is modifying Rule 15c3–1e and Rule 18a–1 to provide that the Commission may approve the temporary use of a provisional model by a nonbank SBSD for the purposes of calculating initial margin if the model had been approved by certain other supervisors.

Two commenters suggested the Commission allow market participants to delegate the duty to run a model to a counterparty or third party noting that it is an accepted market practice for a counterparty to agree that a dealer will make determinations for a security-based swap in the dealer's capacity as calculation agent.[405] In response to this comment, a nonbank SBSD could enter into a commercial arrangement to serve as a third-party calculation agent for entities that are not required to calculate initial margin pursuant to Rule 18a–3, as adopted. In addition, a nonbank SBSD's model can use third-party inputs (*e.g.,* price calculations). However, a nonbank SBSD retains responsibility for the model-based initial margin calculations required by Rule 18a–3, as adopted. As discussed above, paragraph (c)(1)(i) of Rule 18a–3, as adopted, requires a nonbank SBSD to calculate an initial margin amount for each counterparty as of the close of each business day. Under paragraph (d) of Rule 18a–3, the nonbank SBSD must use the standardized or model-based approach, as applicable, to calculate the initial margin amount. The fact that a nonbank SBSD uses a model to perform the calculation and that the model uses third-party inputs does not eliminate or diminish the firm's underlying obligation under the rule to calculate an initial margin amount for each counterparty as of the close of each business day. In light of the comment and the Commission's response that third-party inputs may be used, the Commission believes it would be appropriate to make explicit in the rule that the nonbank SBSD retains responsibility for model-based initial margin calculations. Accordingly, the Commission is modifying the proposed rule text to make this clear.[406]

In summary, the Commission is adopting the model-based approach to calculating initial margin, with the

[399] *See* section II.B.1. of this release (summarizing similarities and differences between the Commission's final margin rules for non-cleared security-based swaps and the final margin rules of the CFTC and the prudential regulators).

[400] *See also Order Granting Conditional Exemption Under the Securities Exchange Act of 1934 in Connection with Portfolio Margining of Swaps and Security-Based Swaps,* 77 FR 75211.

[401] *See also* section II.A.2.b.iii. of this release (discussing adding swaps to the Appendix A methodology for purposes of the standardized haircuts).

[402] *See* Better Markets 11/19/2018 Letter.

[403] If a nonbank SBSD's model is approved for use to compute initial margin under paragraph (d) of Rule 18a–3, the performance of the model would be subject to ongoing regulatory supervision, and the nonbank SBSD will need to submit an amendment to the Commission for approval before materially changing its model. *See, e.g.,* Rule 15c3–1e, as amended; paragraph (d) of Rule 18a–1, as adopted.

[404] *See* IIB11/19/2018 Letter; ISDA 1/23/2013 Letter; SIFMA 3/12/2014 Letter.

[405] *See* ISDA 2/5/2014 Letter; Markit Letter.

[406] *See* paragraph (d)(2)(i) of Rule 18a–3, as adopted. In the final rule, the Commission inserted the phrase ''and be responsible for'' after the phrase ''authorization to use.''

modifications discussed above. The final rule will require a nonbank SBSD to calculate with respect to each account of a counterparty as of the close of each business day: (1) The amount of the current exposure in the account; and (2) the initial margin amount for the account.[407] As discussed above, in response to comments, the Commission modified paragraph (d) of Rule 18a–3 to establish a margin model authorization process that is distinct from the net capital rule model authorization process. This modification will provide flexibility to allow nonbank SBSDs that do not use a model for purposes of the net capital rule to seek authorization to use a model for purposes of the margin rule.[408] It also will permit firms to use an industry standard model such as the model currently being used to comply with the margin rules of the CFTC and the prudential regulators.

Comments and Final Requirements To Increase the Frequency of the Calculations

Two commenters supported the proposed requirement to perform more frequent calculations under specified conditions.[409] Another commenter requested that the Commission clarify that the requirement for a nonbank SBSD to perform calculations more frequently in specified circumstances does not give rise to a regulatory requirement for the nonbank SBSD to collect intra-day margin from its counterparties.[410] The commenter argued that requiring a nonbank SBSD to collect margin more frequently than daily would be operationally difficult and contrary to current market practice.

The Commission is adopting the requirement to increase the frequency of the required calculations during periods of extreme volatility and for accounts with concentrated positions, as proposed, with some non-substantive modifications.[411] In response to the comment about collecting margin intra-day, the Commission clarifies that the rule does not require a nonbank SBSD to collect intra-day margin, although it may choose to do so (such as through a house margin requirement). In addition, more frequent calculations are only required during periods of extreme volatility and for accounts with concentrated positions. However, nonbank SBSDs are subject to Rule 15c3–4, which requires, among other things, that they have a system of internal controls to assist in managing the risks associated with their business activities, including credit risk. In designing a system of internal controls pursuant to Rule 15c3–4, a nonbank SBSD generally should consider whether there are circumstances where the collection of intra-day margin in times of volatility and for accounts with concentrated positions would be necessary to effectively manage credit risk. In addition, a nonbank SBSD generally should consider these factors in its risk monitoring procedures required under paragraph (e)(7) of Rule 18a–3, as adopted, which is discussed below.

ii. Nonbank MSBSPs

As proposed, Rule 18a–3 required 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.[412] Consequently, a nonbank MSBSP needed to calculate as of the close of business each day the amount of equity in each account of a counterparty. Consistent with the proposal for nonbank SBSDs, a nonbank MSBSP was required to increase the frequency of its calculations during periods of extreme volatility and for accounts with concentrated positions.

A commenter stated that it believed that nonbank MSBSPs should be required to calculate initial margin for each counterparty and collect or post initial margin because doing so would allow nonbank MSBSPs to better measure and understand their aggregate counterparty risk.[413] The commenter believed that nonbank MSBSPs should have the personnel necessary to operate daily initial margin programs. Another commenter, who supported bilateral margining for both variation and initial margin, stated that not requiring the bilateral exchange of initial margin is inconsistent with the BCBS/IOSCO Paper and the re-proposals of the CFTC and the prudential regulators.[414] A commenter supported the proposal that nonbank MSBSPs should not have to collect initial margin.[415] Another commenter stated that MSBSPs should be provided flexibility as to whether and to what extent they should be required to pledge initial margin to financial firms.[416]

In response to comments that nonbank MSBSPs should calculate and collect and post initial margin, the margin requirements for nonbank MSBSPs are designed to ''neutralize'' the credit risk between a nonbank MSBSP and its counterparty. This requirement is intended to account for the fact that nonbank MSBSPs will be subject to less stringent capital requirements than nonbank SBSDs. Consequently, in the case of a nonbank MSBSP, the Commission believes it is more prudent to not require the firm to collect initial margin from counterparties, as doing so would increase the counterparties' exposures to the nonbank MSBSP. Therefore, the Commission is not adopting requirements for nonbank MSBSPs to calculate and post or deliver initial margin.

The Commission acknowledges that the final rule, in this case, is not consistent with the final margin rules of the CFTC and the prudential regulators, which generally require nonbank major swap participants, bank MSBSPs, and bank major swap participants to collect and post initial margin from and to specified counterparties.[417] However, the Commission believes that minimizing a counterparty exposure to a nonbank MSBSP by not requiring it to deliver initial margin is prudent, as these firms will not be subject to as robust a capital framework as SBSDs or bank MSBSPs. Similarly, the Commission believes it is prudent to limit the exposure of the nonbank MSBSP to the counterparty by not requiring it to post initial margin, as the counterparty may not be subject to any capital requirement. While the final rule does not impose a requirement to post or deliver initial margin, nonbank MSBSPs and their counterparties are permitted to agree to the exchange of initial margin. For these reasons, the Commission is adopting paragraph (c)(2)(i) of Rule 18a–3 substantially as proposed.[418]

[407] *See* paragraph (c)(1)(i) to Rule 18a–3, as adopted.

[408] *See* paragraph (d)(2) of Rule 18a–3, as adopted.

[409] *See* Better Markets 7/22/2013 Letter; Markit Letter.

[410] *See* SIFMA AMG 2/22/2013 Letter.

[411] *See* paragraph (c)(6) to Rule 18a–3, as adopted. Paragraph (c)(7) of Rule 18a–3, as proposed to be adopted, was re-designated paragraph (c)(6) in the final rule due to non-substantive amendments made to the minimum transfer amount language.

[412] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70262–63.

[413] *See* CFA Institute Letter.

[414] *See* ICI 5/11/2015 Letter.

[415] *See* Financial Services Roundtable Letter.

[416] *See* American Council of Life Insurers 2/22/2013 Letter.

[417] *See also* BCBS/IOSCO Paper at 5 (''All financial firms and systemically important non-financial entities (''covered entities'') that engage in non-centrally cleared derivatives must exchange initial and variation margin as appropriate to the counterparty risks posed by such transactions.'').

[418] *See* paragraph (c)(2)(i) of Rule 18a–3, as adopted. In the final rule, the Commission made several non-substantive modifications. The word ''equity'' was replaced with the phrase ''the current exposure.'' The phrase ''with respect to each account of a counterparty'' was inserted before the word ''calculate'' and the word ''the'' replaced the

b. Account Equity Requirements

i. Nonbank SBSDs

As discussed above, a nonbank SBSD must calculate variation and initial margin amounts with respect to the account of a counterparty as of the close of each business day. Proposed Rule 18a–3: (1) Required a nonbank SBSD to collect margin from the counterparty unless an exception applied; (2) set forth the time frame for when that collateral needed to be collected; (3) prescribed the types of assets that could serve as eligible collateral; (4) prescribed additional requirements for the collateral; (5) prescribed when collateral must be liquidated; and (6) set forth certain exceptions to collecting the collateral.[419]

More specifically, proposed Rule 18a–3 required that a nonbank SBSD collect from the counterparty by noon of the following business day cash, securities, and/or money market instruments in an amount at least equal to the ''negative equity'' (current exposure) in the account plus the initial margin amount unless an exception applied. Assets other than cash, securities, and/or money market instruments were not eligible collateral. The proposed rule further provided that the fair market value of securities and money market instruments (''securities collateral'') held in the account of a counterparty needed to be reduced by the amount of the standardized haircuts the nonbank SBSD would apply to the positions pursuant to the proposed capital rules for the purpose of determining whether the level of equity in the account met the minimum margin requirements. Securities collateral with no ''ready market'' or that could not be publicly offered or sold because of statutory, regulatory, or contractual arrangements or other restrictions effectively could not serve as collateral because it would be subject to a 100% deduction pursuant to the standardized haircuts in the proposed capital rules, which were to be used to take the collateral deductions for the purposes of proposed Rule 18a–3.

In addition, proposed Rule 18a–3 contained certain additional requirements for cash and securities to be eligible as collateral. These requirements were designed to ensure that the collateral was of stable and predictable value, not linked to the value of the transaction in any way, and capable of being sold quickly and easily if the need arose. The requirements included that the collateral was: (1) Subject to the physical possession or control of the nonbank SBSD; (2) liquid and transferable; (3) capable of being liquidated promptly without the intervention of a third party; (4) subject to a legally enforceable collateral agreement, (5) not securities issued by the counterparty or a party related to the counterparty or the nonbank SBSD; and (6) a type of financial instrument for which the nonbank SBSD could apply model-based haircuts if the nonbank SBSD was authorized to use such haircuts. Proposed Rule 18a–3 also required a nonbank SBSD to take prompt steps to liquidate collateral consisting of securities collateral to the extent necessary to eliminate the account equity deficiency.

The Commission proposed five exceptions to the account equity requirements. The first applied to counterparties that were commercial end users. The second applied to counterparties that were nonbank SBSDs. The third applied to counterparties that were not commercial end users and that required their collateral to be segregated pursuant to Section 3E(f) of the Exchange Act. The fourth proposed exception applied to accounts of counterparties that were not commercial end users and that held legacy non-cleared security-based swaps. The fifth provided for a $100,000 minimum transfer amount with respect to a particular counterparty.

Comments and Final Requirements Regarding the Collection and Posting of Margin

As noted above, proposed Rule 18a–3 required a nonbank SBSD to collect margin from the counterparty by noon of the next business day unless an exception applied.[420] Generally, the comments on this aspect of the proposal fell into two categories: (1) Comments requesting that nonbank SBSDs be required to deliver margin (in addition to collecting it); and (2) comments requesting that the required time frame for collecting margin be lengthened.

In terms of requiring nonbank SBSDs to deliver margin, commenters stated that doing so would promote consistency with the recommendations in the BCBS/IOSCO Paper.[421] Commenters also argued that bilateral margining would help to reduce systemic risk.[422] A commenter argued that not requiring a nonbank SBSD to post margin could create an incentive to avoid clearing security-based swaps counter to the Dodd-Frank Act's objective of promoting central clearing.[423] One commenter stated that the Commission did not adequately consider the potential for one-way margining to harm investors and the security-based swap market.[424] This commenter argued that making two-way margining mandatory would provide important risk mitigation benefits to the markets, and protect counterparties of all sizes, not just those large enough to negotiate for two-way margining.[425] Some commenters suggested that the rule should permit the counterparty to require the nonbank SBSD to deliver margin at the counterparty's discretion.[426] Another commenter stated that nonbank SBSDs and financial end users should have the flexibility to determine whether nonbank SBSDs should be required to post initial margin to financial end users.[427]

In response to these comments, the Commission is persuaded that requiring nonbank SBSDs to deliver variation margin to counterparties would provide an important protection to the counterparties by reducing their uncollateralized current exposure to SBSDs. The Commission also believes it would be appropriate to require nonbank SBSDs to deliver variation margin to counterparties in order to further harmonize Rule 18a–3 with the margin rules of the CFTC and the prudential regulators.[428] For these reasons, the Commission has modified the final rule to require a nonbank SBSD to deliver variation margin to a counterparty unless an exception applies. However, as discussed below, the nonbank SBSD is not required to collect or deliver variation or collect initial margin from a commercial end user, a security-based swap legacy account, or a counterparty that is the BIS, the European Stability Mechanism, or one of the multilateral development banks identified in the rule.[429]

word ''each'' to conform the language in the paragraph more closely with the language in paragraph (c)(1)(i) of the final rule.

[419] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70263–69.

[420] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70264.

[421] *See* AIMA 2/22/2013 Letter; ICI 2/4/2013 Letter.

[422] *See* American Council of Life Insurers 11/19/2018 Letter; ICI 2/4/2013 Letter; ICI 5/11/2015 Letter; ICI 11/19/2018 Letter; SIFMA AMG 11/19/2018 Letter.

[423] *See* PIMCO Letter.

[424] *See* ICI 11/19/2018 Letter.

[425] *See* ICI 11/19/2018 Letter.

[426] *See* PIMCO Letter; SIFMA AMG 2/22/2013 Letter.

[427] *See* American Council of Life Insurers 2/22/2013 Letter; American Council of Life Insurers 11/19/2018 Letter.

[428] *See Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74903; *CFTC Margin Adopting Release,* 80 FR at 698.

[429] *See* paragraphs (c)(1)(ii)(A)(*2*) and (c)(1)(iii) of Rule 18a–3, as adopted. The Commission also made some non-substantive changes to paragraph (c)(1)(ii)

Continued

The Commission does not believe it would be appropriate to require nonbank SBSDs to deliver initial margin and, therefore, the final rule does not require it. Requiring nonbank SBSDs to deliver initial margin could impact the liquidity of these firms. Delivering initial margin would prevent this capital of the nonbank SBSD from being immediately available to the firm to meet liquidity needs. If the delivering SBSD is undergoing financial stress or the markets more generally are in a period of financial turmoil, a nonbank SBSD may need to liquidate assets to raise funds and reduce its leverage. Assets in the control of a counterparty would not be available for this purpose. For these reasons, under the net capital rule, most unsecured receivables must be deducted from net worth when the nonbank SBSD computes net capital. The final rule, however, does not prohibit a nonbank SBSD from delivering initial margin. For example, a nonbank SBSD and its counterparty can agree to commercial terms pursuant to which the nonbank SBSD will post initial margin to the counterparty.

In terms of lengthening the time frame for collecting margin, a commenter requested flexibility for nonbank SBSDs to collect initial margin on a different schedule and frequency than variation margin.[430] A second commenter sought clarification concerning how often initial margin needed to be collected and noted that the overall initial margin amount for a portfolio could change even if no new transactions occur because existing transactions may mature or significant market moves may impact values.[431] A third commenter suggested that the Commission require nonbank SBSDs to begin collecting initial margin on a weekly basis and phase in more frequent collections.[432] Another commenter recommended that consistent with the CFTC's and prudential regulators' margin rules, the Commission should require an SBSD to collect margin by the end of the business day following the day of execution and at the end of each business day thereafter, with appropriate adjustments to address operational difficulties associated with parties located in different time zones.[433]

Other commenters recommended a longer time period than one business day to collect margin, citing cross-border transactions as possibly requiring more time.[434] One commenter stated that the time zone differences between the Unites States and certain jurisdictions will cause major operational challenges, and could lead to delayed payments, disputes, and broadly greater operational risk.[435] Another commenter noted that the settlement and delivery periods for securities to be posted as collateral are longer than the time period for collection under the proposed rule, particularly in a cross-border context.[436] A commenter stated that the proposed one business-day requirement did not reflect the operational realities of security-based swap trading, payment, and collateral transfer processes.[437] The commenter argued that the need for additional time was especially critical with respect to transactions with counterparties in countries such as Japan and Australia.

The Commission recognizes that it will take time for nonbank SBSDs to implement processes to collect variation and initial margin on a daily basis if the entity is not currently collecting margin at this frequency. The Commission, therefore, is establishing compliance and effective dates discussed below in section III.B. of this release designed to give nonbank SBSDs and their counterparties a reasonable period of time to implement the operational, legal, and other changes necessary to come into compliance with requirements to collect and deliver margin on a daily basis.

In terms of lengthening the period to collect or deliver margin beyond one business day, promptly obtaining collateral to cover credit risk exposures is vitally important to promoting the financial responsibility of nonbank SBSDs and protecting their counterparties. Collateral protects the nonbank SBSD from consequences of the counterparty's default and the counterparty from the consequences of the nonbank SBSD's default. However, the Commission is modifying the next-day collection requirement in two ways that should mitigate the concerns of commenters. First, the Commission is lengthening time for nonbank SBSDs and MSBSPs to collect or post required margin from noon to the close of business on the next business day.[438] Second, the Commission is lengthening from one to two business days the time frame in which the nonbank SBSD or MSBSP must collect or deliver required margin if the counterparty is located in another country and more than 4 time zones away. These changes should mitigate the concerns of commenters about cross-border transactions.

For the foregoing reasons, the Commission is adopting the proposed requirements to collect variation and initial margin with the modifications discussed above and with certain other non-substantive modifications.[439]

Comments and Final Requirements for Collateral and Taking Deductions on Collateral

As noted above, proposed Rule 18a–3 permitted cash, securities, and money market instruments to serve as collateral to meet variation and initial margin requirements and, if securities or money market instruments were used, required the nonbank SBSD to apply the standardized haircuts in the capital rules to the collateral when computing the equity in the account.[440] Generally, comments addressing these requirements fell into two categories: (1) Comments requesting that the scope of assets qualifying as collateral be broadened, or modified to conform with requirements of the prudential regulators, the CFTC, or the recommendations in the BCBS/IOSCO Paper; and (2) comments requesting that the deductions to securities or money market instruments serving as collateral be calculated using methods other than

to accommodate the new requirement. In the final rule, paragraph (c)(1)(ii)(A) of Rule 18a–3, as proposed to be adopted, was re-designated paragraph (c)(1)(ii)(A)(*1*).

[430] *See* ISDA 1/23/2013 Letter; ISDA 2/5/2014 Letter.

[431] *See* Markit Letter.

[432] *See* SIFMA 3/12/2014 Letter.

[433] *See* SIFMA 11/19/2018 Letter.

[434] *See* American Benefits Council, et al. 1/29/2013 Letter; Letter from Angus D.W. Martowardojo, Governor of Bank Indonesia and Chairman of the Executives Meeting of East Asia-Pacific Central Banks (Aug. 31, 2016) (''EMEAP Letter''); Letter from Mary P. Johannes, Senior Director and Head of ISDA WGMR Initiative, International Swaps and Derivatives Association (Aug. 7, 2015) (''ISDA 8/7/2015 Letter''); Letter from Mary P. Johannes, Senior Director and Head of ISDA WGMR Initiative, International Swaps and Derivatives Association (Sept. 24, 2015) (''ISDA 9/24/2015 Letter''); SIFMA AMG 2/22/2013 Letter.

[435] *See* EMEAP Letter.

[436] *See* ISDA 8/7/2015 Letter.

[437] *See* SIFMA AMG 2/22/2013 Letter.

[438] *See* paragraphs (c)(1)(ii) and (c)(2)(ii) of Rule 18a–3, as adopted.

[439] *See* paragraphs (c)(1)(ii) and (c)(1)(iii) of Rule 18a–3, as adopted. References to cash, securities and/or money market instruments were deleted throughout the rule text and replaced with the term ''collateral'' as a result of other modifications to the rule to expand the types of collateral permitted under the rule. The defined term ''non-cleared security-based swap'' in paragraph (b)(5) of Rule 18a–3, as adopted, is modified to add the phrase ''submitted to and'' before the word ''cleared,'' and to add the phrase ''or by a clearing agency that the Commission has exempted from registration by rule or order pursuant to section 17A of the Act (15 U.S.C. 78q–1)'' before the ''.''. The language regarding exemption from registration was added to the final rule to align the definition more closely with the definitions used in the margin rules of the CFTC and prudential regulators.

[440] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70264.

the standardized haircuts in the capital rules.

In terms of the scope of eligible collateral, commenters supported the broad categories of securities and money market instruments that qualified under the proposal, but asked that the final rule be more consistent with the recommendations in the BCBS/IOSCO Paper or the rules of the CFTC and the prudential regulators.[441] A commenter stated that the Commission should define the term ''eligible collateral,'' preferably by adopting the CFTC's ''forms of margin'' approach.[442] A second commenter recommended that the Commission carefully parallel the collateral approach recommended in the BCBS/IOSCO Paper.[443] This commenter noted that the examples of collateral listed in the BCBS/IOSCO Paper were not exhaustive. Another commenter suggested that regulators and market participants develop a set of consistent definitions for the categories of eligible collateral.[444]

In response to these comments, the BCBS/IOSCO Paper recommends that national supervisors develop their own list of collateral assets, taking into account the conditions of their own markets, and based on the key principle that assets should be highly liquid and should, after accounting for an appropriate haircut, be able to hold their value in a time of financial stress.[445] The examples of collateral in the BCBS/IOSCO Paper are: (1) Cash; (2) high-quality government and central bank securities; (3) high-quality corporate bonds; (4) high-quality covered bonds; (5) equities included in major stock indices; and (6) gold.[446] Eligible securities collateral under the margin rules of the CFTC and the prudential regulators includes: (1) U.S. Treasury securities; (2) certain securities guaranteed by the U.S.; (3) certain securities issued or guaranteed by the European Central Bank, a sovereign entity, or the BIS; (4) certain corporate debt securities; (5) certain equity securities contained in major indices; and (6) certain redeemable government bond funds.[447] Under the Commission's proposed margin rule, these types of securities would be permitted as collateral if they had a ready market. The margin rules of the CFTC and the prudential regulators also permit major foreign currencies, the currency of settlement for the security-based swap, and gold to serve as collateral. The Commission's proposed rule permitted ''cash'' but did not permit foreign currencies to serve as collateral, and the proposed rule did not permit gold to serve as collateral.

The Commission is modifying proposed Rule 18a–3 in response to commenters' concerns about the rule excluding collateral types that are permitted by the CFTC and the prudential regulators. Consequently, the final rule permits cash, securities, money market instruments, a major foreign currency, the settlement currency of the non-cleared security-based swap, or gold to serve as eligible collateral.[448] This will avoid the operational burdens of having different sets of collateral that may be used with respect to a counterparty depending on whether the nonbank SBSD is entering into a security-based swap (subject to the Commission's rule) or a swap (subject to the CFTC's rule) with the counterparty. It also will avoid potential unintended competitive effects of having different sets of collateral for non-cleared security-based swaps under the margin rules for nonbank SBSDs and bank SBSDs. Finally, by giving the option of aligning with the requirements of the CFTC and the prudential regulators, the final rule should avoid the necessity of amending existing collateral agreements that may specifically reference the forms of margin permitted by those requirements.

Commenters requested that certain types of assets be permitted to serve as collateral when dealing with commercial end users and special purpose vehicles.[449] One commenter requested that the Commission expand the collateral permitted under the rule to include shares of affiliated registered funds or clarify that a fund of funds could post shares of an affiliated registered fund to meet a margin requirement under the rule.[450] Another commenter requested that the Commission adopt a definition of collateral that includes U.S. government money market funds.[451] In response to these comments, the final rule does not specifically exclude any type of security provided it has a ready market, is readily transferable, and does not consist of securities and/or money market instruments issued by the counterparty or a party related to the nonbank SBSD or MSBSP, or the counterparty.[452] Generally, U.S. government money market funds should be able to serve as collateral under these conditions.

In terms of applying the standardized haircuts in the nonbank SBSD capital rules to securities and money market instruments serving as collateral, a commenter advocated aligning with the prudential regulators' proposed rules for ease of application and consistency of treatment across instruments, as well as to minimize the opportunity for regulatory arbitrage.[453] Comments received after the CFTC and the prudential regulators adopted their final margin rules supported aligning the haircuts in the Commission's margin rule with the standardized haircuts adopted by the CFTC and the prudential regulators.[454]

The haircuts in proposed Rule 18a–3 (*i.e.,* the standardized haircuts in the proposed nonbank SBSD capital rules) and the haircuts in the margin rules of the CFTC and the prudential regulators (which are based on the recommended standardized haircuts in the BCBS/IOSCO Paper) are largely comparable.[455] However, the Commission also recognizes that there are differences. For example, the Commission's standardized haircuts in some cases are more risk sensitive than those required by final margin rules of the CFTC and the prudential regulators.[456]

[441] *See* American Council of Life Insurers 2/22/2013 Letter; American Council of Life Insurers 11/19/2018 Letter; CFA Institute Letter; MFA 2/22/2013 Letter; SIFMA AMG 11/19/2018; SIFMA 3/12/2014 Letter; SIFMA 11/19/2019 Letter.

[442] *See* MFA 2/22/2013 Letter.

[443] *See* American Council of Life Insurers 2/22/2013 Letter; American Council of Life Insurers 11/19/2018 Letter.

[444] *See* SIFMA 3/12/2014 Letter.

[445] *See* BCBS/IOSCO Paper at 16.

[446] *Id.* at 17–18.

[447] *See Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74870; *CFTC Margin Adopting Release,* 81 FR at 701–2.

[448] *See* paragraph (c)(4)(i)(C) of Rule 18a–3, as adopted. The additional collateral requirements in the final rule are discussed below.

[449] *See* Financial Services Roundtable Letter; MFA 2/22/2013 Letter; Sutherland Letter.

[450] *See* ICI 11/19/2018 Letter.

[451] *See* Letter from Lee A. Pickard, Esq., Pickard, Djinis and Pisarri, on behalf of Federated Investors, Inc. (Nov. 15, 2018) (''Federated 11/15/2018 Letter'').

[452] *See* paragraph (c)(4) of Rule 18a–3, as adopted.

[453] *See* PIMCO Letter.

[454] *See* American Council of Life Insurers 11/19/2018 Letter; SIFMA 11/19/2018 Letter.

[455] *See, e.g.,* paragraph (c)(2)(vi)(J) of Rule 15c3–1, as amended (prescribing a haircut of 15% for equity securities), and BCBS/IOSCO Paper, Appendix B, at 27 (prescribing a haircut of 15% for equities included in major stock indices). *See also* paragraph (c)(2)(vi)(A)(*1*) of Rule 15c3–1, as amended (prescribing a haircut of 0.5% for securities issued or guaranteed by the United States or any agency thereof with 3 months but less than 6 months to maturity), and BCBS/IOSCO Paper, Appendix B, at 27 (prescribing a haircut of 0.5% for high quality government and central bank securities: Residual maturity less than one year).

[456] *See, e.g.,* paragraph (c)(2)(vi)(A)(*1*) of Rule 15c3–1, as amended (prescribing a range of four haircuts of 0% to 1% for securities issued or guaranteed by the United States or any agency thereof with less than 12 months to maturity), and

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At the same time, the Commission believes it would be appropriate to provide nonbank SBSDs the option either to use the standardized haircuts in the nonbank SBSD capital rules as proposed or to use the collateral haircuts in the CFTC's margin rules. Consequently, the final margin rule provides nonbank SBSDs with the option of choosing to use the standardized haircuts in the capital rules or the standardized haircuts in the CFTC's margin rules.[457] The final rule further provides that if the nonbank SBSD uses the CFTC's standardized haircuts it must apply them consistently with respect to the counterparty.[458] This requirement is designed to prevent a nonbank SBSD from ''cherry picking'' either the nonbank SBSD capital haircuts or the CFTC haircuts at different points in time depending on which set provides the more advantageous haircut.

Similar to aligning the sets of eligible collateral, giving the option of aligning the collateral haircuts with the CFTC's collateral haircuts will allow a firm to avoid the operational burdens of having different haircut requirements with respect to a counterparty depending on whether the nonbank SBSD is entering into a security-based swap (subject to the Commission's rule) or a swap (subject to the CFTC's rule) with the counterparty. This option also will avoid potential unintended competitive effects of having different sets of collateral for non-cleared security-based swaps under the margin rules for nonbank SBSDs and bank SBSDs. Finally, by aligning with the requirements of the CFTC and the prudential regulators, the final rule should reduce the likelihood that SBSDs will seek to amend existing collateral agreements that may specifically reference the haircuts in the margin rules of the CFTC or prudential regulators.[459]

With respect to the proposed collateral haircuts, a commenter suggested that the deductions applicable to high-grade corporate debt or liquid structured credit instruments be calculated using the option-adjusted spread (''OAS'').[460] A second commenter noted that the BCBS/IOSCO Paper provides that the haircuts can be determined by a model that is approved by a regulator, in addition to a standardized schedule set forth in the BCBS/IOSCO Paper.[461] In response to these comments, the Commission believes that the simpler and more transparent approach of using the standardized haircuts will establish appropriately conservative discounts on eligible collateral. Moreover, using models to determine haircuts on collateral would not be consistent with the final rules of the CFTC and the prudential regulators.[462]

Finally, a commenter recommended that the Commission apply a 100% haircut to a structured product, asset-backed security, re-packaged note, combination security, and any other complex instrument.[463] In response, the final margin rule requires margin collateral to have a ready market.[464] This is designed to exclude collateral that cannot be promptly liquidated.

A nonbank SBSD must apply the collateral haircuts to collateral used to meet a variation margin requirement and an initial margin requirement as was proposed.[465] However, the Commission is making a conforming modification to require a nonbank SBSD to apply the deductions prescribed in paragraph (c)(3)(i) or (ii) of Rule 18a–3 to variation margin that the firm delivers to a counterparty to meet a variation margin requirement. As discussed above, the final rule now requires nonbank SBSDs to deliver variation margin to counterparties, and applying the haircuts to collateral used for this purpose will serve the same purpose of determining whether the level of equity in the account met the minimum margin requirements, as applying them to collateral collected by the nonbank SBSD. In addition, applying a haircut to collateral delivered by the nonbank SBSD to a counterparty is consistent with the requirements of the CFTC and the prudential regulators.

Comments and Final Requirements Regarding Additional Collateral and Liquidation Requirements

As noted above, proposed Rule 18a–3 prescribed additional requirements for collateral (*e.g.,* it must be liquid and transferable) and required the prompt liquidation of the collateral to eliminate a margin deficiency.[466] A commenter requested that only ''excess securities collateral'' as defined in proposed Rule 18a–4 for purposes of the segregation requirements be subject to the possession or control requirement in proposed Rule 18a–3.[467] The commenter noted that the proposed segregation requirements only required excess securities collateral to be in the SBSD's possession or control. Thus, the commenter argued that imposing a

BCBS/IOSCO Paper, Appendix B, at 27 (prescribing a haircut of 0.5% for high-quality and central bank securities: Residual maturity less than one year); *see also* paragraph (c)(2)(vi)(F)(*1*) of Rule 15c3–1, as amended (prescribing a range of three haircuts of 3% to 6% for nonconvertible debt securities that mature in more than one year but less than five years), and BCBS/IOSCO Paper, Appendix B, at 27 (prescribing a haircut of 4% for high-quality corporate/covered bonds: Residual maturity greater than one year and less than five years). The prudential regulators' and CFTC's final margin rules each prescribe a collateral haircut schedule that is generally consistent with the BCBS/IOSCO Paper. *See Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74910; *CFTC Margin Adopting Release,* 81 FR at 702.

[457] *See* paragraph (c)(3) of Rule 18a–3, as adopted.

[458] *See* paragraph (c)(3)(ii) of Rule 18a–3, as adopted. In the final rule, paragraph (c)(3) of Rule 18a–3, as proposed, is re-designated paragraph (c)(3)(i) of Rule 18a–3, as adopted, and a new subparagraph (c)(3)(ii) is added to read: ''(ii) Notwithstanding paragraph (c)(3)(i) of this section, the fair market value of assets delivered as collateral by a counterparty or the security-based swap dealer may be reduced by the amount of the standardized deductions prescribed in 17 CFR 23.156 if the security-based swap dealer applies these standardized deductions consistently with respect to the particular counterparty.''

[459] As discussed above in section II.B.1. of this release, while paragraphs (c)(4) and (5) of Rule 18a–3, as adopted, respectively require netting and collateral agreements to be in place, the rule does not impose a specific margin documentation requirement as do the margin rules of the CFTC and the prudential regulators.

[460] *See* PIMCO Letter. The commenter stated that OAS generally measures a debt instrument's risk premium over benchmark rates covering a variety of risks and net of any embedded options in the instrument. *See id.* (citing Frank J. Fabozzi, *The Handbook of Fixed Income Securities,* at 908–909 (7th ed. 2005)).

[461] *See* ISDA 1/23/2013 Letter; ISDA 2/5/2014 Letter. *See also* BCBS/IOSCO Paper at 17–19, Appendix B.

[462] *See Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74872; *CFTC Margin Adopting Release,* 81 FR at 702.

[463] *See* Letter from William J. Harrington (Nov. 19, 2018) (''Harrington 11/19/2018 Letter'').

[464] *See* paragraph (c)(4)(i)(A) of Rule 18a–3, as adopted.

[465] *See* paragraph (c)(3) of Rule 18a–3, as adopted. In addition to the changes to the final rule described above to permit the use of the CFTC collateral haircut schedule, in the final rule, the Commission inserted the word ''standardized'' before the word ''deductions'' and deleted the phrase ''determining whether the level of equity in the account meets the requirements of'' to clarify that only the use of standardized haircuts is permitted and to make a conforming change as a result of changes made to the definitions in paragraph (b) of the final rule. In the final rule, the Commission also deleted the phrase ''securities and money market instruments held in the account of'' and replaced it with ''collateral delivered by'' to clarify that the collateral in the account was delivered by a counterparty to the nonbank SBSD. Further, in the final rule, the title of the paragraphs reads: ''*Deductions for collateral*'' as a conforming change. In addition, the phrase ''securities and money market instruments'' has been replaced with the term ''collateral'' to conform to changes made to other parts of the rule. Finally, the phrase ''or security-based swap dealer'' is being added after the phrase ''collateral delivered by a counterparty.'' These changes conform the modification to the final rule requiring nonbank SBSDs to apply the standardized haircuts to collateral they deliver to counterparties to meet a variation margin requirement.

[466] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 7064–65.

[467] *See* SIFMA 2/22/2013 Letter.

possession or control requirement on a broader range of collateral could impose ''serious'' funding costs on SBSDs by requiring them to fund initial and variation margin payments for offsetting transactions through their own resources rather than through the collateral posted by security-based swap customers in accordance with proposed Rule 18a–3. Another commenter requested that the Commission amend paragraph (c)(4)(i) of proposed Rule 18a–3 to recognize initial margin collateral that is held at an independent third-party custodian as being in the control of the nonbank SBSD.[468]

The Commission did not intend the possession or control requirement in proposed Rule 18a–3 to conflict with the proposed possession or control requirement in Rule 18a–4. More specifically, under Rule 18a–4, as proposed, a nonbank SBSD could re-hypothecate collateral received as initial margin pursuant to Rule 18a–3 in limited circumstances and subject to certain conditions. The Commission clarifies that under Rule 18a–3, as adopted, initial margin that is held at a clearing agency to meet a margin requirement of the customer is in the control of the nonbank SBSD for purposes of the rule. Additionally, as discussed above in sections II.A.2.b.ii. and II.A.2.b.v. of this release, the Commission has adopted final capital rules for stand-alone broker-dealers and nonbank SBSDs that permit them to recognize collateral held at a third-party custodian for purposes of: (1) The exception from taking the capital charge when initial margin is held at a third-party custodian;[469] and (2) computing credit risk charges.[470] In each case, the collateral can be recognized if the custodian is a bank as defined in Section 3(a)(6) of the Exchange Act or a registered U.S. clearing organization or depository that is not affiliated with the counterparty or, if the collateral consists of foreign securities or currencies, a supervised foreign bank, clearing organization, or depository that is not affiliated with the counterparty and that customarily maintains custody of such foreign securities or currencies.

The Commission believes collateral held at a third-party custodian also should be recognized for the purposes of determining the account equity requirements in Rule 18a–3. Consequently, the Commission is modifying paragraph (c)(4) in the final rule to provide that the collateral must be either: (1) Subject to the physical possession or control of the nonbank SBSD or MSBSP and may be liquidated promptly by the firm without intervention by any other party (as was proposed); or (2) carried by an independent third-party custodian that is a bank as defined in Section 3(a)(6) of the Exchange Act or a registered U.S. clearing organization or depository that is not affiliated with the counterparty or, if the collateral consists of foreign securities or currencies, a supervised foreign bank, clearing organization, or depository that is not affiliated with the counterparty and that customarily maintains custody of such foreign securities or currencies.[471] This will address the second commenter's concern about recognizing collateral that is held at a third-party custodian.

As discussed above, the Commission has modified proposed Rule 18a–3 to provide a nonbank SBSD with the option to use the collateral haircuts required by the CFTC's rules.[472] In light of this modification, the Commission is modifying the final margin rule to explicitly require that the collateral have a ready market.[473] The requirement that the collateral have a ready market was incorporated into the proposed rule because, as discussed above, the nonbank SBSD was required to use the standardized haircuts in the proposed capital rules for purposes of the collateral deductions. The proposed nonbank SBSD capital rules required the firm to take a 100% deduction for a security or money market instrument that does not have a ready market (as do the final capital rules). Consequently, by incorporating those standardized haircuts into proposed Rule 18a–3, a nonbank SBSD would need to deduct 100% of the value of a security or money market instrument it received as margin if the security or money market instrument did not have a ready market. In other words, the security or money market instrument would have no collateral value for purposes of meeting the account equity requirements in proposed Rule 18a–3. The Commission's modification will retain the proposed requirement that collateral without a ready market has no collateral value and, in particular, will apply that requirement when the standardized haircuts of the CFTC are used, as they do not explicitly impose a ready market test. However, the CFTC, in describing its requirements for collateral, stated that margin assets should share the following fundamental characteristics: They ''should be liquid and, with haircuts, hold their value in times of financial stress.''[474] The CFTC further stated in describing collateral permitted under its rule that it consists of ''assets for which there are deep and liquid markets and, therefore, assets that can be readily valued and easily liquidated.'' The Commission believes that modifying the final rule to make explicit that the ready market test applies when the CFTC's standardized haircuts are used is consistent with these statements by the CFTC about collateral permitted under its margin rule.

For the foregoing reasons, the Commission is adopting the proposed collateral requirements with the modifications discussed above and certain additional non-substantive modifications.[475]

[468] *See* SIFMA 11/19/2018 Letter.

[469] *See* paragraph (c)(2)(xv)(C)(*1*) of Rule 15c3–1, as amended; paragraph (c)(1)(ix)(C)(*1*) of Rule 18a–1, as adopted.

[470] *See* paragraph (c)(4)(v)(B) of Rule 15c3–1e, as amended; paragraph (e)(2)(iii)(E)(*2*) of Rule 18a–1, as adopted.

[471] *See* paragraph (c)(4)(ii)(A) and (B) of Rule 18a–3, as adopted.

[472] *See* paragraph (c)(4)(i)(C) of Rule 18a–3, as adopted.

[473] *See* paragraph (c)(4)(i)(A) of Rule 18a–3, as adopted. The modification replaces paragraph (4)(i) of proposed Rule 18a–3 (which provided that ''The collateral is liquid and transferable'') with paragraph (4)(i)(A) of Rule 18a–3, as adopted (which provides that the collateral ''Has a ready market'') and paragraph (4)(i)(B) of Rule 18a–3, as adopted (which provides that the collateral ''Is readily transferable'').

[474] *See CFTC Margin Adopting Release,* 81 FR at 665.

[475] *See* paragraph (c)(4) of Rule 18a–3, as adopted. As a consequence of the modifications discussed above, paragraph (c)(4)(i) is re-designated paragraph (c)(4)(i)(A) through (E), paragraph (c)(4)(ii) is re-designated paragraph (c)(4)(ii)(A) and (B), and paragraphs (c)(4)(iii), (iv), and (v) are deleted. The Commission made the following additional non-substantive modifications to paragraph (c)(4) of Rule 18a–3, as adopted: (1) The phrase ''A security-based swap dealer and'' in the preface of the paragraph (c)(4) is changed to ''A security-based swap dealer or''; (2) the phrases ''cash and,'' ''securities and money market instruments,'' and ''delivered as collateral'' in the preface to paragraph (c)(4) are deleted and replaced with the phrase ''collateral delivered''; (3) the phrase ''The collateral is subject to the physical possession or control of the security-based swap dealer or the major security-based swap participant'' is deleted from paragraph (c)(4)(i) and replaced with the phrase ''The collateral:,'' and the phrase ''Subject to the physical possession or control of the security-based swap dealer or the major security-based swap participant'' is added to re-designated paragraph (c)(4)(ii)(A); (4) the phrase ''The collateral does not consist of securities and/or money market instruments issued by the counterparty or a party related to the security-based swap dealer, the major security-based swap participant, or to the counterparty.'' is deleted along in paragraph (c)(4)(v) and the phrase ''Does not consist of securities and/or money market instruments issued by the counterparty or a party related to the security-based swap dealer, the major security-based swap participant, or the counterparty; and'' is added to new paragraph (c)(4)(i)(D); (5) the phrase ''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

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Finally, the Commission did not receive any comments addressing the prompt liquidation requirement and is adopting it with several non-substantive modifications.[476]

Comments and Final Requirements Regarding Exceptions to Collecting Margin

Commercial End Users. As noted above, the Commission proposed five exceptions to the account equity requirements, and the first exception applied to counterparties that are commercial end users.[477] This exception provided that a nonbank SBSD need not collect variation or initial margin from a counterparty that was a commercial end user. A commenter opposed any exceptions in the rule, stating that failing to collect and deliver margin contributed significantly to the 2008 financial crisis.[478] Another commenter argued that commercial end users carry market risk and can default on their obligations to the nonbank SBSD, which may then be faced with liquidity challenges.[479] This commenter stated that the lack of margin from these market participants can be a source of systemic risk that can ''ripple through the financial market ecosystem.''

After Rule 18a–3 was proposed, the Terrorism Risk Insurance Program Reauthorization Act of 2015 (''TRIPRA'') was enacted.[480] Title III of TRIPRA amended Section 15F(e) of the Exchange Act to provide that the requirements of Section 15F(e)(2)(B)(ii) (which requires the Commission to adopt margin requirements for nonbank SBSDs with respect to non-cleared security-based swaps) shall not apply to a security-based swap in which a counterparty qualifies for an exception under Section 3C(g)(1) of the Exchange Act or that satisfies the criteria in Section 3C(g)(4) of the Exchange Act (the exceptions from mandatory clearing for commercial end users). Consequently, Congress mandated an exception for commercial end users from the Commission's margin rules for non-cleared security-based swaps.[481] While the statutory provision establishes a commercial end user exception, defining the term ''commercial end user'' will serve an important purpose. In particular, the definition will implement the statutory provision and serve as a cross-reference for the term ''commercial end user,'' which is referenced in other parts of the Commission's rules. Consequently, the Commission is adopting the exception and related definition with modifications to conform the definition to the statutory text.[482] In the final rule, the term ''commercial end user'' is defined to mean a counterparty that qualifies for an exception from clearing under section 3C(g)(1) of the Exchange Act and implementing regulations or satisfies the criteria in Section 3C(g)(4) of the Exchange Act and implementing regulations.[483]

In response to the concerns raised by the commenters regarding the exception, a nonbank SBSD will be required to take a capital deduction in lieu of margin or credit risk charge if it does not collect margin from a commercial end user counterparty. The capital deduction or charge is intended to require a nonbank SBSD to set aside net capital to address the risks that would be mitigated through the collection of initial margin.[484] The set-aside net capital will serve as an alternative to obtaining collateral for this purpose. Consequently, the final capital rules and amendments work in tandem with the margin rules to require capital deductions or credit risk charges that will require nonbank SBSDs to allocate capital against the market and credit exposures resulting from transactions with commercial end users, which may not be fully collateralized.

In addition, as discussed below, a nonbank SBSD will be required to establish, maintain, and document procedures and guidelines for monitoring the risk of accounts holding non-cleared security-based swaps. Among other things, a nonbank SBSD will 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.[485] Consequently, nonbank SBSDs that do not collect variation and/or initial margin from a commercial end user will need to establish a credit limit for the end user and periodically review the credit limit in accordance with their risk monitoring guidelines.[486] The final rule also does not prohibit a nonbank SBSD from requiring a commercial end user to post variation and initial margin under its own house margin requirements.

Financial Market Intermediaries. The second exception to collecting margin applied when the counterparty was another SBSD.[487] More specifically, the Commission proposed two alternatives with respect to SBSD counterparties. Under the first alternative, a nonbank SBSD would need to collect variation margin but not initial margin from the other SBSD (''Alternative A''). Under the second alternative, a nonbank SBSD would be required to collect variation and initial margin from the other SBSD

against the counterparty and any other parties to the agreement; and'' is deleted in paragraph (c)(4)(iv) and the phrase ''Is subject to an agreement between the security-based swap dealer or the major security-based swap participant and the counterparty that 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; and'' is added to re-designated paragraph (c)(4)(i)(E); (6) the phrase ''The collateral is liquid and transferable'' is deleted from paragraph (c)(4)(ii) and replaced with the phrase ''The collateral is either''; and (7) the phrase ''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''; is deleted from paragraph (c)(4)(iii) and the phrase ''and may be liquidated promptly by the security-based swap dealer or the major security-based swap participant without intervention by any other party; or'' is added to re-designated paragraph (c)(4)(ii)(A) after the phrase ''Subject to the physical possession or control of the security-based swap dealer or the major security-based swap participant.''

[476] *See* paragraph (c)(7) of Rule 18a–3, as adopted. This paragraph was re-numbered in the final rule as a result of changes made to other paragraphs in the rule. In the final rule, the word ''and'' was replaced with ''or'' between the phrase ''A security-based swap dealer'' and the phrase ''major security-based swap participant''; the phrase ''securities and money market instruments'' was replaced with the word ''positions''; and the phrase ''account equity'' was replaced with the word ''margin'' in two places. These changes to the rule were non-substantive amendments to conform the final rule text with changes made to other parts of the rule.

[477] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70265–66.

[478] *See* CFA Institute Letter.

[479] *See* OneChicago 2/19/2013 Letter.

[480] *See* Public Law 114–1, 129 Stat. 3 (2015).

[481] Section 3C(g) of the Exchange Act provides that the Commission shall consider whether to exempt small banks, savings associations, Farm Credit System institutions, and credit unions with total assets of $10 billion or less. 15 U.S.C. 78c–3(g)(3)(B). If the Commission implements an exclusion for such entities from clearing, those entities would be encompassed within the definition of *commercial end user* under the rule. *See End-User Exception to Mandatory Clearing of Security-Based Swaps; Proposed Rule,* Exchange Act Release No. 63556 (Dec. 15, 2010), 75 FR 79992 (Dec. 21, 2010).

[482] *See* paragraphs (b)(2) and (c)(1)(iii)(A) of Rule 18a–3, as adopted.

[483] *See* paragraph (b)(2) of Rule 18a–3, as adopted. This language is consistent with the final rule adopted by the prudential regulators to implement Title III of TRIPRA and the CFTC's final margin rule. *See Margin and Capital Requirements for Covered Swap Entities,* 81 FR 50605 (Aug. 2, 2016); *CFTC Margin Adopting Release,* 81 FR at 677–79.

[484] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70245.

[485] *See* paragraph (e)(2) of Rule 18a–3, as adopted.

[486] *See Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74848–49 (''Finally, the Agencies note that the exception or exemption of a transaction from the margin requirements in no way prohibits a covered swap entity from requiring initial and/or variation margin on such transactions but does not impose initial or variation margin requirements as a regulatory matter.''); *see also CFTC Margin Adopting Release,* 81 FR at 648 (''The Commission has other requirements [17 CFR 23.600 (Risk Management Program for swap dealers and major swap participants)] that should address the monitoring of risk exposures for those entities'').

[487] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70267–68.

and the initial margin needed to be held at a third-party custodian (''Alternative B'').[488]

Some commenters supported Alternative A. One of these commenters argued that the requirement to collect initial margin from other SBSDs under Alternative B would severely curtail the use of non-cleared security-based swaps for hedging.[489] The commenter argued that this result would disrupt key financial services, such as those that facilitate the availability of home loans and corporate finance. The commenter argued that the requirement to collect initial margin from another SBSD would have detrimental pro-cyclical effects because it would increase collateral demands in times of market stress. A second commenter believed that Alternative B could limit credit availability, be destabilizing, and have undesirable pro-cyclical effects.[490] While generally supporting harmonization of the Commission's margin rules with the recommendations of the BCBS/IOSCO Paper, this commenter supported Alternative A. The commenter stated that harmonization in this case is not appropriate because it would put stress on the funding models of U.S. nonbank SBSDs if they were required to post initial margin to other SBSDs.[491] A third commenter argued that the proposal to require the exchange of large amounts of liquid initial margin come at a time when other regulators and regulations are also focusing on and imposing new requirements with respect to liquidity in the financial sector.[492] This commenter urged the Commission to evaluate initial margin requirements in light of the changing financial regulatory environment and to establish regulations that will support capital growth and customer protection while minimizing systemic risk. Some commenters also supported expanding the Alternative A approach so that nonbank SBSDs would not be required to collect initial margin from swap dealers, stand-alone broker-dealers, banks, foreign banks, and foreign broker-dealers.[493]

Other commenters supported Alternative B, arguing that it was more consistent with the intent of the Dodd-Frank Act and that Alternative A would permit an inappropriate build-up of systemic risk within the financial system.[494] One commenter argued that the Commission should not be swayed by claims that Alternative B would make it difficult for nonbank SBSDs to hedge transactions, or that it would shrink the size of the global security-based swap market.[495] Another commenter argued that it would be inappropriate to allow a nonbank SBSD to have non-cleared security-based swap exposure to another SBSD without any requirement to collect initial margin or to take a capital charge to address the risk of the non-cleared security-based swap.[496] Some commenters noted that the CFTC and the prudential regulators require the exchange of initial margin between SBSDs and swap dealers, and the Commission should do so as well in order to harmonize its rules with the rules of the CFTC and the prudential regulators.[497] One commenter argued that a lack of harmonization would reduce the likelihood of achieving substituted compliance determinations.[498] Finally, a commenter responding to the 2018 comment reopening argued that the proposed rule text modifications were made despite the fact that insufficient margin and capital were two of the triggers of the financial crisis.[499]

In the Commission's judgment, Alternative A is the prudent approach because it will promote the liquidity of nonbank SBSDs by not requiring them to deliver initial margin to other SBSDs. As discussed above, delivering initial margin would prevent this capital of the nonbank SBSD from being immediately available to be used by the firm. If the delivering SBSD is undergoing financial stress or the markets more generally are in a period of financial turmoil, a nonbank SBSD may need to liquidate assets to raise funds and reduce its leverage. However, if assets are in the control of another SBSD, they would not be available for this purpose. For these reasons, the nonbank SBSD capital rule treats most unsecured receivables as assets that must be deducted from net worth when the firm computes net capital.

In addition, the Commission believes that nonbank SBSDs serve an important function in the non-cleared security-based swap market by providing liquidity to market participants and by performing important market making functions. Thus, the Commission believes its margin rule for non-cleared security-based swaps should promote the liquidity of these entities, which, in turn, will help ensure their safety and soundness. Further, the Commission believes these considerations support expanding the exception beyond SBSD counterparties to include other financial market intermediary counterparties such as swap dealers, FCMs, stand-alone broker-dealers, banks, foreign banks, and foreign broker-dealers.[500] The Commission believes it is appropriate to expand the list given their importance to the securities markets, the liquidity impact on these entities if they are required to post initial margin, and the fact that these entities will be subject to a regulatory capital standard that would incentivize them to collateralize exposures to their security-based swap counterparties.

A nonbank SBSD will be required to take a capital deduction in lieu of margin or credit risk charge if it does not collect initial margin from a counterparty that is a financial market intermediary. As discussed above, the capital deduction or credit risk charge is intended to require a nonbank SBSD to set aside net capital to address the risks that are mitigated through the collection of initial margin. Furthermore, the nonbank SBSD will be required to establish, maintain, and document procedures and guidelines for monitoring the risk of accounts holding non-cleared security-based swaps.[501] These include procedures for determining, approving, and periodically reviewing credit limits for each counterparty. Consequently, a nonbank SBSD will need to establish credit limits for each counterparty to a non-cleared security-based swap, including counterparties that are financial market intermediaries.

While Alternative A is not consistent with the final rules of the CFTC and the

[488] Alternative B would not be an exception to the account equity requirements in Rule 18a–3 because it would require the nonbank SBSD to collect variation and initial margin from another SBSD. However, the proposed exception related to how the collateral must be held—at an independent third-party custodian on behalf of the counterparty—and, therefore, not in the possession or control of the nonbank SBSD.

[489] *See* ISDA 1/23/2013 Letter.

[490] *See* SIFMA 2/22/2013 Letter.

[491] *See* SIFMA Letter 11/19/2018. *See also* ISDA 11/19/2018 Letter.

[492] *See* Financial Services Roundtable Letter. *See also* Letter from Robert Rozell (Nov. 8, 2018) (''Rozell Letter'').

[493] *See Capital, Margin, and Segregation Comment Reopening,* 83 FR 53013–14*; SIFMA 11/19/2018 Letter.*

[494] *See* Americans for Financial Reform Education Fund Letter; Barnard Letter; Citadel 11/19/2018 Letter; Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors (Nov. 8, 2018) (''Council of Institutional Investors Letter'').

[495] *See* Americans for Financial Reform Letter.

[496] *See* OneChicago 2/19/2013 Letter.

[497] *See* Americans for Financial Reform Education Fund Letter; Citadel 11/19/2018 Letter; Rutkowski Letter.

[498] *See* Citadel 11/19/2018 Letter.

[499] *See* Better Markets 11/19/2018 Letter.

[500] *See Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53013–14 (soliciting comment on whether the dealer to dealer initial margin exception should be expanded to other types of financial market intermediaries).

[501] *See* paragraph (e) of Rule 18a–3, as adopted.

prudential regulators, the rule does not prohibit nonbank SBSDs from collecting initial margin from another financial intermediary as a house margin requirement or by agreement. In addition, the adoption of Alternative A as one requirement in the margin rule should not negatively affect potential substituted compliance determinations because the Commission expects regulators will focus on regulatory outcomes as a whole rather than on requirement-by-requirement similarity.[502] Finally, the adoption of Alternative A with modifications discussed above should alleviate commenters' concerns that imposing initial margin requirements would severely curtail the use of non-cleared security-based swaps for hedging.

For these reasons, the Commission is adopting Alternative A with the modifications discussed above.[503]

Counterparties that Use Third-Party Custodians. The third proposed exception applied to counterparties that are not commercial end users and that elect to have their initial margin segregated pursuant to Section 3E(f) of the Exchange Act.[504] Among other things, Section 3E(f) provides that a counterparty may elect to have its initial margin segregated in an account carried by an independent third-party custodian. Under the proposed exception, the nonbank SBSD did not need to directly hold the initial margin required from the counterparty. This accommodated the counterparty's right under Section 3E(f) to elect to have the third-party custodian hold the initial margin. The Commission did not receive any comments specifically addressing this provision but is modifying it to remove the reference to Section 3E(f) to address the potential that the initial margin might be held at a third-party custodian pursuant to other provisions. For the foregoing reasons, the Commission is adopting this exception with the modification described above and certain non-substantive modifications.[505]

Legacy Accounts. The fourth proposed exception applied to accounts of counterparties that are not commercial end users and that hold legacy non-cleared security-based swaps.[506] Under this proposed exception, the nonbank SBSD did not need to collect variation or initial margin from the counterparty.

Some commenters expressed support for this exception. One of these commenters suggested that the Commission except legacy transactions, unless both counterparties agree that margin should be exchanged.[507] A second commenter suggested that legacy trades be excepted unless the nonbank SBSD includes them in a netting set with new transactions.[508] Some commenters also provided suggestions as to what should be deemed a legacy transaction, citing novated contracts and existing legacy security-based swaps that have been modified for loss mitigation purposes, or contracts that have been amended to replace references to the London Inter-bank Offered Rate (''LIBOR'').[509] Commenters also requested clarification as to whether the legacy account exception for nonbank SBSDs applies to both variation and initial margin or to initial margin only.[510] A commenter argued that initial margin requirements should not apply to legacy security-based swaps, but that the exception should only apply until the legacy contracts expire or are revised.[511] This commenter further argued that the exception should not apply to variation margin because, without this type of protection, counterparties are exposed to potential losses as a consequence of the default of trading partners.

The Commission is adopting the proposed exception for accounts holding legacy security-based swaps[512] with a modification to make explicit that the exception applies to variation and initial margin in response to comments seeking clarification on that point.[513] Under the final rule, nonbank SBSDs can collect variation or initial margin with respect to legacy transactions pursuant to house requirements or agreement.

With regard to the comment that counterparties should be required to post variation margin since they may be exposed to potential losses, a nonbank SBSD will be required to take a capital deduction in lieu of margin or credit risk charge if it does not collect variation and/or initial margin with respect to a legacy account. Furthermore, the nonbank SBSD will be required to establish, maintain, and document procedures and guidelines for monitoring the risk of legacy accounts. With respect to the comment about the effect of the replacement of references to LIBOR in security-based swap contracts, the Commission intends to consult and coordinate with other regulators on this question.

Minimum Transfer Amount. The fifth exception established a minimum transfer amount.[514] Under this provision, a nonbank SBSD was not required to collect margin if the total amount of the requirement was equal to or less than $100,000. If this amount was exceeded, the nonbank SBSD needed to collect margin to cover the entire amount of the requirement, not just the amount that exceeded $100,000.

Several commenters supported this exception, or supported increasing it to amounts that ranged from $250,000 to

[502] *See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants,* 81 FR at 30078–30079.

[503] *See* paragraph (c)(1)(iii)(B) of Rule 18a–3, as adopted. The text of the final rule is modified to add swap dealers, broker-dealers, FCMs, banks, foreign banks, and foreign broker-dealers to the list of counterparties covered by the exception.

[504] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70268–69.

[505] In the final rule, this exception is contained in paragraph (c)(1)(iii)(C) of Rule 18a–3, as adopted. This paragraph states ''The requirements of paragraph (c)(1)(ii)(B) of this section do not apply to an account of a counterparty that delivers the collateral to meet the initial margin amount to an independent third-party custodian.''

[506] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70269.

[507] *See* PIMCO Letter.

[508] *See* SIFMA 3/12/2014 Letter.

[509] *See* Letter from the Alternative Reference Rates Committee (Jul. 12, 2018) (''ARRC Letter''); AFGI 2/15/2013 Letter; SIFMA 2/22/2013 Letter.

[510] *See* Financial Services Roundtable Letter; ISDA 1/23/2013 Letter.

[511] *See* CFA Institute Letter.

[512] *See* paragraph (c)(1)(iii)(D) of Rule 18a–3, as adopted. In the final rule, the Commission modified the defined term ''security-based swap legacy account'' by replacing the word ''effective'' in two places with the word ''compliance.'' *See* paragraph (b)(6) of Rule 18a–3, as adopted. The Commission made these modifications to link the legacy account exception to the compliance date of Rule 18a–3 (*i.e.,* the date when nonbank SBSDs must begin complying with the rules) as opposed to the effective date, which will occur before these entities are required to register as SBSDs and comply with the rule. The term *security-based swap legacy account* was re-designated subparagraph (b)(6) of the rule due to non-substantive changes made to other parts of the rule. Finally, the phrase ''one or more'' was inserted after the phrase ''is used to hold.''

[513] *See* paragraph (c)(1)(iii)(D) of Rule 18a–3, as adopted. *See also See Capital, Margin, and Segregation Proposing Release,* 77 FR 70269. The Commission's intent was to propose an exception that applied to both variation and initial margin. *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70269 (''Under the fourth exception to the account *equity* requirements in proposed 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.''). The proposed rule text, however, inadvertently limited the exception to the collection of initial margin. In the final rule, the Commission also deleted the phrase ''of a counterparty that is not a commercial end user'' from this subsection because it is redundant, as commercial end users are subject to an exception from the rule under paragraph (c)(1)(iii)(A) of Rule 18a–3. Finally, the word ''legacy'' was moved to before the word ''account'' to conform the language with the definition of security-based swap legacy account in paragraph (b)(6) of the rule. *See* paragraph (c)(1)(iii)(D) of Rule 18a–3, as adopted.

[514] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70272.

$500,000.[515] Commenters also asked the Commission to clarify whether the proposed minimum transfer amount applies to both initial and variation margin, and recommended that different jurisdictions use the same currency to designate thresholds.[516] A commenter also supported consistent minimum transfer amounts across domestic regulators.[517] The CFTC and the prudential regulators adopted a minimum transfer amount of $500,000.[518] One commenter opposed a minimum transfer amount for variation margin.[519]

The Commission agrees with commenters that the minimum transfer amount should be increased to $500,000. This will reduce operational burdens for nonbank SBSDs and their counterparties by not requiring them to transfer small amounts of collateral on a daily basis. It also will align the rule with the minimum transfer amount adopted by the CFTC and the prudential regulators and, thereby, reduce potential operational burdens and competitive impacts that could result from inconsistent requirements.

In response to the commenter concerned about applying the minimum transfer amount to variation margin, a nonbank SBSD will be required to take a capital deduction in lieu of margin or credit risk charge if it does not collect variation and/or initial margin pursuant to the minimum transfer amount exception.

For these reasons, the Commission is adopting the minimum transfer amount exception with an increase to $500,000, and with minor modifications.[520]

The Commission also clarifies that the minimum transfer amount applies to both initial and variation margin. Thus, required initial and variation margin need not be collected if the combined requirements are below $500,000. However, if the $500,000 level is exceeded, the entire amount must be collected (*i.e.,* not the just amount that exceeds $500,000). Finally, in response to a comment, nonbank SBSDs may negotiate a lower ''house'' minimum transfer amount with their counterparties.

Initial Margin Threshold. The CFTC and the prudential regulators have adopted a fixed-dollar $50 million threshold under which initial margin need not be collected.[521] The CFTC defines its initial margin threshold amount to mean an aggregate credit exposure of $50 million resulting from all non-cleared swaps of a swap dealer and its affiliates with a counterparty and its affiliates.[522] The prudential regulators adopted a similar threshold, except that it covers aggregate credit exposure resulting from all non-cleared security-based swaps and swaps.[523]

Some commenters requested that the Commission adopt a threshold consistent with the thresholds adopted by the CFTC and the prudential regulators, and with the recommendations in the BCBS/IOSCO Paper.[524] A commenter stated that initial margin thresholds can be a useful means for reducing the aggregate liquidity impact of mandatory initial margin requirements while still protecting an SBSD from large uncollateralized potential future exposures to counterparties.[525] Another commenter suggested that if pension plans are subject to initial margin requirements, then dealers should be able to set initial margin thresholds for them on a case-by-case basis.[526] A third commenter suggested that low-risk financial end users should be allowed an uncollateralized threshold of $100 million.[527] Other commenters raised concerns about the consequences of breaching the threshold and noted that doing so would trigger the need to execute agreements to address the posting of initial margin.[528]

In the 2018 comment reopening, the Commission asked whether it would be appropriate to establish a risk-based threshold where, for example, a nonbank SBSD would not be required to collect initial margin to the extent the amount does not exceed the lesser of: (1) 1% of the SBSD's tentative net capital; or (2) 10% of the net worth of the counterparty.[529] The Commission stated that the purpose would be to establish a threshold that is scalable and has a more direct relation to the risk to the nonbank SBSD arising from its security-based swap activities. The Commission also stated that a fixed-dollar threshold, depending on the size and activities of the nonbank SBSD, could either be too large and, therefore, not adequately address the risk, or too small and, therefore, overcompensate for the risk.

In response to the potential risk-based threshold discussed in the comment period reopening, most commenters argued that the Commission should adopt a fixed-dollar $50 million threshold consistent with the final margin rules of the CFTC and the prudential regulators.[530] A commenter suggested that this would result in benefits such as predictability and transparency.[531] This commenter also argued that a threshold harmonized with that of other regulators would prevent opportunities for counterparties to engage in regulatory arbitrage, and recommended that any drawbacks (such as the threshold being too large in relation to a nonbank SBSD's net capital) be addressed through additional capital charges.[532] A commenter raised concerns that a different threshold

[515] *See* American Council of Life Insurers 2/22/2013 Letter; American Council of Life Insurers, et al. 1/29/2013 Letter; ICI 11/19/2018 Letter; ISDA 11/19/2018 Letter; Markit Letter; SIFMA AMG 2/22/2013 Letter; SIFMA AMG 11/19/2018 Letter; SIFMA 3/12/14 Letter; SIFMA 11/19/2018 Letter.

[516] *See* ISDA 2/5/2014 Letter; SIFMA 3/12/14 Letter.

[517] *See* American Council of Life Insurers 2/22/2013 Letter.

[518] *See Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74903; *CFTC Margin Adopting Release,* 81 FR at 697. *See also* BCBS/IOSCO Paper at 10 (recommending a minimum transfer amount of €500,000).

[519] *See* Harrington 11/19/2018 Letter.

[520] *See* paragraph (c)(1)(iii)(I) and (c)(2)(iii)(D) of Rule 18a–3, as adopted. In the final rule the minimum transfer amount paragraph was moved to the exceptions section of the rule as a non-substantive change to facilitate cross-references to the capital rules related to capital charges in lieu of margin and credit risk charges. This modification also will improve the overall consistency and structure of the margin rule. Therefore, the exception appears twice in the final rule text, rather than once, as proposed, with references to both nonbank SBSDs and MSBSPs. *See* paragraph (c)(1)(iii)(I) and (c)(2)(iii)(D) of Rule 18a–3, as adopted. Finally, the phrase ''cash, securities, and money market instruments'' has been replaced with the term ''collateral'' as a result of changes made to other paragraphs of the rule.

[521] *See CFTC Margin Adopting Release,* 81 FR at 652; *Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74863; *see also* BCBS/IOSCO Paper, principle 2.1 (providing that covered entities must exchange initial margin with a threshold not to exceed €50 million).

[522] *See CFTC Margin Adopting Release,* 81 FR at 697.

[523] *Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74901.

[524] *See, e.g.,* ICI 5/11/2015 Letter; Ropes & Gray Letter; SIFMA 3/12/2014 Letter.

[525] *See* SIFMA 2/22/2013 Letter.

[526] *See* American Benefits Council Letter, et al., 1/29/2013 Letter.

[527] *See* PIMCO Letter.

[528] *See* Letter from Scott O'Malia, Chief Executive Officer, International Swaps and Derivatives Association, Kenneth E. Bentsen, Jr., President & CEO, Securities Industry and Financial Markets Association, Ananda Radhakrishnan, Vice President, Center for Bank Derivatives Policy, American Bankers Association, James Kemp, Managing Director, Global Foreign Exchange Division, GFMA, and Briget Polichene, Chief Executive Officer, Institute of International Bankers (Sept. 12, 2018) (''ISDA, SIFMA, ABA, et al. 9/12/18 Letter'').

[529] *See Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53013.

[530] *See* Center for Capital Markets Competitiveness, Chamber of Commerce 11/19/2018 Letter; ICI 11/19/2018 Letter; ISDA 11/19/2018 Letter.

[531] *See* SIFMA 11/19/2018 Letter. This commenter recommended that the Commission adopt a $50 million initial margin threshold, but recommended that the drawbacks of the fixed-dollar threshold could be addressed through additional capital charges, such as credit concentration capital charges.

[532] *See* SIFMA 11/19/2018 Letter.

would result in significant compliance challenges if trading desks that trade both security-based swaps and swaps were required to apply different standards to the same counterparty.[533] Another commenter believed that a scalable threshold would cause significant operational challenges and inefficiencies by subjecting individual SBSDs to different thresholds for the collection of initial margin.[534]

Several commenters argued against including an initial margin threshold in the final rule. Two stated that there is no threshold in the margin rules for cleared security-based swaps, and establishing one for non-cleared security-based swaps would increase systemic risk.[535] One commenter argued that the Commission did not explain its views on why a counterparty specific threshold (*e.g.,* $50 million) should be rejected in favor of a measure that would be tied to a percentage of the nonbank SBSD's tentative net capital.[536]

In response to comments, the Commission believes that it would be appropriate to establish a threshold that is more consistent with the thresholds adopted by the CFTC and the prudential regulators. This will eliminate potential competitive disparities and address operational concerns raised by commenters. For these reasons, the Commission is adopting a fixed-dollar $50 million initial margin threshold below which initial margin need not be collected.[537] As discussed below, the threshold in the Commission's final margin rule is consistent with the threshold in the prudential regulators' margin rules.

Pursuant to the threshold, an SBSD need not collect the calculated amount of initial margin to the extent that the sum of that amount plus all other credit exposures resulting from non-cleared security-based swaps and swaps of the nonbank SBSD and its affiliates with the counterparty and its affiliates does not exceed $50 million. The threshold will be calculated across all non-cleared security-based swaps and swaps of the nonbank SBSD and its affiliates with the counterparty and its affiliates, with the exception that non-cleared security-based swap transactions with commercial end users and non-cleared swap transactions that are exempted under Section 4s(e)(4) of the CEA need not be included in the calculation. The margin rules of the CFTC and the prudential regulators similarly exclude transactions with commercial end users from their respective fixed-dollar $50 million thresholds. Moreover, as discussed above, the TRIPRA statute precludes the Commission from adopting margin requirements for commercial end users.

The Commission's fixed-dollar $50 million threshold is consistent with the threshold established by the prudential regulators in that the calculation includes both non-cleared security-based swaps and swaps (in contrast to the CFTC's threshold, which includes only swaps in the calculation). Including both non-cleared security-based swaps and swaps in the calculation will result in a more prudent requirement that takes into account a broader range of exposures. Further, because bank SBSDs can deal in security-based swaps, aligning the nonbank SBSD threshold with the bank threshold will eliminate a potential competitive disparity between the two types of U.S. entities that deal in security-based swaps. Also, if the calculation of the Commission's threshold were limited to security-based swaps, SBSDs and counterparties potentially would need to make 3 threshold calculations: One for the Commission's rule (security-based swaps only), one for the CFTC's rule (swaps only), and one for the prudential regulators' rule (security-based swaps and swaps). By conforming to the prudential regulator's rule, SBSDs and counterparties need only make two calculations (the Commission/prudential regulator threshold and the CFTC threshold). Further, a counterparty that breaches the Commission's fixed-dollar $50 million threshold will not necessarily breach the CFTC's fixed-dollar $50 million threshold exception given that the former calculation includes security-based swap and swap exposures and the latter includes only swap exposures.

The Commission recognizes that a fixed-dollar threshold (as opposed to a scalable threshold) does not necessarily bear a relation to the financial condition of the nonbank SBSD and its counterparty. To address this issue, as discussed above, and as suggested by a commenter, a nonbank SBSD will be required to take a capital deduction in lieu of margin or a credit risk charge if it does not collect initial margin pursuant to the fixed-dollar $50 million threshold exception. Furthermore, the nonbank SBSD will be required to establish, maintain, and document procedures and guidelines for monitoring counterparty risk. Consequently, the Commission does not believe the fixed-dollar $50 million threshold exception will unduly increase systemic risk as suggested by a commenter. For these reasons, the Commission believes it is appropriate to adopt the exception to promote greater consistency with the margin requirements of the prudential regulators.

Finally, commenters raised concerns about the consequences of breaching a fixed-dollar $50 million threshold and noted that doing so would trigger the need to execute agreements to address the posting of initial margin.[538] The Commission recognizes that after a breach counterparties may need time to execute agreements, establish processes for exchanging initial margin, and take other steps to comply with the initial margin requirement.[539] Therefore, the Commission is modifying the final rule to permit a nonbank SBSD to defer collecting the initial margin amount for up to two months following the month in which a counterparty no longer qualifies for the fixed-dollar $50 million threshold exception for the first time.[540] This is designed to provide the counterparty with sufficient time to take the steps necessary to begin posting initial margin pursuant to the final rule.

Affiliates. The margin rules of the CFTC and the prudential regulators have exceptions for counterparties that are affiliates.[541] Some commenters requested that the Commission also adopt exceptions for affiliates.[542] One

[533] *See* ICI 11/19/2018 Letter.

[534] *See* ISDA 11/29/2018 Letter.

[535] *See* Better Markets 11/19/2018 Letter; OneChicago 11/19/2018 Letter.

[536] *See* Better Markets 11/19/2018 Letter.

[537] *See* paragraph (c)(1)(iii)(H)(*1*) of Rule 18a–3, as adopted.

[538] *See* ISDA, SIFMA, American Bankers Association, et al 9/12/2018 Letter.

[539] As discussed above in section II.B.1. of this release, while paragraphs (c)(4) and (5) of Rule 18a–3, as adopted, respectively require netting and collateral agreements to be in place, the rule does not impose a specific margin documentation requirement as do the margin rules of the CFTC and the prudential regulators.

[540] *See* paragraph (c)(1)(iii)(H)(*2*) of Rule 18a–4, as adopted. Paragraph (c)(1)(iii)(H)(*2*) of the final rule states ''Notwithstanding paragraph (c)(1)(iii)(H)(*1*) of this section, a security-based swap dealer may defer collecting the amount required under paragraph (c)(1)(ii)(B) of this section for up to two months following the month in which a counterparty no longer qualifies for this threshold exception for the first time.''

[541] *See CFTC Margin Adopting Release,* 81 FR at 673–674; *Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74887–90.

[542] *See* Letter from Representative Ted Budd, Representative Patrick McHenry et. al. (May 14, 2019); Letter from John Court, Managing Director and Senior Associate General Counsel, The Clearing House, Cecelia A. Calaby, Executive Director and General Counsel, American Bankers Association Securities Association, and Jason Shafer, Vice President, American Bankers Association (Nov. 24, 2014) (''Clearing House 11/24/14 Letter''); Letter from John Court, Managing Director/Deputy General Counsel, The Clearing House, Cecelia A. Calaby, Senior Vice President, Office of Regulatory Policy, American Bankers Association and Executive Director and General Counsel, American Bankers Association Securities Association, and Kyle

commenter stated that inter-affiliate transactions do not increase the overall risk profile or leverage of the SBSD.[543] Another commenter noted that some affiliates enter into security-based swap transactions with their nonbank SBSD affiliates, either for individual hedging purposes or as part of the consolidated group's broader risk strategy.[544]

Other commenters opposed an exception for affiliates.[545] One of these commenters urged the Commission to impose strong margin requirements for security-based swaps between bank affiliates and other entities under the Commission's authority.[546]

The Commission is persuaded that there should an exception for affiliates in order to reduce potential competitive disparities, and to promote consistency with the margin requirements of the CFTC. Therefore, the Commission is modifying the final rule to establish an initial margin exception when the counterparty is an affiliate of the SBSD.[547]

Although they will not be required to collect initial margin from affiliates, a nonbank SBSD must collect variation margin from them. In addition, as discussed above, a nonbank SBSD will be required to take a capital deduction in lieu of margin or credit risk charge if it does not collect initial margin from an affiliate. The nonbank SBSD also will be required to establish, maintain, and document procedures and guidelines for monitoring the risk of affiliates. Moreover, the final rule does not prohibit a nonbank SBSD from requiring an affiliate to post initial margin under its own house margin requirements.

The BIS, European Stability Mechanism, Multilateral Development Banks, and Sovereigns. The margin rules of the CFTC and the prudential regulators have exceptions for counterparties that are not a financial end user as that term is defined in their rules.[548] Their definitions of financial end user exclude the BIS, multilateral development banks, and sovereign entities.[549]

Some commenters requested that the Commission adopt exceptions for these types of entities to be consistent with the margin rules of the CFTC and the prudential regulators, and with the recommendations in the BCBS/IOSCO Paper.[550] One of these commenters argued that international consistency among covered entities subject to margin requirements, including the definition of public sector entities, is critical to competitive parity and comity.[551] Another commenter argued that the approach to margin for foreign sovereign governments, central banks, and multilateral lending or development organizations should be determined through international consensus.[552] A commenter recommended that the Commission adopt a definition of ''financial end user'' consistent with the margin rules of the CFTC and the prudential regulators, which—as noted above—results in exceptions for sovereign entities, multilateral development banks, and the BIS.[553] The commenter argued that different treatment of these entities will create unnecessary competitive disparities.

The Commission is persuaded that there should be some exceptions for these types of entities in order to reduce potential competitive disparities. However, the Commission also believes that the exception for sovereign entities should be more limited, given the wide range of potential counterparties that would be within this category and their differing levels of creditworthiness. Limiting the exception for sovereign entities will help ensure the safety and soundness of nonbank SBSDs.

For these reasons, the Commission is adopting an exception from collecting variation and initial margin if the counterparty is the BIS, the European Stability Mechanism, or one of a number of multilateral development banks identified in the rule.[554] These multilateral development banks are the International Bank for Reconstruction and Development, the Multilateral Investment Guarantee Agency, the International Finance Corporation, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the European Investment Fund, the Nordic Investment Bank, the Caribbean Development Bank, the Islamic Development Bank, the Council of Europe Development Bank, and any other multilateral development bank that provides financing for national or regional development in which the U.S. government is a shareholder or contributing member. These specific counterparties also are not required to collect and/or post variation margin under the final margin rules of the CFTC and/or the prudential regulators.[555] The Commission believes these counterparties pose minimal credit risk and, therefore, it is an appropriate trade-off to except them from the margin requirements (which are designed to protect the nonbank SBSD from counterparty risk) in order to eliminate the potential competitive disparities and operational burdens of treating them differently than under the rules of the CFTC and the prudential regulators.[556]

The exception for sovereign entities is more limited. Specifically, the final rule excepts a nonbank SBSD from collecting initial margin from a counterparty that is a sovereign entity if the nonbank SBSD has determined that the

Brandon, Managing Director, Director of Research, SIFMA (June 1, 2015) (''Clearing House 6/1/15 Letter''); Letter from Coalition for Derivatives End-Users (Feb. 22, 2013) (''Coalition for Derivatives End-Users 2/22/2013 Letter''); Financial Services Roundtable Letter; ISDA 1/23/2013 Letter; ISDA 2/5/2014 Letter; ISDA 11/19/2018 Letter; SIFMA 2/22/2013 Letter; SIFMA 3/12/2014 Letter; SIFMA 11/19/2019 Letter. The Clearing House proposed two alternatives for initial margin: A requirement that a nonbank SBSD collect initial margin from less regulated affiliates and segregate it, and not collect (or post) initial margin from highly regulated affiliates. Variation margin would still be collected under this proposal. In lieu of these proposals, The Clearing House also proposed a pooled segregated collateral account held at the parent company level. *See* Clearing House 6/1/15 Letter. One commenter recommended that variation margin requirements apply to an inter-affiliate transaction only when an SBSD is transacting with an unregulated/non-prudentially supervised affiliate. *See* SIFMA 2/22/2013 Letter. This commenter also recommended that the Commission should not require nonbank SBSDs to collect initial margin from affiliates that are subject to the same centralized risk management program as the nonbank SBSD. *See* SIFMA 11/19/2018 Letter.

[543] *See* ISDA 11/19/2018 Letter.

[544] *See* SIFMA 11/19/2018 Letter.

[545] *See* CFA Institute Letter; Letter from Elijah E. Cummings, Ranking Member, Committee on Oversight and Government Reform and Elizabeth Warren, Ranking Member, Subcommittee on Economic Policy (Nov. 10, 2015) (''Cummings and Warren Letter'').

[546] *See* Cummings and Warren Letter.

[547] *See* paragraph (c)(1)(iii)(G) of Rule 18a–3, as adopted. This paragraph in the final rule will read: [t]he requirements of paragraph (c)(1)(ii)(B) of this section do not apply to an account of a counterparty that is an affiliate of the security-based swap dealer.

[548] *See CFTC Margin Adopting Release,* 81 FR at 642; *Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74855.

[549] *See CFTC Margin Adopting Release,* 81 FR at 642; *Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74855. *See also* BCBS/IOSCO Paper, paragraph 2(c) (recommending that margin standards should not be applied in such a way that would require sovereigns, central banks, multilateral development banks, or the BIS to either collect or post margin).

[550] *See* Financial Services Roundtable Letter; SIFMA 2/22/2013 Letter; SIFMA 3/12/2014 Letter; SIFMA 11/19/2018 Letter.

[551] *See* SIFMA 3/12/2014 Letter.

[552] *See* Financial Services Roundtable Letter.

[553] *See* SIFMA 11/19/2018 Letter.

[554] *See* paragraph (c)(1)(iii)(E) of Rule 18a–3, as adopted.

[555] *See CFTC Margin Adopting Release,* 81 FR at 642; *Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74855. *See also* BCBS/IOSCO Paper at 10. The CFTC's approach generally treats the European Stability Mechanism consistent with the treatment of a multilateral development bank for purposes of the CFTC margin rule. *See* CFTC Letter No. 17–34 (Jul. 24, 2017).

[556] *See CFTC Margin Adopting Release,* 81 FR at 642; *Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74855.

counterparty has only a minimal amount of credit risk pursuant to policies and procedures or credit risk models established under applicable net capital rules for nonbank SBSDs.[557] The final capital rules for nonbank SBSDs require these entities to have policies and procedures for assessing the creditworthiness of certain types of securities or money market instruments for purposes of applying standardized haircuts.[558] The rules also require firms authorized to use models to compute haircuts to have a model for determining credit risk charges. The firms will need to use these policies and procedures or models (as applicable) to determine whether a sovereign entity has a minimal amount of credit risk in order to apply this exception. A sovereign entity that the nonbank SBSD has determined has a minimal amount of credit risk for purposes of the nonbank capital rules would qualify for the initial margin exception in Rule 18a–3.

Nonbank SBSDs must collect variation margin from and deliver variation margin to counterparties that are sovereign entities under the final rule. In contrast, the final margin rules of the CFTC and the prudential regulators do not require an SBSD or swap dealer to exchange variation margin with a counterparty that is a sovereign entity.[559] Collecting variation margin from sovereign entity counterparties is an important means of managing credit exposure to these entities and limiting the amount of unsecured receivables that comprise the firm's capital. As discussed above, in contrast to the multilateral development banks identified in the rule, the Commission believes that the exception for sovereign entities should be more limited given the wide range of potential counterparties in this category and their differing levels of creditworthiness. Limiting the exception for sovereign entities and requiring that these counterparties post variation margin will help ensure the safety and soundness of nonbank SBSDs. Therefore, the Commission does not believe it is appropriate to except such counterparties from the variation margin requirements of the final rule.

Requests for Other Exceptions

Commenters suggested that the Commission except other counterparties from the margin requirements in Rule 18a–3. The proposed exceptions included: Pension plans; [560] securitization and similar special purpose vehicles; [561] state and municipal government entities; [562] low risk financial end users; [563] financial end users such as captive financial affiliates and mutual life insurance companies; [564] emerging market counterparties that constitute only a certain percentage of a nonbank SBSD's volume; [565] and counterparties trading non-cleared derivatives below a certain notional amount (*e.g.,* financial end users without material swaps exposure).[566] Other commenters suggested that the Commission adopt exceptions to the margin requirements recommended in the BCBS/IOSCO Paper, including for entities that have less than a specified gross notional amount of outstanding non-centrally cleared swaps.[567]

A commenter opposed any exceptions, arguing that exceptions for certain market participants were a significant contributor to the systemic risk disruptions during the 2008 financial crisis.[568] A commenter specifically opposed exceptions for asset-backed security issuers.[569]

The Commission does not believe it is necessary or prudent to establish special exceptions for these specific types of counterparties. The Commission acknowledges that not establishing special exceptions for some of these types of counterparties may lead to different margin requirements across both foreign and domestic regulators. On balance, however, the Commission believes that, given the funding profiles of nonbank SBSDs and the role of margin in promoting liquidity and self-sufficiency and managing credit exposure, the expansion of the exceptions in the manner suggested by commenters would not be prudent. The addition of the fixed-dollar $50 million threshold exception should provide relief to many of these counterparties from the requirement to deliver initial margin. Moreover, as discussed above, the Commission is providing SBSDs with a deferral period that should provide sufficient time for them and their counterparties to implement any documentation, custodial, or operational arrangements that they deem necessary to comply with Rule 18a–3.[570]

ii. Nonbank MSBSPs

As discussed earlier, proposed Rule 18a–3 required a nonbank MSBSP 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.[571] By noon of the next business day, the nonbank MSBSP was 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.[572] In other words, the nonbank MSBSP was required to either collect or deliver variation margin but not required to collect or deliver initial margin. The proposed rule did not require the nonbank MSBSP to apply the

[557] *See* paragraph (c)(1)(iii)(F) of Rule 18a–3, as adopted. The exception applies to a counterparty that is a central government (including the U.S. government) or an agency, department, ministry, or central bank of a central government if the security-based swap dealer has determined that the counterparty has only a minimal amount of credit risk pursuant to policies and procedures established pursuant to Rule 15c3–1 or 18a–1 (as applicable).

[558] *See Removal of Certain References to Credit Ratings Under the Securities Exchange Act of 1934,* Exchange Act Release No. 71194 (Dec. 27, 2013), 79 FR 1522 (Jan. 8, 2014) (discussing the ''minimal amount of credit risk'' standard). *See also* paragraph (c)(2)(vi)(I) of Rule 15c3–1.

[559] *See CFTC Margin Adopting Release,* 81 FR at 642; *Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74855.

[560] *See* American Benefits Council, et al. 1/29/2013 Letter.

[561] *See* Financial Services Roundtable Letter; ISDA 1/23/2013 Letter; ISDA 2/5/2014 Letter; SIFMA 2/22/2013 Letter; SIFMA 3/12/2014 Letter.

[562] *See* Financial Services Roundtable Letter; ISDA 1/23/2013 Letter.

[563] *See* SIFMA AMG 2/22/2013 Letter.

[564] *See* Coalition for Derivatives End-Users 2/22/2013 Letter.

[565] *See* SIFMA 3/12/2014 Letter.

[566] *See* ICI 11/19/2018 Letter; ISDA 11/19/2018 Letter; ISDA, SIFMA, American Bankers Association, et al. 9/12/18 Letter; SIFMA 11/19/2018 Letter; SIFMA AMG 11/19/2018 Letter. These commenters generally supported that the Commission only require counterparties with ''material swaps exposure'' to post initial margin.

[567] *See* Financial Services Roundtable Letter; ISDA 2/5/2014 Letter; Letter from Lutz-Christian Funke, Senior Vice President, and Frank Czichowski, Senior Vice President and Treasurer, KfW Bankengruppe (Dec. 19, 2012) (''KfW Bankengruppe Letter''); SIFMA 2/22/2013 Letter; SIFMA 3/12/2014 Letter; World Bank Letter.

[568] *See* CFA Institute Letter. This commenter specifically opposed exceptions for small banks, savings associations, farm credit system institutions, credit unions and foreign governments.

[569] *See* Letter from William J. Harrington (May 12, 2015) (''Harrington 5/12/2015 Letter'').

[570] As discussed above, while paragraphs (c)(4) and (5) of Rule 18a–3, as adopted, respectively require netting and collateral agreements to be in place, the rule does not impose a specific margin documentation requirement as do the margin rules of the CFTC and the prudential regulators. Consequently, an existing netting or collateral agreement with a counterparty that was entered into by the nonbank SBSD in order to comply with the margin documentation requirements of the CFTC or the prudential regulators will suffice for the purposes of Rule 18a 3, as adopted, if the agreement meets the requirements of paragraph (c)(4) or (5), as applicable.

[571] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70270–71.

[572] The nonbank MSBSP would need to deliver cash, securities, and/or money market instruments and, consequently, under the proposal, other types of assets would not be eligible as collateral.

standardized haircuts to securities or money market instruments when calculating the variation margin requirement for an account because the proposed capital rule for these entities did not use standardized haircuts (or model-based haircuts).

Under the proposal, a nonbank MSBSP was subject to certain of the account equity requirements that applied to nonbank SBSDs and were discussed above. First, the types of assets that could be used to meet the nonbank MSBSP's obligation to either collect or deliver variation margin were limited to cash, securities, or money market instruments. Second, the nonbank MSBSP was subject to the additional collateral requirements designed to ensure that the collateral was of stable and predictable value, not linked to the value of the transaction in any way, and capable of being sold quickly and easily if the need arises. Third, the nonbank MSBSP was subject to the requirement to take prompt steps to liquidate collateral consisting of securities or money market instruments to the extent necessary to eliminate an account equity deficiency (though the measure of a deficiency related solely to required variation margin, as these entities were not required to collect initial margin).

Proposed Rule 18a–3 also provided exceptions under which a nonbank MSBSP was not required to collect and, in some cases, deliver variation margin. The first exception applied to counterparties that were commercial end users. Under this exception, the nonbank MSBSP was not required to collect variation margin from the commercial end user. The second exception applied to counterparties that were SBSDs. Under this exception, the nonbank MSBSP was not required to collect variation margin from the SBSD. However, under proposed Rule 18a–3, a nonbank SBSD was required to collect variation and initial margin from an MSBSP. The third exception applied to legacy accounts. Under this exception, the nonbank MSBSP was not required to collect or deliver variation margin with respect to positions in a legacy account. The fourth exception was the $100,000 minimum transfer amount provision. Under this exception, the nonbank MSBSP was not required to collect or deliver variation margin if the margin requirement was less than $100,000.

Comments and Final Account Equity Requirements for Nonbank MSBSPs

A commenter stated that nonbank MSBSPs should be required to apply haircuts to the value of securities and money market instruments when determining whether the level of equity in the account meets the minimum requirement.[573] Under the final rules being adopted today, nonbank MSBSPs are not subject to a capital standard that uses standardized or model based haircuts. Consequently, the Commission believes it would not be appropriate to require these firms to apply the standardized haircuts to the variation margin they receive from counterparties.

The Commission did not receive any specific comments on the commercial end user exception and is adopting it as proposed, with a non-substantive modification.[574] As discussed above, however, the Commission modified the definition of ''commercial end user'' as a result of amendments to Section 15F(e) of the Exchange Act.

The Commission did not receive any specific comments on the exception for SBSD counterparties. The Commission, however, is removing this exception from the final rule because it is unnecessary. The final rule requires nonbank SBSDs to collect and post variation margin with respect to most counterparties including nonbank MSBSPs, and, consequently, a specific exception from collecting variation margin from nonbank SBSDs would be inconsistent with the requirement that they deliver variation margin to counterparties, including nonbank MSBSPs.

Several commenters supported the Commission's proposed legacy account exception for nonbank MSBSPs.[575] Commenters stated that applying the new rules to legacy accounts would be highly disruptive as the underlying agreements were negotiated based on the law in effect at the time of execution, and that, specifically, financial guarantee insurers are subject to extensive regulation by state insurance companies, and their security-based swap guarantees reflect the restrictions and obligations imposed by those regimes.[576] The Commission is adopting the legacy account exception for nonbank MSBSPs substantially as proposed.[577]

The Commission is making several conforming modifications to the account equity requirements for nonbank MSBSPs in light of modifications made to the account equity requirements for nonbank SBSDs discussed above in section II.B.2.i. of this release. First, the final rule provides that the nonbank MSBSP must collect or deliver variation margin by the close of business on the next business day following the day of the calculation, except that the collateral can be collected or delivered by the close of business on the second business day following the day of the calculation if the counterparty is located in another country and more than four time zones away.[578] Second, the modifications to the collateral requirements in paragraph (c)(4) of Rule 18a–3, as adopted, apply to nonbank MSBSPs, including that the collateral to meet a margin requirement must consist of cash, securities, money market instruments, a major foreign currency, the security of settlement of the non-cleared security-based swap, or gold.[579] Third, the final rule includes an exception from collecting variation margin if the counterparty is the BIS, the European Stability Mechanism, or one of the multilateral development banks identified in the rule (there is no exception from delivering variation margin to these types of counterparties).[580] Fourth, the Commission is making the minimum transfer amount a specific exception to the account equity requirements for nonbank MSBSPs and raising the amount from $100,000 to $500,000.[581]

Finally, a commenter stated that commercial end users do not normally operate under the fiduciary obligations applicable to financial firms for the safekeeping of client funds and, therefore, are unequipped to handle collateral while a contract is open.[582] Therefore, the commenter suggested that margin that a nonbank MSBSP is required to deliver to a commercial end user be held at a third-party custodian. In response, the final rules do not

[573] *See* CFA Institute Letter.

[574] *See* paragraph (c)(2)(iii)(A) of Rule 18a–3, as adopted. In the final rule, the phrase ''an account of'' was inserted before the phrase ''a counterparty'' to more closely align the text with paragraph (c)(1)(iii)(A) of the final rul.

[575] *See* AFGI 2/15/2013 Letter; AFGI 7/22/2013 Letter.

[576] *See* AFGI 2/15/2013 Letter; AFGI 7/22/2013 Letter.

[577] *See* paragraph (c)(2)(iii)(B) of Rule 18a–3, as adopted. In the final rule, the Commission deleted the phrase ''of a counterparty that is not a commercial end user'' from this paragraph because the phrase is redundant, as an exception for commercial end users is contained in paragraph (c)(2)(iii)(A) of Rule 18a–3, as adopted. The exception for legacy accounts has been re-designated paragraph (c)(2)(iii)(B) of Rule 18a–3, as adopted, since the exception for SBSDs was deleted from the final rule. Finally, the word ''legacy'' was moved to before the word ''account'' to align the phrase with the definition in paragraph (b)(6) of Rule 18a–3, as adopted.

[578] *See* paragraph (c)(2)(ii) of Rule 18a–3, as adopted.

[579] *See* paragraph (c)(4) of Rule 18a–3, as adopted (applying its provisions to nonbank SBSDs and MSBSPs).

[580] *See* paragraph (c)(2)(iii)(C) of Rule 18a–3, as adopted.

[581] *See* paragraph (c)(2)(iii)(D) of Rule 18a–3, as adopted.

[582] *See* CFA Institute Letter.

prevent a nonbank MSBSP from entering into an agreement with a commercial end user under which variation margin required to be delivered to the commercial end user is held at a third-party custodian.

For the foregoing reasons, the Commission is adopting the proposed account equity requirements for nonbank MSBSPs with the modifications discussed above.[583]

c. Risk Monitoring and Procedures

Under proposed Rule 18a–3, a nonbank SBSD was required to monitor the risk of the positions in the account of each counterparty to a non-cleared security-based swap and establish, maintain, and document procedures and guidelines for monitoring those risks.[584] The nonbank SBSD also was also 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. The Commission did not receive any comments on these proposed requirements and for the reasons discussed in the proposing release is adopting them as proposed.[585]

C. Segregation

1. Background

The Commission is adopting security-based swap segregation requirements for SBSDs and stand-alone broker-dealers pursuant to Sections 3E and 15(c)(3) of the Exchange Act.[586] Section 3E(b) of the Exchange Act provides that, for cleared security-based swaps, the money, securities, and property of a security-based swap customer 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. However, Section 3E(c)(1) of the Exchange Act also provides that, for cleared security-based swaps, customers' money, securities, and property may, for convenience, be commingled and deposited in the same one or more accounts with any bank, trust company, or clearing agency. Section 3E(c)(2) further provides that, notwithstanding Section 3E(b), in accordance with such terms and conditions as the Commission may prescribe by rule, regulation, or order, any money, securities, or property of the security-based swaps customer of a broker, dealer, or SBSD described in Section 3E(b) may be commingled and deposited as provided in Section 3E with any other money, securities, or 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 swaps customer of the broker, dealer, or SBSD.

Section 3E(f) of the Exchange Act establishes a program by which a counterparty to non-cleared security-based swaps with an SBSD or MSBSP can elect to have initial margin held at an independent third-party custodian (individual segregation). Section 3E(f)(4) provides that if the counterparty does not choose to require segregation of funds or other property (*i.e.,* waives segregation), the SBSD or MSBSP shall send a report to the counterparty on a quarterly basis stating that the firm's back office procedures relating to margin and collateral requirements are in compliance with the agreement of the counterparties. The statutory provisions of Sections 3E(b) and (f) are self-executing.

Finally, Section 15(c)(3)(A) of the Exchange Act provides, in pertinent part, that no broker-dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security (except a government security) or commercial paper, bankers' acceptances, or commercial bills) in contravention of such rules and regulations as the Commission shall prescribe as necessary or appropriate in the public interest or for the protection of investors to provide safeguards with respect to the financial responsibility and related practices of brokers-dealers including, but not limited to, the acceptance of custody and use of customers' securities and the carrying and use of customers' deposits or credit balances. The statute further provides, in pertinent part, that the rules and regulations shall require the maintenance of reserves with respect to customers' deposits or credit balances. The Commission adopted Rule 15c3–3 pursuant to this authority in Section 15(c)(3)(A) of the Exchange Act.[587]

The Commission is adopting omnibus segregation requirements pursuant to which money, securities, and property of a security-based swap customer relating to cleared and non-cleared security-based swaps must be segregated but can be commingled with money, securities, or property of other customers. The omnibus segregation requirements for stand-alone SBSDs (including firms registered as OTC derivatives dealers) and bank SBSDs are codified in Rules 18a–4 and 18a–4a.[588] The omnibus segregation requirements for stand-alone broker-dealers and broker-dealer SBSDs are codified in amendments to Rules 15c3–3 and 15c3–3b.[589]

The omnibus segregation requirements are mandatory with respect to money, securities, or other property relating to cleared security-based swaps that is held by a stand-alone broker-dealer or SBSD (*i.e.,* customers cannot waive segregation). With respect to non-cleared security-based swap transactions, the omnibus segregation requirements are an alternative to the statutory provisions discussed above pursuant to which a counterparty can elect to have initial margin individually segregated or to waive segregation. However, under the final omnibus segregation rules for stand-alone broker-dealers and broker-dealer SBSDs in Rule 15c3–3, counterparties that are not an affiliate of the firm cannot waive segregation. Affiliated counterparties of a stand-alone broker-dealer or broker-dealer SBSD can waive segregation. Under Section 3E(f) of the Exchange Act and Rule 18a–4, all counterparties (affiliated and non-affiliated) to a non-cleared security-based swap transaction with a stand-alone or bank SBSD can waive segregation. The omnibus segregation requirements are the ''default'' requirement if the counterparty does not elect individual segregation or to waive segregation (in the cases where a counterparty is permitted to waive segregation). As discussed below in section II.E.2. of this release, Rule 18a–4 also has exceptions pursuant to which a foreign stand-alone or bank SBSD or MSBSP need not comply with the

[583] *See* paragraphs (c)(2)(ii) and (iii) of Rule 18a–3, as adopted.

[584] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70272–70273.

[585] *See* paragraph (e) of Rule 18a–3, as adopted.

[586] 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 market 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.

[587] *See Broker-Dealers; Maintenance of Certain Basic Reserves,* Exchange Act Release No, 9856 (Nov. 29, 1972), 37 FR 25224, 25226 (Nov. 29, 1972).

[588] *See* Rule 18a–4, as adopted; Rule 18a–4a, as adopted. *See also* undesignated introductory paragraph to Rule 18a–4, as adopted (stating that the rule applies to stand-alone SBSDs registered as OTC derivatives dealers).

[589] *See* paragraph (p) of Rule 15c3–3, as amended; Rule 15c3–3b, as adopted.

segregation requirements (including the omnibus segregation requirements) for certain transactions.

The omnibus segregation requirements do not apply to MSBSPs.[590] However, if an MSBSP requires initial margin from a counterparty with respect to non-cleared security-based swaps, the counterparty can request that the collateral be held at a third-party custodian pursuant to Section 3E(f) of the Exchange Act.[591]

As proposed, the segregation requirements for all types of SBSDs would have been codified in Rules 18a–4 and 18a–4a. However, a commenter requested that Rule 15c3–3 be amended so that initial margin delivered to a stand-alone broker-dealer by a counterparty to a cleared security-based swap and which the stand-alone broker-dealer in turn delivers to a clearing agency could be treated under the proposed omnibus segregation requirements.[592] In the 2018 comment reopening, the Commission asked whether omnibus segregation requirements parallel to those in proposed Rule 18a–4 should be codified in Rule 15c3–3, in which case they would apply to stand-alone broker-dealers and broker-dealer SBSDs.[593] One commenter argued that the Commission should apply the omnibus segregation requirements of Rule 15c3–3 to a broker-dealer SBSD, but recommended a single possession or control requirement for all positions, including those that are portfolio margined.[594] Another commenter supported the integration of security-based swap segregation requirements for stand-alone broker-dealers into Rule 15c3–3, including the express recognition in Rule 15c3–3 of margin posted by a stand-alone broker-dealer to a clearing agency.[595] Other commenters stated that the Commission should consider raising segregation requirements to achieve regulatory consistency, or harmonize rules with other regulators to avoid operational issues that could fragment the security-based swap market.[596]

The Commission believes it is appropriate to codify the omnibus segregation requirements for stand-alone broker-dealers and broker-dealer SBSDs in Rules 15c3–3 and 15c3–3b. Absent this modification, a stand-alone broker-dealer that engages in security-based swap activity would continue to be subject to the segregation requirements of Rules 15c3–3 and 15c3–3a as they existed prior to today's amendments. However, as discussed in more detail below, these pre-existing requirements are not tailored to security-based swaps in the way that the omnibus segregation requirements are tailored. Consequently, by codifying the omnibus segregation requirements in Rules 15c3–3 and 15c3–3b, stand-alone broker-dealers also will be subject to the tailored requirements and will meet their pre-existing segregation obligations through them. Furthermore, Section 3E(b) of the Exchange Act imposes self-executing segregation requirements on stand-alone broker-dealers (as well as SBSDs) that would place strict restrictions on, and not permit the commingling of, collateral for a cleared security-based swap unless the Commission, pursuant to Section 3E(c), permits it by rule, regulation, or order. The omnibus segregation requirements being adopted in Rules 15c3–3 and 15c3–3b will permit stand-alone broker-dealers to commingle this collateral and take other actions with respect to it that otherwise would have been prohibited. Thus, the Commission believes that stand-alone broker-dealers will benefit by being subject to more tailored and flexible segregation requirements.

As discussed above, non-affiliated customers of a stand-alone broker-dealer or broker-dealer SBSD will not be permitted to waive segregation. Section 15(c)(3) of the Exchange Act does not have a provision that is analogous to Section 3E(f)(4), which provides that if the counterparty does not choose to require segregation of funds or other property with respect to non-cleared swaps, the SBSD or MSBSP shall send a report to the counterparty on a quarterly basis stating that the firm's back office procedures relating to margin and collateral requirements are in compliance with the agreement of the counterparties. Under Section 15(c)(3) of the Exchange Act and Rule 15c3–3 thereunder, persons—other than affiliates—are not permitted to waive segregation. This reflects the important protection that segregation provides to customers. It also serves to promote the safety and soundness of stand-alone broker-dealers. Segregating securities and cash of customers makes these assets readily available to be returned to the customers and therefore makes it more likely that a stand-alone broker-dealer (and a broker-dealer SBSD) can meet its obligations to the customers. Thus, segregation protects customers and supports the liquidity of stand-alone broker-dealers (and will have the same effect on broker-dealer SBSDs). Moreover, segregation reduces the risk that customers will "run" on a stand-alone broker-dealer when it is experiencing financial difficulty or the securities markets are in turmoil (and will have the same effect on broker-dealer SBSDs). Customers whose assets are being segregated know that the assets are being protected. Conversely, persons whose assets are not being segregated may act precipitously to withdraw them from a firm if they perceive that the firm is experiencing financial difficulty or the markets are in turmoil. This could put severe liquidity pressure on the firm, particularly since the assets these persons are seeking to withdraw may not be readily available to the firm (*e.g.,* they may be re-hypothecated or serving as collateral for loans to the broker-dealer). Affiliates are less likely to create this "run" risk as they will have more information about the financial condition of the firm and their shared parent holding company.

In addition, as discussed below, a number of commenters have raised questions about how claims would be handled in the liquidation of a broker-dealer SBSD. In addition, one commenter argued that stand-alone broker-dealers and broker-dealer SBSDs should be subject to a single set of omnibus segregation requirements for security-based swaps and related cash and all other types of securities and related cash.[597] This commenter argued that separating security-based swap positions from all other security positions for purposes of the possession or control and reserve account requirements of the omnibus segregation rule could foster legal uncertainty in a SIPA liquidation. As discussed below in sections II.C.3.a. and II.C.3.b. of this release, the Commission does not believe at this time that security-based swaps should be combined with other types of securities positions for the purposes of the possession or control and reserve account calculations.[598]

[590] A broker-dealer dually registered as an MSBSP will be subject to the omnibus segregation requirements in Rule 15c3–3 by virtue of being a broker-dealer.

[591] *See* 15 U.S.C. 78c–5(f).

[592] *See* Letter from Kathleen M. Cronin, Senior Managing Director, General Counsel, CME Group Inc. (Feb. 22, 2013) ("CME Letter").

[593] *See Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53016.

[594] *See* SIFMA 11/19/2018 Letter.

[595] *See* FIA 11/19/2018 Letter.

[596] *See* Better Markets 11/19/2018 Letter; ISDA 11/19/2018 Letter.

[597] SIFMA 11/19/2018 Letter.

[598] Combining security-based swap transactions, particularly non-cleared security-based swap transactions, with other securities positions for purposes of the reserve account calculation would mean that credit items owed to retail customers could be used to fund debits relating to non-cleared security-based swap transactions. The Commission

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However, the Commission does share the commenter's concern about taking steps to avoid legal uncertainty. In this regard, customers could be harmed in cases where a stand-alone broker-dealer or broker-dealer SBSD that holds cash and securities for persons who waived segregation with respect to their non-cleared security-based transactions, but did not (because they could not) waive segregation with respect to cash and securities that are not related to non-cleared security-based swap transactions. More specifically, there could be questions about the status of a particular person's claim in a liquidation proceeding and potentially result in the amount of cash and securities that were segregated by the stand-alone broker-dealer or broker-dealer SBSD being insufficient to satisfy the claims of all persons who a court ultimately determines are customers under SIPA and are entitled to a *pro rata* share of customer property.

For these reasons, the omnibus segregation requirements are being codified in Rule 15c3–3 to apply to stand-alone broker-dealers and broker-dealer SBSDs with a limitation that non-affiliates cannot waive segregation with respect to non-cleared security-based swap transactions (in addition to not being able to waive segregation with respect to all other securities transactions). In order to implement this limitation, the Commission is modifying the subordination provisions in the final rule to provide that only an affiliate of the stand-alone broker-dealer or broker-dealer SBSD can waive segregation with respect to non-cleared security-based swap transactions. In particular, the Commission is modifying the definition of ''security-based swap customer'' to provide that, with respect to persons who subordinate their claims, the term excludes an affiliate of the stand-alone broker-dealer or broker-dealer SBSD.[599] Thus, a person who is not an affiliate will be a ''security-based swap customer'' (regardless of whether the person attempts to subordinate) and therefore cash and securities of the customer related to non-cleared security-based swaps will be subject to the omnibus segregation requirements. The Commission is making a conforming amendment to the requirement that the stand-alone broker-dealer or broker-dealer SBSD obtain a subordination agreement from a person who waives segregation with respect to non-cleared security-based swaps to provide that the provision applies to *affiliates* that waive segregation because persons who are not affiliates cannot waive segregation.[600]

Commenters sought clarification on how customer collateral held by an SBSD as initial margin to secure a security-based swap would be treated in the event of the SBSD's insolvency.[601] A commenter requested clarification on how counterparties to an entity that is both an SBSD and CFTC-regulated swap dealer would be treated in the event of the insolvency of the firm.[602] The same commenter stated that it is unclear how claims of a security-based swap customer of a broker-dealer SBSD would be treated relative to the claims of other types of customers of the firm, including whether security-based swaps would be subject to SIPA protections.

In response to commenters' requests for clarification, Section 3E(g) of the Exchange Act applies the customer protection elements of the stockbroker liquidation provisions to cleared security-based swaps and related collateral, and to collateral delivered as margin for non-cleared security-based swaps if collateral is subject to a customer protection requirement under Section 15(c)(3) of the Exchange Act or a segregation requirement. The Dodd-Frank Act also amended the U.S. Bankruptcy Code, and the CFTC has promulgated rules to implement that amendment, to provide the protections of Subchapter IV of Chapter 7 of the Bankruptcy Code and CFTC Regulation Part 190 to collateral associated with cleared swaps.[603] Finally, SIPA protects customers of SIPC-member broker-dealers. SIPA defines a ''customer'' as any person (including any person with whom the broker-dealer deals as principal or agent) who has a claim on account of securities received, acquired, or held by the broker-dealer in the ordinary course of its business as a broker-dealer from or for the securities accounts of such person for safekeeping, with a view to sale, to cover consummated sales, pursuant to purchases, as collateral, security, or for purposes of effecting transfer.[604]

The omnibus segregation requirements will apply to stand-alone broker-dealers and broker-dealer SBSDs pursuant to new paragraph (p) of Rule 15c3–3, as discussed above. They also will apply to stand-alone and bank SBSDs if they elect to clear security-based swap transactions for other persons or otherwise do not meet the conditions of the exemption discussed below in section II.C.2. of this release. In this regard, Section 3E of the Exchange Act authorizes the Commission to promulgate segregation rules for all types of SBSDs. In contrast, Section 15F of the Exchange Act authorizes the prudential regulators to promulgate capital and margin rules for bank SBSDs. Further, the requirements of the prudential regulators with respect to segregating initial margin apply to non-cleared security-based swaps (*i.e.,* they do not address cleared security-based swaps). As discussed above, with respect to cleared security-based swaps, Section 3E(b) of the Exchange Act imposes self-executing segregation requirements on stand-alone broker-dealers and SBSDs that place strict restrictions on, and do not permit the commingling of, collateral for a cleared security-based swap unless the Commission, pursuant to Section 3E(c), permits it by rule, regulation, or order. Therefore, the Commission believes the statute itself imposes strict segregation requirements on bank SBSDs with respect to cleared security-based swaps in the absence of Commission rulemaking. The Commission's omnibus segregation requirements implement Section 3E(c) in a manner that is designed to protect security-based swap customers, but in a tailored way that will permit stand-alone broker-dealers and SBSDs to commingle collateral with respect to cleared security-based swaps and take other actions with respect to the collateral that otherwise would have been prohibited. Consequently, bank SBSDs (along with nonbank SBSDs and stand-alone broker-dealers) will benefit from the flexibility offered by the omnibus segregation requirements to the extent they elect to clear security-based swap transactions for other persons. However, as noted above and discussed below in section II.C.2. of this release, stand-alone and bank SBSDs will be exempt from the omnibus segregation requirements of Rule 18a–4 under certain conditions, including that they do not clear security-based swaps for other persons.[605] The Commission expects that bank SBSDs will operate under this exemption, because in order to clear swaps for other persons they would need to be registered as an FCM, which would subject them to CFTC capital requirements in addition to the

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does not believe that retail customers should be subject to this risk.

[599] *See* paragraph (p)(1)(vi) of Rule 15c3–3, as amended.

[600] *See* paragraph (p)(4)(ii)(B) of Rule 15c3–3, as amended.

[601] *See, e.g.,* Letter from Angie Karna, Managing Director, Legal, Nomura Global Financial Products, Inc. (Sept. 10, 2014) (''Nomura Letter''); SIFMA AMG 2/22/2013 Letter.

[602] *See* SIFMA AMG 2/22/2013 Letter.

[603] *See Protection of Cleared Swaps Customer Contracts and Collateral; Commodity Broker Bankruptcy Provisions,* 77 FR 6336 (Feb. 7, 2012).

[604] *See* 15 U.S.C. 78lll(2).

[605] *See* paragraph (f) of Rule 18a–4, as adopted.

capital requirements imposed by their prudential regulator.

Commenters recommended that the Commission adopt individual segregation requirements for cleared security-based swaps. A commenter stated that the European Commission has finalized regulations mandating that central counterparties allow customers to choose between omnibus segregation and individual segregation for their cleared derivatives assets and positions.[606] A second commenter stated that if the stand-alone broker-dealer or SBSD defaults, any cleared security-based swap customer collateral that is individually segregated would likely be outside the estate of the stand-alone broker-dealer or SBSD for bankruptcy purposes, thereby facilitating customers' retrieval of their collateral.[607] This commenter also indicated that cleared security-based swap customers registered with the Commission under the Investment Company Act of 1940 may be precluded from having their collateral held at an SBSD that is not a bank. A third commenter argued that collateral posted as margin should be segregated by client, rather than on an omnibus basis.[608] A number of these commenters advocated that the Commission modify its proposal for cleared security-based swaps to allow for the approach adopted by the CFTC, known as legal separation with operational comingling (''LSOC'').[609] Under the CFTC's LSOC rules, the collateral of multiple cleared swap customers can be commingled in one account.[610]

Implementing an individual segregation regime for cleared security-based swaps, including an LSOC-like approach, would require implementing new rules governing the treatment of collateral held by clearing agencies. For example, under the CFTC's rules, the DCO and the FCM that is a member of the DCO must take certain steps to ensure that the collateral attributable to non-defaulting swap customers is not used to pay for obligations arising from other defaulting swap customers. Implementing such rules would be outside the scope of this rulemaking, which involves segregation requirements for SBSDs (not clearing agencies).

A commenter requested clarification as to how property remaining in a portfolio margin account of a security-based swap customer should be treated when all the security-based swap positions in the account are temporarily closed out or expire before the customer enters into a new security-based swap transaction.[611] As noted above, this commenter also argued that the Commission should apply the omnibus segregation requirements of Rule 15c3–3 to a broker-dealer SBSD, but recommended a single possession or control requirement for all positions, including those that are portfolio margined.[612] As stated above, implementing portfolio margining will require further coordination with the CFTC. If the entity is a broker-dealer, the security-based swap customer could request that cash and securities in the security-based swap account be transferred to a traditional securities account, in which case it would be subject to the segregation requirements of Rules 15c3–3 and 15c3–3a that existed prior to today's amendments.[613] A commenter argued that swaps should be permitted to be held in a security-based swap account to facilitate portfolio margining for related or offsetting positions in the account.[614] As discussed above with respect to Rule 18a–3, the Commission has modified the rule to accommodate portfolio margining of security-based swaps and swaps.

A commenter stated that if MSBSPs are not required to comply with the proposed omnibus segregation requirements, many firms will apply to register as MSBSPs as a way to circumvent them.[615] The Commission does not agree. First, Section 3E(a) of the Exchange Act makes it unlawful for a person to accept any money, securities, or property (or to extend credit in lieu thereof) from, for, or on behalf of a security-based swap customer to margin, guarantee, or secure a cleared security-based swap unless the person is registered as a broker-dealer or an SBSD. This prohibition severely limits the activities a stand-alone MSBSP can engage in with respect to effecting transactions for cleared security-based swap customers (as compared to the activities permitted of broker-dealers and SBSDs). Second, the omnibus segregation requirements as applied to non-cleared security-based swaps are designed to provide a third segregation option to security-based swap customers in addition to the statutory options of individual segregation or waiving segregation altogether. The Commission believes that SBSDs will favor having the ability to utilize this third option. Third, a firm with security-based swap activity exceeding the *de minimis* threshold must register as an SBSD.[616] A firm that does not want to comply with the omnibus segregation requirements by virtue of being an SBSD will need to restrict its activities to stay below the *de minimis* threshold. For these reasons, the Commission does not believe firms will seek to register as MSBSPs to avoid the omnibus segregation requirements.

Moreover, MSBSPs will be subject to the self-executing segregation provisions in Section 3E(f) of the Exchange Act for collateral relating to non-cleared security-based swap transactions, and, consequently, their customers can request individual segregation. Therefore, an MSBSP will be subject to a rigorous statutory segregation requirement. Finally, the omnibus segregation requirements may not be practical for stand-alone MSBSPs, given the potentially wide range of business models under which they may operate, and the uncertain impact that requirements designed for broker-dealers could have on these commercial entities.

For the reasons discussed above, the Commission is adopting the omnibus segregation requirements for SBSDs modeled on the segregation requirements for broker-dealers but, as discussed below, with an exemption for stand-alone and bank SBSDs if they meet the conditions in the final rule, including that they do not clear security-based swaps transactions for other persons.

2. Exemption

In the 2018 comment reopening, the Commission asked whether there are aspects of the proposed omnibus segregation requirements where greater clarity regarding the operation of the rule would be helpful.[617] One commenter supported the use of third-party custodians to avoid the omnibus

[606] *See* MFA 2/22/2013 Letter (citing Regulation (EU) No. 648/2012 of the European Parliament of the Council on OTC derivative transactions, central counterparties and trade repositories (July 4, 2012)).

[607] *See* ICI 2/4/2013 Letter.

[608] *See* CFA Institute Letter.

[609] *See* AIMA 2/22/2013 Letter; MFA 2/22/2013 Letter; SIFMA AMG 2/22/2013 Letter; Vanguard Letter.

[610] *See Protection of Cleared Swaps Customer Contracts and Collateral; Commodity Broker Bankruptcy Provisions,* 77 FR 6336.

[611] *See* SIFMA 2/22/2013 Letter.

[612] *See* SIFMA 11/19/2018 Letter.

[613] *See* paragraphs (a) and (o) of Rule 15c3–3; Rule 15c3–3a.

[614] *See* CFA Institute Letter.

[615] *See* CFA Institute Letter.

[616] *See* Section 3(a)(71) of the Exchange Act (defining the term ''security-based swap dealer''); *Entity Definitions Adopting Release,* 77 FR 30596; *Registration Process for Security-Based Swap Dealers and Major Security-Based Swap Participants,* 80 FR 48964.

[617] *See Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53016.

segregation requirements.[618] Several commenters recommended that the Commission modify its final segregation requirements based on entity type and whether or not the entity offered counterparty clearing.[619] More specifically, one commenter recommended that no customer protection and segregation requirements should apply to a stand-alone broker-dealer if it does not clear security-based swap transactions.[620] Instead, the firm should be required to provide certain notices to customers: (1) Regarding their right to request that initial margin related to non-cleared security-based swaps be held at a third-party custodian; and (2) disclosing that the customer has no customer claim in the event of the SBSD's insolvency.[621] Another commenter recommended that the Commission not impose the omnibus segregation requirements on bank SBSDs, foreign SBSDs, and stand-alone SBSDs.[622] This commenter argued that the proposed omnibus segregation requirements could conflict with bank liquidation or resolution schemes, could cause jurisdictional disputes, and would not be consistent with the Exchange Act. In addition, this commenter argued that the omnibus segregation requirements would impair hedging and funding activities for stand-alone SBSDs. Another commenter was concerned about the application of omnibus segregation requirements to foreign SBSDs that are not registered broker-dealers.[623] With respect to non-cleared security-based swaps, this commenter suggested that the proposed omnibus segregation requirements not apply at all.

These comments echoed comments the Commission previously received opposing the application of the omnibus segregation requirements to a bank. Commenters argued that imposing the omnibus segregation requirements on banks was unnecessary because rules of the prudential regulators require initial margin for non-cleared security-based swaps to be segregated at a third-party custodian.[624] One of these commenters recommended that the Commission adopt an approach similar to that of the Department of Treasury, which exempts government securities dealers from customer protection requirements if the entity is a bank that meets certain conditions.[625]

The Commission is persuaded that it would be appropriate to exempt from the omnibus segregation requirements stand-alone and bank SBSDs that do not clear security-based swaps for other persons. As discussed above, the omnibus segregation requirements implement the provisions of Section 3E of the Exchange Act that require Commission rulemaking to permit SBSDs to commingle their customers' cleared security-based swaps. If the stand-alone or bank SBSD does not clear security-based swaps for other persons then there is no need for the omnibus segregation requirements with respect to those positions. Moreover, as discussed above, with respect to non-cleared security-based swaps, the omnibus segregation requirements provide an alternative to the statutory options available to counterparties to request individual segregation or to waive segregation. Thus, counterparties will have the option of protecting their initial margin for non-cleared security-based swaps by exercising their statutory right to individual segregation.

This modification from the proposed rule is designed to mitigate commenters' concerns that the proposed omnibus segregation requirements may conflict with bank liquidation or resolution schemes. In addition, as discussed above, Section 3E(g) of the Exchange Act applies the customer protection elements of the stockbroker liquidation provisions to cleared security-based swaps and related collateral, and to collateral delivered as initial margin for non-cleared security-based swaps if the collateral is subject to a customer protection requirement under Section 15(c)(3) of the Exchange Act or a segregation requirement. Consequently, a stand-alone SBSD that does not have cleared security-based swap customers and is not subject to a segregation requirement with respect to collateral for non-cleared security-based swaps will not implicate the stockbroker liquidation provisions.

For the foregoing reasons, the final rule exempts stand-alone and bank SBSDs from the requirements of Rule 18a–4 if the SBSD meets certain conditions, including that the SBSD does not clear security-based swap transactions for other persons, provides notice to the counterparty regarding the right to segregate initial margin at an independent third-party custodian, and discloses in writing that any collateral received by the SBSD for non-cleared security-based swaps will not be subject to a segregation requirement and regarding how a claim of the counterparty for the collateral would be treated in a bankruptcy or other formal liquidation proceeding of the SBSD.[626]

Under the first condition, the stand-alone or bank SBSD must not: (1) Effect transactions in cleared security-based swaps for or on behalf of another person; (2) have any open transactions in cleared security-based swaps executed for or on behalf of another person; and (3) hold or control any money, securities, or other property to margin, guarantee, or secure a cleared security-based swap transaction executed for or on behalf of another person (including money, securities, or other property accruing to another person as a result of a cleared security-based swap transaction).[627] For the reasons discussed above, this condition will ensure that the exemption is only available to stand-alone SBSDs or bank SBSDs that do not clear security-swaps for other persons.

Under the second condition, the stand-alone or bank SBSD must provide the notice required pursuant to Section 3E(f)(1)(A) of the Exchange Act in writing to a duly authorized individual prior to the execution of the first non-cleared security-based swap transaction with the counterparty occurring after the compliance date of the rule.[628] Section 3E(f)(1)(A) of the Exchange Act 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.[629] This condition will require a stand-alone or bank SBSD 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 compliance date.[630] Consequently, the stand-alone or bank SBSD must give the notice in writing before the counterparty is required to

[618] *See* American Council of Life Insurers 11/19/2018 Letter.

[619] *See* Morgan Stanley 11/19/2018 Letter; SIFMA 11/19/2018 Letter.

[620] *See* Morgan Stanley 11/19/2018 Letter.

[621] This commenter also recommended that if the Commission wants to ensure that non-cleared security-based swap counterparties can have their collateral protected at a Commission registrant, a more appropriate way to do so would be to permit a stand-alone SBSD to provide non-cleared security-based swap clients with the option of placing initial margin at a full-purpose broker-dealer affiliate. *See* Morgan Stanley 11/19/2018 Letter.

[622] *See* SIFMA 11/19/2018 Letter.

[623] *See* IIB 11/19/2018 Letter.

[624] *See* Financial Services Roundtable Letter; SIFMA AMG 2/22/2013 Letter.

[625] *See* SIFMA 2/22/2013 Letter.

[626] *See* paragraph (f) of Rule 18a–4, as adopted.

[627] *See* paragraph (f)(1) of Rule 18a–4, as adopted.

[628] *See* paragraph (f)(2) of Rule 18a–4, as adopted.

[629] *See* 15 U.S.C. 78c–5(f)(1)(A).

[630] *Compare* paragraph (d)(1) of Rule 18a–4, as adopted.

deliver margin to the SBSD. This will give the counterparty an opportunity to determine whether to elect individual segregation or to waive segregation.

Under the third condition, the stand-alone or bank SBSD must disclose in writing to a counterparty before engaging in the first non-cleared security-based swap transaction with the counterparty that any margin collateral received and held by the SBSD will not be subject to a segregation requirement and how a claim of the counterparty for the collateral would be treated in a bankruptcy or other formal liquidation proceeding of the SBSD.[631] This condition is designed to provide the counterparty with additional information to determine whether to elect individual segregation or to waive segregation by describing the potential consequences of waiving segregation.

3. Segregation Requirements for Security-Based Swaps

a. Possession or Control of Excess Securities Collateral

i. Requirement To Obtain Possession or Control

Paragraph (b)(1) of Rule 15c3–3, as it existed before today's amendments, requires a stand-alone broker-dealer that carries customer securities and cash (''carrying broker-dealer'') to promptly obtain and thereafter maintain physical possession or control of all customer fully paid and excess margin securities. Fully paid and excess margin securities, as defined in paragraphs (a)(3) and (a)(5) of the rule, respectively, generally are securities the carrying broker-dealer is carrying for customers that are not being used as collateral arising from margin loans to the customer or to facilitate a customer's short sale of a security. Physical possession or control as used in paragraph (b)(1) of Rule 15c3–3 under these pre-existing requirements means the carrying broker-dealer cannot lend or hypothecate securities and must hold them itself or, as is more common, at a satisfactory control location.

As part of the omnibus segregation requirements, the Commission proposed that SBSDs be required to promptly obtain and thereafter maintain physical possession or control of all excess securities collateral carried for the accounts of security-based swap customers.[632] The Commission modeled these proposed requirements for SBSDs on the pre-existing requirements in paragraph (b)(1) of Rule 15c3–3 and intended that physical possession or control have the same meaning in terms of prohibiting the SBSD from lending or hypothecating the excess securities collateral and requiring the SBSD to hold the collateral itself or in a satisfactory control location.

The term ''security-based swap customer'' was 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. The proposed definition excluded 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. The term ''excess securities collateral'' was defined to mean securities and money market instruments (''securities collateral'') 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. Thus, securities collateral held by the SBSD that was not being used to meet a variation margin requirement of the customer needed to be protected by maintaining physical possession or control of it. This would be the case with respect to securities collateral held by the SBSD to meet the customer's initial margin requirement or that had a value in excess of the initial margin requirement.

The definition of excess securities collateral had two exclusions that permitted an SBSD to use, under certain narrowly prescribed circumstances, securities collateral of a security-based swap customer not being held to meet a variation margin requirement of the customer. Under the first exclusion, the SBSD could use the securities collateral to meet a margin requirement of a clearing agency resulting from a security-based swap transaction of the customer. This exclusion was designed to accommodate the margin requirements of clearing agencies, which will require SBSDs to deliver collateral to cover exposures arising from cleared security-based swaps of the SBSD's security-based swap customers. The exclusion required that the securities collateral be held in a qualified clearing agency account. The term ''qualified clearing agency account'' was defined to mean an account of the SBSD at a clearing agency that met certain conditions designed to ensure that the securities collateral was isolated from the proprietary assets of the SBSD and identified as property of the firm's security-based swap customers. Excluding the securities collateral from the definition of excess securities collateral meant it was not subject to the physical possession or control requirement. This allowed the clearing agency to hold the securities collateral against obligations of the SBSD's customers without the SBSD violating the physical possession or control requirement.[633]

Under the second exclusion from the definition of ''excess securities collateral,'' the SBSD could use securities collateral to meet a margin requirement of a second SBSD resulting from the first SBSD entering into a non-cleared security-based swap transaction with the second SBSD. However, the transaction with the second SBSD needed to be for the purpose of offsetting the risk of the non-cleared security-based swap transaction between the first SBSD and the security-based swap customer. This exclusion was 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.

The exclusion required that the securities collateral be held in a qualified registered security-based swap dealer account. The term ''qualified registered security-based swap dealer account'' was defined to mean an account at a second unaffiliated SBSD that met certain conditions designed to ensure that the securities collateral provided to the second SBSD was isolated from the proprietary assets of the first SBSD and identified as property of the firm's 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 was designed to ensure that if the second SBSD fails, the first SBSD would be treated as a security-based swap customer in a liquidation proceeding and, therefore, accorded applicable protections under the bankruptcy laws. Thus, because the account was at a second SBSD, the second SBSD needed to treat the first SBSD as a customer and the first SBSD's account was subject to the proposed omnibus segregation requirements. Excluding the securities collateral from

[631] *See* paragraph (f)(3) of Rule 18a–4, as adopted.

[632] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70278–82.

[633] As discussed below, under the proposed omnibus segregation requirements, the values of these security-based swap customer securities and money market instruments held by the clearing agency needed to be included in the reserve formula calculations.

the definition of ''excess securities collateral'' meant that the first SBSD did not have to hold them in accordance with the physical possession or control requirement. This allowed the first SBSD to finance customer transactions in non-cleared security-based swaps by using the customer's securities collateral to secure an offsetting transaction with a second SBSD.

Comments and Final Physical Possession or Control Requirements

A commenter stated that the proposed use of market value rather than haircut value for the securities collateral posted in connection with non-cleared security-based swaps would require that an SBSD use its own resources to fund margin requirements.[634] The Commission did not intend this result and is modifying the definition of ''excess securities collateral'' so that stand-alone broker-dealers or SBSDs may use securities collateral for non-cleared security-based swaps in an amount that equals the regulatory margin requirement of the SBSD with whom they are entering into a hedging transaction taking into account haircuts required by that regulatory requirement.[635] For purposes of this modification, the Commission clarifies that ''regulatory margin requirement'' means the amount of initial margin the SBSD-hedging counterparty is required to collect from the stand-alone broker-dealer or SBSD and not any greater ''house'' margin amount the SBSD-hedging counterparty may require as a supplement to the regulatory requirement. If the SBSD-hedging counterparty imposes a supplemental ''house'' margin requirement, the stand-alone broker-dealer or SBSD cannot use the customer's securities collateral to meet the additional requirement. Securities collateral used in this manner will not be excluded from the definition of ''excess securities collateral'' and therefore must be in the physical possession or control of the stand-alone broker-dealer or SBSD. Thus, the stand-alone broker-dealer or SBSD would need to fund the supplemental ''house'' margin requirement of the SBSD-hedging counterparty using proprietary cash or securities.

In the 2018 comment reopening, the Commission asked whether it should modify the definition of ''excess securities collateral'' to account for the fact that the prudential regulators require initial margin to be held at a third-party custodian.[636] As discussed above, the proposed second exclusion from the definition of ''excess securities collateral'' required that the securities collateral be held in a qualified registered security-based swap dealer account (*i.e.,* an account at a second SBSD). Thus, the proposed definition of ''qualified registered security-based swap dealer account'' did not contemplate holding the securities collateral at a third-party custodian. Absent modification, the proposed rule would have created the unintended consequence of preventing an SBSD from posting a customer's securities collateral to a third-party custodian in accordance with the requirements of the prudential regulators. Thus, the SBSD would have been required to use proprietary securities or cash to enter into a hedging transaction with a bank SBSD.

Consequently, in the 2018 comment reopening, the Commission asked whether the definition of ''excess securities collateral'' should exclude securities collateral held in a third-party custodial account, subject to the same limitations and conditions as apply to securities collateral re-hypothecated directly to a second SBSD. The Commission asked whether the term ''third-party custodial account'' should be defined to mean an account carried by an independent third-party custodian that meets the following conditions:

- It is established for the purposes of meeting regulatory margin requirements of another SBSD;
- The account is carried by a bank under Section 3(a)(6) of the Exchange Act;
- The account is designated for and on behalf of the SBSD for the benefit of its security-based swap customers and 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 and are being kept separate from any other accounts maintained by the SBSD with the bank; 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.

The conditions in the definition of ''third-party custodial account'' in the 2018 comment reopening were designed to ensure that securities collateral posted to the custodian is isolated from the proprietary assets of the SBSD and identified as property of its security-based swap customers.[637] The objective was to facilitate the prompt return of the securities collateral to the customers if the SBSD fails.

As discussed above, commenters suggested that the Commission recognize a broader range of custodians for purposes of the provisions in the final capital rules that permit stand-alone broker-dealers and nonbank SBSDs to avoid taking a capital charge when initial margin is held at a third-party custodian.[638] These same commenters similarly suggested that the definition of ''third-party custodial account'' for purposes of the segregation rules include a broader range of custodians. One of these commenters suggested that the definition of ''third-party custodial account'' for purposes of the segregation rules be modified to include domestic clearing agencies and depositories.[639] The second commenter suggested that the definition include foreign banks.[640]

For the reasons discussed above, the final segregation rules being adopted today modify the proposed definition of ''excess securities collateral'' to exclude securities collateral held in a ''third-party custodial account'' as that term is defined in the rules.[641] The final segregation rules also incorporate the definition of ''third-party custodial account'' that was included in the 2018 comment reopening but with the modifications suggested by the commenters to broaden the definition to include domestic clearing organizations and depositories and foreign supervised banks, clearing organizations, and depositories.[642] As a result of these modifications, the definition of ''third-party custodial account'' in the final segregation rules means, among other

[634] *See* SIFMA 2/22/2013 Letter.

[635] *See* paragraph (p)(1)(ii)(B) of Rule 15c3–3, as amended; paragraph (a)(2)(ii) of Rule 18a–4, as adopted.

[636] *See Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53016–17.

[637] *Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53016–17.

[638] *See* IIB 11/19/2018 Letter; SIFMA 11/19/2018 Letter. The provisions in the final capital rules that permit broker-dealers and nonbank SBSDs to avoid taking a capital charge when initial margin is held at a third-party custodian are discussed above in section II.A.2. of this release.

[639] *See* SIFMA 11/19/2018 Letter.

[640] *See* IIB 11/19/2018 Letter.

[641] *See* paragraph (p)(1)(ii)(B) of Rule 15c3–3, as amended; paragraph (a)(2)(ii) of Rule 18a–4, as adopted.

[642] *See* paragraph (p)(1)(viii) of Rule 15c3–3, as amended; paragraph (a)(10) of Rule 18a–4, as adopted.

conditions, an account carried by a bank as defined in Section 3(a)(6) of the Exchange Act or a registered U.S. clearing organization or depository or, if the collateral to be held in the account consists of foreign securities or currencies, a supervised foreign bank, clearing organization, or depository that customarily maintains custody of such foreign securities or currencies. Thus, the definition includes the same types of custodians as are permitted by the final capital rules for purposes of the exception from taking the capital charge when initial margin is held at a third-party custodian [643] and computing credit risk charges.[644] These same types of custodians also are permitted by Rule 18a–3 for the purposes of calculating the account equity requirements.[645]

In addition to these modifications, the Commission believes it is appropriate to modify the proposed definition of ''qualified registered security-based swap dealer account'' to remove the limitation that the account be held at an unaffiliated SBSD. This limitation would have had the unintended consequence of impeding a financial institution from centralizing its risk management of security-based swaps in a central booking entity through affiliate transactions or of transferring risk from one affiliate to another to manage the risk of the position in the jurisdiction where the underlying security is traded, for example. Therefore, the Commission is not adopting the affiliate limitation in the final rule.[646]

For the foregoing reasons, the Commission is adopting the proposed physical possession or control requirements with the modifications discussed above and certain other non-substantive modifications.[647]

A commenter urged the Commission to conform its proposal to the recommendations in the BCBS/IOSCO Paper with respect to re-hypothecation of collateral for non-cleared security-based swaps, by limiting re-hypothecation of securities collateral to circumstances that facilitate hedging of derivatives transactions entered into with customers.[648] The Commission agrees that securities collateral with respect to non-cleared security-based swaps should be re-hypothecated only in order to hedge a transaction with a security-based swap customer. Consequently, as discussed above, the final rules permit re-hypothecation only for this purpose.

A commenter questioned whether it was necessary for the Commission to promulgate a possession or control requirement for security-based swap customers that is separate from and in addition to the requirement for traditional securities customers under Rules 15c3–3 given the common insolvency treatment of securities and security-based swap customers.[649] The commenter argued that requiring separate calculations could increase operational risk. In response, the possession or control requirement is tailored to security-based swaps activity. For example, the definition of excess securities collateral, which is tied to the security-based swap possession or control requirement, is different than the definitions of ''fully paid'' and excess margin securities, which are tied to the existing possession or control requirement in Rule 15c3–3. The Commission believes it is appropriate to have separate requirements to help ensure that stand-alone and broker-dealer SBSDs appropriately account for excess securities collateral in the context of security-based swap activities and fully paid and excess margin securities in the context of traditional securities activities.

Commenters asked the Commission to permit re-hypothecation of securities collateral for non-cleared security-based swap transactions to entities other than other SBSDs.[650] One of these commenters noted that SBSDs may use products such as cleared and non-cleared swaps, cleared security-based swaps, and futures to hedge security-based swap transactions.[651] Conversely, another commenter opposed the re-hypothecation of initial margin.[652]

In response, the exemption from Rule 18a–4 being adopted today will permit SBSDs that operate under the exemption to re-hypothecate initial margin collateral received from counterparties for non-cleared security-based swaps unless the counterparty elects to have the initial margin held at a third-party custodian. The Commission anticipates that most stand-alone and bank SBSDs will operate under this exemption because, for example, to clear swaps for others the firms would need to register with the CFTC as an FCM and be subject to the specific rules governing FCMs.

If a stand-alone or bank SBSD does not operate under the exemption because it clears security-based swaps for others, the Commission believes the strict limits on re-hypothecation should apply. This type of firm will receive and hold initial margin for both cleared and non-cleared security-based swaps. Securities and cash collateral held directly by the firm would be fungible and, therefore, the Commission believes it should be subject to the strict limitations of the omnibus segregation requirements in order to facilitate the prompt return of the collateral to cleared and non-cleared security-based swap customers of the SBSD.

The Commission designed the hedging exception for non-cleared security-based swap collateral to accommodate a limited scenario: The industry practice of dealers in OTC derivatives maintaining ''matched books'' of transactions.[653] The Commission does not believe it would be appropriate at this time to either broaden the exception to permit the securities collateral to be used in connection with other types of products, or to prohibit the re-hypothecation of initial margin. The second SBSD must treat the securities collateral it receives in the hedging transaction in accordance with the omnibus segregation requirements being adopted today for security-based swaps. This is designed to ensure that the securities collateral posted by the first SBSD to the second

[643] *See* paragraph (c)(2)(xv)(C)(*1*) of Rule 15c3–1, as amended; paragraph (c)(1)(ix)(C)(*1*) of Rule 18a–1, as adopted. The exception is discussed above in section II.A.2.b.ii. of this release.

[644] *See* paragraph (c)(4)(v)(B) of Rule 15c3–1e, as amended; paragraph (e)(2)(iii)(E)(*2*) of Rule 18a–1, as adopted. The computation is discussed in section II.A.2.b.v. of this release.

[645] *See* paragraph (c)(4)(ii)(A) and (B) of Rule 18a–3, as adopted. This provision is discussed in section II.B.2.b.i. of this release.

[646] *See* paragraph (p)(1)(iv) of Rule 15c3–3, as amended; paragraph (a)(6) of Rule 18a–4, as adopted.

[647] *See* paragraph (p)(2)(i) of Rule 15c3–3, as amended; paragraph (b)(1) of Rule 18a–4, as adopted. Conforming changes are made to reflect the phrase ''special account for the exclusive benefit of security-based swap dealer customers'' in the definition of qualified registered security-based swap dealer account is changed to ''special reserve account for the exclusive benefit of security-based swap customers.'' *See* paragraphs (c)(2)(iv)(E)(*1*), (p)(1)(iv), (p)(1)(vii), (p)(1)(vii)(A), (p)(3), (p)(3)(i), (p)(3)(i)(B), (p)(3)(i)(C), (p)(3)(iii), and (p)(3)(iv) of Rule 15c3–3, as amended, paragraph (c)(1)(iii)(D) of Rule 18a–1, as adopted, and paragraphs (c), (c)(1), (c)(1)(ii), (c)(1)(iii), (c)(3), (c)(4), and (e)(1)(i) of Rule 18a–4, as adopted. In addition, the definition of qualified clearing agency account in the two rules is modified to align them more closely with the language used in Section 3E(b) of the Exchange Act, which addresses the segregation of cleared security-based swaps. The revised language replaces the phrase ''established to hold funds and other property in order to purchase, margin, guarantee, secure, adjust, or settle clear security based swaps'' with the phrase ''that holds funds and other property in order to margin, guarantee, or secure cleared security-based swap transactions.''

[648] *See* SIFMA 3/12/2014 Letter.

[649] *See* SIFMA 2/22/2013 Letter.

[650] *See* ISDA 1/23/13 Letter; SIFMA 2/22/2013 Letter.

[651] *See* SIFMA 2/22/2013 Letter.

[652] *See* SIFMA AMG 11/19/2018 Letter.

[653] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70279.

SBSD remains within the omnibus segregation program.

ii. Good Control Locations

As discussed above, paragraph (b) of Rule 15c3–3, as it existed before today's amendments, requires a carrying broker-dealer to promptly obtain and thereafter maintain physical possession or control of a customer's fully paid and excess margin securities. The pre-existing provisions of paragraph (c) of the rule identify locations that are deemed to be under the control of the carrying broker-dealer. As part of the omnibus segregation requirements, the Commission proposed five locations where an SBSD could hold excess securities collateral and be deemed in control of it.[654] The Commission modeled these proposed requirements for SBSDs on the pre-existing requirements in paragraph (c) of Rule 15c3–3. The identification of these satisfactory control locations was designed to limit where the SBSD could hold excess securities collateral. The identified locations were places from which securities collateral can promptly be retrieved and returned to security-based swap customers. The Commission did not receive any comments addressing these specific provisions and for the reasons discussed in the proposing release is adopting them as substantially as proposed.[655]

iii. Steps To Obtain Possession or Control

Paragraph (d) of Rule 15c3–3, as it existed before today's amendments, requires a carrying broker-dealer to determine each business day the quantity of fully paid and excess margin securities it has in its physical possession or control based on its books and records and the quantity of such securities it does not have in its possession or control. If a quantity of fully paid and excess margin securities is not in the carrying broker-dealer's physical possession or control, the firm must initiate steps to bring them within its physical possession or control.

As a component of the omnibus segregation requirements, the Commission proposed to require that each business day an SBSD must determine from its books and records the quantity of excess securities collateral that the firm had in its physical possession or control as of the close of the previous business day and the quantity of excess securities collateral the firm did not have in its physical possession or control on that day.[656] The SBSD also needed to take steps to retrieve excess securities collateral from certain specifically identified non-control locations if securities collateral of the same issue and class are at the locations. The Commission modeled these proposed requirements for SBSDs on the pre-existing requirements in paragraph (d) of Rule 15c3–3. The Commission did not receive any comments addressing these specific provisions and for the reasons discussed in the proposing release is adopting them with the certain amendments.[657]

b. Security-Based Swap Customer Reserve Account

Paragraph (e) of Rule 15c3–3, as it existed before today's amendments, requires a carrying broker-dealer to maintain a reserve of cash or qualified securities in an account at a bank that is at least equal in value to the net cash owed to customers, including cash obtained from the use of customer securities. The account must be titled ''Special Reserve Bank Account for the Exclusive Benefit of Customers.'' The amount of net cash owed to customers is computed pursuant to a formula set forth in Rule 15c3–3a. Under this formula, the carrying broker-dealer adds up customer credit items (*e.g.,* cash in customer securities accounts and cash obtained through the use of customer margin securities) and then subtracts from that amount customer debit items (*e.g.,* margin loans). 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. The carrying 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. The carrying broker-dealer must make a deposit into the customer reserve account if the computation shows an increase in the reserve requirement.

As a component of the omnibus segregation requirements, the Commission proposed reserve account requirements for SBSDs that were modeled on the pre-existing requirements of paragraph (e) of Rule 15c3–3 and Rule 15c3–3a.[658] More specifically, proposed Rule 18a–4 required an SBSD to maintain a special account for the exclusive benefit of security-based swap customers separate from any other bank account of the SBSD. The term ''special account for the exclusive benefit of security-based swap customers'' (''SBS Customer Reserve Account'') was defined to mean an account at a bank that is not the SBSD or an affiliate of the SBSD and that met certain conditions designed to ensure that cash and qualified securities deposited into the account were isolated from the proprietary assets of the SBSD and identified as property of the security-based swap customers.

The proposed rule provided that the SBSD must at all times maintain in an SBS Customer Reserve Account, through deposits into the account, cash and/or qualified securities in amounts computed daily in accordance with the formula set forth in proposed Rule 18a–4a. This formula required the SBSD to add up credit items and debit items. If, under the formula, the credit items exceeded the debit items, the SBSD would be required to maintain cash and/or qualified securities in that net amount in an SBS Customer Reserve Account. The credit and debit items identified in the proposed formula included the same credit and debit items in the Rule 15c3–3a formula. Further, the proposed formula identified two additional debit items: (1) Margin related to cleared security-based swap transactions in accounts carried for

[654] *See* 77 FR at 70280–82.

[655] *See* paragraph (p)(2)(ii) of Rule 15c3–3, as amended; paragraph (b)(2) of Rule 18a–4, as adopted. For clarity, the phrase ''security-based swap'' is inserted before the phrase ''customer securities'' in paragraph (b)(2)(v) of Rule 18a–4. The text of the parallel paragraph in Rule 15c3–3, as amended, reflects this modification. In the final rule, the phrase ''security-based swap'' was inserted before the word ''accounts'' in paragraph (b)(1) of the rule to clarify that the possession or control requirements apply only to security-based swap accounts. *See also* paragraph (p)(2)(i) of Rule 15c3–3, as amended.

[656] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70281–82.

[657] For clarity, the phrase ''security-based swap'' is being inserted before ''customer securities'' in paragraph (b)(2)(v) of Rule 18a–4, as adopted. The text of paragraph (b)(3)(vii) of Rule 18a–4, as adopted, is modified to align it with existing broker-dealer possession or control requirements with respect to the allocation of a customers' fully paid and excess margin securities to short positions. *See* paragraph (d)(5) of Rule 15c3–3, as amended; *Financial Responsibility Rules for Broker-Dealers,* Exchange Act Release No. 70072 (July 30, 2013), 78 FR 51823, 51835–51836 (Aug. 21, 2013) (explaining non-substantive amendments to the final rule with respect to the allocation of customers' fully paid and excess margin securities to short positions). In addition to the modifications discussed above, the Commission is adopting the following non-substantive changes to paragraph (b)(3)(vii) of Rule 18a–4: (1) The phrase ''security-based swap dealer's'' is added before ''books or records''; (2) the phrase ''that allocate to a short position'' is added before ''of the security-based swap dealer''; (3) the phrase ''as a proprietary short position or as'' is replaced with ''or''; (4) the phrase ''more than 10 days business (or'' is replaced with ''for''; and (5) the phrase ''days if the security based swap dealer is a market maker in the securities'' is removed. The text of the parallel paragraphs of Rule 15c3–3, as amended, reflects these modifications to the proposed text in Rule 18a–4.

[658] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70282–86.

security-based swap customers required and on deposit in a qualified clearing agency account at a clearing agency; and (2) 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 items were designed to accommodate the two exclusions from the definition of ''excess securities collateral'' discussed above pursuant to which an SBSD could deliver a customer's collateral to a clearing agency to meet a margin requirement of the clearing agency or to a second SBSD to meet a regulatory margin requirement of the second SBSD. They also accommodated customer cash collateral delivered for this purpose. In either case, the debit items would offset related credit items in the formula.

As proposed, if the total credits exceeded the total debits, the SBSD needed to maintain that net amount on deposit in a SBS Customer Reserve Account in the form of funds and/or qualified securities. The term ''qualified security'' as defined in proposed Rule 18a–4 meant: (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 a 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. The proposed conditions for obligations of a State or subdivision of a State (''municipal securities'') were 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 were used for this purpose.

As discussed above, an SBSD was required to add up credit and debit items pursuant to the formula in proposed Rule 18a–4a. If, under the formula, the credit items exceeded the debit items, the SBSD was required to maintain cash and/or qualified securities in that net amount in the SBS Customer Reserve Account. Under the proposal, an SBSD was required to take certain deductions for purposes of this requirement. The amount of cash and/or qualified securities in the SBS Customer Reserve Account needed to equal or exceed the amount required pursuant to the formula in proposed Rule 18a–4a *after* applying the deductions.

First, under the proposal, if municipal securities were held in the account, the SBSD was required to apply the standardized haircut specified in Rule 15c3–1 to the value of the municipal securities. Second, if municipal securities were held in the account, the SBSD needed to deduct the aggregate value of the municipal securities of a single issuer to the extent that value exceeded 2% of the amount required to be maintained in the SBS Customer Reserve Account. Third, if municipal securities were held in the account, the SBSD needed to deduct the aggregate value of all municipal securities to the extent that amount exceeded 10% of the amount required to be maintained in the SBS Customer Reserve Account. Fourth, the proposal required that the SBSD deduct the amount of funds held in an SBS Customer Reserve Account at a single bank to the extent that amount exceeded 10% of the equity capital of the bank as reported on its most recent Consolidated Report of Condition and Income (''Call Report''). This proposal was consistent with the proposed 2007 amendments to Rule 15c3–3 that were pending at the time.[659]

The proposed rule also provided that it would be unlawful for an SBSD to accept or use credits identified in the items of the formula in proposed Rule 18a–4a except to establish debits for the specified purposes in the items of the formula. 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 the proposed formula. Thus, the SBSD would be prohibited from using customer cash to, for example, pay expenses.

The proposed rule also provided that the computations necessary to determine the amount required to be maintained in the SBS 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. Further, the SBSD could make a withdrawal from the SBS Customer Reserve Account only if the amount remaining in the account after the withdrawal equaled or exceeded the amount required to be maintained in the account.

Finally, the proposed rule required an SBSD to promptly deposit funds or qualified securities into an SBS Customer Reserve Account if the amount of funds and/or qualified securities held in one or more SBS Customer Reserve Accounts falls below the amount required to be maintained by the rule.

Comments and Final Reserve Account Requirements

A commenter argued that a separate calculation for the SBS Customer Reserve Account is not necessary given the common insolvency treatment of securities customers and security-based swap customers.[660] However, similar to the daily possession or control requirement calculation, the Commission believes it is appropriate as an initial matter to require separate reserve computations. First, broker-dealers historically have not engaged in significant amounts of security-based swap activities. Given the customer protection objectives of the reserve account requirements, the Commission believes the prudent approach is to require two reserve account calculations and accounts. Second, the SBS Customer Reserve Account requirements are tailored to security-based swap activities. For example, the SBS Customer Reserve Account formula has debit items relating to margin delivered to security-based swap clearing agencies and other SBSDs. The Commission believes it is appropriate to have separate requirements to help ensure that stand-alone and broker-dealer SBSDs appropriately account for debits and credits in the context of their security-based swap activities and in their traditional securities activities. Third, the definition of qualified securities for purposes of the SBS Customer Reserve Account requirement includes certain municipal securities; whereas the definition of qualified securities for purposes of the traditional securities reserve account requirement is limited to government securities.

A commenter objected to the application of the SBS Customer Reserve Account requirements to bank SBSDs due to the existing customer protection requirements applicable to banks.[661] The commenter argued that the SBS Customer Reserve Account calculation would be operationally intensive. In response, bank SBSDs are exempt from the final omnibus segregation requirements if they meet the conditions of the exemption, including not clearing security-based swap transactions for others.[662] If a bank

[659] *See Amendments to Financial Responsibility Rules for Broker-Dealers,* Exchange Act Release No. 55431 (Mar. 9, 2007), 72 FR 12862 (Mar. 19, 2007). *See also Financial Responsibility Rules for Broker-Dealers,* 78 FR at 51832–35.

[660] *See* SIFMA 2/22/2013 Letter.

[661] *See* SIFMA 2/22/2013 Letter.

[662] *See* paragraph (f) to Rule 18a–4, as adopted.

SBSD is appropriately operating pursuant to the exemption, it will not be required to perform the SBS Customer Reserve Account calculation. To the extent a bank SBSD does not take advantage of the exemption, the Commission believes that the computation a bank SBSD will be required to perform will be less operationally complex because generally it should only involve cleared security-based swaps. The prudential regulators' margin rules for non-cleared security-based swaps applicable to banks require that initial margin be held at a third-party custodian. Therefore, initial margin arising from non-cleared security-based swaps generally should not be a factor in the SBS Customer Reserve Account formula for these entities.

A commenter requested that the Commission require a weekly SBS Customer Reserve Account computation rather than a daily computation.[663] The commenter stated that calculating the reserve account formula is an onerous process that is operationally intensive and requires a significant commitment of resources. The commenter further stated that the Commission can achieve its objective of decreasing liquidity pressures on SBSDs while limiting operational burdens by requiring weekly computations and permitting daily computations. The Commission acknowledges that a daily reserve calculation will increase operational burdens as compared to a weekly computation. Therefore, in response to comments, the Commission is modifying the final rules to require a weekly SBS Customer Reserve Account computation.[664] The final rules further provide that stand-alone broker-dealers or SBSDs may perform daily computations if they choose to do so.[665] These modifications to the final rules align with the existing reserve account computation requirements in paragraph (e) of Rule 15c3–3.

Another commenter asked the Commission to prohibit an SBSD from using funds in the SBS Customer Reserve Account held for one customer to extend credit to another customer.[666] The SBS Customer Reserve Account deposit will equal or exceed the net monies owed to security-based swap customers as calculated using the formula in Rules 15c3–3b and 18a–4a, as adopted. The logic behind the formula is that credits (monies owed to customers) are offset by debits (monies owed by customers) and, if there is a net amount of credits in excess of debits, that amount is reserved in the form of cash or qualified securities. Consequently, implementing the commenter's suggestion would not be consistent with the omnibus segregation requirements, which are designed to permit the commingling of customer assets in a safe manner.

A commenter requested that the Commission modify the definition of ''qualified security'' in Rule 18a–4 to include U.S. government money market funds.[667] In the proposal, the Commission sought to align the definition of qualified security in Rule 18a–4 with the existing definition of qualified security in Rule 15c3–3 with one exception: Namely, the Commission proposed that the Rule 18a–4 definition include certain municipal securities because Section 3E(d) of the Exchange Act provides that municipal securities are a ''permitted investment'' for purposes of the segregation requirements for cleared security-based swaps. There is no corresponding statutory requirement to permit municipal securities to be a ''permitted investment'' for purposes of the segregation requirements and implementing regulations under Section 15(c)(3) of the Exchange Act applicable to stand-alone broker-dealers. While Section 3E(d) of the Exchange Act authorizes the Commission to expand the list of permitted investments for purposes of the omnibus segregation requirements for security-based swaps, the Commission believes the definitions in the two rules should be consistent and the types of securities permitted to be deposited into the customer reserve accounts required by each rule limited to the safest and most liquid securities.

In addition, the commenter stated that limiting instruments to be utilized by SBSDs under financial responsibility requirements will create pressure on regulated entities in search of those limited instruments to buy and sell on a continuous basis in their reserve accounts.[668] The Commission disagrees. As discussed above, the final rule contains an exemption for stand-alone SBSDs from the omnibus segregation requirements of Rule 18a–4, as adopted, if certain conditions are met.[669] This modification to the final rule will reduce the number of SBSDs subject to the omnibus segregation requirements in the final rules and reduce the amounts that will need to be deposited into these accounts. This modification as well as the availability of municipal securities as qualified securities under Rule 18a–4, as adopted, should mitigate the commenter's concerns regarding the availability of qualified securities. For these reasons, the Commission is not modifying the proposal to permit U.S. government money market funds to serve as qualified securities as suggested by the commenter.

A commenter urged the Commission to reconsider the provision in the proposed rule requiring the SBS Customer Reserve Accounts to be maintained at a bank that is not affiliated with the SBSD.[670] The primary concern with permitting an affiliated bank to carry the SBS Customer Reserve Account is that the SBSD or stand-alone broker-dealer may not exercise due diligence with the same degree of impartiality and care when assessing the financial soundness of an affiliated bank as it would with an unaffiliated bank.[671] The decision of the SBSD or stand-alone broker-dealer to hold cash in a reserve account at an affiliated bank may be driven in part by profit or for reasons based on the affiliation, regardless of any due diligence it may conduct or the overall safety and soundness of the bank.[672] However, this concern largely pertains to cash deposits because they become part of the assets of the bank and can be used by the bank for any of its business activities.[673] As discussed below, the concern about cash deposits is being addressed through a 100% deduction of cash held in an SBS Customer Reserve Account at an affiliated bank.[674] Unlike cash, qualified securities deposited with a bank are held in a custodial capacity and, absent

[663] *See* SIFMA 2/22/2013 Letter.

[664] *See* paragraphs (p)(3)(A) and (B) of Rule 15c3–3, as amended; paragraphs (c)(3)(i) and (ii) of Rule 18a–4, as adopted.

[665] *See* paragraph (p)(3)(B) of Rule 15c3–3, as amended; paragraph (c)(3)(ii) of Rule 18a–4, as adopted.

[666] *See* ICI 2/4/2013 Letter.

[667] *See* Federated 11/15/2018 Letter; Letter from Lee A. Pickard, Esq., Pickard, Djinis and Pisarri, on behalf of Federated Investors, Inc. (Dec. 7. 2018) (''Federated 12/7/2018 Letter'').

[668] *See* Federated 11/15/2018 Letter.

[669] *See* paragraph (f) of Rule 18a–4, as adopted.

[670] *See* SIFMA 2/22/2013 Letter.

[671] *See Financial Responsibility Rules for Broker-Dealers,* 78 FR at 51833.

[672] *See id.*

[673] *See* Federal Reserve, Division of Banking Supervision and Regulation, *Commercial Bank Examination Manual, Section 3000.1, Deposit Accounts* (stating that deposits are the primary funding source for most banks and that banks use deposits in a variety of ways, primarily to fund loans and investments), *available at http://www.federalreserve.gov/boarddocs/supmanual/cbem/3000.pdf. See also* OCC Banking Circular (BC–196), Securities Lending (May 7, 1985) (stating securities should be lent only pursuant to a written agreement between the lender institution and the owner of the securities specifically authorizing the institution to offer the securities for loan), *available at http://www.occ.gov/static/news-issuances/bulletins/pre-1994/banking-circulars/bc-1985-196.pdf.*

[674] *See* paragraph (p)(3)(i)(E) of Rule 15c3–3, as amended; paragraph (c)(1)(i)(E) of Rule 18a–4, adopted.

an agreement between the bank and the depositor, cannot be used by the bank. Consequently, in response to the comment, the Commission is modifying the final rule from the proposal so that it no longer requires the SBS Customer Reserve Account to be maintained at an unaffiliated bank.[675]

The Commission also is modifying the final rules to require an SBSD to deduct 100% of the amount of cash held at an affiliated bank and to increase the deduction threshold for cash held at a non-affiliated bank from 10% to 15% of the bank's equity capital.[676] These modifications more closely align the SBS Customer Reserve Account requirements with the pre-existing customer reserve account requirements for traditional securities.[677] However, the Commission is adding an exception to the 15% deduction to accommodate bank SBSDs that choose to maintain the SBS Customer Reserve Account themselves rather than at an affiliated or non-affiliated bank.[678] Under the exception, they would not need to take the 15% deduction.

One commenter argued that these changes would lead to undue risk for SBSDs and their customers.[679] The Commission does not agree. Increasing the deduction threshold from 10% to 15% aligns the threshold with the threshold in the pre-existing requirements for traditional securities under existing Rule 15c3–3. Further, the exemption from the requirements of Rule 18a–4 likely will appreciably reduce the amounts that will need to be deposited into the SBS Customer Reserve Accounts.[680] For example, the Commission expects that the omnibus segregation requirements largely will apply to cleared security-based swaps transactions where a substantial portion of the initial margin received by the stand-alone broker-dealer or SBSD will be passed on to the clearing agency. Consequently, it will not need to be locked up in SBS Customer Reserve Accounts. Moreover, the Commission does not believe that increasing the threshold from 10% to 15% will unduly undermine the objective of addressing the risk that arises when a bank's deposit base is overly reliant on a single depositor. Finally, permitting a bank SBSD to maintain its own SBS Customer Reserve Account is designed to strike an appropriate balance in terms of achieving the objectives of the segregation rule, while providing the firm with sufficient flexibility in terms of locating its reserve account deposits. This scenario also does not raise the same concerns that arise when an SBSD uses a separate bank to maintain its SBS Customer Reserve Account. Moreover, the Commission expects that most bank SBSDs will operate under the exemption from the omnibus segregation requirements of Rule 18a–4. Therefore, the Commission does not believe these modifications to the final rule will lead to undue risks for SBSDs and their customers.

In addition, the Commission is making a conforming modification to the text of the debit item with respect to margin relating to non-cleared security-based swaps. As discussed above, the definition of ''excess securities collateral'' has been modified to account for the fact that the prudential regulators require initial margin collected by a bank SBSD to be held at a third-party custodian (rather than being held directly by the bank SBSD).[681] The rule, as proposed, did not account for the possibility that a nonbank SBSD might pledge a customer's initial margin to a third-party custodian pursuant to the margin rules of the prudential regulators. The modification to the definition of ''excess securities collateral'' discussed above addresses this issue with respect to the possession or control requirement. The modification to the debit item with respect to margin relating to non-cleared security-based swap transactions will address this issue with respect to the SBS Customer Reserve Account requirement. Specifically, the Commission is modifying the debit item to include margin related to non-cleared security-based swap transactions in accounts carried for security-based swap customers required and held at a ''third-party custodial account'' as that term is defined in the rules.[682] This will allow the SBSD to offset the corresponding credit item that results from using customer collateral to meet the margin requirement of another SBSD when the customer collateral is posted to a third-party custodian (rather than provided directly to the other SBSD).

The Commission originally proposed that it would be unlawful for an SBSD to accept or use credits identified in the items of the formula set forth in Exhibit A to the proposed rule ''except to establish debits for the specified purposes in the items of the formula.'' [683] This phrase in proposed Rule 18a–4 varied from the phrase in the parallel pre-existing requirement in Rule 15c3–3.[684] The Commission did not intend to establish a different standard for SBSDs and is modifying the phrase as used in Rules 15c3–3, as amended, and 18a–4, as adopted, to align it with the pre-existing text.

For these reasons, the Commission is adopting these provisions relating to the

[675] To make this modification, the Commission revised the definition of ''special reserve account for the exclusive benefit of security-based swap customers'' to remove the provision requiring that the bank be unaffiliated. *See* paragraph (p)(1)(vii) of Rule 15c3–3, as amended; paragraph (a)(9) of Rule 18a–4, as adopted.

[676] *See* paragraph (p)(3)(i)(D) of Rule 15c3–3, as amended; paragraph (c)(1)(D) of Rule 18a–4, as adopted. *See also Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53017–18 (soliciting comment on potential rule language that would modify the proposal in this manner).

[677] *See* 17 CFR 240.15c3–3(e)(5). *See also Financial Responsibility Rules for Broker-Dealers,* 78 FR at 51832–51833 (explaining the rationale for permitting securities but not cash to be held at an affiliated bank).

[678] *See* paragraph (c)(1)(ii) of Rule 18a–4, as adopted. The final rule text of paragraph (c)(1)(ii) of Rule 18a–4, as adopted, states ''*Exception.* A security-based swap dealer for which there is a prudential regulator need not take the deduction specified in paragraph (c)(1)(i)(D) of this section if it maintains the special reserve account for the exclusive benefit of security-based swap customers itself rather than at an affiliated or non-affiliated bank.'' To add this exception, in the final rule, a ''(i)'' was inserted before the phrase ''In determining the amount maintained'' in paragraph (c)(1) of Rule 18a–1, as adopted, and paragraphs (c)(1)(i) through (iv) of Rule 18a–4, as proposed, were re-designated paragraphs (c)(1)(i)(A) through (D) in Rule 18a–4, as adopted. A new subparagraph (c)(1)(i)(E) provides ''The total amount of cash deposited with an affiliated bank.'' The final phrasing of new subparagraph (c)(1)(i)(E) does not contain the phrase ''for a security-based swap dealer for which there is not a prudential regulator'' that was contained in the re-opening as a potential modification because it is redundant to the exception language in paragraph (c)(1)(ii) of Rule 18a–4, as adopted. *See also Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53017–18 (soliciting comment on potential rule language that would modify the proposal in this manner).

[679] *See* Better Markets 11/19/2018 Letter. *See also Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53017–18.

[680] *See* paragraph (f) of Rule 18a–4.

[681] *See* paragraph (p)(1)(ii)(B) of Rule 15c3–3, as amended; paragraph (a)(2)(ii) of Rule 18a–4, as adopted. *See also* 12 CFR 45.7; 12 CFR 237.7; 12 CFR 624.7; 12 CFR 1221.7; 17 CFR 23.157.

[682] *See* Rule 15c3–3b, as adopted, Item 16; Rule 18a–4a, as adopted, Item 14. In addition, the Commission is deleting Items 3 and 10 from Rule 18a–4a, as adopted, because that rule will be used by non-broker-dealer SBSDs. As discussed above, the security-based swap segregation requirements, including the SBS Reserve Account requirements, that apply to broker-dealers, including broker-dealer SBSDs, are being codified in Rule 15c3–3, as amended, and Exhibit B to Rule 15c3–3 (Rule 15c3–3b), as adopted. Items 3 and 10 relate to the broker-dealer margin account business with respect to securities other than security-based swaps. Consequently, these Line Items are not necessary for the security-based swap customer reserve formula that non-broker-dealer SBSDs will use to determine their SBS Reserve Account requirement and, therefore, are not included in the final rule. *See* Exhibit A to Rule 18a–4 (Rule 18a–4a), as adopted.

[683] *See* paragraph (c)(2) of Rule 18a–4, as proposed to be adopted.

[684] *Compare* 17 CFR 240.15c3–3(e)(2), *with* paragraph (c)(2) of Rule 18a–4, as proposed to be adopted.

SBS Customer Reserve Account with the modifications described above.[685]

c. Special Provisions for Non-Cleared Security-Based Swap Counterparties

i. Notice Requirement

Section 3E(f)(1)(A) of the Exchange Act 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.[686] To provide greater clarity as to the meaning of ''beginning'' as used in the statute, proposed Rule 18a–4 required 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.[687] Consequently, the notice needed to be given in writing before the counterparty was required to deliver margin to the SBSD or MSBSP. This gave the counterparty an opportunity to determine whether to elect individual segregation, waive segregation, or affirmatively or by default elect omnibus segregation.

A commenter recommended that the Commission clarify that the notice must be sent to the customer (or investment manager authorized to act on behalf of a customer) in accordance with mutually agreed terms by the parties, or absent such terms, to a person reasonably believed to be authorized to accept notices on behalf of a customer.[688] The Commission agrees that the rule should provide more clarity and has modified the requirement to provide that the notice must be sent to a duly authorized individual. This person could be an individual that is mutually agreed to by the parties.

For these reasons, the Commission is adopting the proposed notice requirement with the modification described above.[689] The notification provision in Rule 15c3–3 applies only to a broker-dealer SBSD or MSBSP because the notification requirements in Section 3E(f)(1)(A) of the Exchange Act apply only to SBSDs and MSBSPs (and not to stand-alone broker-dealers).

ii. Subordination Agreements

Proposed Rule 18a–4 required an SBSD to obtain agreements from counterparties that elect either individual segregation or waive segregation with respect to non-cleared security-based swaps under Section 3E(f) of the Exchange Act. In the agreements, the counterparties needed to subordinate all of their claims against the SBSD to the claims of security-based swap customers.[690] By entering into subordination agreements, these counterparties would be excluded from the definition of security-based swap customer in proposed Rule 18a–4.[691] 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 was subject to a bankruptcy proceeding.

Under the proposal, an SBSD needed to obtain a conditional subordination agreement from a counterparty that elects individual segregation. The agreement was conditional because the subordination agreement would not be effective in a case where the counterparty's assets were included in the bankruptcy estate of the SBSD, notwithstanding that they had been held by a third-party custodian (rather than the SBSD). Specifically, the proposed rule provided that the counterparty must 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 in a formal liquidation proceeding.

An SBSD needed to obtain an unconditional subordination agreement from a counterparty that waives segregation altogether. By waiving individual and omnibus segregation, the counterparty agrees that cash, securities, and money market instruments delivered to the SBSD as initial margin can be used by the SBSD for any business purpose and need not be isolated from the proprietary assets of the SBSD. Therefore, these counterparties are foregoing the protections of segregation. As a consequence, they should not be entitled to a ratable share of the customer property of the SBSD in the event the SBSD is liquidated in a formal proceeding. If they were deemed security-based swap customers, they could have a *pro rata* priority claim on customer property. This could disadvantage the security-based swap customers that did not waive segregation by diminishing the amount of customer property available to be distributed to them.

A commenter stated that the subordination agreement required of customers that elect individual segregation was not necessary because the initial margin provided by the customer was held at a third-party custodian and therefore would not become ''customer property'' held by the failed SBSD.[692] The commenter argued that a ''legally unnecessary subordination agreement is prone to creating ambiguity, unforeseen consequences and complication . . . and runs contrary to the goal of investor protection . . . .'' The Commission disagrees. The subordination agreement is designed to reduce ambiguity, unforeseen consequences, and complications that may arise during an SBSD's liquidation by clarifying that the subordinating customers are not entitled

[685] *See* paragraph (p)(3) of Rule 15c3–3, as amended; paragraph (c) of Rule 18a–4, adopted. The following non-substantive modifications are being made. The phrase ''a political'' is added before the phrase ''subdivision of a state'' in the definition of qualified security in paragraphs (p)(1)(v)(C) and (p)(3)(i) of Rule 15c3–3, as amended, and paragraphs (a)(7)(iii) and (c)(1) of Rule 18a–4, as adopted because, under Section 3E(d) of the Exchange Act, ''obligations . . . of any political subdivision of a State'' are ''Permitted Investments.'' The phrase ''Consolidated Report of Condition and Income'' is replaced with the phrase ''Call Report or any successor form the bank is required to file by its appropriate federal banking agency (as defined by section 3 of the Federal Deposit Insurance Act)'' in paragraph (p)(3)(i)(D) of Rule 15c3–3, as amended, and paragraph (c)(1)(i)(D) of Rule 18a–4, as adopted. This modification uses the commonly known name of the report and accounts for the potential that bank regulators could change the form of the report in the future. The Commission replaced the phrase ''It is unlawful for a security-based swap dealer'' in paragraph (c)(2) of Rule 18a–4, as proposed, with the phrase ''a security-based swap dealer must not.'' *See* paragraph (p)(3)(ii) of Rule 15c3–3, as amended (using the phrase ''a broker or dealer must not''). *See also Amendments to Financial Responsibility Rules for Broker-Dealers,* 72 FR 12862; *Financial Responsibility Rules for Broker-Dealers,* 78 FR at 51838 (similarly modifying the proposed amendments to Rule 15c3–3 to replace the phrase ''It shall be unlawful'' ''because any violation of the rules and regulations promulgated under the Exchange Act is unlawful and therefore it is unnecessary to use this phrase in the final rule''). The Commission replaced the term ''funds'' in paragraph (c)(4) of Rule 18a–4, as proposed, with the term ''cash.'' *See* paragraph (p)(3)(iv) of Rule 15c3–3, as amended.

[686] *See* 15 U.S.C. 78c–5(f)(1)(A).

[687] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70287.

[688] *See* SIFMA 2/22/2013 Letter.

[689] *See* paragraph (p)(4)(i) of Rule 15c3–3, as amended; paragraph (d)(1) of Rule 18a–4, as adopted. A non-substantive modification is being made to replace the term ''effective date'' with the term ''compliance date'' because, as discussed below in section III of this release, the effective of the final notification rules will fall before the compliance date. The Commission intended the notification requirement to apply to transactions that occur on or after the date SBSDs and MSBSPs begin complying with the rule. Finally, the word ''swap'' is inserted before the word ''dealer.''

[690] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70287–88. The proposed subordination requirements did not apply to MSBSPs because they would not have security-based swap customers.

[691] *See* paragraph (a)(6) of proposed Rule 18a–4.

[692] *See* Ropes & Gray Letter.

to a *pro rata* share of customer property from the liquidation. By entering into the subordination agreements, customers who elect individual segregation are affirmatively waiving their rights to make customer claims with respect to initial margin held by the third-party custodian. Their recourse is to the third-party custodian that is holding the collateral. Therefore, a properly designed and executed subordination agreement affirms the rights of customers that elect individual segregation as compared to the rights of customers whose assets are treated under the omnibus segregation requirements.

The Commission, however, is modifying the final subordination requirements for collateral held at a third-party custodian so that it is no longer are limited to funds or other property that is segregated pursuant to Section 3E(f) of the Exchange Act. As discussed above in section II.A.2.b.ii. of this release, a counterparty's collateral to meet a margin requirement of the nonbank SBSD may be held at a third-party custodian pursuant to other laws. Consequently, the Commission is modifying the rule text to provide that the subordination agreement is required ''from a counterparty whose funds or other property to meet a margin requirement of the [nonbank SBSD] are held at a third-party custodian.'' [693]

Another commenter stated that customers electing individual segregation should not be required to subordinate claims other than those with respect to such initial margin held by the third-party custodian.[694] The commenter objected to the provision in the proposed rule requiring the customer to subordinate *all* of its claims against the SBSD to the claims of other security-based swap customers. The Commission agrees that the proposed text of the rule was ambiguous and could be read to mean the customer must subordinate claims to property that is held by the SBSD (as opposed to the third-party custodian). Therefore, the Commission is modifying the final rule from the proposal to clarify that the counterparty electing individual segregation must subordinate its claims against the SBSD only for the funds or other property *held at the third-party custodian.*[695]

Because a counterparty will not subordinate *all* of its claims against a stand-alone broker-dealer or broker-dealer SBSD, the Commission is making conforming modifications to the final rule to specifically identify the two classes of carrying broker-dealer customers that must be accounted for in the subordination agreements. In particular, the Commission is adding the phrase ''(including PAB customers)'' following the term ''to the claims of customers'' in paragraph (p)(1)(vi) and paragraphs (p)(4)(ii)(A) and (B) of Rule 15c3–3, as amended. PAB customers are other broker-dealers for whom the carrying broker-dealer is holding cash and/or securities.[696] Under amendments to Rule 15c3–3 adopted after the rules in this release were proposed, a carrying broker-dealer must include (and thereby protect) the cash and securities it carries for other customers by including them in a PAB reserve account computation.[697] Broker-dealer customers also have priority claims to cash and securities held at the carrying broker-dealer in a SIPA proceeding. Consequently, their status as a protected class of creditors must be accounted for in the provisions of the rule relating to subordination agreements.

Finally, as discussed above, the Commission is making a conforming amendment to the requirement that the stand-alone broker-dealer or broker-dealer SBSD obtain a subordination agreement from a person who waives segregation with respect to non-cleared security-based swaps to provide that the provision applies to *affiliates* that waive segregation because persons who are not affiliates cannot waive segregation.[698]

For these reasons, the Commission is adopting the subordination requirements with the modifications discussed above.[699]

D. Alternative Compliance Mechanism

As discussed throughout this release, commenters urged the Commission to harmonize the requirements being adopted today with requirements of the CFTC. Commenters sought harmonization with respect to the Commission's capital requirements,[700] margin requirements,[701] and segregation requirements.[702] One commenter stated that ''[i]f the Commission and CFTC do not harmonize their capital rules, they should defer to the capital rules of one another in the case of'' an entity that is registered as an SBSD and a swap dealer and ''whose swaps or [security-based swaps] represent a de minimis portion of the [entity's] combined swap and [security-based swap] business.'' [703] This commenter further stated that ''[i]n cases where the firm is predominantly engaged in swap activity, imposing different capital requirements would be inefficient.'' Another commenter stated that ''[i]f harmonization is not achievable, the rules should be coordinated so that [the Commission] defers to the capital and margin rules of the CFTC for an SBSD that is not a broker-dealer and whose [security-based swaps] constitute a very small proportion of its business (*e.g.,* less than 10% of the notional amount of its outstanding combined swap and SBS positions).'' [704]

In response to these comments seeking harmonization, the final capital, margin, and segregation rules being adopted today have been modified from the proposed rules to achieve greater consistency with the requirements of the CFTC. However, as discussed throughout this release, there are differences between the approaches taken by the Commission and the CFTC.

[693] *See* paragraph (p)(4)(ii)(A) of Rule 15c3–3, as amended; paragraph (d)(2)(i) of Rule 18a–4, as adopted.

[694] *See* Financial Services Roundtable Letter.

[695] *See* paragraph (p)(4)(ii)(A) of Rule 15c3–3, as amended; paragraph (d)(2)(i) of Rule 18a–4, as adopted. The provision in paragraph (p) of Rule 15c3–3 provides that the counterparty's subordination also does not apply to the extent that the funds or other property provided by the counterparty are treated as customer property as defined in 15 U.S.C. 78*lll*(4) in a liquidation of the broker-dealer. *See* paragraph (p)(4)(ii)(A) of Rule 15c3–3, as amended. This clause is being added to account for the fact that broker-dealers are liquidated in SIPA proceedings.

[696] ''PAB'' is an acronym for proprietary accounts of broker-dealers. *See* paragraph (a)(16) of Rule 15c3–3 (defining the term PAB account).

[697] *Financial Responsibility Rules for Broker-Dealers,* 78 FR at 51827–51832 (discussing PAB accounts); paragraph (e) of Rule 15c3–3; Rule 15c3–3a. Consequently, this modification more closely aligns the segregation requirements with the pre-existing requirements for traditional securities under existing Rule 15c3–3, and would clarify that a security-based swap customer's subordination includes a subordination to the claims of PAB customers.

[698] *See* paragraph (p)(4)(ii)(B) of Rule 15c3–3, as amended.

[699] *See* paragraph (p)(4)(ii) of Rule 15c3–3, as amended; paragraph (d)(2) of Rule 18a–4, as adopted. The Commission also made a non-substantive amendment to replace the phrase ''does not choose'' with ''affirmatively chooses not'' to clarify that the requirements related to the subordination agreements where a counterparty elects to have no segregation only apply when a counterparty affirmatively chooses to waive segregation. *See* paragraph (p)(4)(ii)(B) of Rule 15c3–3, as amended; paragraph (d)(2)(ii) of Rule 18a–4, as adopted.

[700] *See, e.g.,* Citadel 11/19/18 Letter; Financial Services Roundtable Letter; FIA 11/19/2018 Letter; Morgan Stanley 11/19/2018 Letter.

[701] *See, e.g.,* American Council of Life Insurers 11/19/2018 Letter; Citadel 11/19/2018 Letter; Financial Services Roundtable Letter; MFA 2/22/2013 Letter; SIFMA 11/19/2018 Letter.

[702] *See, e.g.,* AIMA 2/22/2013 Letter; ISDA 11/19/2018 Letter; MFA 2/22/2013 Letter; SIFMA AMG 2/22/2013 Letter; Vanguard Letter.

[703] *See* SIFMA 11/19/2018 Letter.

[704] *See* Mizuho/ING Letter. *See also* Center for Capital Markets Competitiveness, US Chamber of Commerce 11/19/2019 Letter. This commenter supported a safe harbor that would allow firms to rely on their compliance with the rules of the Commission or the CFTC to satisfy comparable requirements set by the other agency.

Moreover, the Commission believes that some registered swap dealers (or entities that will register as swap dealers in the future) will need to also register as security-based swap dealers because their security-based swaps business—while not a significant part of their overall business mix—exceeds the *de minimis* exception to the ''security-based swap dealer'' definition.[705] In light of the differences between the rules of the Commission and the CFTC, the Commission believes it is appropriate to permit such firms to comply with the capital, margin, and segregation requirements of the CEA and the CFTC's rules, provided the firm's security-based swaps business is not a significant part of the security-based swap market and predominantly involves dealing in swaps as compared to security-based swaps. In this circumstance, the CFTC's regulatory interest in the firm will greatly exceed the Commission's regulatory interest given the relative size of its swaps business as compared to its security-based swaps business.[706]

For these reasons, the Commission is adopting an alternative compliance mechanism in Rule 18a–10 pursuant to which a stand-alone SBSD that is registered as a swap dealer and predominantly engages in a swaps business may elect to comply with the capital, margin and segregation requirements of the CEA and the CFTC's rules in lieu of complying with the capital, margin, and segregation requirements in Rules 18a–1, 18a–3, and 18a–4.[707] This will address the concern raised by the commenters that it would be inefficient to impose differing requirements on a firm that is predominantly a swap dealer.

A firm may elect to operate pursuant to Rule 18a–10 if it meets certain conditions. First, under paragraphs (a)(1) through (3) of Rule 18a–10, the firm must be registered with the Commission as a stand-alone SBSD (*i.e.,* not also registered as a broker-dealer or an OTC derivatives dealer) and registered with the CFTC as a swap dealer. The Commission believes it is appropriate to permit stand-alone SBSDs—which will not be integrated into the traditional securities markets to the same degree as stand-alone broker-dealers and broker-dealer SBSDs—to comply with Rule 18a–10 because their securities activities will be limited to dealing in security-based swaps. The requirement to be registered with the CFTC is designed to ensure that the firm is subject to CFTC oversight given that it will be adhering to the CFTC's rules.

Second, under paragraph (a)(4) of Rule 18a–10, the stand-alone SBSD must be exempt from the segregation requirements of Rule 18a–4. As discussed above in section II.C.2. of this release, the Commission has added a provision to Rule 18a–4 that will exempt a stand-alone or bank SBSD from the rule's omnibus segregation requirements if it meets certain conditions, including that it does not clear security-based swaps for other persons. Section 3E(g) of the Exchange Act applies the customer protection elements of the stockbroker liquidation provisions to cleared security-based swaps and related collateral, and to collateral delivered as initial margin for non-cleared security-based swaps if the collateral is subject to a customer protection requirement under Section 15(c)(3) of the Exchange Act or a segregation requirement. Consequently, a stand-alone SBSD that does not have cleared security-based swap customers and is not subject to a segregation requirement with respect to collateral for non-cleared security-based swaps will not implicate the stockbroker liquidation provisions. Given this result, the Commission believes it would be appropriate to permit the firm to comply with CEA and CFTC segregation requirements to the extent applicable in lieu of Rule 18a–4.

Third, under paragraph (a)(5) of Rule 18a–10, the aggregate gross notional amount of the firm's outstanding security-based swap positions must not exceed the lesser of two thresholds as of the most recently ended quarter of the firm's fiscal year.[708] The thresholds are: (1) The maximum fixed-dollar gross notional amount of open security-based swaps specified in paragraph (f) of the rule (''maximum fixed-dollar threshold''); and (2) 10% of the combined aggregate gross notional amount of the firm's open security-based swap and swap positions (''10% threshold'').

These thresholds are designed to limit the availability of the alternative compliance mechanism to firms whose security-based swaps business is not a significant part of the security-based swap market and that are predominately engaged in a swaps business as compared to a security-based swaps business. In this regard, the capital, margin, and segregation requirements being adopted today are designed to promote the safety and soundness of an SBSD and the ability of the Commission to oversee the firm and, thereby, protect the firm, its counterparties, and the integrity of the security-based swap market. Moreover, the security-based swap market and the broader securities markets (such as the cash markets for equity and fixed-income securities) are interrelated, given that economically similar instruments can be traded in both markets (*e.g.,* an equity security in the cash market and a total return swap referencing that security in the security-based swap market). For these reasons, the Commission has a heightened regulatory interest in stand-alone SBSDs that will be significant participants in the security-based swap market. Therefore, in crafting the alternative compliance mechanism, the Commission sought to calibrate the maximum-fixed-dollar and 10% thresholds to exclude stand-alone SBSDs that will be significant participants in this market.[709]

The amount of the maximum fixed-dollar threshold is $250 billion for a transitional period of 3 years and then will drop to $50 billion (unless the Commission issues an order as discussed below). Based on current information about the security-based swap market and the participants and potential participants in that market, the Commission believes that a stand-alone SBSD with a gross notional amount of outstanding security-based swaps of no more than $50 billion will not be a

[705] *See* 17 CFR 240.3a71–2 (''Rule 3a71–2'').

[706] In situations under Rule 18a–10 where a stand-alone SBSD elects to meet its regulatory requirements by complying with the CEA and the CFTC's rules, because of the differences in the Commission's and the CFTC's rules, the Commission anticipates that its staff will work closely with the staffs of the CFTC and the National Futures Association.

[707] The term ''stand-alone SBSD'' when used in this section II.D. of the release does not include a firm that is also registered as an OTC derivatives dealer. As discussed below, the alternative compliance mechanism is not available to a nonbank SBSD that is also registered as a broker-dealer, including a broker-dealer that is an OTC derivatives dealer. In theory, a bank SBSD could use the alternative compliance mechanism if it met the required conditions. However, these entities will be subject to the Commission's final segregation rule for stand-alone and bank SBSDs (Rule 18a–4), but not the Commission's final capital and margin rules. Moreover, as discussed above in section II.C.2. of this release, Rule 18a–4, as adopted, contains an exemption provision. The Commission expects bank SBSDs will take advantage of the exemption provision in the segregation rule rather than use the alternative compliance mechanism. The reason for this belief is that the exemption in Rule 18a–4 does not place a limit on the size of the firm's security-based swap business as a condition to qualify for the exemption, and it does not require firms to comply with requirements of the CEA and the CFTC's rules.

[708] The gross notional amount is based on the notional amounts of the firm's security-based swaps and swaps that are outstanding as of the quarter end. It is not based on transaction volume during the quarter.

[709] *See also* section VI. of the release (providing an economic analysis of Rule 18a–10, as adopted, including the costs and benefits of the rule).

significant participant in the security-based swap market. However, as stated above in section I.A. of this release, the Commission recognizes that the firms subject to the capital, margin, and segregation requirements being adopted today are operating in a market that continues to experience significant changes in response to market and regulatory developments. For these reasons, the Commission believes it is appropriate to set a maximum fixed-dollar threshold that is well in excess of $50 billion for a transitional period of 3 years. Therefore, the maximum fixed-dollar threshold will be $250 billion for 3 years, starting on the compliance date for the capital, margin and segregation rules being adopted today. This transitional $250 billion threshold will provide a stand-alone SBSD operating under the alternative compliance mechanism (*i.e.,* firms that are predominantly engaged in a swaps business) with a substantial amount of leeway to develop their security-based swaps business without managing the level of that business to the lower $50 billion threshold. If the security-based swaps business of these firms develops to a degree that the $50 billion threshold would require them to refrain from taking on additional business, the Commission can assess whether the amount of the additional business that causes them to exceed the threshold makes them a significant participant in the security-based swap market.

The transitional period therefore will provide the Commission with the opportunity to evaluate the impact that the $50 billion threshold would have on firms operating pursuant to the alternative compliance mechanism before the threshold drops from $250 billion to $50 billion. Moreover, the final rule establishes a process through which the Commission, by order, can: (1) Maintain the maximum fixed-dollar amount at $250 billion for an additional period of time or indefinitely after the 3-year transition period ends; or (2) lower it to an amount that is less than $250 billion but greater than $50 billion.[710] This process could provide firms operating under the alternative compliance mechanism with additional time to transition from the $250 billion threshold to the $50 billion threshold or another threshold.

The final rules provide that the Commission will issue an order after considering the levels of security-based swap activity of stand-alone SBSDs operating under the alternative compliance mechanism. The Commission intends to analyze how significant these entities are to the security-based swap market and broader securities markets based on their levels of their security-based swap activity. The analysis will consider the firm's individual and collective impact on the security-based swap market. Based on this analysis, the Commission could decide to take no action and let the $250 billion maximum fixed-dollar threshold transition to $50 billion on the 3-year anniversary of the compliance date for the capital, margin, and segregation rules being adopted today. Alternatively, the Commission could decide to reset the maximum fixed-dollar threshold to a level greater than $50 billion (but no more than $250 billion) or provide additional time for firms to transition from a $250 billion threshold to the $50 billion threshold.

The process in the final rule provides that the Commission will publish notice of the potential change to the maximum fixed-dollar threshold (*i.e.,* extending the $250 billion threshold for an additional period of time or indefinitely, or lowering it to a level between $250 billion and $50 billion) and subsequently issue an order regarding the change. The Commission intends to provide such notice in sufficient time for the public to be aware of the potential change.

In summary, the maximum fixed-dollar threshold sets an absolute limit on the availability of the alternative compliance mechanism irrespective of the size of the firm's swaps business as compared to its security-based swaps business. Thus, a firm potentially may not exceed the 10% threshold given the large size of its swaps business but could exceed the maximum fixed-dollar threshold because its security-based swaps business is sufficiently large. This absolute limit is designed to exclude stand-alone SBSDs that are significant participants in the security-based swap market from qualifying for the alternative compliance mechanism.

The 10% threshold establishes a limit on the ratio of the firm's security-based swaps business to its combined security-based swaps and swaps businesses. In crafting this threshold, the Commission sought to limit the availability of the alternative compliance mechanism to firms that are predominantly engaged in a swaps business as compared to a security-based swaps business. Consequently, if the firm's security-based swap business does not exceed the maximum fixed-dollar threshold, it nonetheless may not qualify for the alternative compliance mechanism if its security-based swaps business exceeds the ratio set by the 10% threshold. This is designed to limit the alternative compliance mechanism to firms for which the CFTC (as opposed to the Commission) has a heightened regulatory interest.

Under paragraph (a)(5) of Rule 18a–10, the firm must not exceed the lesser of these thresholds as of the most recently ended quarter of its fiscal year. This point-in-time requirement is designed to simplify the process for determining whether the firm meets the condition by aligning it with when the firm closes its books for financial recordkeeping and reporting purposes. A quarterly test (as opposed to an annual test) also is designed to ensure that a firm using the alternative compliance mechanism consistently limits its security-based swaps business in a manner that aligns with the Commission's objective: To provide this option only to firms that are not a significant part of the security-based swap market and predominantly deal in swaps as compared to security-based swaps. Moreover, a quarterly test (as opposed to a requirement to meet the threshold test at all times) is designed to limit the possibility that a firm operating pursuant to the alternative compliance mechanism inadvertently exceeds one of the thresholds for a brief period of time (particularly by an immaterial amount) and, as a consequence, can no longer use it.

Paragraph (b) of Rule 18a–10 sets forth requirements for a firm that is operating pursuant to the rule. Paragraph (b)(1) provides that the firm must comply with the capital, margin, and segregation requirements of the CEA and the CFTC's rules applicable to swap dealers and treat security-based swaps and related collateral pursuant to those requirements to the extent the requirements do not specifically address security-based swaps and related collateral. Consequently, a firm that is subject to Rule 18a–10 must comply with applicable capital, margin, and segregation requirements of the CEA and the CFTC's rules and a failure to comply with one or more of those rules will constitute a failure to comply with Rule 18a–10. Moreover, the firm must treat security-based swaps and related collateral pursuant to the requirements of the CEA and the CFTC's rules even if the CEA and the CFTC's rules do not specifically address security-based swaps and related collateral. This provision is designed to ensure that security-based swaps and related collateral do not fall into a ''regulatory gap'' with respect to a nonbank SBSD operating under the alternative compliance mechanism. Thus, if a capital, margin, or segregation

[710] *See* paragraphs (f)(1)(i) and (ii) of Rule 18a–10, as adopted.

requirement applicable to a swap or collateral related to a swap is silent as to a security-based swap or collateral related to a security-based swap, the nonbank SBSD must treat the security-based swap or collateral related to a security-based swap pursuant to the requirement applicable to the swap or collateral related to the swap.[711]

Paragraph (b)(2) of Rule 18a–10 requires the firm to provide a written disclosure to its counterparties after it begins operating pursuant to the rule. The disclosure must be provided before the first transaction with the counterparty after the firm begins operating pursuant to the rule. The disclosure must notify the counterparty that the firm is complying with the applicable capital, margin, and segregation requirements of the CEA and the CFTC's rules in lieu of complying with Rules 18a–1, 18a–3, and 18a–4. The disclosure requirement is designed to alert the counterparty that the firm is not complying with these Commission rules notwithstanding the fact that the firm is registered with the Commission as an SBSD. This will provide the counterparty with the opportunity to assess the implications of transacting with the SBSD under these circumstances.

Paragraph (b)(3) of Rule 18a–10 requires the firm to immediately notify the Commission and the CFTC in writing if it fails to meet a condition in paragraph (a) of the rule. This notice—by immediately alerting the Commission and the CFTC of the firm's status—will provide the agencies with the opportunity to promptly evaluate the situation and coordinate any regulatory responses such as increased monitoring of the firm.

Paragraph (c) of Rule 18a–10 addresses when a firm fails to comply with a condition in paragraph (a) of the rule and, therefore, no longer qualifies to operate pursuant to the rule. The paragraph provides that a firm in that circumstance must begin complying with Rules 18a–1, 18a–3, and 18a–4 no later than either: (1) Two months after the end of the month in which the firm failed to meet the condition in paragraph (a); or (2) for a longer period of time as granted by the Commission by order subject to any conditions imposed by the Commission. This period of time to come into compliance with the Commission's rules (''compliance period'') is modeled on the *de minimis* exception to the ''security-based swap dealer'' definition.[712] Under paragraph (b) of Rule 3a71–2, an entity that no longer meets the requirements of the *de minimis* exception will be deemed to not be an SBSD until the earlier of the date on which it submits a complete application to register as an SBSD or two months after the end of the month in which the entity becomes no longer able to take advantage of the exception. The compliance period in Rule 18a–10 is designed to provide an SBSD with time to implement systems, controls, policies, and procedures and take other necessary steps to comply with Rules 18a–1, 18a–3, and 18a–4. The Commission, by order, can grant the SBSD additional time if necessary.

The conditions in paragraphs (a)(1) through (4) of Rule 18a–10 must be met at all times an SBSD is operating pursuant to the rule. Consequently, the compliance period will begin to run on the day of a month that the SBSD fails to meet a condition in paragraphs (a)(1) through (4). As discussed above, whether a firm meets the condition in paragraph (a)(5) of Rule 18a–10 will be determined as of the most recently ended quarter of the firm's fiscal year. Therefore, a firm could fail to meet this condition only on a day that is the end of one of its fiscal year quarters. If the firm fails to meet the condition on one of those days, the compliance period will begin to run on that day.

Paragraph (d) of Rule 18a–10 addresses how a firm would elect to operate pursuant to the rule. Under paragraph (d)(1), a firm can make the election as part of the process of applying to register as an SBSD. In this case, the firm must provide written notice to the Commission and the CFTC during the registration process of its intent to operate pursuant to the rule. Upon being registered as an SBSD, the firm can begin complying with Rule 18a–10, provided it meets the conditions in paragraph (a) of the rule.

Under paragraph (d)(2) of Rule 18a–10, an SBSD can make the election after the firm has been registered as an SBSD. In this case, the firm must provide written notice to the Commission and the CFTC of its intent to operate pursuant to the rule and continue to comply with Rules 18a–1, 18a–3, and 18a–4 for two months after the end of the month in which the firm provides the notice or for a shorter period of time as granted by the Commission by order subject to any conditions imposed by the Commission. The requirement that the firm continue complying with the Commission's rules for a period of time after making the election is designed to provide the Commission and the CFTC with an opportunity to examine the firm before it begins operating pursuant to the alternative compliance mechanism and to prepare for the firm no longer complying with the Commission's rules.

As discussed above, paragraph (b)(3) requires a firm operating pursuant to the rule to immediately notify the Commission and the CFTC in writing if the SBSD fails to meet a condition in paragraph (a). Further, paragraphs (d)(1) and (2) require a firm to provide written notice to the Commission and the CFTC of its intent to operate pursuant to the rule. Paragraph (e) of Rule 18a–10 provides that the notices required by the rule must be sent by facsimile transmission to the principal office of the Commission and the regional office of the Commission for the region in which the security-based swap dealer has its principal place of business or an email address to be specified separately, and to the principal office of the CFTC in a manner consistent with the notification requirements of the CFTC.[713] The paragraph also requires that notices include a brief summary of the reason for the notice and the contact information of an individual who can provide further information about the matter that is the subject of the notice. This will facilitate the ability of the Commission and the CFTC to follow-up with the firm and gather further information about the matter that triggered the notice requirement.

E. Cross-Border Application of Capital, Margin, and Segregation Requirements

1. Capital and Margin Requirements

In 2013, the Commission preliminarily interpreted the Title VII requirements associated with registration to apply generally to the activities of registered entities. In reaching that preliminary conclusion, the Commission did not concur with the views of certain commenters that the Title VII requirements should not apply to the foreign security-based swap activities of registered entities, stating that such a view could be difficult to

[711] *See, e.g.,* Letter from Eileen T. Flaherty, Director, Division of Swap Dealer and Intermediary Oversight, and Jeffrey M. Bandman, Acting Director, Division of Clearing and Risk, CFTC, to Mary P. Johannes, Senior Director, ISDA (Aug. 23, 2016) (providing no-action relief to swap dealers and major swap participants with respect to the CFTC's margin rules for non-cleared swaps pursuant to which these entities can portfolio margin non-cleared swaps with non-cleared security-based swaps, provided, among other conditions, the security-based swaps shall be treated as if they were swaps for all applicable provisions of the CFTC's margin rules).

[712] *See* Rule 3a71–2.

[713] *See* 17 CFR 240.17a–11 (requiring a similar process to provide notice to the Commission and the CFTC). *See also Staff Guidance for Filing Broker-Dealer Notices, Statements, and Reports, available at https://www.sec.gov/divisions/marketreg/bdnotices.htm* (providing a fax number that broker-dealers may use to send these notices).

reconcile with, among other things, the statutory language describing the requirements applicable to SBSDs.[714]

a. Treatment of Cross-Border Transactions

The Commission further preliminarily identified capital and margin requirements as entity-level requirements, rather than requirements specifically applicable to particular transactions. Entity-level requirements primarily address concerns relating to the entity as a whole, with a particular focus on safety and soundness of the entity to reduce systemic risk in the U.S. financial system. The Commission accordingly proposed to apply the entity-level requirements on a firm-wide basis to address risks to the SBSD as a whole. The Commission did not propose any exception from the application of the entity-level requirements to SBSDs.[715]

Commenters did not address the proposal to treat capital requirements as entity-level requirements. The Commission continues to believe these requirements must apply to the entity as a whole. In reaching this conclusion, the Commission recognizes that the objective of the capital rule for SBSDs is the same as the capital rule for broker-dealers—to ensure that the entity maintains at all times sufficient liquid assets to promptly satisfy its liabilities, and to provide a cushion of liquid assets in excess of liabilities to cover potential market, credit, and other risks.[716] The tangible net worth standard applicable to nonbank MSBSPs is intended to be applied to the entity as a whole to ensure the MSBSP's solvency is based on tangible assets. Therefore, the Commission is also treating the nonbank MSBSP capital requirements as entity-level requirements.

With respect to margin, a commenter pointed out that ''the application and enforcement of margin requirements applies on a transaction-by-transaction basis and the calculation of margin depends on the circumstances of a particular [security-based swap].'' [717] Another commenter opposed characterizing margin as an entity-level requirement due to a concern that doing so could result in a substituted compliance determination where firms could ''comply with only a comparable foreign regime in every circumstance, regardless of who they transact with or where the transactions occur.'' [718] The commenter advocated that the Commission ''either treat margin as a transaction-level requirement or not permit substituted compliance in these transactions.'' A number of commenters requested that margin be treated as a transaction-level requirement for consistency with other domestic and foreign regulators.[719] Some commenters also argued there could be costs and operational complications resulting from subjecting a foreign registrant to both Commission and home country margin requirements.[720]

Margin is designed to protect the nonbank SBSD or MSBSP from the consequences of a counterparty's default.[721] Permitting different margin requirements based on the location of the counterparty is not consistent with this objective. Further, treating margin as a transaction-level requirement could cause those counterparties entering into transactions that constitute the U.S. business of a nonbank registrant to bear a greater burden in ensuring the safety and soundness of the nonbank registrant than counterparties that are part of the nonbank registrant's foreign business.[722]

The Commission also concludes that treating margin solely as a transaction-level requirement would not adequately further the objectives of using margin to ensure the safety and soundness of nonbank registrants because it could result in entities with global businesses collecting significantly less collateral than would otherwise be required to the extent that they are not required by local law to collect comparable margin from their counterparties. This potential outcome could increase the registrant's risk of failure if certain counterparties are not required to post margin, especially during a period when the market is already unstable.[723]

In response to the comment that treating margin requirements as entity-level requirements would permit nonbank SBSDs in every circumstance to use foreign requirements to satisfy the margin requirements, the Commission intends to consider certain factors to mitigate this risk prior to making a substituted compliance determination. More specifically, the Commission intends to consider whether the foreign financial regulatory system requires registrants to adequately cover their current and potential future exposure to OTC derivatives counterparties, and ensures registrants' safety and soundness, in a manner comparable to the applicable provisions arising from the Exchange Act and its rules and regulations.[724]

For all of these reasons, the Commission is treating the nonbank SBSD margin requirements as entity-level requirements. The margin requirements applicable to nonbank MSBSPs are intended to be applied to the entity as a whole for the same reasons the margin requirements for nonbank SBSDs are intended to apply to the entity as a whole. Therefore, the Commission is also treating the nonbank

[714] *See Cross-Border Proposing Release,* 78 FR at 30986.

[715] *See* 78 FR at 31011. The Commission similarly expressed the preliminary view that MSBSPs should be required to adhere to the entity-level requirements. *See* 78 FR at 31035.

[716] *See Cross-Border Proposing Release,* 78 FR at 31011.

[717] *See* Letter from Kenneth E. Bentsen, Jr., President, SIFMA, Walt Lukken, President and Chief Executive Officer, Futures Industry Association, and Richard M. Whiting, Executive Officer and General Counsel, The Financial Services Roundtable (Aug. 21, 2013) (''SIFMA 8/21/2013 Letter'').

[718] *See* Letter from Dennis M. Kelleher, President and Chief Executive Officer, Stephen W. Hall, Securities Specialist, and Katelynn O. Bradley, Attorney, Better Markets, Inc. (Aug. 21, 2013) (''Better Markets 8/21/2013 Letter'').

[719] *See, e.g.,* Letter from Koichi Ishikura, Executive Chief of Operations for International Headquarters, Japan Securities Dealers Association (Aug. 21, 2013) (''Japan SDA Letter'') (urging the Commission and the CFTC to align their rules to avoid ''hamper[ing] efficient management of derivatives transactions'').

[720] *See, e.g.,* Letter from Sarah A. Miller, Chief Executive Officer, Institute of International Bankers (Aug. 21, 2013) (''IIB 8/21/2013 Letter'') (stating that it would be ''cost-intensive'' to ''negotiate and execute separate credit support documentation, make separate margin calculations and have separate operational procedures across its swap and [security-based swap] transactions'').

[721] The Commission acknowledges that the requirement that nonbank SBSDs post variation margin to counterparties is primarily designed to protect the counterparty from the consequences of the nonbank SBSD's default. However, because the collection of variation and initial margin by the nonbank SBSD is critical to the safety and soundness of the nonbank SBSD, the Commission believes it appropriate to treat margin as an entity-level requirement even though the component of the rule requiring the nonbank SBSD to post variation margin is designed to protect the counterparty.

[722] *See* Section 15F(e)(3)(A) of the Exchange Act (providing that the Commission's statutorily mandated initial and variation margin requirements shall ''help ensure the safety and soundness'' of the SBSD or MSBSP).

[723] 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. So, when ''trigger events'' occurred during the financial crisis, counterparties faced significant liquidity strains in seeking to meet the requirements to deliver collateral. As a result, some dealers experienced large uncollateralized exposures to counterparties experiencing financial difficulty, which, in turn, risked exacerbating the already severe market dislocation. *See, e.g.,* Orice M. Williams, Director, Financial Markets and Community Investment, GAO, *Systemic Risk: Regulatory Oversight and Recent Initiatives to Address Risk Posed by Credit Default Swaps,* GAO–09–397T (Mar. 2009); GAO, *Financial Crisis: Review of Federal Reserve System Financial Assistance to American International Group, Inc.,* GAO–11–616 (Sept. 2011).

[724] *See* paragraph (d)(5) of Rule 3a71–6, as amended.

MSBSP margin requirements as entity-level requirements.

The Commission preliminarily identified the SBSD segregation requirements as transaction-level requirements.[725] Consequently, proposed Rule 18a–4 contained provisions to address the application of the segregation requirements to cross-border security-based swap transactions of foreign SBSDs. The applicable segregation requirements are tailored depending on the type of registrant, security-based swap, and customer. The Commission did not receive comments specifically addressing this proposed treatment of segregation requirements. However, one commenter stated that it ''support[s] the Commission's overall proposal to distinguish between entity-level and transaction-level requirements'' and that it ''generally support[s] the Commission's proposed cross-border application of segregation requirements to foreign SBSDs.''[726] The Commission continues to treat segregation requirements as transaction-level requirements.

Amendments to the Substituted Compliance Rule

The Commission proposed to make substituted compliance potentially available in connection with the requirements applicable to foreign SBSDs pursuant to Section 15F of the Exchange Act, other than the registration requirements. Because the capital and margin requirements were grounded in Section 15F, substituted compliance generally would have been available for those requirements under the proposal.[727] Upon a Commission substituted compliance determination, a person would be able to satisfy relevant capital or margin requirements by substituting compliance with corresponding requirements under a foreign regulatory system.

The Commission subsequently adopted Rule 3a71–6, which provides that substituted compliance is available with respect to the Commission's business conduct requirements, and (rather than addressing all requirements under Section 15F of the Exchange Act) reserved the issue as to whether substituted compliance also would be available in connection with other requirements under that statute.[728] Rule 3a71–6 was amended to make substituted compliance available with respect to the Commission's trade acknowledgment and verification requirements.[729] Today the Commission is amending Rule 3a71–6 to make the nonbank SBSD and MSBSP capital and margin requirements available for substituted compliance determinations.

One commenter expressed concerns that there is no adequate legal or policy justification for allowing substituted compliance.[730] In contrast to the implication of that comment, however, substituted compliance does not constitute exemptive relief and does not excuse registered SBSDs and MSBSPs from having to comply with the Commission's capital and margin requirements. Instead, substituted compliance provides an alternative method of satisfying those requirements under Title VII.

i. Basis for Substituted Compliance in Connection With Capital and Margin Requirements

In light of the global nature of the security-based swap market and the prevalence of cross-border transactions within that market, there is the potential that the application of the Title VII capital and margin requirements may duplicate or conflict with applicable foreign requirements, even when the two sets of requirements implement similar goals and lead to similar results. Such duplications or conflicts could disrupt existing business relationships, and, more generally, reduce competition and market efficiency.[731]

To address those effects, the Commission concludes that under certain circumstances it may be appropriate to allow for the possibility of substituted compliance whereby foreign SBSDs and MSBSPs may satisfy Section 15F(e) of the Exchange Act and Rules 18a–1, 18a–2, and 18a–3 thereunder by complying with comparable foreign requirements. Allowing for the possibility of substituted compliance in this manner may help achieve the benefits of these capital and margin requirements in a way that helps avoid regulatory duplication or conflict and hence promotes market efficiency, enhances competition, and facilitates a well-functioning global security-based swap market. Accordingly, Rule 3a71–6 is amended to identify Section 15F(e) of the Exchange Act and Rules 18a–1, 18a–2, and 18a–3 thereunder as being eligible for substituted compliance.[732]

A number of comments addressed substituted compliance as it specifically applies to the Commission's capital and margin requirements. One commenter generally asked the Commission to ''recognize local margin requirements'' for foreign SBSDs,[733] while other commenters requested that the Commission coordinate with the prudential regulators on substituted compliance determinations for capital and margin.[734] Similarly, another commenter requested that the Commission jointly propose and adopt rules reflecting a harmonized and unified approach to the cross-border application of the security-based swaps and swaps provisions of Title VII of the Dodd-Frank Act.[735] While a joint rulemaking would present logistical challenges due to timing differences in agencies' implementation of cross-border regimes, the Commission staff has consulted and coordinated with the CFTC, the prudential regulators, and foreign regulatory authorities on the cross-border application of its rules, and plans to continue such consultation and coordination during the substituted compliance determination process.[736]

A few commenters sought blanket substituted compliance determinations that would automatically grant substituted compliance without requiring an independent comparability determination with respect to firms subject to foreign capital or margin requirements that are consistent with

[725] *See Cross-Border Proposing Release,* 78 FR at 31010–31011.

[726] *See* IIB 8/21/2013 Letter.

[727] *See Cross-Border Proposing Release,* 78 FR at 31085.

[728] *See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants,* Exchange Release No. 77617 (Apr. 14, 2016). *See Cross-Border Proposing Release,* 78 FR at 31207.

[729] *See Trade Acknowledgment and Verification of Security-Based Swap Transactions,* Exchange Act Release No. 78011 (June 8, 2016), 81 FR 39808, 30143–44 (June 17, 2016).

[730] *See* Better Markets 11/19/2018 Letter. *See also* Harrington 11/19/2018 Letter.

[731] *See generally Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants,* 81 FR at 30073–74 (addressing the basis for making substituted compliance available in the context of the business conduct requirements).

[732] *See* paragraph (d) of Rule 3a71–6, as adopted. Paragraph (a)(1) of Rule 3a71–6 provides that the Commission may, conditionally or unconditionally, by order, make a determination with respect to a foreign financial regulatory system that compliance with specified requirements under that foreign financial system by a registered SBSD and/or registered MSBSP, or class thereof, may satisfy the corresponding requirements identified in paragraph (d) of the rule that would otherwise apply.

[733] *See* ISDA 1/23/2013 Letter.

[734] *See* Center for Capital Markets Competitiveness, Chamber of Commerce 11/19/2018 Letter; ICI 11/19/2018 Letter; SIFMA 8/21/2013 Letter.

[735] *See* Letter from Walt L. Lukken, President and Chief Executive Officer, Futures Industry Association (Nov. 29, 2018) (''FIA 11/29/2018 Letter'').

[736] Section 712(a)(2) of the Dodd-Frank Act provides in part that the Commission shall ''consult and coordinate to the extent possible with the [CFTC] and the prudential regulators for the purposes of assuring regulatory consistency and comparability, to the extent possible.''

certain international standards.[737] In contrast, another commenter recommended that the Commission *not* consider consistency with the prudential regulators, international standards, and foreign regulators when making substituted compliance determinations.[738] In response to these comments, the Commission believes it is appropriate to analyze directly a foreign jurisdiction's capital and margin requirements. In particular, jurisdictions may customize their capital and margin requirements to local markets and activities. In addition, Rule 3a71–6 provides that the Commission's substituted compliance determination will take into consideration the effectiveness of the supervisory compliance program administered and the enforcement authority exercised by the foreign regulatory authority, which are expected to vary among foreign jurisdictions. Consequently, the analysis of any particular foreign jurisdiction's capital and margin requirements will be fact specific and therefore a ''blanket approach'' would not be appropriate.

Another commenter sought an exemption for foreign firms with respect to the Commission's margin requirements (among other requirements) pursuant to which they could comply with local requirements that are not comparable to U.S. requirements, provided the aggregate notional value of swaps in the jurisdictions where this exemption is used does not exceed 15% of the firm's total swap activities.[739] The Commission does not believe such an exemption would be appropriate because it could negatively impact the safety and soundness of the firm if the local requirements were less rigorous than the Commission's requirements.

ii. Comparability Criteria, and Consideration of Related Requirements

The Commission will endeavor to take a holistic approach in determining the comparability of foreign requirements for substituted compliance purposes, focusing on regulatory outcomes as a whole rather than on requirement-by-requirement similarity.[740] The Commission's comparability assessments associated with Section 15F(e) of the Exchange Act and Rules 18a–1, 18a–2, and 18a–3 thereunder accordingly will consider whether, in the Commission's view, the foreign regulatory system achieves regulatory outcomes that are comparable to the regulatory outcomes associated with the capital and margin requirements. More specifically, paragraph (a)(2)(i) of Rule 3a71–6 provides that the Commission's substituted compliance determination will take into account factors that the Commission determines appropriate, such as, for example, ''the scope and objectives of the relevant foreign regulatory requirements . . . , as well as the effectiveness of the supervisory compliance program administered, and the enforcement authority exercised, by a foreign financial regulatory authority or authorities in such system to support its oversight of such foreign security-based swap entity (or class thereof) or of the activities of such security-based swap entity (or class thereof).''

In reviewing applications, the Commission may determine to conduct its comparability analyses regarding the capital and margin requirements in conjunction with comparability analyses regarding other Exchange Act requirements that promote risk management in connection with SBSDs and MSBSPs. Accordingly, depending on the applicable facts and circumstances, the comparability assessment associated with the capital and margin requirements may constitute part of a broader assessment of the foreign regulatory system's risk mitigation requirements, and the applicable comparability assessments may be conducted at the level of those risk mitigation requirements as a whole. Commenters generally requested additional guidance regarding the criteria the Commission would consider when making a substituted compliance determination.[741] Such criteria have been set forth in the final rule as discussed below.

Comparability Criteria for Nonbank SBSD Capital Requirements

Rule 3a71–6 provides that prior to making a substituted compliance determination regarding SBSD capital requirements, the Commission intends to consider (in addition to any conditions imposed), whether the capital requirements of the foreign financial regulatory system are designed to help ensure the safety and soundness of registrants [742] in a manner that is comparable to the applicable provisions arising under the Exchange Act and its rules and regulations.[743] Under this provision, the Commission would analyze whether the capital and other prudential requirements of the foreign jurisdiction from an outcome perspective help ensure the safety and soundness of the registrants in a manner that is comparable to the applicable provisions arising under the Exchange Act and its rules and regulations.

Comparability Criteria for Nonbank MSBSP Capital Requirements

Nonbank MSBSPs are subject to a tangible net worth standard, rather than a net liquid assets test. This different standard recognizes that the entities required to register as nonbank MSBSPs may engage in a diverse range of business activities different from, and broader than, the securities activities conducted by stand-alone broker-dealers or nonbank SBSDs. In light of these considerations, Rule 3a71–6 provides that prior to making a substituted compliance determination regarding MSBSP capital requirements, the Commission intends to consider (in addition to any conditions imposed), whether the capital requirements of the foreign financial regulatory system are comparable to the applicable provisions arising under the Exchange Act and its rules and regulations.[744]

Comparability Criteria for Nonbank SBSD and MSBSP Margin Requirements

Obtaining collateral is one of the ways OTC derivatives dealers manage their credit risk exposure to OTC derivatives counterparties. Prior to the financial crisis, in certain circumstances, counterparties were able to enter into OTC derivatives transactions without having to deliver collateral. When ''trigger events'' occurred during the financial crisis, those counterparties faced significant liquidity strains when they were required to deliver collateral.

In light of these considerations, Rule 3a71–6 provides that prior to making a substituted compliance determination regarding SBSD margin requirements, the Commission intends to consider (in addition to any conditions imposed) whether the foreign financial regulatory

[737] *See, e.g.,* Citigroup 4/24/2018 Meeting; IIB/SIFMA Letter; IIB 11/19/2018 Letter; ISDA 11/19/2018 Letter; SIFMA 3/12/2014 Letter; SIFMA 11/19/2018 Letter.

[738] *See* Harrington 11/19/2018 Letter.

[739] *See* SIFMA 8/21/2013 Letter.

[740] *See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants,* 81 FR at 30078–79.

[741] *See, e.g.,* Letter from Americans for Financial Reform (Aug. 22, 2013) (''Americans for Financial Reform 8/22/2013 Letter''); Letter from Futures and Options Association (Aug. 21, 2013) (''Futures and Options Association Letter''). *See also Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53018–19 (soliciting comment on potential rule language that would modify the proposal in this manner).

[742] *See* Section 15F(e)(3)(A) of the Exchange Act (providing that the capital requirements for SBSDs shall ''help ensure the safety and soundness'' of the SBSD).

[743] *See* paragraph (d)(4)(i) of Rule 3a71–6, as amended.

[744] *See* paragraph (d)(4)(ii) of Rule 3a71–6, as amended.

system requires registrants to adequately cover their current and future exposure to OTC derivatives counterparties,[745] and ensures registrants' safety and soundness,[746] in a manner comparable to the applicable provisions arising under the Exchange Act and its rules and regulations.[747]

Similarly, Rule 3a71–6 provides that prior to making a substituted compliance determination regarding MSBSP margin requirements, the Commission intends to consider (in addition to any conditions imposed) whether the foreign financial regulatory system requires registrants to adequately cover their current exposure to OTC derivatives counterparties, and ensures registrants' safety and soundness, in a manner comparable to the applicable provisions arising under the Exchange Act and its rules and regulations.[748]

2. Segregation Requirements

a. Treatment of Cross-Border Transactions

As discussed above, the Commission proposed to treat the segregation requirements of Section 3E of the Exchange Act and proposed Rule 18a–4 as transaction-level requirements. Further, these requirements were not available for substituted compliance determinations. However, proposed Rule 18a–4 included provisions that addressed the applicability of these requirements with respect to different types of cross-border transactions.[749] These provisions in proposed Rule 18a–4 applied to foreign SBSDs and MSBSPs that were not dually registered as broker-dealers. Consequently, a broker-dealer SBSD needed to treat cross-border transactions no differently than any other types of transactions for purposes of the segregation requirements in Section 3E of the Exchange Act and proposed Rule 18a–4.

The cross-border provisions in proposed Rule 18a–4 for foreign stand-alone and bank SBSDs and MSBSPs distinguished between entities that were a U.S. branch or agency of a foreign bank, or neither of the above, and between cleared or non-cleared security-based swap transactions. The objective underlying these distinctions was to ensure that U.S. customers of a foreign stand-alone or bank SBSD or MSBSP were protected in the event the firm needed to be liquidated in a formal proceeding. Consequently, the differing treatment of cross-border transactions depending on these distinctions was tied to the applicable bankruptcy or liquidation laws that would apply to a failed foreign stand-alone or bank SBSD or MSBSP.

A commenter expressed general support for the Commission's proposed cross-border treatment of segregation requirements for foreign SBSDs as ''consistent with the objective of applying segregation requirements so they work in tandem with applicable insolvency laws.'' [750] Another commenter believed the Commission intended to make segregation requirements eligible for substituted compliance, and asked the Commission to clarify this fact.[751] The Commission is adopting the approach as proposed that segregation is a transaction-level (rather than entity-level) requirement, because the Commission believes transaction-based rules are the best mechanism for protecting U.S. customers, given that varying possible liquidation outcomes depending on the type of registrant, security-based swap, and customer involved.

Another commenter generally requested substituted compliance for all transaction-level requirements (which includes segregation requirements) to mitigate the risk of duplicative and/or conflicting regulatory requirements.[752] The transaction-based approach to segregation considers the risk of duplicative and/or conflicting regulatory requirements, but without requiring a substituted compliance application to be submitted. Similarly, another commenter asked for an exemption from the Commission's omnibus segregation requirements for foreign SBSDs (including foreign bank SBSDs) ''whose segregation and custody of customer assets are subject to the supervision of a local regulatory authority,'' because an insolvent or liquidated foreign SBSD would be subject to banking regulations or home country law, rather than SIPA or the U.S. Bankruptcy Code's stockbroker liquidation provisions.[753] However, the commenter's proposed approach does not consider that the Commission's approach is designed to protect U.S. customers of foreign SBSDs and MSBSPs.

The same commenter requested that the Commission follow the Department of Treasury's approach, which exempts banks from its government securities dealer customer protection requirements if they meet certain conditions and are subject to certain prudential regulator rules. More specifically, the commenter requested a blanket exemption from the Commission's omnibus segregation requirements for foreign SBSDs that are foreign banks with a U.S. branch because they would be liquidated under banking regulations instead of SIPA or the stockbroker liquidation provisions. In response, the Commission recognizes that a foreign SBSD that is not a registered broker-dealer but is a foreign bank may not be eligible to be liquidated pursuant to the stockbroker liquidation provisions, and as such, the foreign SBSD's insolvency proceeding would be administered under U.S. or foreign banking regulations. However, the Commission believes that due to existing ring-fencing laws, imposing segregation requirements on such a foreign SBSD with respect to certain security-based swap customers that are U.S. persons in all circumstances, and with respect to security-based swap customers regardless of U.S. person status when it receives funds or other property arising out of a transaction with a U.S. branch or agency of the foreign SBSD, will reduce the likelihood of U.S. counterparties incurring losses by helping identify customers' assets in an insolvency proceeding and would potentially minimize disruption to the U.S. security-based swap market.

A commenter requested that foreign SBSDs be exempted from transaction-level requirements (including segregation) when transacting with foreign funds managed by U.S. asset managers, because transaction-level requirements primarily focus on protecting counterparties by imposing certain obligations on both U.S. and foreign SBSDs.[754] A second commenter

[745] *See* Section 15F(e)(3) of the Exchange Act (stating that the margin requirements adopted under Section 15F(e)(2) of the Exchange Act must, among other things, ''be appropriate for the risk associated with the non-cleared security-based swaps held as a [SBSD] or [MSBSP]'').

[746] *See* Section 15F(e)(3) of the Exchange Act (stating that the margin requirements adopted under Section 15F(e)(2) of the Exchange Act must, among other things, ''help ensure the safety and soundness of the [SBSD] or [MSBSP]'').

[747] *See* paragraph (d)(5)(i) of Rule 3a71–6, as amended.

[748] *See* paragraph (d)(5)(ii) of Rule 3a71–6, as amended.

[749] *See Cross-Border Proposing Release,* 78 FR at 31018–22.

[750] *See* IIB 8/21/2013 Letter.

[751] *See* SIFMA 8/21/2013 Letter. *See also* IIB 11/19/2018 Letter (requesting that in connection with collateral for cleared security-based swaps, the Commission's segregation requirements should only apply to transactions with U.S. persons, and the foreign SBSD should be permitted to satisfy these requirements through substituted compliance.)

[752] *See, e.g.,* Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, Managed Funds Association, and Adam Jacobs, Director, Head of Markets Regulation, Alternative Investment Management Association (Aug. 19, 2013) (''MFA/AIMA 8/19/2013 Letter'').

[753] *See* IIB 8/21/2013 Letter.

[754] *See* Letter from Karrie McMillan, General Counsel, Investment Company Institute, and Dan

stated that collateral segregation and disclosure requirements should only apply to transactions with U.S. counterparties, so long as the firm maintains a separate account for collateral collected from U.S. persons as a way to protect U.S. counterparties in case of bankruptcy. The commenter also requested that foreign branches of U.S. banks which are not part of registered broker-dealers not be subject to segregation requirements when transacting with non-U.S. persons, to ''mitigate the competitive effects'' foreign branches may suffer relative to foreign SBSDs that are subject to segregation requirements in a narrower set of circumstances.

In response to these comments, granting these exemption requests would put U.S. customers' interests at risk in case of a foreign SBSD's bankruptcy. A primary purpose of the Commission's segregation requirements is to facilitate the prompt return of property to U.S. customers and security-based swap customers either before or during a liquidation if a registrant fails. The Commission is able to limit the segregation rules applicable to U.S. branches of foreign banks to a narrower set of transactions, because the applicable insolvency laws enable a ring-fencing mechanism by which regulators may ring fence creditor claims ''arising out of transactions had by them with'' the U.S. branches or agencies of the foreign bank.[755]

For the foregoing reasons, the Commission—as discussed below—is adopting the substance of the proposed segregation cross-border provisions in paragraph (e) of Rule 18a–4, but—as discussed in the next section—the Commission is modifying the structure of the paragraph by re-organizing it and making other non-substantive modifications.

Final Cross-Border Provisions for Foreign Bank SBSDs

A foreign bank SBSD that has a branch or agency in the United States should not be eligible to be a debtor under the U.S. stockbroker liquidation scheme.[756] Instead, the foreign bank's U.S. branches and agencies would likely be liquidated under federal or state banking law which ''ring fences'' creditor claims ''arising out of transactions had by them with'' the U.S. branches or agencies.[757] With respect to a foreign bank SBSD that has no branch or agency in the United States, such entities probably would not be liquidated in the United States for jurisdictional reasons. The treatment of U.S. customers in such a liquidation is unknown because it depends on the laws of the jurisdiction where the foreign SBSD is liquidated. However, many jurisdictions' laws provide for ring fencing similar to U.S. bank liquidation laws.

The proposed cross-border segregation provisions for foreign bank SBSDs were based on the understanding that ring fencing prioritized the claims of U.S. creditors above the claims of foreign creditors (rather than the actuality that *both* U.S. and foreign creditor claims arising out of a transaction with U.S. branches and agencies receive priority). Therefore, proposed Rule 18a–4 required a foreign bank SBSD with a U.S. branch to comply with the segregation requirements in Section 3E of the Exchange Act, and the rules and regulations thereunder (*e.g.,* proposed Rule 18a–4), with respect to cleared and non-cleared security-based swap transactions only with U.S. persons. The proposed cross-border provisions did not expressly address a foreign bank SBSD that has no branch or agency in the United States.

For the foregoing reasons, Rule 18a–4, as adopted, clarifies that the segregation requirements of Section 3E of the Exchange Act, and the rules and regulations thereunder, apply to a foreign bank SBSD (*i.e.,* a foreign bank, savings bank, cooperative bank, savings and loan association, building and loan association, or credit union): (1) With respect to a security-based swap customer that is a U.S. person (regardless of which branch or agency the customer's transactions arise out of), and (2) with respect to a security-based swap customer that is not a U.S. person if the foreign bank SBSD holds funds or other property arising out of a transaction had by such person with a U.S. branch or agency of the foreign SBSD.[758] Thus, the final cross-border provisions for foreign bank SBSDs expressly account for foreign bank SBSDs that do not have a U.S. branch and for foreign customers who transact with a U.S. branch of a foreign bank SBSD and, therefore, may be protected by U.S. ring fencing laws along with U.S. customers.

The Commission also proposed that the foreign bank SBSD maintain a special account designated for the exclusive benefit of U.S. security-based swap customers.[759] However, this language is removed as extraneous text because Rule 18a–4, as adopted, already requires SBSDs to maintain a special reserve account for the exclusive benefit of security-based swap customers.[760]

Final Cross-Border Provisions for Foreign Stand-Alone SBSDs

A foreign stand-alone SBSD should be subject to the U.S. Bankruptcy Code's stockholder liquidation provisions. In particular, Section 3E(g) of the Exchange Act provides ''customer'' status under the stockbroker liquidation provisions to all counterparties to cleared security-based swaps, making no distinction between U.S. and non-U.S. customers or counterparties.[761] If the Commission were to apply the segregation requirements only to assets of U.S. customers but not to assets of non-U.S. customers, the amount of assets segregated (*i.e.,* the assets of U.S. person customers) could be insufficient to satisfy the combined priority claims of both U.S. and non-U.S. customers in a stockbroker liquidation proceeding, potentially resulting in losses to U.S. customers. Therefore, proposed Rule 18a–4 required a foreign stand-alone SBSD to comply with the segregation requirements of Section 3E of the Exchange Act, and the rules and regulations thereunder, with respect to assets received from both U.S. and non-U.S. persons if the foreign stand-alone SBSD received collateral from at least one U.S. person to secure cleared security-based swaps.

Section 3E(g) of the Exchange Act also extends customer protection under the stockbroker liquidation provisions to collateral delivered as margin for non-cleared security-based swaps if the collateral is subject to a customer protection requirement under Section 15(c)(3) of the Exchange Act or a segregation requirement. Therefore, proposed Rule 18a–4 required a foreign stand-alone SBSD to comply with the segregation requirements of Section 3E of the Exchange Act, and the rules and regulations thereunder, with respect to non-cleared security-based swap transactions with U.S. persons (but not with non-U.S. persons). Under that approach, the collateral posted by U.S. person counterparties was subject to a segregation requirement and therefore these persons would have ''customer'' status under the stockbroker liquidation

Waters, Managing Director, ICI Global (Aug. 21, 2013) (''ICI 8/21/2013 Letter'').

[755] *See* 12 U.S.C. 3102(j).

[756] *See* 11 U.S.C. 109(b)(3)(B).

[757] *See, e.g.,* 12 U.S.C. 3102(j)(2); NY Banking Law § 606(4)(a).

[758] *See* paragraph (e)(1)(i) of Rule 18a–4, as adopted.

[759] *See Cross-Border Proposing Release,* 78 FR at 31022.

[760] *See* paragraph (c)(1) of Rule 18a–4, as adopted.

[761] *See also* 11 U.S.C. 741(2).

provisions.[762] Collateral posted by non-U.S. persons was not subject to a segregation requirement and, therefore, these persons would not have ''customer'' status.

For these reasons, the Commission is adopting the substance of the proposed cross-border provisions for foreign stand-alone SBSDs.[763] However, the Commission is making a clarifying modification to more clearly state that these provisions apply to a foreign SBSD that is not a broker-dealer and is not a foreign bank, savings bank, cooperative bank, savings and loan association, building and loan association, or credit union.[764]

Final Cross-Border Provisions for Foreign MSBSPs

The omnibus segregation requirements in Rule 18a–4 do not apply to MSBSPs. Consequently, if an MSBSP holds collateral for a security-based swap, it will be subject only to: (1) Paragraph (d) of Rule 18a–4, which requires an SBSD or MSBSP to provide notice of the customer's right to require segregation, and (2) Section 3E(f)(1)(B) of the Exchange Act, which provides that, if requested by the security-based swap customer, the MSBSP shall separately segregate the funds or other property for the benefit of the security-based swap customer. Consequently, proposed Rule 18a–4 excepted a foreign MSBSP that is not a broker-dealer from the segregation requirements in Section 3E of the Exchange Act and the disclosure requirements in paragraph (d) of Rule 18a–4 with respect to assets received from a security-based swap customer that is not a U.S. person to secure security-based swaps.[765] The Commission did not receive comment on this proposed exception and is adopting the substance of the proposal.[766]

b. Disclosure Requirements

The Commission proposed disclosure requirements for foreign SBSDs because the treatment of security-swap customers in a liquidation proceeding may vary depending on the foreign SBSD's status and the insolvency laws applicable to the foreign SBSD. In particular, a foreign SBSD was required to disclose to a U.S. security-based swap customer—prior to accepting any assets from the person with respect to a security-based swap—the potential treatment of the assets segregated by the foreign SBSD pursuant to Section 3E of the Exchange Act, and the rules and regulations thereunder, in insolvency proceedings under U.S. bankruptcy law and applicable foreign insolvency laws.[767] The intent was to require that a foreign SBSD disclose whether it could be subject to the stockbroker liquidation provisions in the U.S. Bankruptcy Code, whether the segregated funds or other property could be afforded customer property treatment under the U.S. bankruptcy law, and any other relevant considerations that may affect the treatment of the assets segregated under Section 3E of the Exchange Act in such foreign SBSD's insolvency proceedings. One commenter responded to the Commission's request for comment by opposing applying segregation-related disclosure requirements to transactions with non-U.S. counterparties, because of the Commission's more limited interest in non-U.S. counterparties. The Commission agrees and is adopting its proposal to limit the disclosure requirement to counterparties that are U.S. persons.

In addition, the Commission is modifying the rule text to clarify that the disclosures must be made in writing. As discussed above, the Commission intended that the matters to be disclosed would inform the counterparty about the application of U.S. bankruptcy and foreign insolvency laws to segregated funds or other property the SBSD will hold for the counterparty. The Commission does not believe that an SBSD could provide disclosure on these complex issues in a manner that, in fact, would inform the counterparty about them other than in writing. Therefore, the final rule explicitly provides that the disclosure must be in writing.

For the foregoing reasons, the Commission is adopting the disclosure requirements with the modifications described above.[768]

c. Non-Substantive Modifications

The Commission is making several organizational, clarifying, and non-substantive modifications to the proposed cross-border segregation rule text.

Paragraph (e) of Rule 18a–4 now has a simplified organizational structure compared to paragraphs (e) and (f) of proposed Rule 18a–4. First, the rule text no longer explicitly states that a foreign broker-dealer SBSD is subject to Section 3E of the Exchange Act and the Commission's security-based swap segregation requirements, even though broker-dealers continue to be subject to the segregation requirements.[769] The Commission's security-based swap segregation requirements applicable to stand-alone broker-dealers are located in paragraph (p) of Rule 15c3–3.[770] Thus, all broker-dealers registered with the Commission are subject to Rule 15c3–3, and there are no cross-border exemptions from Rule 15c3–3, even if the broker-dealer is also a foreign SBSD or MSBSP. The proposed rule text was intended to identify exemptions from the Commission's security-based swap segregation rules. As a result, it is not necessary to explicitly state that broker-dealers are subject to Rule 15c3–3 even if they are also foreign SBSDs or MSBSPs.

Second, rather than categorizing the applicable rules by cleared and non-cleared security-based swaps, and then further subdividing them by entity type, the rule paragraphs are now categorized by entity type. In addition, instead of a single paragraph addressing the cross-border non-cleared security-based swap segregation treatment of all foreign SBSDs that are not broker-dealers, there are separate paragraphs addressing foreign SBSDs that are not broker-dealers and are not foreign banks, and foreign SBSDs that are not broker-dealers and are foreign banks. Since a foreign SBSD that is neither a broker-dealer nor a foreign bank is the only entity that must apply a different rule depending on whether the security-based swaps are cleared or non-cleared, this is the only paragraph that requires

[762] Section 3E(g) of the Exchange Act provides that the term ''customer,'' as defined in Section 741 of title 11 of the U.S. Code, excludes any person, to the extent that such person has a claim based on any open repurchase agreement, open reverse repurchase agreement, stock borrowed agreement, non-cleared option, or non-cleared security-based swap 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.

[763] *See* paragraph (e)(1)(ii) of Rule 18a–4, as adopted.

[764] Throughout paragraph (e) of Rule 18a–4, as adopted, the phrase ''foreign bank, foreign savings bank, foreign cooperative bank, foreign savings and loan association, foreign building and loan association, or foreign credit union'' parallels and is intended to have the same meeting as the phrase ''foreign bank, savings bank, cooperative bank, savings and loan association, building and loan association, or credit union'' in 11 U.S.C. 109(b)(3)(B).

[765] *See Cross-Border Proposing Release,* 78 FR at 31035.

[766] *See* paragraph (e)(2) of Rule 18a–4, as adopted.

[767] *See Cross-Border Proposing Release,* 78 FR at 31022.

[768] *See* paragraph (e)(3) of Rule 18a–4, as adopted.

[769] *See Cross-Border Proposing Release,* 78 FR at 31020–21. As discussed below, the Commission is re-organizing paragraph (e) and making other non-substantive modifications to the paragraph.

[770] *See Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53016 (soliciting comment on potential rule language that would modify the proposal in this manner).

subparagraphs for cleared and non-cleared security-based swaps.[771]

Paragraph (e)(2) of Rule 18a–4, which prescribes the segregation requirements applicable to foreign MSBSPs, is now structured in the affirmative instead of the negative by identifying which requirements apply to foreign MSBSPs instead of identifying which requirements ''shall not'' apply to foreign MSBSPs.[772]

The Commission is also making several changes to simplify and clarify the rule text. Instead of including a cross-reference to the rule defining ''foreign security-based swap dealer,'' ''foreign major security-based swap participant,'' and ''U.S. person'' each time these terms appear, definitions of these terms are added to the ''Definitions'' section in Rule 18a–4.[773] With respect to SBSDs, ''counterparty'' is replaced with ''security-based swap customer'' for consistency with the rest of Rule 18a–4 which uses the defined term ''security-based swap customer.'' To eliminate ambiguity about the term ''registered'' SBSD, MSBSP, or broker-dealer, the rule text now clarifies that ''registered'' refers to an entity registered with the Commission by explicitly cross-referencing the section of the Exchange Act that the entity would register under (*i.e.,* ''foreign [SBSD or MSBSP] registered under Section 15 of the Exchange Act (15 U.S.C. 78o–10)'' or ''broker or dealer registered under Section 15 of the Exchange Act (15 U.S.C. 78o)'').

Several simplifying changes are being made to the cross-border segregation rule text. Throughout the rule text, the phrase ''any assets received . . . to margin, guarantee, or secure a [cleared or non-cleared] security-based swap (including money, securities, or property accruing to such [U.S. person or non-U.S. person] counterparty as the result of such a security-based swap transaction)'' is simplified to better align with the language used in other rule text. Thus, paragraph (e)(1)(ii) of Rule 18a–4, as adopted, now references ''funds or other property for [a or at least one] security-based swap customer that is a U.S. person with respect to a [cleared or non-cleared] security-based swap transaction'' to parallel Rule 18a–4's definition of a security-based swap customer. For the same reason, paragraph (e)(3) of Rule 18a–4, as adopted, now references ''funds or other property'' instead of ''assets,'' references ''funds or other property received, acquired, or held for'' instead of ''assets collected from,'' and references ''receiving, acquiring, or holding funds or other property'' instead of ''accepting any assets.'' Finally, paragraph (e)(2) of Rule 18a–4, as adopted, now omits the reference to ''assets . . . to margin, guarantee, or secure a security-based swap'' as extraneous.[774]

F. Delegation of Authority

The Commission is amending its rules governing delegations of authority to the Director of the Division of Trading and Markets (''Division''). The amendments delegate authority to the Division with respect to requirements in Rules 18a–1 and 18a–4, and are modeled on preexisting delegations of authority with respect to requirements in parallel Rules 15c3–1 and 15c3–3 under 17 CFR 200.30–3 (''Rule 30–3''). The amendments also add additional delegations of authority with respect to Rule 18a–1d (Satisfactory Subordinated Loan Agreements), as well as to Appendix E to Rule 15c3–1 and paragraph (d) to Rule 18a–1 with respect to the approval of the temporary use of a provisional model. These delegations are intended to permit Commission staff to perform functions under Rule 18a–1d for stand-alone SBSDs that are currently performed by a broker-dealer's DEA (*i.e.,* FINRA) under Appendix D to Rule 15c3–1.[775]

The amendments to Rule 30–3 authorize the Director of the Division to: (1) Review amendments to applications of SBSDs filed pursuant to paragraph (d) of Rule 18a–1 and to approve such amendments, unconditionally or subject to specified terms and conditions;[776] (2) impose additional conditions, pursuant to paragraph (d)(9)(iii) of Rule 18a–1 on an SBSD that computes certain of its net capital deductions pursuant to paragraph (d) of Rule 18a–1;[777] (3) require that an SBSD provide information to the Commission pursuant to paragraph (d)(2) of Rule 18a–1;[778] (4) pursuant to Rule 15c3–3 and Rule 18a–4, find and designate as control locations for purposes of paragraph (p)(2)(ii)(E) of Rule 15c3–3, and paragraph (b)(2)(v) of Rule 18a–4, certain broker-dealer and SBSD accounts which are adequate for the protection of customer securities;[779] (5) pursuant to paragraph (b)(6) of Rule 18a–1d, approve prepayment of a subordinated loan;[780] (6) pursuant to paragraph (c)(4) of Rule 18a–1d, approve prepayment of a revolving subordinated loan agreement;[781] (7) pursuant to paragraph (c)(5) of Appendix D to Rule 18a–1, examine any proposed subordinated loan agreement filed by a security-based swap dealer and find the agreement acceptable;[782] (8) determine, pursuant § 240.18a–1(d)(7)(ii), that the notice a security-based swap dealer must provide to the Commission pursuant to § 240.18a–1(d)(7)(i) will become effective for a shorter or longer period of time;[783] and (9) approve, pursuant to § 240.15c3–1e(a)(7)(ii) and § 240.18a–1(d)(5)(ii) of this chapter, the temporary use of a provisional model, in whole or in part, unconditionally or subject to any conditions or limitations.[784] In addition, paragraph (a)(7)(i)'s cross-reference to Rule 15c3–1 is corrected to reference paragraph (a)(6)(iii)(B) instead of paragraph (a)(6)(iii)(E), and paragraph (a)(7)(iv)'s cross-reference to Rule 15c3–1 is corrected to reference paragraph (a)(1)(ii) instead of paragraphs (f)(1)(i) and (ii).

These delegations of authority are intended to preserve Commission resources and increase the effectiveness and efficiency of the Commission's oversight of the financial responsibility rules for SBSDs being adopted today under the authority of the Dodd-Frank

[771] *See* paragraph (e)(1)(ii)(A) and (B) of Rule 18a–4, as adopted.

[772] *See* paragraph (e)(2) of Rule 18a–4, as adopted.

[773] *See* paragraphs (a)(3), (4), and (10) of Rule 18a–4, as adopted.

[774] Further, the phrase ''[S]ection 3E(f) of the Act (15 U.S.C. 78c–5(f))'' is replaced with ''section 3E of the Act (15 U.S.C. 78c–5)'' in paragraph (e)(2) of Rule 18a–4, as adopted, for consistency with the other subparagraphs under paragraph (e) of Rule 18a–4, which reference Section 3E of the Exchange Act. In addition, the following stylistic, corrective, and punctuation changes are being made to improve the rule's readability: (1) Adding or elaborating on paragraph and subparagraph headings; (2) replacing ''who'' with ''that'' in paragraphs (e)(1)(i) and (e)(3) of Rule 18a–4; (3) replacing the word ''shall'' with the word ''must'' in paragraph (e)(3) of Rule 18a–4; (4) replacing ''the U.S. bankruptcy law'' with ''U.S. bankruptcy law'' in paragraph (e)(3) of Rule 18a–4; and (5) replacing ''Section 3E of the Act'' and ''Section 3E of the Act, and the rules and regulations thereunder'' with ''section 3E of the Act (15 U.S.C. 3E( ), and the rules and regulations thereunder,'' the second and third times it appears in paragraph (e)(3) for completeness and for consistency with the first reference to ''Section 3E of the Act (15 U.S.C. 78c–5), and the rules and regulations thereunder'' in the same paragraph.

[775] The Commission is the examining authority for stand-alone SBSDs because they are not required to be a member of an SRO.

[776] *See* paragraph (a)(7)(vi)(A) of Rule 30–3, as amended.

[777] *See* paragraph (a)(7)(vi)(C) of Rule 30–3, as amended.

[778] *See* paragraph (a)(7)(vi)(D) of Rule 30–3, as amended.

[779] *See* paragraph (a)(10)(i) of Rule 30–3, as amended.

[780] *See* paragraph (a)(7)(vii)(A) of Rule 30–3, as amended.

[781] *See* paragraph (a)(7)(vii)(B) of Rule 30–3, as amended.

[782] *See* paragraph (a)(7)(vii)(C) of Rule 30–3, as amended.

[783] *See* paragraph (a)(7)(vi)(E) of Rule 30–3, as amended.

[784] *See* paragraph (a)(7)(vi)(F) of Rule 30–3, as amended.

Act. Nevertheless, the Division may submit matters to the Commission for its consideration, as it deems appropriate.

Administrative Law Matters

The Commission finds, in accordance with the Administrative Procedure Act (''APA''),[785] that these amendments relate solely to agency organization, procedure, or practice, and do not relate to a substantive rule. Accordingly, the provisions of the APA regarding notice of rulemaking, opportunity for public comment, and publication of the amendment prior to its effective date are not applicable. For the same reason, and because this amendment does not substantively affect the rights or obligations of non-agency parties, the provisions of the Small Business Regulatory Enforcement Fairness Act,[786] are not applicable. Additionally, the provisions of the Regulatory Flexibility Act, which apply only when notice and comment are required by the APA or other law,[787] are not applicable. Further, because this amendment imposes no new burdens on private persons, the Commission does not believe that the amendment will have any anti-competitive effects for purposes of Section 23(a)(2) of the Exchange Act.[788] Finally, this amendment does not contain any collection of information requirements as defined by the Paperwork Reduction Act of 1980, as amended.

III. Explanation of Dates

A. Effective Date

These final rules will be effective 60 days after the date of this release's publication in the **Federal Register**.

B. Compliance Dates

In the release establishing the registration process for SBSDs and MSBSPs, the Commission adopted a compliance date for SBSD and MSBSP registration requirements (the ''Registration Compliance Date'') that was tied to four then-pending rule sets.[789] Two of those four rule sets have been adopted [790] and the Commission is adopting today in this release one of the remaining two rule sets. The Commission believes it appropriate to set the Registration Compliance Date in this release rather than in final rules establishing recordkeeping and reporting requirements for SBSDs and MSBSPs.[791] Accordingly, the Registration Compliance Date is 18 months after the later of: (1) The effective date of final rules establishing recordkeeping and reporting requirements for SBSDs and MSBSPs; or (2) the effective date of final rules addressing the cross-border application of certain security-based swap requirements.[792] Similarly, the compliance date for the rule amendments and new rules being adopted in this release is 18 months after the later of: (1) The effective date of final rules establishing recordkeeping and reporting requirements for SBSDs and MSBSPs; or (2) the effective date of final rules addressing the cross-border application of certain security-based swap requirements. The Commission believes this extended compliance date addresses commenters' concerns about needing enough time to prepare for and come into compliance with the new requirements.[793] In this regard, the Commission notes that commenters recommended a period of 18 to 24 months following adoption of final rules for firms to come into compliance.[794] With respect to the capital requirements being adopted today, a commenter recommended that SBSD capital requirements take effect at the later of: (1) 2 years after the start of the margin implementation period; and (2) the effective date of the swaps push-out rule, and that, once in effect, SBSD capital standards be determined with reference to the transaction activity of counterparties subject to then-applicable initial margin requirements, taking into account the transition period in the BCBS/IOSCO Paper.[795] The compliance date being adopted today is a reasonable amount of time to come into compliance with the new requirements, given that it is triggered by the adoption of rules that were only recently proposed. Consequently, in practice, the compliance date will be more than 18 months from today's date.

Some commenters recommended that the Commission adopt a compliance date that is shorter than 18 months.[796] The Commission agrees that the Title VII dealer regime should be stood up as expeditiously as possible but must balance that objective with the need to provide firms with a reasonable amount of time to adapt to the new regime. Specifically, firms need time to familiarize themselves with the requirements in the rules being adopted today and how they interact with other security-based swap rules. Firms also need to make and implement informed decisions about business structure and to develop and build compliance systems and controls.

Regarding the Commission's policy statement on the sequencing of final rules governing security-based swaps,[797] commenters recommended establishing phase-in periods for each major new

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[785] *See* 5 U.S.C. 553(b)(3)(A).

[786] *See* 5 U.S.C. 804(3)(C).

[787] *See* 5 U.S.C. 603.

[788] *See* 15 U.S.C. 78w(a)(2).

[789] The Registration Compliance Date was set as the later of: Six months after the date of publication in the **Federal Register** of final rules establishing capital, margin, and segregation requirements for SBSDs and MSBSPs; the compliance date of final rules establishing recordkeeping and reporting requirements for SBSDs and MSBSPs; the compliance date of final rules establishing business conduct requirements under Sections 15F(h) and 15F(k) of the Exchange Act; or the compliance date for final rules establishing a process for a registered SBSD or MSBSP to make an application to the Commission to allow an associated person who is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on the SBSD or MSBSP's behalf. *See Registration Process for Security-Based Swap Dealers and Major Security-Based Swap Participants; Final Rule,* 80 FR at 48988.

[790] *See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants,* Exchange Act Release No. 77617 (Apr. 14, 2016), 81 FR 29960, 30081 (May 13, 2019); *Applications by Security-Based Swap Dealers or Major Security-Based Swap Participants for Statutorily Disqualified Associated Persons to Effect or Be Involved in Effecting Security-Based Swaps,* Exchange Act Release No. 84858 (Dec. 19, 2018), 84 FR 4906, 4920 (Feb. 19, 2019).

[791] The Registration Compliance Date is also the compliance date for final rules establishing business conduct requirements under Sections 15F(h) and 15F(k) of the Exchange Act and for acknowledgement and verification of security-based swap transactions. Rule of Practice 194 was effective on April 22, 2019.

[792] The Commission proposed these rules on May 10, 2019, which include rules and/or guidance regarding security-based swap transactions ''arranged, negotiated, or executed'' by personnel located in the United States, the cross-border scope of the SBSD *de minimis* exception, the certification and opinion of counsel requirement of Rule 15Fb2–1, the questionnaire and application requirement of Rule 18a–5, and the cross-border application of the statutory disqualification prohibition within Section 15F(b)(6) of the Exchange Act. *See Proposed Guidance and Rule Amendments Addressing Cross-Border Application of Certain Security-Based Swap Requirements,* Exchange Act Release No. 85823 (May 10, 2019), 84 FR 24206 (May 24, 2019).

[793] *See also Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53019 (soliciting comment on potential rule language that would modify the proposal in this manner).

[794] *See, e.g.,* IIB 11/19/2018 Letter (18 months); Letter from Karrie McMillan, General Counsel, Investment Company Institute (Aug. 13, 2012) (''ICI 8/13/2012 Letter'') (18–24 months); ICI 11/19/2018 Letter (24 months); ISDA 11/19/2018 Letter (18 months); Mizuho/ING Letter (4 years); Morgan Stanley 11/19/2018 Letter (18 months); SIFMA 11/19/2018 Letter (18 months).

[795] *See* Morgan Stanley 10/29/2014 Letter.

[796] *See, e.g.,* Better Markets 11/19/2018 Letter (6 months); Harrington 11/19/2018 Letter (1 month).

[797] *See Statement of General Policy on the Sequencing of the Compliance Dates for Final Rules Applicable to Security-Based Swaps Adopted Pursuant to the Securities Exchange Act of 1934 and the Dodd-Frank Wall Street Reform and Consumer Protection Act,* Exchange Act Release No. 67177 (June 11, 2012), 77 FR 35625 (June 14, 2012). Comments on the Sequencing Policy Statement which are relevant to the Commission's capital, margin, and segregation requirements are *available at http://www.sec.gov/comments/s7-05-12/s70512.shtml*.

requirement based on asset class and market participant type.[798] Commenters also suggested imposing requirements on the relatively less complex, more standardized, more liquid products and on interdealer transactions before imposing requirements on more complex, less standardized and less liquid products or transactions involving end users and other smaller market participants.[799] Another commenter suggested grouping rulemakings into two categories in terms of the applicable compliance date.[800] Other commenters requested that the Commission delay the compliance date for the rules being adopted today until after SBSDs and MSBSPs are required to register with the Commission.[801] In contrast, a commenter recommended that there should be a single compliance date with respect to the Commission's margin rules for all relevant market participants after a reasonable compliance period, arguing that a phased-in compliance schedule would create unfairly inconsistent treatment among market participants.[802]

The Commission does not believe it is necessary to phase in the capital, margin, and segregation requirements by asset or market participant type. The compliance date for the rules being adopted today will be more than 18 months from today's date. The Commission believes this will give entities adequate time to take the necessary steps to comply with the new requirements. The Commission also does not believe it would be appropriate to delay the compliance date for the Commission's capital, margin, and segregation rules beyond the date when SBSDs and MSBSPs must register with the Commission, because this would undermine the Commission's ability to effectively regulate and supervise these registrants.

A variety of comments stated that the implementation of the margin rules must be delayed in relation to domestic and foreign regulators, international standard setters, and the development of market infrastructure.[803] Several other jurisdictions and regulators, including the CFTC and the prudential regulators, have finalized margin requirements and certain entities are now subject to these requirements. Given this fact, coupled with a compliance date in excess of 18 months, the Commission believes the industry will have adequate time to come into compliance with the margin rules being adopted today.

Several commenters addressed the timing of the implementation of the Commission's margin rules relative to its clearing rules. A commenter believed that the Commission should not implement the final margin rules until after relevant mandatory central clearing is fully implemented under the Dodd-Frank Act.[804] Other commenters similarly suggested that the non-cleared margin rules should be implemented after clearing rules take effect.[805] A commenter noted that mandatory clearing has not been phased in across market participants and that rules relating to margin for non-cleared transactions should not apply to a particular market participant until the mandatory clearing requirement applies to that participant.[806]

In response to these comments, the Commission does not believe it would be appropriate to link the compliance date for the margin rules to the implementation of mandatory clearing. The margin rule applies to non-cleared security-based swaps and is designed to promote the safety and soundness of nonbank SBSDs and nonbank MSBSPs and to protect their counterparties. Therefore, the Commission believes the better approach is to make the compliance date of the margin rule the same as the Registration Compliance Date for SBSDs and MSBSPs. As discussed above, both of these compliance dates will be 18 months after the later of: (1) The effective date of final rules establishing recordkeeping and reporting requirements for SBSDs and MSBSPs; or (2) the effective date of final rules addressing the cross-border application of certain security-based swap requirements.

Another commenter suggested that non-cleared security-based swap margin rules should become effective only after operational requirements for non-cleared margin can be met, and submitted models have been reviewed.[807] A commenter recommended that the Commission adopt a compliance date that is at least 2 years from the effective date of a final capital rule to allow for sufficient time for the Commission or FINRA to approve internal models for capital purposes.[808] As discussed above, the compliance date will be in excess of 18 months after these rules are adopted. This should provide sufficient time for the Commission to review the models of entities that will register as nonbank SBSDs and whose models have not already been approved. Moreover, as discussed above, the final capital rules provide that the Commission can approve the temporary use of a provisional model under certain conditions.[809]

C. Effect on Existing Commission Exemptive Relief

Compliance with certain provisions of the Exchange Act and certain rules and regulations thereunder in connection with security-based swap transactions, positions and/or activity is currently subject to temporary exemptive relief granted by the Commission. The rules

[798] *See* ICI 8/13/2012 Letter; Letter from Jeff Gooch, Chief Executive Officer, MarkitSERV (Aug. 13, 2012) (''MarkitSERV Letter''); Letter from Kenneth E. Bentsen, Jr., Executive Vice President, Public Policy and Advocacy, Securities Industry and Financial Markets Association (Aug. 13, 2012) (''SIFMA 8/13/2012 Letter''); Letter from Douglas L. Friedman, General Counsel, Tradeweb Markets LLC (Sept. 5, 2012) (''Tradeweb Letter''), Appendix 1 (supporting the CFTC's proposal to phase in compliance with clearing, trade execution and trade reporting requirements by class of market participant and asset class).

[799] *See* SIFMA 8/13/2012 Letter (recommending certain single-name credit default swaps as examples of more liquid and standardized products and total return swaps on equity securities or loans as examples of less liquid and standardized products); ICI 8/13/2012 Letter.

[800] *See* Letter from Chris Barnard (Aug. 13, 2012) (''Barnard 8/13/2012 Letter'').

[801] *See* ISDA 11/19/2018 Letter.

[802] *See* MFA 2/22/2013 Letter.

[803] *See* Letter from Jason Shafer, Vice President/ Senior Counsel, Center for Bank Derivatives Policy, American Bankers Association, and Cecilia Calaby, Executive Director and General Counsel, American Bankers Association Securities Association (July 29, 2016) (''American Bankers Association Letter'') (asking U.S. regulators to synchronize their margin rules' effective dates with the European Union's schedule); ICI 11/24/2014 Letter (recommending coordinating a longer phase-in period for variation margin with the CFTC and the prudential regulators); IIB 11/19/2018 Letter (requesting a delay in the compliance date for margin rules if the compliance date falls before the final phase-in recommended by the BCBS and IOSCO); ISDA 2/5/2014 Letter (recommending a 2 year phase-in after final margin rules are adopted in the U.S., Europe, and Japan); PIMCO Letter (generally); SIFMA 3/12/2014 Letter (recommending a 2 year phase-in after final margin rules are adopted in the U.S., Europe, and Japan).

[804] *See* Sutherland Letter.

[805] *See* American Benefits Council, et al. 1/29/2013 Letter; ISDA 1/23/2013 Letter.

[806] *See* Letter from Kyle Brandon, Managing Director, Director of Research, Securities Industry and Financial Markets Association (Jan. 13, 2015) (''SIFMA 1/13/2015 Letter'') (''[P]hasing in uncleared [security-based swap] margin requirements too close in time to clearing determinations could lead to such margin requirements becoming effective for a certain class of [security-based swap] before that class of [security-based swap] is required to be cleared—effectively forcing clearing before the class is ready, as the cost of engaging in uncleared [security-based swap] transactions would be greater.''); SIFMA 3/12/2014 Letter.

[807] *See* SIFMA AMG 2/22/2013 Letter. *See also* Mizuho/ING Letter (requesting that capital requirements be phased in if the Commission does not plan to approve models already approved by certain other regulators).

[808] *See* Citadel 5/15/2017 Letter.

[809] *See* paragraph (a)(7)(ii) of Rule 15c3–1e, as amended; paragraph (d)(5)(ii) of Rule 18a–1, as adopted.

the Commission is adopting and amending today relate to temporary exemptive relief for 3 key areas of requirements applicable to SBSDs and MSBSPs: (1) Financial responsibility-related requirements; (2) segregation requirements for non-cleared security-based swaps; and (3) requirements in connection with certain CDS portfolio margin programs.

First, the Commission has provided limited exemptions for registered broker-dealers, subject to certain conditions and limitations, from the application of Sections 7 and 15(c)(3) of the Exchange Act, Rules 15c3–1, 15c3–3,[810] and 15c3–4, and Regulation T in connection with security-based swaps, some of which exemptions were solely to the extent the provisions or rules did not apply to the broker-dealer's security-based swap positions or activities as of July 15, 2011 (collectively, the ''Financial Responsibility Rule Exemptions'').[811] In connection with this and other exemptive relief, the Commission also provided that, until such time as the underlying exemptive relief expires, no contract entered into on or after July 16, 2011 shall be void or considered voidable by reason of Section 29(b) of the Exchange Act because any person that is a party to the contract violated a provision of the Exchange Act for which the Commission provided exemptive relief in the Exchange Act Exemptive Order (''Section 29(b) Exemption'').[812] The Financial Responsibility Rule Exemptions are scheduled to expire on the compliance date for any final capital, margin, and segregation rules for SBSDs and MSBSPs.[813] Accordingly, all of the Financial Responsibility Rule Exemptions, together with the portion of the Section 29(b) Exemption that relates to the Exchange Act provisions for which the Commission provided exemptive relief in the Financial Responsibility Rule Exemptions, will expire upon the compliance date set forth in section III.B. of this release.

Second, compliance with Section 3E(f) of the Exchange Act is currently subject to temporary exemptive relief.[814] That relief includes an exemption for SBSDs and MSBSPs from the segregation requirements for non-cleared security-based swaps in Section 3E(f) of the Exchange Act, as well as an exemption (similar but not identical to the Section 29(b) Exemption discussed above) providing that no SBS contract entered into on or after July 16, 2011 shall be void or considered voidable by reason of Section 29(b) of the Exchange Act because any person that is a party to the contract violated Section 3E(f) of the Exchange Act. Both of these exemptions will expire on the Registration Compliance Date set forth in section III.B. of this release.

Finally, on December 14, 2012, the Commission issued an order granting conditional exemptive relief from compliance with certain provisions of the Exchange Act in connection with a program to commingle and portfolio margin customer positions in cleared CDS that include both swaps and security-based swaps in a segregated account established and maintained in accordance with Section 4d(f) of the CEA.[815] This exemptive relief does not contain a sunset date; however, the exemptive relief for dually-registered clearing agency/DCOs is subject to two conditions that will be triggered by the adoption of final rules setting forth margin and segregation requirements applicable to security-based swaps.[816] By their terms, these two conditions will begin to apply by the later of: (1) Six months after adoption of final margin and segregation rules applicable to security-based swaps consistent with Section 3E of the Exchange Act; or (2) the compliance date of such rules. As discussed above in section III.B. of this release, the compliance date for the rules the Commission is adopting today will be 18 months after the later of: (1) The effective date of final rules establishing recordkeeping and reporting requirements for SBSDs and MSBSPs; or (2) the effective date of final rules addressing the cross-border application of certain security-based swap requirements.[817] Accordingly, each dually registered clearing agency/DCO must comply with these two

[810] The exemption from Rule 15c3–3 was not available for activities and positions of a registered broker-dealer related to cleared security-based swaps to the extent that the registered broker-dealer is a member of a clearing agency that functions as a central counterparty for security-based swaps, and holds customer funds or securities in connection with cleared security-based swaps.

[811] *See Order Granting Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Pending Revision of the Definition of ''Security'' to Encompass Security-Based Swaps, and Request for Comment,* Exchange Act Release No. 64795 (July 1, 2011), 76 FR 39927 (July 7, 2011) (''Exchange Act Exemptive Order'')

[812] *See* Exchange Act Exemptive Order at 39940.

[813] The Financial Responsibility Rule Exemptions originally were set to expire on the compliance date for final rules further defining the terms ''security-based swap'' and ''eligible contract participant.'' *See* Exchange Act Exemptive Order at 39938–39. In the final rules further defining the term ''security-based swap,'' the Commission extended this expiration date to February 13, 2013. *See Product Definitions Adopting Release* at 48304. On February 7, 2013, the Commission extended the expiration date until February 11, 2014. *See Order Extending Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Revision of the Definition of ''Security'' to Encompass Security-Based Swaps, and Request for Comment,* Exchange Act Release No. 68864 (Feb. 7, 2013), 78 FR 10218, 10220 (Feb. 13, 2013). On February 5, 2014, the Commission further extended the expiration date until the compliance date set forth in any final capital, margin, and segregation rules for SBSDs and MSBSPs. *See Order Extending Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Revision of the Definition of ''Security'' to Encompass Security-Based Swaps, and Request for Comment,* Exchange Act Release No. 71485 (Feb. 5, 2014), 79 FR 7731, 7734 (Feb. 10, 2014).

[814] *See Order Pursuant to Sections 15F(b)(6) and 36 of the Securities Exchange Act of 1934 Extending Certain Temporary Exemptions and a Temporary and Limited Exception Related to Security-Based Swaps,* Exchange Act Release No. 75919 (Sept. 15, 2015), 80 FR 56519 (Sept. 18, 2015); *Temporary Exemptions and Other Temporary Relief, Together with Information on Compliance Dates for New Provisions of the Securities Exchange Act of 1934 Applicable to Security-Based Swaps,* Exchange Act Release No. 64678 (June 15, 2011), 76 FR 36287 (June 22, 2011).

[815] *Order Granting Conditional Exemptions Under the Securities Exchange Act of 1934 in Connection With Portfolio Margining of Swaps and Security-Based Swaps,* Exchange Act Release No. 68433 (Dec. 14, 2012), 77 FR 75211 (Dec. 19, 2012) (''CDS Portfolio Margin Order'').

[816] *See* CDS Portfolio Margin Order at 75219 (conditions (a)(1) and (2)). Specifically, the first condition requires that the clearing agency/DCO, by the later of (i) six months after the adoption date of final margin and segregation rules applicable to security-based swaps consistent with Section 3E of the Exchange Act or (ii) the compliance date of such rules, take all necessary action within its control to obtain any relief needed to permit its dually-registered broker-dealer/FCM clearing members to maintain customer money, securities, and property received by the broker-dealer/FCM to margin, guarantee, or secure customer positions in cleared CDS, which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 3E of the Exchange Act and any rules thereunder for the purpose of clearing (as a clearing member of the clearing agency/DCO) such customer positions under a program to commingle and portfolio margin CDS. The second condition requires that the clearing agency/DCO, by the later of (i) six months after the adoption date of final margin and segregation rules applicable to security-based swaps consistent with Section 3E of the Exchange Act or (ii) the compliance date of such rules, take all necessary action within its control to establish rules and operational practices to permit a dually-registered broker-dealer/FCM (at the broker-dealer/FCM's election) to maintain customer money, securities, and property received by the broker-dealer/FCM to margin, guarantee, or secure customer positions in cleared CDS, which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 3E of the Exchange Act and any rules thereunder for the purpose of clearing (as a clearing member of the clearing agency/DCO) such customer positions under a program to commingle and portfolio margin CDS.

These two conditions are intended to provide for portfolio margining within a securities account as an alternative for customers who may desire to conduct portfolio margining under a securities account structure as opposed to a swaps account. *See* CDS Portfolio Margining Order at 75215–75218 (discussing conditional exemptions for dually-registered Clearing Agencies/DCOs from Sections 3E(b), (d) and (e) of the Exchange Act).

[817] *See Proposed Guidance and Rule Amendments Addressing Cross-Border Application of Certain Security-Based Swap Requirements,* 84 FR 24206.

conditions no later than that date. Before the compliance date, the Commission intends to continue coordinating with the CFTC to address portfolio margining of security-based swaps and swaps by nonbank SBSDs and swap dealers.

D. Application to Substituted Compliance

For the amendments to Rule 3a71–6, the Commission is adopting an effective date of 60 days following publication in the **Federal Register**. There will be no separate compliance date in connection with that rule, as the rule does not impose obligations upon entities. As discussed above, SBSDs and MSBSPs will not be required to comply with the capital and margin requirements until they are registered, and the registration requirement for those entities will not be triggered until a number of regulatory benchmarks have been met.

In practice, the Commission recognizes that if the requirements of a foreign regime are comparable to Title VII requirements, and the other prerequisites to substituted compliance also have been satisfied, then it may be appropriate to permit an SBSD or MSBSP to rely on substituted compliance commencing at the time that entity is registered with the Commission. Accordingly, the Commission would consider substituted compliance requests that are submitted prior to the compliance date for its capital and margin requirements. The Commission believes this addresses commenters' concerns that the compliance date could be before substituted compliance determinations are made.[818]

IV. Paperwork Reduction Act

Certain provisions of the new rules and amendments contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 (''PRA'').[819] The Commission published notice requesting comment on the collection of information requirements[820] and submitted the amendments and the proposed new rules to the Office of Management and Budget (''OMB'') for review in accordance with the PRA.[821] The Commission's earlier PRA assessments have been revised to reflect the modifications to the final rules and amendments from those that were proposed, the adoption of new Rule 18a–10 as a result of comments received,[822] and additional information and data now available to the Commission.[823] 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:

Rule	Rule title	OMB control No.
Rule 18a–1, Rule 18a–1a, Rule 18a–1b, Rule 18a–1c, and Rule 18a–1d.	Net capital requirements for SBSDs for which there is not a prudential regulator	3235–0701
Rule 18a–2	Capital requirements for MSBSPs for which there is not a prudential regulator	3235–0699
Rule 18a–3 and Rule 18a–10	Non-cleared security-based swap margin requirements for SBSDs and MSBSPs for which there is not a prudential regulator; Alternative compliance mechanism for security-based swap dealers that are registered as swap dealers and have limited security-based swap activities.	3235–0702
Rule 18a–4 and exhibit	Segregation requirements for SBSDs and MSBSPs	3235–0700
Rule 15c3–1 and appendices	Net capital requirements for brokers or dealers	3235–0200
Rule 15c3–3 and exhibits	Customer protection—reserves and custody of securities	[824] 3235–0078
Rule 3a71–6	Substituted compliance for SBSDs and MSBSPs	3235–0715

A. Summary of Collections of Information Under the Rules and Rule Amendments

1. Rule 18a–1 and Amendments to Rule 15c3–1

Rule 18a–1 establishes minimum capital requirements for stand-alone SBSDs and the amendments to Rule 15c3–1 augment capital requirements for broker-dealers to accommodate broker-dealer SBSDs and to enhance the provisions applicable to ANC broker-dealers. The new rule and amendments establish new collections of information requirements.

First, under paragraphs (a)(2) and (d) of Rule 18a–1, a stand-alone SBSD must apply to the Commission to be authorized to use internal models to compute net capital. As part of the application process, a stand-alone SBSD is required to provide the Commission staff with information specified in the rule. In addition, a stand-alone SBSD authorized to use internal models will review and update the models it uses to compute market and credit risk, as well as backtest the models.

[818] *See* IIB 11/19/2018 Letter; SIFMA 11/19/2018 Letter.

[819] *See* 44 U.S.C. 3501, *et seq.*

[820] *See Capital, Margin, and Segregation Proposing Release,* 77 FR 70214; *Cross-Border Proposing Release,* 81 FR at 31204. *See also Trade Acknowledgment and Verification of Security-Based Swap Transactions,* 81 FR at 39831–33 (discussing the paperwork burden for Rule 3a71–6).

[821] *See* 44 U.S.C. 3507(d); 5 CFR 1320.11.

[822] As discussed in more detail below, the Commission is adopting new Rule 18a–10 in response to comments received on the proposal not related to the collection of information discussion in the proposing release. Therefore, the proposal did not contain a collection of information for this new rule. The Commission estimates that 3 stand-alone SBSDs will elect to operate under Rule 18a–10. As discussed in more detail below, however, these respondents were included in the proposing release in other collections of information (Rule 18a–1 and Rule 18a–3, as proposed), and have been moved to the information collection for Rule 18a–10. Therefore, the total respondents in the collections of information for Rules 18a–1 and 18a–3, as adopted, have been adjusted by three respondents. The hour burdens and costs for the collection of information for Rule 18a–10, as adopted, are included in the collection of information for Rule 18a–3, as adopted.

[823] 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 2013,* modified to account for an 1,800-hour work-year and inflation, and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, in addition to SIFMA's *Office Salaries in the Securities Industry 2013,* modified by Commission staff to account for an 1,800-hour work-year and inflation, and multiplied by 2.93 to account for bonuses, firm size, employee benefits, and overhead.

[824] The proposed hour burdens for the collection of information related to Rule 15c3–3, as amended, in this release were included in the collection of information for proposed Rule 18a–4 in the proposing release. These hours were moved (and modified as a result of comments) to the existing collection of information in Rule 15c3–3, as amended, as a result of changes made to the final rule to require that broker-dealers that are also registered as nonbank SBSDs comply with the segregation requirements of paragraph (p) to Rule 15c3–3, as amended, with respect to their security-based swap activities. In addition, as a result of comments received, the collection of information in the final rule related to Rule 15c3–3, as amended, contains additional respondents to account for the activities of stand-alone broker-dealers engaged in security-based swap activities.

Second, under paragraph (f) of Rule 18a–1 and paragraph (a)(10)(ii) of Rule 15c3–1, as amended, nonbank SBSDs, including broker-dealer SBSDs, are required to implement internal risk management controls in compliance with certain requirements of Rule 15c3–4.

Third, under paragraph (c)(1)(vi)(B)(1)(*iii*)(*A*) of Rule 18a–1 and paragraph (c)(2)(vi)(P)(*1*)(*iii*) of Rule 15c3–1, as amended, broker-dealers, broker-dealer SBSDs, and stand-alone SBSDs not using models are 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, for the purposes of calculating ''haircuts'' on non-cleared CDS. These firms could use a third-party classification system or develop their own classification system.

Fourth, under paragraph (h) of Rule 18a–1, stand-alone SBSDs are required to provide the Commission with certain written notices with respect to equity withdrawals.

Fifth, under paragraph (c)(5) of Rule 18a–1d, a stand-alone SBSD is required to file with the Commission two copies of any proposed subordinated loan agreement at least 30 days prior to the proposed execution date of the agreement, as well as 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.

Finally, under paragraph (c)(1)(ix)(C)(*3*) of Rule 18a–1 and paragraph (c)(2)(xv)(C)(*3*) of Rule 15c3–1, as amended, stand-alone broker-dealers and nonbank SBSDs may treat collateral held by a third-party custodian to meet an initial margin requirement of a security-based swap or swap customer as being held by the stand-alone broker-dealer or nonbank SBSD for purposes of avoiding the capital deduction in lieu of margin or credit risk charge if certain conditions are met.

2. Rule 18a–2

Rule 18a–2 establishes capital requirements for nonbank MSBSPs. In particular, a nonbank MSBSP is required at all times to have and maintain positive tangible net worth, and comply with Rule 15c3–4 with respect to its security-based swap and swap activities.

3. Rule 18a–3

Rule 18a–3 prescribes non-cleared security-based swap margin requirements for nonbank SBSDs and MSBSPs. Paragraph (e) of Rule 18a–3 requires a nonbank SBSD to monitor the risk of each account, and establish, maintain, and document procedures and guidelines for monitoring the risk.

Finally, under paragraph (d) to Rule 18a–3, a nonbank SBSD applying to the Commission for authorization to use and be responsible for a model to calculate the initial margin amount under the rule will be subject to the application process and ongoing conditions in Rule 15c3–1e or paragraph (d) of Rule 18a–1, as applicable, governing the use of internal models to compute net capital.

4. Rule 18a–4 and Amendments to Rule 15c3–3

Rule 18a–4 establishes segregation requirements for cleared and non-cleared security-based swap transactions for bank and stand-alone SBSDs, as well as notification requirements for these entities. Amendments to Rule 15c3–3 establish segregation requirements for stand-alone broker-dealers and broker-dealer SBSDs that are largely parallel to the requirements in Rule 18a–4. Specifically, new paragraph (p) to Rule 15c3–3 establishes segregation requirements for stand-alone broker-dealers and broker-dealer SBSDs with respect to their security-based swap activity. The provisions of Rule 18a–4, as well as the amendments to Rule 15c3–3, are modeled on existing Rule 15c3–3—the broker-dealer segregation rule. Rules 18a–4 and 15c3–3 also contain provisions that are not modeled specifically on Rule 15c3–3 as it exists today. First, paragraph (d) of Rule 18a–4 and paragraph (p)(4) of Rule 15c3–3 require SBSDs and MSBSPs 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. Second, SBSDs must obtain subordination agreements from counterparties that elect individual or omnibus segregation.

Additionally, paragraph (a)(5)(iii) of Rule 18a–4 and paragraph (p)(1)(iii) of Rule 15c3–3, as amended, impose documentation requirements with respect to a qualified clearing agency account a broker-dealer or SBSD maintains at a clearing agency that holds funds and other property in order to margin, guarantee, or secure cleared security-based swaps of the firm's security-based swap customers.

Under paragraph (a)(4) of Rule 18a–4 and paragraph (p)(1)(iv) of Rule 15c3–3, as amended, a qualified registered security-based swap dealer account is defined to mean an account at an SBSD registered with the Commission pursuant to Section 15F of the Exchange Act that meets conditions that are largely identical to the conditions for a qualified clearing agency account.

Finally, paragraph (c)(1) of Rule 18a–4 and paragraph (p)(3)(i) of Rule 15c3–3 require an stand-alone broker-dealer and SBSD, among other things, to maintain a special reserve account for the exclusive benefit of security-based swap customers separate from any other bank account of the broker-dealer or SBSD.

Paragraph (c)(1) of Rule 18a–4 and paragraph (p)(3)(i) of Rule 15c3–3, as amended, provide that the stand-alone broker-dealer or SBSD must at all times maintain in a customer reserve account, through deposits into the account, cash and/or qualified securities in amounts computed weekly in accordance with the formula set forth in Exhibit A to Rule 18a–4 or Exhibit B to Rule 15c3–3, which is modeled on the formula in Exhibit A to Rule 15c3–3.

Paragraph (e) of Rule 18a–4 specifies when foreign stand-alone and bank SBSDs and MSBSPs are not required to comply with the segregation requirements in Section 3E of the Exchange Act and Rule 18a–4 thereunder. In addition, a foreign stand-alone or bank SBSD is required to disclose to a U.S. security-based swap customer the potential bankruptcy treatment of property segregated by the SBSD.

Finally, under paragraph (f) of Rule 18a–4, a stand-alone or bank SBSD will be exempt from the requirements of Rule 18a–4 if the SBSD meets certain conditions, including that the SBSD provides notice to the counterparty regarding the right to segregate initial margin at an independent third-party custodian, and provides certain disclosures in writing regarding the collateral received by the SBSD.

5. Rule 18a–10

Rule 18a–10 is an alternative compliance mechanism pursuant to which a stand-alone SBSD that is registered as a swap dealer and predominantly engages in a swaps business may elect to comply with the capital, margin, and segregation requirements of the CEA and the CFTC's rules in lieu of complying with Rules 18a–1, 18a–3, and 18a–4.

Paragraph (b) of Rule 18a–10 sets forth certain requirements for a firm that is operating pursuant to the rule. Among other things, paragraph (b)(2) of Rule 18a–10 requires the firm to provide a written disclosure to its counterparties before the first transaction with the counterparty after the firm begins the operating pursuant to the rule notifying the counterparty that the firm is complying with the applicable capital, margin, and segregation requirements of the CEA and the CFTC's rules in lieu of complying with applicable Commission rules. Paragraph (b)(3) of Rule 18a–10 requires a stand-alone SBSD operating pursuant to the rule to immediately notify the Commission and the CFTC in writing if it fails to meet a condition in paragraph (a) of the rule.

Finally, paragraph (d) of Rule 18a–10 addresses how a firm would elect to operate pursuant to the rule. Under paragraph (d)(1), a firm can make the election as part of the process of applying to register as an SBSD. In this case, the firm must provide written notice to the Commission and the CFTC during the registration process of its intent to operate pursuant to the rule. Under paragraph (d)(2) of Rule 18a–10, an SBSD can make an election to operate under the alternative compliance mechanism after the firm has been registered as an SBSD by providing written notice to the Commission and the CFTC of its intent to operate pursuant to the rule.

6. Amendments to Rule 3a71–6

The Commission is amending Rule 3a71–6 to provide persons with the ability to apply for substituted compliance with respect to the capital and margin requirements of Section 15F(e) of the Exchange Act and Rules 18a–1, 18a–2, and 18a–3 thereunder.

B. Use of Information

The Commission, its staff, and SROs, as applicable, will use the information collected under Rules 18a–1, 18a–2, 18a–3, 18a–4, and 18a–10, as well as the amendments to Rule 15c3–1 and Rule 15c3–3 to evaluate whether an SBSD, MSBSP, or stand-alone broker-dealer is in compliance with each rule that applies to the entity and to help fulfill their oversight responsibilities. The Commission plans to use the information collected pursuant to Rule 3a71–6, as amended, to evaluate requests for substituted compliance with respect to the capital and margin requirements. The collections of information also will help to ensure that SBSDs, MSBSPs, and stand-alone broker-dealers are meeting their obligations under the new rules and rule amendments and have the required policies and procedures in place. In this regard, the collections of information will be used by the Commission as part of its ongoing efforts to monitor and enforce compliance with the federal securities laws through, among other things, examinations and inspections.

Rules 18a–1 and 18a–2, and the amendments to Rule 15c3–1, are integral parts of the Commission's financial responsibility program for nonbank SBSDs and MSBSPs, and stand-alone broker-dealers. Rules 18a–1 and 15c3–1 are designed to ensure that nonbank SBSDs and stand-alone broker-dealers, respectively, have sufficient liquidity to meet all unsubordinated obligations to customers and counterparties and, consequently, if the nonbank SBSD or stand-alone broker-dealer fails, sufficient resources to wind-down in an orderly manner without the need for a formal proceeding. The collections of information in Rule 18a–1, Rule 18a–2 and the amendments to Rule 15c3–1 facilitate the monitoring of the financial condition of nonbank SBSDs and MSBSPs, and stand-alone broker-dealers by the Commission and its staff.

Rule 18a–3 is intended to help ensure the safety and soundness of the nonbank SBSD or MSBSP. Records maintained by these entities relating to the collection of collateral required by Rule 18a–3 will assist examiners in evaluating whether nonbank SBSDs are in compliance with requirements in the rule.

Rule 18a–4 and the amendments to Rule 15c3–3 are integral to the Commission's financial responsibility program as they are designed to protect the rights of security-based swap customers and their ability to promptly obtain their property from an SBSD or stand-alone broker-dealer. The collection of information requirements in the rule and amendments will facilitate the process by which the Commission and its staff monitor how SBSDs and stand-alone broker-dealers are fulfilling their custodial responsibilities to security-based swap customers. Rule 18a–4 and the amendments to Rule 15c3–3 also require that an SBSD to provide certain notices to its counterparties to alert them to the alternatives available to them with respect to segregation of non-cleared security-based swaps. The Commission and its staff will use this new collection of information to confirm registrants are providing the requisite notice to counterparties.

Rule 18a–10 requires a stand-alone SBSD to: (1) Provide certain disclosures to its counterparties to alert them that the firm will be complying with the capital, margin, and segregation requirements of the CEA and the CFTC's rules in lieu of Rules 18a–1, 18a–3, and 18a–4; (2) to notify the Commission and the CFTC the firm is electing to operate under the conditions of the rule; and (3) provide a notice to the Commission and the CFTC if it fails to meet a condition of the rule. The Commission and its staff will use this new collection of information to confirm which registrants are operating under the conditions of the rule. In addition, the Commission will use the information to confirm that registrants are providing the requisite disclosures to counterparties, and assist examiners in evaluating whether SBSDs are in compliance with requirements in the rule.

Finally, the requests for substituted compliance determinations under Rule 3a71–6 are required when a person seeks a substituted compliance determination with respect to the capital and margin requirements applicable to foreign SBSDs and MSBSPs. Consistent with Exchange Act Rule 0–13(h), the Commission will publish in the **Federal Register** a notice that a complete application has been submitted, and provide the public the opportunity to submit to the Commission any information that relates to the Commission action requested in the application.

C. Respondents

The Commission estimated the number of respondents in the proposing release.[825] The Commission received no comment on these estimates and continues to believe they are appropriate. However, the number of respondents has been updated to include stand-alone broker-dealers engaged in security-based swap activities as well as the number of foreign SBSDs and MSBSPs. In addition, in response to comments received, the Commission is adopting new Rule 18a–10, which has resulted in the number of respondents being updated in Rules 18a–1, as adopted, and Rule 18a–3, as adopted.

The following charts summarize the Commission's respondent estimates:

Type of respondent	Number of respondents
SBSDs	50
Bank SBSDs	25
Nonbank SBSDs	25
Broker-Dealer SBSDs	16
Non-broker-dealer SBSDs	34
Stand-Alone SBSDs	9

[825] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70292–93.

Type of respondent	Number of respondents
ANC Broker-Dealer SBSDs	10
Broker-Dealer SBSDs (Not Using Models)	6
Stand-Alone SBSDs (Using Models)	4
Stand-Alone SBSDs (Not Using Models)	2
Stand-Alone Broker-Dealers	25
Nonbank MSBSPs	5
Nonbank SBSDs subject to Rule 18a–3	22
Foreign SBSDs and MSBSPs	22
Foreign SBSDs and/or foreign MSBSPs submitting substituted compliance applications	3
Bank SBSDs exempt from requirements of Rule 18a–4	25
Stand-Alone SBSDs exempt from requirements of Rule 18a–4	6
Stand-Alone SBSDs operating under Rule 18a–10	3

Consistent with prior releases, based on available data regarding the single-name CDS market—which the Commission believes will comprise the majority of security-based swaps—the Commission estimates that the number of nonbank MSBSPs likely will be five or fewer and, in actuality, may be zero.[826] Therefore, to capture the likely number of nonbank MSBSPs that may be subject to the collections of information for purposes of the PRA, the Commission estimates that five entities will register with the Commission as nonbank MSBSPs.[827] The Commission estimates there will be 1 broker-dealer MSBSP for the purposes of calculating paperwork burdens, in recognition that broker-dealer MSBSPs and stand-alone MSBSPs are subject to different burdens under the new and amended rules in certain instances.

Consistent with prior releases, the Commission estimates that 50 or fewer entities ultimately may be required to register with the Commission as SBSDs, and 16 broker-dealers will likely seek to register as SBSDs.[828]

Because many of the dealers that currently engage in OTC derivatives activities are banks, the Commission estimates that approximately 75% of the 34 non-broker-dealer SBSDs will be bank SBSDs (*i.e.,* 25 firms), and the remaining 25% will be stand-alone SBSDs (*i.e.,* 9 firms).[829]

Of the nine stand-alone SBSDs, the Commission estimates, based on its experience with ANC broker-dealers and OTC derivatives dealers, that four firms will apply to use internal models to compute net capital under Rule 18a–1.[830] This estimate has been reduced from six in the proposing release [831] to four to account the adoption of Rule 18a–10, which will enable stand-alone SBSDs to elect an alternative compliance mechanism and comply with capital, margin, and segregation requirements of the CEA and the CFTC's rules in lieu of Rules 18a–1, 18a–3, and 18a–4. Finally, in the proposing release, the Commission estimated that 3 stand-alone SBSDs would not apply to use models.[832] This estimate has been modified from 3 firms to 2 firms to account for the nonbank SBSDs that will elect the alternative compliance mechanism under Rule 18a–10.

Of the 16 broker-dealer SBSDs, the Commission estimates that 10 firms will operate as ANC broker-dealer SBSDs authorized to use internal models to compute net capital under Rule 15c3–1.[833]

The Commission estimates that 25 registered broker-dealers will be engaged in security-based swap activities but will not be required to register as an SBSD or MSBSP (*i.e.,* will be stand-alone broker-dealers). 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.[834] First, because the Exchange Act has not previously defined security-based swaps as securities, security-based swaps have not been required to be traded through registered broker-dealers.[835] 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. The existing financial responsibility requirements make it more costly to conduct these activities in a broker-dealer than in an unregulated entity. As a result, security-based swap activities are mostly concentrated in affiliates of stand-alone broker-dealers.[836]

For purposes of the exemption from the requirements of Rule 18a–4 for stand-alone SBSDs and bank SBSDs, the Commission estimates that 25 bank SBSDs and 6 stand-alone SBSDs will be exempt from the requirements of Rule 18a–4 pursuant to paragraph (f) of the rule.[837] For purposes Rule 18a–10, the Commission estimates that 3 stand-alone SBSDS will operate pursuant to the rule.[838]

For purposes of estimating the number of respondents with respect to the amendments to Rule 3a71–6, applications for substituted compliance may be filed by foreign financial authorities, or by non-U.S. SBSDs or MSBSPs. Consistent with prior estimates, the Commission staff expects that there may be approximately 22 non-

[826] *See Registration Process for Security-Based Swap Dealers and Major Security-Based Swap Participants,* 80 FR at 48990. *See also Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant",* 77 FR at 30727.

[827] *See Applications by Security-Based Swap Dealers or Major Security-Based Swap Participants for Statutorily Disqualified Associated Persons to Effect or Be Involved in Effecting Security-Based Swaps,* 84 FR at 4921.

[828] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70292.

[829] The Commission does not anticipate that any firms will be dually registered as a broker-dealer and a bank.

[830] Internal 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 will choose to do so.

[831] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70293.

[832] *See* 77 FR at 70293.

[833] Currently, 5 broker-dealers are registered as ANC broker-dealers. The Commission has previously estimated that all current and future ANC broker-dealers will also register as SBSDs. *See Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers; Capital Rule for Certain Security-Based Swap Dealers,* 79 FR at 25261.

[834] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70302.

[835] *See* Section 761 of the Dodd-Frank Act (amending definition of *security* in Section 3 of the Exchange Act).

[836] *See ISDA Margin Survey 2015* (Aug. 2015). The ISDA survey examines the state of collateral use and management among derivatives dealers and end-users. The appendix to the survey lists firms that responded to the survey, including broker-dealers. The ISDA margin surveys cited in this release are available at *https://www.isda.org/category/research/surveys/*.

[837] *See* paragraph (f) of Rule 18a–4, as adopted. The Commission estimates that all 25 bank SBSDs will be exempt from the requirements of Rule 18a–4. These bank SBSDs will be subject to disclosure and notice requirements under paragraph (f) of Rule 18a–4, as adopted.

[838] These respondents (2 stand-alone SBSDS using models and one stand-alone SBSD not using models) have been moved from the collections of information for proposed Rules 18a–1 and 18a–3. In the proposing release, the Commission estimated that 25 nonbank SBSDs would be subject to Rule 18a–3, as proposed. *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70293. As a result of the adoption of Rule 18a–10, the Commission estimates that 22 nonbank SBSDs will be subject to Rule 18a–3 (25 nonbank SBSDs minus 3 stand-alone SBSDs electing to operate under Rule 18a–10 = 22 respondents). As discussed above, the collection of information for Rule18a–10 is included with the collection of information for Rule 18a–3.

U.S. entities that may potentially register as SBSDs.[839] Potentially, all such non-U.S. SBSDs, or some subset thereof, may seek to rely on substituted compliance in connection with the requirements being adopted today.[840] For purposes of the PRA, however, consistent with prior estimates, the Commission estimates that 3 of these security-based swap entities will submit such applications in connection with the Commission's capital and margin requirements.[841]

D. Total Initial and Annual Recordkeeping and Reporting Burden

1. Rule 18a–1 and Amendments to Rule 15c3–1

The burden estimates for Rule 18a–1 and the amendments to Rule 15c3–1 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.[842]

First, under paragraph (a)(2) of Rule 18a–1, a stand-alone SBSD is required to file an application for authorization to compute net capital using internal models.[843] The requirements for the application are set forth in paragraph (d) of Rule 18a–1, which is modeled on the application requirements of Appendix E to Rule 15c3–1 applicable to ANC broker-dealers.[844]

Based on its experience with ANC broker-dealers and OTC derivatives dealers, the Commission expects that stand-alone SBSDs that apply to use internal models to calculate net capital will already have developed models and internal risk management control systems. Rule 18a–1 also contains additional requirements that stand-alone SBSDs may not yet have incorporated into their models and control systems. Therefore, stand-alone SBSDs will incur one-time hour burdens and start-up costs in order to develop their models in accordance with Rule 18a–1, as well as submit the models along with their application to the Commission for approval. While the Commission's burden 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 4 stand-alone SBSDs that apply to use the internal models would spend approximately 1,000 hours to: (1) Develop and submit their models and the description of its their risk management control systems to the Commission; (2) to create and compile the various documents to be included with their applications; and (3) to work with the Commission staff through the application process. The hour burdens include approximately 100 hours for an in-house attorney to complete a review of the application. Consequently, the Commission staff estimates that the total burden associated with the application process for the stand-alone SBSDs will result in an industry-wide one-time hour burden of approximately 4,000 hours.[845] In addition, the Commission staff allocates 75% (3,000 hours) of these one-time burden hours[846] to internal burden and the remaining 25% (1,000 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.[847] The Commission staff estimates $400 per hour for external costs for retaining outside consultants, resulting in a one-time industry-wide external cost of $400,000.[848]

The Commission staff estimates that a stand-alone SBSD authorized to use internal models will 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. Consequently, the Commission staff estimates that the total burden associated with reviewing and back-testing the models for the 4 stand-alone SBSDs will result in an industry-wide annual hour burden of approximately 24,960 hours per year.[849] In addition, the Commission staff allocates 75% (18,720 hours)[850] of these burden hours to internal burden and the remaining 25% (6,240 hours) to external burden to hire outside professionals to assist in reviewing, updating and backtesting the models.[851] The Commission staff estimates $400 per hour for external costs for retaining outside professionals, resulting in an industry-wide external cost of $2.5 million annually.[852]

Stand-alone SBSDs electing to file an application with the Commission to use an internal model will incur start-up costs including information technology costs to comply with Rule 18a–1. Based on the estimates for the ANC broker-dealers,[853] it is expected that a stand-alone SBSD will incur an average of approximately $8.0 million to modify its information technology systems to meet the model requirements of the Rule 18a–

[839] *See Trade Acknowledgment and Verification of Security-Based Swap Transactions,* 81 FR at 39832.

[840] It is possible that some subset of MSBSPs will be non-U.S. MSBSPs that will seek to rely on substituted compliance in connection with the final capital and margin rules. *See Trade Acknowledgment and Verification of Security-Based Swap Transactions,* 81 FR at 39832.

[841] *See Trade Acknowledgment and Verification of Security-Based Swap Transactions,* 81 FR at 38392.

[842] The burden hours related to the proposed collection of information requirements with respect to the proposed liquidity stress test requirements for nonbank SBSDs that were included in the proposing release have been deleted from the PRA collections of information in this release because these requirements are not being adopted today. *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70294.

[843] A broker-dealer SBSD seeking Commission authorization to use internal models to compute market and credit risk charges will apply under the existing provisions of Appendix E to Rule 15c3–1.

[844] 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. *See* Commission, *Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 15c3–1.*

[845] 4 stand-alone SBSDs × 1,000 hours = 4,000 hours.

[846] The internal hours likely will be performed by an in-house attorney (1,000 hours), a risk management specialist (1,000 hours), and a compliance manager (1,000 hours). Therefore, the estimated internal cost for this hour burden is calculated as follows: (In-house attorney for 1,000 hours at $422 per hour) + (risk management specialist for 1,000 hours at $202 per hour) + (compliance manager for 1,000 hours at $314 per hour) = $938,000.

[847] 4,000 hours × .75 = 3,000 hours; 4,000 hours × .25 = 1,000 hours. 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.

[848] 1,000 hours × $400 per hour = $400,000. *See Financial Responsibility Rules for Broker-Dealers,* 78 FR 51823 (citing PRA analysis in *Product Definitions Adopting Release,* 77 FR at 48334 (providing an estimate of $400 per hour to engage an outside attorney)). *See also Crowdfunding,* Exchange Act Release No. 76324 (Oct. 30, 2015), 80 FR 71387 (Nov. 16, 2015); *FAST Act Modernization and Simplification of Regulation S–K,* Exchange Act Release No. 81851 (Oct. 11, 2017), 82 FR 50988 (Nov. 2, 2017). The Commission recognizes that the costs of retaining outside professionals may vary depending on the nature of the professional services, but for purposes of this PRA analysis, the Commission estimates that such costs would be an average of $400 per hour.

[849] 4 stand-alone SBSDs × (5,600 hours + 640 hours) = 24,960 hours.

[850] These functions likely will be performed by a risk management specialist (9,360 hours) and a senior compliance examiner (9,360 hours). Therefore, the estimated internal cost for this hour burden is calculated as follows: (Risk management specialist for 9,360 hours at $202 per hour) + (senior compliance examiner for 9,360 hours at $241 per hour) = $4,122,380.

[851] 24,960 hours × .75 = 18,720; 24,960 hours × .25 = 6,240. 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.

[852] 6,240 hours × $400 per hour = $2,496,000.

[853] *See Alternative Net Capital Requirements for Broker-Dealers That Are Part of Consolidated Supervised Entities,* 69 FR 34428.

1, for a total one-time industry-wide cost of $32 million.[854]

Second, a nonbank SBSD is required to comply with most provisions of Rule 15c3–4, which requires the establishment of a risk management control system as if it were an OTC derivatives dealer.[855] ANC broker-dealers currently are required to comply with Rule 15c3–4.[856] The Commission staff estimates that the requirement to comply with Rule 15c3–4 will result in one-time and annual hour burdens to nonbank SBSDs. The Commission staff estimates that the average amount of time a firm will spend implementing its risk management control system will be 2,000 hours,[857] resulting in an industry-wide one-time hour burden of 24,000 hours across the 12 nonbank SBSDs not already subject to Rule 15c3–4.[858]

In implementing its policies and procedures, a nonbank SBSD is required to document and record its system of internal risk management controls. The Commission staff estimates that each of these 12 nonbank SBSDs will 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 3,000 hours.[859]

Nonbank SBSDs may incur start-up costs to comply with the provisions of Rules 15c3–1 and 18a–1 that require compliance with Rule 15c3–4, including information technology costs. Based on the estimates for similar collections of information,[860] it is expected that a nonbank SBSD will incur an average of approximately $16,000 for initial hardware and software expenses, while the average ongoing cost will be approximately $20,500 per nonbank SBSD to meet the requirements of the Rule 18a–1 and the amendments to Rule 15c3–1, for a total industry-wide initial cost of $192,000 and an ongoing cost of $246,000 per year.[861]

Third, under paragraph (c)(2)(vi)(P)(*1*)(*iii*) of Rule 15c3–1, as amended, and paragraph (c)(1)(vi)(B)(*1*)(*iii*)(*A*) of Rule 18a–1, nonbank SBSDs not authorized to use models are 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 CDS reference obligors for purposes of calculating ''haircuts'' on non-cleared security-based swaps under applicable net capital rules.

As discussed above, the Commission staff estimates that 4 broker-dealer SBSDs and 2 nonbank SBSDs not using models will utilize the CDS haircut provisions under the amendments to Rules 15c3–1 and 18a–1, respectively. Consequently, these firms will use an industry sector classification system that is documented for the credit default swap reference obligors. The Commission expects that these firms will utilize external classification 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 will spend approximately 1 hour per year documenting these industry sector classification systems, for a total annual hour burden of 6 hours.[862]

Fourth, under paragraph (h) of Rule 18a–1, a nonbank SBSD is required to file certain notices with the Commission relating to the withdrawal of equity capital. Broker-dealers—which will include broker-dealer SBSDs—currently are required to file these notices under paragraph (e) of Rule 15c3–1. Based on the number of notices currently filed by broker-dealers, the Commission staff estimates that the notice requirements will result in annual hour burdens to stand-alone SBSDs. The Commission staff estimates that each of the 6 stand-alone SBSDs will file approximately 2 notices annually with the Commission. In addition, the Commission staff estimates that it will take a stand-alone SBSD approximately 30 minutes to file these notices, resulting in an industry-wide annual hour burden of 6 hours.[863]

Fifth, under Rule 18a–1d, a nonbank SBSD is required to file a proposed subordinated loan agreement with the Commission (including nonconforming subordinated loan agreements). Broker-dealers currently are subject to such a requirement. Based on staff experience with Rule 15c3–1, the Commission staff estimates that each of the 6 stand-alone SBSDs will spend approximately 20 hours of internal employee resources drafting or updating its subordinated loan agreement template to comply with the requirement, resulting in an industry-wide one-time hour burden of approximately 120 hours.[864] In addition, based on staff experience with Rule 15c3–1, the Commission staff estimates that each stand-alone SBSD will file 1 proposed subordinated loan agreement with the Commission per year and that it will take a firm approximately 10 hours to prepare and file the agreement, resulting in an industry-wide annual hour burden of approximately 60 hours.[865]

Finally, as a result of comments received, Rules 15c3–1 and 18a–1

[854] 4 stand-alone SBSDs × $8 million = $32 million.

[855] *See* paragraph (f) to Rule 18a–1, as adopted; paragraph (a)(10)(ii) of Rule 15c3–1, as amended.

[856] *See* paragraph (a)(7)(iii) of Rule 15c3–1, as amended.

[857] This estimate is based on the one-time burden estimated for an OTC derivatives dealer to implement its 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. *See* Commission, *Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 15c3–4.*

[858] 25 nonbank SBSDs minus 10 ANC broker-dealer SBSDs = 15 nonbank SBSDs minus 3 nonbank SBSDs electing the alternative compliance mechanism under Rule 18a–10, as adopted = 12 nonbank SBSDs. 12 nonbank SBSDs × 2,000 hours = 24,000 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. This work will likely be performed by a combination of an in-house attorney (8,000 hours), a risk management specialist (8,000 hours), and an operations specialist (8,000 hours). Therefore, the estimated internal cost for this hour burden is calculated as follows: (Attorney for 8,000 hours at $422 per hour) + (risk management specialist for 8,000 hours at $202 per hour) + (operations specialist for 8,000 hours at $139 per hour) = $6,104,000.

[859] 12 nonbank SBSDs × 250 hours = 3,000 hours. These hour-burden estimates are consistent with similar collections of information under Appendix E to Rule 15c3–1. *See Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 15c3–1.* These hours likely will be performed by a risk management specialist. Therefore, the estimated internal cost for this hour burden is calculated as follows: Risk management specialist for 3,000 hours at $202 per hour = $606,000.

[860] *See, e.g., 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).

[861] 12 nonbank SBSDs × $16,000 = $192,000; 12 nonbank SBSDs × $20,500 = $246,000.

[862] (2 nonbank SBSDs not using models × 1 hour) + (4 broker-dealer SBSDs × 1 hour) = 6 hours. This work will likely be performed by an internal compliance attorney. Therefore, the estimated internal cost for this hour burden is calculated as follows: Internal compliance attorney for 6 hours at $371 per hour = $2,226.

[863] (6 stand-alone SBSDs × 2 notices) × 30 minutes = 6 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. *See Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 15c3–1.* The Commission believes stand-alone SBSDs will likely perform these functions internally using an internal compliance attorney. Therefore, the estimated internal cost for this hour burden is calculated as follows: Internal compliance attorney for 6 hours at $371 per hour = $2,226.

[864] 6 stand-alone SBSDs × 20 hours = 120 hours. This work will likely be performed by an in-house attorney. Therefore, the estimated internal cost for this hour burden is calculated as follows: Attorney for 120 hours at $422 per hour = $50,640.

[865] 6 stand-alone SBSDs × 1 loan agreement × 10 hours = 60 hours. This work will likely be performed by an in-house attorney. Therefore, the estimated internal cost for this hour burden is calculated as follows: Attorney for 60 hours at $422 per hour = $25,320.

permit a stand-alone broker-dealer and a nonbank SBSD to treat collateral held by a third-party custodian to meet an initial margin requirement of a security-based swap or swap customer as being held by the stand-alone broker-dealer or nonbank SBSD for purposes of the capital deduction in lieu of margin provisions of the rule if certain conditions are met. The Commission staff estimates that the 16 broker-dealer SBSDs and 6 stand-alone SBSDs will engage outside counsel to draft and review the account control agreement at a cost of $400 per hour for an average of 20 hours per respondent, resulting in a one-time cost burden of $176,000 for these 22 entities.[866] Based on staff experience with the net capital and customer protection rules, the Commission estimates that the 16 broker-dealer SBSDs and 6 stand-alone SBSDs will enter into approximately 100 account control agreements per year with security-based swap customers and that it will take approximately 2 hours to execute each account control agreement, resulting in an industry-wide annual hour burden of 4,400 hours.[867]

The Commission staff estimates 16 broker-dealer SBSDs and 6 stand-alone SBSDs will need to maintain written documentation of their legal analysis of the account control agreement. Based on staff experience, the Commission estimates that broker-dealers (including broker-dealer SBSDs) and stand-alone SBSDs will meet this requirement split evenly between obtaining a written opinion of outside legal counsel or through the firm's own ''in-house'' analysis. The Commission estimates that the approximate cost to a broker-dealer (including a broker-dealer SBSD) or a stand-alone SBSD to obtain an opinion of counsel will be $8,000.[868] This figure is based on an estimate of 20 hours per opinion for outside counsel at $400 per hour, resulting in an industry-wide one-time cost of $88,000.[869] In addition, the Commission estimates it will take a broker-dealer (including a broker-dealer SBSD) or a stand-alone SBSD approximately 20 hours to conduct a written ''in house'' analysis, resulting in an industry-wide one-time hour-burden of 220 hours.[870]

2. Rule 18a–2

Rule 18a–2 requires nonbank MSBSPs to have and maintain positive tangible net worth and implement a system of internal risk management controls under Rule 15c3–4. The Commission staff estimates that the average amount of time a firm will spend implementing its risk management control system will be 2,000 hours,[871] resulting in an industry-wide one-time hour burden of 10,000 hours.[872]

In implementing its policies and procedures, a nonbank MSBSP will be required to document and record its system of internal risk management controls, and prepare and maintain written guidelines regarding its internal control system. The Commission staff estimates that each of the 5 nonbank MSBSPs will 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.[873]

Because nonbank MSBSPs may not initially have the systems or expertise internally to meet the risk management requirements of Rule 18a–2, these firms will 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.[874]

Nonbank MSBSPs may incur start-up costs to comply with Rule 18a–2, including information technology costs. Based on the estimates for similar collections of information,[875] the Commission staff expects that a nonbank MSBSP will incur an average of approximately $16,000 for initial hardware and software expenses, while the average ongoing cost will be approximately $20,500 per nonbank MSBSP to meet the requirements of the Rule 18a–2, for a total industry-wide initial cost of $80,000 and ongoing cost of $102,500.[876]

3. Rule 18a–3

Paragraph (e) of Rule 18a–3 requires a nonbank SBSD to establish and implement risk monitoring procedures with respect to counterparty accounts. Because these firms will be required to comply with Rule 15c3–4, the Commission staff estimates that each of the 22 nonbank SBSDs will spend an average of approximately 210 hours establishing the written risk analysis methodology, resulting in an industry-wide one-time hour burden of approximately 4,620 hours.[877] In

[866] (16 broker-dealer SBSDs + 6 stand-alone SBSDs) × $400 per hour × 20 hours = $176,000.

[867] (16 broker-dealer SBSDs + 6 stand-alone SBSDs) × 100 account control agreements × 2 hours = 4,400 hours. This work will likely be performed by an in-house attorney. Therefore, the estimated internal cost for this hour burden is calculated as follows: Attorney for 4,400 hours at $422 per hour = $1,856,800.

[868] Consistent with the business conduct release, an opinion of counsel is estimated at $400 per hour multiplied by the number of hours to produce the opinion. *See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants,* 81 FR 29960, 30137 n. 1732 (citing consistency with the opinion of counsel paperwork burden in the release adopting a registration process for SBSDs and MSBSPs).

[869] This estimate is based on the amount of time it is estimated for a broker-dealer to obtain an opinion of outside counsel as required under Appendix C to Rule 15c3–1 and staff experience. (8 broker-dealer SBSDs + 3 stand-alone SBSDs) × $400 per hour × 20 hours = $88,000.

[870] (8 broker-dealer SBSDs + 3 stand-alone SBSDs) × 20 hours = 220 hours. This work will likely be performed by an internal compliance attorney. Therefore, the estimated internal cost for this hour burden is calculated as follows: Compliance attorney for 220 hours at $371 per hour = $81,620.

[871] This estimate is based on the one-time burden estimated for an OTC derivatives dealer to implement 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. *See Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 15c3–4.*

[872] 5 MSBSPs × 2,000 hours = 10,000 hours. This work will 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 (3,333.33 hours). Therefore, the estimated internal cost for this hour burden is calculated as follows: (Internal compliance attorney for 3,333.33 hours at $371 per hour) + (risk management specialist for 3,333.33 hours at $202 per hour) + (operations specialist for 3,333.33 hours at $139 per hour) = $2,373,330.96.

[873] 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. *See Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 15c3–1.* This work will likely be performed by a risk management specialist. Therefore, the estimated internal cost for this hour burden is calculated as follows: Risk management specialist for 1,250 hours at $202 per hour = $252,500.

[874] 5 nonbank MSBSPs × $80,000 = $400,000.

[875] *See Risk Management Controls for Brokers or Dealers with Market Access,* 75 FR at 69814.

[876] 5 nonbank MSBSPs × $16,000 = $80,000. 5 nonbank MSBSPs × $20,500 = $102,500.

[877] (25 nonbank SBSDs minus 3 stand-alone SBSDs electing the alternative compliance mechanism under Rule 18a–10, as adopted = 22 nonbank SBSDs) × 210 hours = 4,620 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 to use risk-based models and parameters to set and review margin requirements). This work will likely be performed internally by an assistant general counsel (1,540 hours), an internal compliance attorney (1,540 hours), and a risk management specialist (1,540 hours). Therefore, the estimated internal cost for this hour burden is calculated as follows: (Assistant general counsel for 1,540 hours at $473 per hour) + (risk management specialist for 1,540 hours at $202 per hour) + (compliance attorney for 1,540 hours at $371 per hour) = $1,610,840.

addition, based on staff experience, the Commission staff estimates that a nonbank SBSD will 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.[878]

Start-up 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 broker-dealer SBSDs because these firms may already be subject to similar margin requirements.[879] For the remaining 6 nonbank SBSDs, because these written procedures may be novel undertakings for these firms, the Commission staff assumes these nonbank SBSDs will have their written risk analysis methodology reviewed by outside counsel. As a result, the Commission staff estimates that these nonbank SBSDs will likely incur $2,000 in legal costs, or $12,000 in the aggregate initial burden to review and comment on these materials.[880]

Based on comments received, the Commission modified the language in the final rule to provide that a nonbank SBSD may use a model to calculate the initial margin amount under the rule, if the use of the model has been approved by the Commission. Paragraph (d) of Rule 18a–3, as adopted, provides that a nonbank SBSD seeking approval to use a margin model will be subject to an application process and ongoing conditions set forth in Rule 15c3–1e and paragraph (d) of Rule 18a–1 governing the use of internal models to compute net capital.

Based on staff experience, the Commission estimates it will take a nonbank SBSD approximately 50 hours to prepare and submit an application to the Commission to seek authorization to use a model to calculate initial margin. Based on observations regarding market participants' implementation of final swap margin rules adopted by other regulators, the Commission believes it is likely that 22 nonbank SBSDs will seek Commission approval to use a model to calculate initial margin resulting in a total industry-wide one-time hour burden of 1,100 hours.[881] The Commission also estimates that each nonbank SBSD will spend approximately 250 hours per year reviewing, updating, and backtesting their initial margin model, resulting in a total industry-wide annual hour burden of 5,500 hours.[882]

4. Rule 18a–4 and Amendments to Rule 15c3–3

As discussed above in section II.C. of this release, the Commission is amending Rule 15c3–3 to establish security-based swap segregation requirements for stand-alone broker-dealers and broker-dealer SBSDs and adopting Rule 18a–4 to establish largely parallel segregation requirements applicable to stand-alone and bank SBSDs, as well as notification requirements for nonbank SBSDs. The Commission estimates that 41 respondents, consisting of 25 stand-alone broker-dealers and 16 broker-dealer SBSDs, will be subject to the physical possession or control and reserve account requirements for security-based swaps in paragraph (p) of Rule 15c3–3. [883] The Commission estimates that 17 respondents, consisting of 16 broker-dealer SBSDs and 1 broker-dealer MSBSP, will be subject to paragraph (p)(4)(i)'s counterparty notification requirement with respect to non-cleared security-based swap transactions. The Commission estimates that 16 broker-dealer SBSDs will be subject to the requirement to obtain a subordination agreement from counterparties in paragraph (p)(4)(ii) of Rule 15c3–3.

Rule 18a–4, as adopted, will apply to SBSDs and MSBSPs that are not also registered as broker-dealers with the Commission.[884] The Commission estimates that 3 stand-alone SBSDs and 4 MSBSPs will be subject to the collection of information requirements of Rule 18a–4, as adopted (because the Commission estimates that the 25 bank SBSD and 6 stand-alone SBSDs will be exempt from the omnibus segregation requirements).[885]

Under Rule 18a–4 and the amendments to Rule 15c3–3, SBSDs and broker-dealers engaged in security-based swap activities are required to establish special reserve accounts with banks and obtain written acknowledgements from, and enter into written contracts with, the banks. Based on staff experience with Rule 15c3–3, the Commission staff estimates that each of the 44 respondents [886] will establish 6 special reserve accounts at banks (2 for each type of special reserve account). Further, based on staff experience with Rule 15c3–3, the Commission staff estimates that each respondent will 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 7,920 hours.[887] The Commission staff estimates that 25%[888] of the 44 respondents (approximately 11 respondents) will establish a new special reserve account each year because, for example, they change their banking relationship, for each type of special reserve account. Therefore, the Commission staff estimates an industry-wide annual hour burden of approximately 990 hours.[889]

Paragraph (c)(1) of Rule 18a–4 and paragraph (p)(3)(i) of Rule 15c3–3

[878] 22 stand-alone SBSDs × 60 hours = 1,320 hours. This work will likely be performed by an internal compliance attorney. Therefore, the estimated internal cost for this hour burden is calculated as follows: Compliance attorney for 1,320 hours at $371 per hour = $489,720.

[879] *See, e.g.,* FINRA Rules 4210 and 4240. *See also Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants,* 81 FR at 29967 (noting burden for paragraph (g) of Rule 15Fh–3 is based on existing FINRA rules).

[880] The Commission staff estimates the review of the written risk analysis methodology will require 5 hours of outside counsel time at a cost of $400 per hour. *See also Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants,* 81 FR at 30093.

[881] 22 nonbank SBSDs × 50 hours = 1,100 hours. This work will likely be performed by an in-house attorney. Therefore, the estimated internal cost for this hour burden is calculated as follows: Attorney for 1,100 hours at $422 per hour = $464,200. A nonbank SBSD may use standardized haircuts to compute initial margin because of the cost of using an initial margin model. However, the Commission is conservatively estimating that 22 nonbank SBSDs will choose to use a model to compute initial margin for purposes of this collection of information.

[882] 22 nonbank SBSDs × 250 hours = 5,500 hours. This work will likely be performed internally by a compliance attorney (2,750 hours) and a risk management specialist (2,750 hours). Therefore, the estimated internal cost for this hour burden is calculated as follows: (Risk management specialist for 2,750 hours at $202 per hour) + (compliance attorney for 2,750 hours at $371 per hour) = $1,575,750.

[883] The 16 broker-dealer SBSD respondents were included in the proposed collection of information for proposed Rule 18a–4. Other than the addition of paragraph (p) to Rule 15c3–3, as amended, the Commission is not amending the requirements of existing Rule 15c3–3.

[884] *See* Rule 18a–4, as adopted.

[885] 50 SBSDs minus 16 broker-dealer SBSDs minus 25 bank SBSDs minus 6 stand-alone SBSDs = 3 stand-alone SBSDs. 5 nonbank MSBSPs minus 4 nonbank MSBSPs that are not broker-dealers = 1 broker-dealer MSBSP.

[886] 16 broker-dealer SBSDs + 3 stand-alone SBSDs + 25 stand-alone broker-dealers = 44 respondents.

[887] 44 respondents × 6 special reserve accounts × 30 hours = 7,920 hours. This work will likely be performed by an internal compliance attorney. Therefore, the estimated internal cost for this hour burden is calculated as follows: Compliance attorney for 7,920 hours at $371 per hour = $2,938,320.

[888] This number is based on the currently approved PRA collection for Rule 15c3–3. *See* Commission, *Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 15c3–3.*

[889] 11 SBSDs × 3 types of special reserve accounts × 30 hours = 990 hours. This work will likely be performed by an internal compliance attorney. Therefore, the estimated internal cost for this hour burden is calculated as follows: Internal compliance attorney for 990 hours at $371 per hour = $367,290.

provide that the SBSD or broker-dealer engaged in security-based swap activities must at all times maintain in a special 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 and Exhibit B to Rule 15c3–3. Paragraph (c)(3) of Rule 18a–4 and paragraph (p)(3)(iii) of Rule 15c3–3 provide that the computations necessary to determine the amount required to be maintained in the special bank account must be made on a weekly basis. Based on experience with the Rule 15c3–3 reserve computation paperwork burden hours and with the OTC derivatives industry, the Commission staff estimates that it will take 1–5 hours to compute each reserve computation, and that the average time spent across all the respondents will be approximately 2.5 hours. Accordingly, the Commission staff estimates that the resulting industry-wide annual hour burden is approximately 5,720 hours.[890]

Under paragraph (d)(1) of Rule 18a–4, paragraph (f)(2) of Rule 18a–4, and paragraph (p)(4)(i) of Rule 15c3–3, an SBSD or an MSBSP is required to provide a notice to a counterparty prior to their first non-cleared security-based swap transaction after the compliance date. All 50 SBSDs and 5 MSBSPs are required to provide these notices to their counterparties. The Commission staff estimates that these 55 entities will 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.[891]

The number of notices sent in the first year the rule is effective will depend on the number of counterparties with which each SBSD or MSBSP engages in security-based swap transactions. The number of counterparties an SBSD or MSBSP has will 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 will have approximately 1,000 counterparties at any given time.[892] Therefore, the Commission staff estimates that approximately 55,000 notices will be sent in the first year the rule is effective.[893] The Commission staff estimates that each of the 50 SBSDs and 5 MSBSPs will spend approximately 10 minutes sending out the notice, resulting in an industry-wide one-time hour burden of approximately 9,167 hours.[894] The Commission staff further estimates that the 50 SBSDs and 5 MSBSPs will establish account relationships with 200 new counterparties per year. Therefore, the Commission staff estimates that approximately 11,000 notices will be sent annually,[895] resulting in an industry-wide annual hour burden of approximately 1,833 hours.[896]

Under paragraph (d)(2) of Rule 18a–4 and paragraph (p)(4)(ii) of Rule 15c3–3, an SBSD is required to obtain subordination agreements from certain counterparties. The Commission staff estimates that each SBSD will spend, on average, approximately 200 hours to draft and prepare standard subordination agreements, resulting in an industry-wide one-time hour burden of 3,800 hours.[897] Because the SBSD will enter into these agreements with security-based swap customers, after the SBSD prepares a standard subordination agreement in-house, the Commission staff also estimates that an SBSD will have outside counsel review the standard subordination agreements and that the review will take approximately 20 hours at a cost of approximately $400 per hour. As a result, the Commission staff estimates that each SBSD will incur one-time costs of approximately $8,000,[898] resulting in an industry-wide one-time cost of approximately $152,000.[899]

As discussed above, the Commission staff estimates that each of the 19 SBSDs would have approximately 1,000 counterparties at any given time. The Commission staff further estimates that approximately 50% of these counterparties will either elect individual segregation or, if permitted, to waive segregation altogether.[900] The Commission staff estimates that an SBSD will spend 20 hours per counterparty to enter into a written subordination agreement, resulting in an industry-wide one-time hour burden of approximately 190,000 hours.[901] Further, as discussed above, the Commission staff estimates that each of the 19 SBSDs will establish account relationships with 200 new counterparties per year. The Commission staff further estimates that 50% or 100 of these counterparties will either elect individual segregation or, if permitted, to waive segregation altogether. Therefore, the Commission staff estimates an industry-wide annual hour burden of approximately 38,000 hours.[902]

[890] 44 respondents × 52 weeks × 2.5 hours/week = 5,720 hours. This work will likely be performed by a financial reporting manager. Therefore, the estimated internal cost for this hour burden is calculated as follows: Financial reporting manager for 5,720 hours at $295 per hour = $1,687,400.

[891] (50 SBSDs + 5 MSBSPs) × $400 per hour × 10 hours = $220,000. This work will likely be performed by an outside counsel with expertise in financial services law to help ensure that counterparties are receiving the proper notice under the statutory requirement.

[892] The Commission previously estimated that there are approximately 10,900 market participants in security-based swap transactions. *See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants,* 81 FR at 30089. Based on the 10,900 market participants and Commission staff experience with the securities and OTC derivatives industry, the Commission staff estimates that each SBSD and MSBSP will 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 will establish account relationships with approximately 200 new counterparties per year, or approximately 20% of a firm's existing counterparties.

[893] (50 SBSDs + 5 MSBSPs) × 1,000 counterparties = 55,000 notices.

[894] 55,000 notices × (10 minutes/60 minutes) = 9,167 hours. A compliance clerk will likely send these notices. Therefore, the estimated internal cost for this hour burden is calculated as follows: Compliance clerk for 9,167 hours at $71 per hour = $650,857.

[895] (50 SBSDs + 5 MSBSPs) × 200 counterparties = 11,000 notices.

[896] 11,000 notices × (10 minutes/60 minutes) = 1,833 hours. A compliance clerk will likely send these notices. Therefore, the estimated internal cost for this hour burden is calculated as follows: Compliance clerk for 1,833 hours at $71 per hour = $130,143.

[897] 200 hours × 19 SBSDs = 3,800 hours. An in-house attorney will likely draft these agreements because the Commission staff expects that drafting contracts will be one of the typical job functions of an in-house attorney. Therefore, the estimated internal cost for this hour burden is calculated as follows: Attorney for 3,800 hours at $422 per hour = $1,603,600.

[898] $400 × 20 hours = $8,000.

[899] $8,000 × 19 SBSDs = $152,000.

[900] 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 choose to avoid the potential additional cost associated with individual segregation. Therefore, the Commission staff estimates that approximately 50% of counterparties will either elect individual segregation or, if permitted, to waive segregation altogether.

[901] 19 SBSDs × 500 counterparties × 20 hours = 190,000. This work will likely be performed by an internal compliance attorney (95,000 hours) and a compliance clerk (95,000 hours). Therefore, the estimated internal cost for this hour burden is calculated as follows: (Internal compliance attorney for 95,000 hours at $371 per hour) + (compliance clerk for 95,000 hours at $71 per hour) = $41,990,000.

[902] 19 SBSDs × 100 counterparties × 20 hours = 38,000 hours. This work will likely be performed by an internal compliance attorney (19,000 hours) and a compliance clerk (19,000 hours). Therefore, the estimated internal cost for this hour burden is calculated as follows: (Compliance attorney for 19,000 hours at $371 per hour) + (compliance clerk for 19,000 hours at $71 per hour) = $8,398,000.

Paragraph (e) of Rule 18a–4 establishes exemptions for foreign stand-alone or bank SBSDs and MSBSPs from the segregation requirements in Section 3E of the Exchange Act, and the rules and regulations thereunder, with respect to certain transactions. The Commission previously estimated that there will be 22 foreign SBSDs, but does not have sufficient information to reasonably estimate the number of foreign firms that are dually registered as broker-dealers or are foreign banks, how many U.S. counterparties foreign stand-alone or bank SBSDs will have, and how many eligible firms will opt out of complying with Section 3E of the Exchange Act and the rules and regulations thereunder. Moreover, as discussed above, the Commission estimates that the 25 bank SBSDs and 6 stand-alone SBSDs will be exempt from the omnibus segregation requirements. Therefore, the Commission is making the conservative estimate that 22 foreign SBSDs will be subject to paragraph (e) of Rule 18a–4.

Under paragraph (e)(3) of Rule 18a–4, foreign SBSDs are required to provide disclosures in writing to their U.S. counterparties. The Commission believes that, in most cases, these disclosures will be made through amendments to the foreign SBSD's existing trading documentation.[903] Because these disclosures relate to new regulatory requirements, the Commission anticipates that all foreign SBSDs will need to incorporate new language into their existing trading documentation with U.S. counterparties. Disclosure of the potential treatment of segregated assets in insolvency proceedings under U.S. bankruptcy law and foreign insolvency laws pursuant to paragraph (e)(3) of Rule 18a–4 will likely vary depending on the counterparty's jurisdiction. Accordingly, the Commission expects that these disclosures often may need to be tailored to address the particular circumstances of each trading relationship. However, in some cases, trade associations or industry working groups may be able to develop standard disclosure forms that can be adopted by foreign SBSDs with little or no modification. In either case, the paperwork burden associated with developing new disclosure language and incorporating this language into a registered foreign SBSD's trading documentation will vary depending on: (1) The number of non-U.S. counterparties with whom the registered foreign SBSD trades; (2) the number of jurisdictions represented by the foreign SBSD's counterparties; and (3) the availability of standardized disclosure language. To the extent standardized disclosures become available, the paperwork burden on foreign SBSDs will be limited to amending existing trading documentation to incorporate the standardized disclosures. Conversely, more time will be necessary where a greater degree of customization is required to develop the required disclosures and incorporate this language into existing documentation.

The Commission estimates the maximum total paperwork burden associated with developing new disclosure language will require each of the 22 foreign SBSDs to spend 5 hours of in-house counsel time on 30 jurisdictions.[904] This will create a total one-time industry burden of 3,300 hours.[905] This estimate assumes little or no reliance on standardized disclosure language. In addition, the Commission estimates the total paperwork burden associated with incorporating new disclosure language into each foreign SBSD's trading documentation will be approximately 11,000 hours for all 22 foreign SBSDs.[906]

The Commission expects that the majority of the paperwork burden associated with the new disclosure requirements will be experienced during the first year as language is developed, whether by individual foreign SBSDs or through collaborative efforts, and trading documentation is amended. After the new disclosure language is developed and incorporated into trading documentation, the Commission believes that the ongoing burden associated with paragraph (e) of Rule 18a–4, as adopted, will be limited to periodically updating the disclosures to reflect changes in the applicable law or to incorporate new jurisdictions with security-based swap counterparties. The Commission estimates that this ongoing paperwork burden will not exceed 110 hours per year for all 22 foreign SBSDs (approximately 5 hours per foreign SBSD per year).

Paragraph (f) of Rule 18a–4 provides an exemption from the rule's requirements if certain conditions are met. These conditions include a requirement in paragraph (f)(3) of the rule that the stand-alone or bank SBSD must provide notice to a counterparty regarding the right to segregate initial margin at an independent third-party custodian, and make certain disclosures in writing regarding collateral received by the SBSD.[907]

Paragraph (f)(3) of Rule 18a–4 requires disclosure that margin collateral received and held by the firm will not be subject to a segregation requirement and of how a claim of a counterparty for the collateral would be treated in a bankruptcy or other formal liquidation proceeding of the firm. The Commission estimates the maximum total paperwork burden associated with developing new disclosure language for the purposes of this provision will require each of the 31 SBSDs (25 bank SBSDs and 6 stand-alone SBSDs) to spend 5 hours of in-house counsel time. This will create a total one-time industry burden of 155 hours.[908] This estimate assumes little or no reliance on standardized disclosure language. In addition, the Commission estimates the total paperwork burden associated with incorporating new disclosure language into each SBSD's trading documentation will be approximately 310,000 hours for all 31 SBSDs.[909] The Commission expects that the majority of the paperwork burden associated with the new disclosure requirements under paragraph (f)(3) of Rule 18a–4, as adopted will be experienced during the first year as language is developed. After the new disclosure language is developed and incorporated into trading documentation, the Commission believes that the ongoing burden associated with paragraph (f)(3) of Rule 18a–4, as adopted, will be limited to periodically updating the disclosures. The Commission estimates that this ongoing paperwork burden will not exceed 155 hours per year for all 31

[903] *See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants,* 81 FR 29960.

[904] The Commission staff estimates the total paperwork burden associated with developing new disclosure language for each foreign SBSD would be 5 hours spent on disclosure agreements relating to 30 potential jurisdictions. *See Cross-Border Proposing Release,* 78 FR at 31107 (providing similar estimates).

[905] 22 foreign SBSDs × 5 in-house counsel hours × 30 potential jurisdictions = 3,300 hours.

[906] The Commission staff estimates that the average foreign SBSD will have 50 active non-U.S. counterparties. Accordingly, the Commission staff estimates the cost of incorporating new disclosure language into the trading documentation of an average foreign SBSD would be 500 hours per foreign SBSD (based on 10 hours of in-house counsel time × 50 active non-U.S. counterparties).

[907] The PRA estimates for paragraph (f)(2) of Rule 18a–4 are discussed above with the notice provisions of paragraph (d)(2) to Rule 18a–4.

[908] 31 SBSDs (25 bank SBSDs + 6 stand-alone SBSDs) × 5 in-house counsel hours = 155 hours.

[909] The Commission staff estimates that the average SBSD will have approximately 1,000 counterparties at any given time. Accordingly, the Commission staff estimates the cost of incorporating new disclosure language into the trading documentation of an average SBSD would be 10,000 hours per SBSD (based on 10 hours of in-house counsel time × 1,000 counterparties).

SBSDs (approximately 5 hours per SBSD per year).[910]

5. Rule 18a–10

In response to comments urging the Commission to harmonize requirements with the CFTC, as well as specific comments requesting that the Commission defer to the CFTC's rules if a nonbank SBSD is registered as a swap dealer and conducts only a limited amount of security-based swaps business, the Commission is adopting new Rule 18a–10. Rule 18a–10 contains an alternative compliance mechanism pursuant to which a stand-alone SBSD that is registered as a swap dealer and predominantly engages in a swaps business may elect to comply with the capital, margin, and segregation requirements of the CEA and the CFTC's rules in lieu of complying with Rules 18a–1, 18a–3, and 18a–4. As discussed above, the Commission estimates that 3 stand-alone SBSDs will elect to operate under Rule 18a–10. These respondents were included in the proposing release in other collections of information (Rule 18a–1 and Rule 18a–3, as proposed), and have been moved to the information collection for new Rule 18a–10.[911]

The Commission estimates paperwork burden associated with developing new disclosure language under paragraph (b)(2) of Rule 18a–10 will require each of the 3 stand-alone SBSDs to spend 5 hours of in-house counsel time. This would create a total one-time industry burden of 15 hours.[912] This estimate assumes little or no reliance on standardized disclosure language. In addition, the Commission estimates the total paperwork burden associated with incorporating new disclosure language into each stand-alone SBSD's trading documentation will be approximately 30,000 hours for all 3 stand-alone SBSDs.[913] The Commission expects that the majority of the paperwork burden associated with the new disclosure requirements under paragraph (b)(2) of Rule 18a–10, as adopted, will be experienced during the first year as language is developed. After the new disclosure language is developed and incorporated into trading documentation, the Commission believes that the ongoing burden associated with paragraph (b)(2) of Rule 18a–10 will be limited to periodically updating the disclosures. The Commission estimates that this ongoing paperwork burden will not exceed 15 hours per year for all 3 stand-alone SBSDs.[914]

Based on the number of notices currently filed by broker-dealers, the Commission staff estimates that the notice requirement of paragraph (b)(3) of Rule 18a–10 will result in annual hour burdens to stand-alone SBSDs. The Commission staff estimates that 1 stand-alone SBSD will file 1 notice annually with the Commission. In addition, the Commission staff estimates that it will take a stand-alone SBSD approximately 30 minutes to file this notice, resulting in an industry-wide annual hour burden of 30 minutes.[915]

Finally, under paragraphs (d)(1) and (d)(2) of Rule 18a–10, respectively, a stand-alone SBSD can make an election to operate under the alternative compliance mechanism, during the registration process or after the firm registers as an SBSD, by providing written notice to the Commission and the CFTC of its intent to operate pursuant to the rule. The Commission believes that in the first 3 years of the effective date of the rule that the 3 nonbank SBSDs that elect to operate under Rule 18a–10 will file the notice as part of their application process. Therefore, the Commission believes that the time it would take an entity to file a notice as part of the application process would be *de minimis* and, therefore, would not result in an hour burden for this collection of information or any collection of information associated with registering with the Commission as an SBSD.[916] Finally, since the Commission believes that the 3 nonbank SBSDs will elect to operate under the rule as part of their registration process, the Commission believes that there will be no respondents, and no paperwork hour or cost burden under the PRA associated with paragraph (d)(2) of Rule 18a–10, as adopted.

6. Rule 3a71–6

Rule 3a71–6, as amended, will require submission of certain information to the Commission to the extent person request a substituted compliance determination with respect to the Title VII capital and margin requirements. The Commission expects that foreign SBSDs and MSBSPs will seek to rely on substituted compliance upon registration, and that it is likely that the majority of such requests will be made during the first year following the effective date of this amendment. Requests would not be necessary with regard to applicable rules and regulations of a foreign jurisdiction that have previously been the subject of a substituted compliance determination in connection with the applicable rules.

The Commission expects that the majority of substituted compliance applications will be submitted by foreign authorities, and that very few substituted compliance requests will come from SBSDs or MSBSPs. For purposes of this assessment, the Commission estimates that 3 SBSDs or MSBSPs will submit such applications in connection with the Commission's capital and margin requirements.[917] After consideration of the release adopting Rule 3a71–6, the Commission estimates that the total paperwork burden incurred by such entities associated with preparing and submitting a request for a substituted compliance determination in connection with the capital and margin requirements will be approximately 240 hours, plus $240,000 for the services of outside professionals for all 3 requests.[918]

[910] 31 SBSDs (25 bank SBSDs + 6 stand-alone SBSDs) × 5 hours per SBSD = 155 hours.

[911] As a result, the total respondents for Rules 18a–1 and 18a–3 have been reduced by three. In addition, these respondents will be exempt from Rule 18a–4 under the conditions of paragraph (f) of the rule if they meet certain conditions, but will continue to be included in the collection of information for the rule because the conditions in paragraph (f) contain a collection of information under the PRA. Finally, the collections of information for Rule 18a–10 will be included with the collections of information with Rule 18a–3 for purposes of submission to OMB.

[912] 3 stand-alone SBSDs × 5 in-house counsel hours = 15 hours.

[913] The Commission staff estimates that the average SBSD will have approximately 1,000 counterparties at any given time. Accordingly, the Commission staff estimates the cost of incorporating new disclosure language into the trading documentation of an average SBSD would be 10,000 hours per stand-alone SBSD (based on 10 hours of in-house counsel time × 1,000 counterparties).

[914] 3 stand-alone SBSDs × 5 hours per SBSD = 15 hours.

[915] 1 stand-alone SBSD × 1 notice × 30 minutes = 30 minutes. This estimate is based on the 30 minutes it is estimated a stand-alone broker-dealer spends filing a notice under Rule 15c3–1. *See Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 15c3–1.* This work will likely be performed by an internal compliance attorney. Therefore, the estimated internal cost for this hour burden is calculated as follows: Internal compliance attorney for 30 minutes at $371 per hour = $185.50.

[916] *See also Registration Process for Security-Based Swap Dealers and Major Security-Based Swap Participants,* Exchange Act Release No. 75611 (Aug. 5, 2015), 80 FR 48964, 48989 (Aug. 14, 2015).

[917] *See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants,* 81 FR at 30097. *See also Trade Acknowledgment and Verification of Security-Based Swap Transactions,* 81 FR at 39382.

[918] *See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants,* 81 FR at 30097 (''The Commission estimates that the total one-time paperwork burden incurred by such entities associated with preparing and submitting a request for a substituted compliance determination in connection with the business conduct requirements will be approximately 240 hours, plus $240,000 for the services of outside professionals for all three

Continued

E. Collection of Information is Mandatory

The collections of information pursuant to the amendments and new rules are mandatory, as applicable, for ANC broker-dealers, broker-dealers, SBSDs, and MSBSPs. Compliance with the collection of information requirements associated with Rule 3a71–6, regarding the availability of substituted compliance, is mandatory for all foreign financial authorities, foreign SBSDs, or foreign MSBSPs that seek a substituted compliance determination. Compliance with the collection of information requirements associated with Rule 18a–10 regarding the availability of an alternative compliance mechanism is mandatory for all stand-alone SBSDs that elect to operate under the conditions of the rule.

F. Confidentiality

The Commission expects to receive confidential information in connection with the collections of information. To the extent that the Commission receives confidential information pursuant to these collections of information, such information will be kept confidential, subject to the provisions of applicable law.[919]

requests''). The Commission further stated that in practice those amounts may overestimate the costs of requests pursuant to Rule 3a71–6 as adopted, as such requests would solely address the business conduct requirements, rather than the broader proposed scope of substituted compliance set forth in the cross-border proposing release. 81 FR at 30097 n. 1583. To the extent that an SBSD submits substituted compliance requests in connection with the business conduct requirements, the trade acknowledgment and verification requirements, and the capital and margin requirements, the Commission believes that the paperwork burden associated with the requests would be greater than that associated with a narrower request, given the need for more information regarding the comparability of the relevant rules and the adequacy of the associated supervision and enforcement practices. In the Commission's view, however, the burden associated with such a combined request would not exceed the prior estimate. *See Trade Acknowledgment and Verification of Security-Based Swap Transactions,* 81 FR at 39833 n. 258.

[919] *See, e.g.,* 15 U.S.C. 78x (governing the public availability of information obtained by the Commission); 5 U.S.C. 552 *et seq.* (Freedom of Information Act or ''FOIA''). *See also* paragraph (d)(1) of Rule 18a–1. FOIA provides at least two pertinent exemptions under which the Commission has authority to withhold certain information. FOIA Exemption 4 provides an exemption for matters that are ''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).

G. Retention Period for Recordkeeping Requirements

Under Rule 17a–4, ANC broker-dealers are required to preserve for a period of not less than 3 years, the first 2 years in an easily accessible place, certain records required under Rule 15c3–4 and certain records under Rule 15c3–1e. Rule 17a–4 specifies the required retention periods for a broker-dealer. Many of a broker-dealer's records must be retained for 3 years; certain other records must be retained for longer periods.

V. Other Matters

Pursuant to the Congressional Review Act,[920] the Office of Information and Regulatory Affairs has designated these rules as a ''major rule,'' as defined by 5 U.S.C. 804(2).

VI. Economic Analysis

The Commission is adopting: (1) Rules 18a–1 and 18a–2, and amendments to Rule 15c3–1, to establish capital requirements for nonbank SBSDs and MSBSPs; (2) Rule 18a–3 to establish margin requirements for non-cleared security-based swaps applicable to nonbank SBSDs and MSBSPs; and (3) Rule 18a–4, and amendments to Rule 15c3–3, to establish segregation requirements for SBSDs and notification requirements with respect to segregation for SBSDs and MSBSPs.[921] Some of the amendments to Rules 15c3–1 and 15c3–3 will apply to stand-alone broker-dealers to the extent that they engage in security-based swap or swap activities.[922] The Commission also is amending Rule 15c3–1 to increase the minimum net capital requirements for ANC broker-dealers and amending Rule 3a71–6 to address the potential availability of substituted compliance in connection with the Commission's capital and margin requirements for foreign SBSDs and MSBSPs. Further, the Commission is adopting an alternative compliance mechanism in Rule 18a–10 pursuant to which a stand-alone SBSD that is registered as a swap dealer and predominantly engages in a swaps business may elect to comply with the capital, margin, and segregation requirements of the CEA and the CFTC's rules in lieu of complying with the capital, margin, and segregation requirements being adopted today. Finally, the Commission is adopting a rule that specifies when a foreign non-broker-dealer SBSD or MSBSP need not comply with the segregation requirements of Section 3E of the Exchange Act and the rules thereunder.

The Commission is sensitive to the economic impacts of the rules it is adopting. Some of the 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 economic effects—including the benefits, costs, and effects on efficiency, competition, and capital formation—that will result from the adoption of Rules 18a–1, 18a–2, 18a–3, 18a–4, and Rule 18a–10, and from the adoption of the amendments to Rules 15c3–1, 15c3–3, and 3a71–6. The economic effects considered in adopting these new rules and amendments are discussed below and have informed the policy choices described throughout this release.

The discussion below provides a baseline against which the rules may be evaluated. For the purposes of this economic analysis, the baseline incorporates the state of the security-based swap and swap markets as they exist today and does not include any of the regulatory provisions that have not yet been adopted. However, to the extent that such provisions have been anticipated by and therefore affected the behavior of market participants those practices will be considered part of the baseline.

The Commission does not currently have comprehensive data on the state of the U.S. security-based swap and swap markets. Consequently, the Commission is using the limited data currently available to develop the baseline and to inform the following analysis of the anticipated costs and benefits resulting from the rules and amendments being adopted today.[923] These rules and amendments have the potential to significantly affect efficiency, competition, and capital formation in the security-based swap and swap markets, with the impact not being limited to the specific entities that fall within the meaning of the terms ''security-based swap dealer'' and ''major security-based swap

[920] 5 U.S.C. 801 *et seq.*

[921] *See* section II of this release.

[922] For example, the standardized haircuts for security-based swaps and swaps will apply to stand-alone broker-dealers as will the segregation requirements for security-based swaps.

[923] In the proposing release, the Commission requested data and information from commenters to assist it in analyzing the economic consequences of the proposed rules. *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70300. *See also Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53019–20 (similarly requesting data).

participant.'' The following analysis will also consider these effects.

A. Baseline

To assess the economic impact of the capital, margin, and segregation rules being adopted today, the Commission is using as its baseline the state of the security-based swap and swap markets as they exist at the time of this release, including applicable rules the Commission has already adopted, but excluding rules the Commission has proposed but not finalized.[924] The analysis includes the statutory provisions that currently govern the security-based swap market pursuant to the Dodd-Frank Act, and rules adopted by the Commission regarding: (1) Entity definitions;[925] (2) cross-border activities;[926] (3) registration of security-based swap data repositories;[927] (4) registration of SBSDs and MSBSPs;[928] (5) reporting and dissemination of security-based swap information;[929] (6) dealing activity of non-U.S. persons with a U.S. connection;[930] (7) business conduct standards;[931] (8) trade acknowledgments;[932] and (9) applications with respect to statutory disqualifications.[933] These statutes and final rules—even if compliance is not yet required—are part of the existing regulatory landscape that market participants expect to govern their security-based swap activity. There are limitations in the degree to which the Commission can quantitatively characterize the current state of the security-based swap market. As described in more detail below, because the available data on security-based swap transactions do not cover the entire market, the Commission has developed its understanding of market activity using a sample that includes only certain portions of the market.

Under the baseline, the security-based swap and swap markets are dominated, both globally and domestically, by a small number of firms, generally entities that are, or are affiliated with, large commercial banks.[934] The economic impacts of the rules and amendments being adopted here are expected to primarily stem from their effect on the relatively small number of entities that act as dealers and major participants in this market. These firms will become subject to the segregation requirements of Rule 15c3–3, as amended, or Rule 18a–4 with respect to security-based swap transactions. These firms—if they are a stand-alone broker-dealer, nonbank SBSD, or nonbank MSBSP—will also become subject to the capital requirements of Rules 15c3–1, 18a–1, and/or 18a–2, as applicable, and—if they are a nonbank SBSD and MSBSP—will also become subject to the margin requirements of Rule 18a–3.[935] Many of the directly affected entities—including nonbank entities—are currently part of a bank holding company. Therefore, certain Federal Reserve regulations applicable to these entities (at the bank-holding company level) enter into the baseline and otherwise impact the analysis of the costs and benefits. Moreover, participants in the security-based swap and swap markets can fall under a number of other regulatory regimes, including those of: the prudential regulators, the CFTC, or numerous international regulatory authorities.[936]

Prior to the Dodd-Frank Act, many participants in the security-based swap and swap markets generally were not directly supervised by the Commission.[937] The Commission does not possess regulatory reports from many of these entities that can be used to determine the nature and extent of their participation in these markets. Consequently, in the Commission's analysis, the nature of an entity's participation in these markets will generally be inferred from transaction data. Market participants meeting the registration thresholds outlined in the Commission's intermediary definitions[938] and cross-border rules are expected to register with the Commission.[939] As discussed elsewhere, the Commission expects that up to 50 entities may register as SBSDs, and that up to an additional five entities may register as MSBSPs.[940] In addition, the Commission estimates that, of the 50 entities expected to register as SBSDs, 16 are registered with the Commission as broker-dealers.[941] Of the 50 entities expected to register as SBSDs, 22 are expected to be non-U.S. persons.[942]

Certain provisions in the amendments and the rules being adopted today affect broker-dealers. Thus, the baseline incorporates the current capital and segregation requirements for broker-dealers under Rules 15c3–1 and 15c3–3 as well as the current state of the

[924] The Commission also considered, where appropriate, the impact of rules and technical standards promulgated by other regulators, such as the CFTC, the prudential regulators, and the European Securities and Markets Authority, on practices in the security-based swap and swap markets.

[925] *See Entity Definitions Adopting Release,* 77 FR 30596.

[926] *See Application of ''Security-Based Swap Dealer'' and ''Major Security-Based Swap Participant'' Definitions to Cross-Border Security-Based Swap Activities,* Exchange Act Release No. 72472 (June 25, 2014, 79 FR 47278 (Aug. 12, 2014).

[927] *See Security-Based Swap Data Repository Registration, Duties, and Core Principles,* Exchange Act Release No. 74246 (Feb. 11, 2015), 80 FR 14438 (Mar. 19, 2015).

[928] *See Registration Process for Security-Based Swap Dealers and Major Security-Based Swap Participants,* 80 FR 48964.

[929] *See Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information,* Exchange Act Release No. 74244 (Feb. 11, 2015), 80 FR 14563 (Mar. 19, 2015). *See also Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information,* Exchange Act Release No. 78321 (July 14, 2016), 81 FR 53546 (Aug. 12, 2016).

[930] *See Security-Based Swap Transactions Connected With a Non-U.S. Person's Dealing Activity That Are Arranged, Negotiated, or Executed by Personnel Located in a U.S. Branch or Office of an Agent; Security-Based Swap Dealer De Minimis Exception,* Exchange Act Release No. 77104 (Feb. 10, 2016), 81 FR 8598 (Feb. 19, 2016).

[931] *See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants,* 81 FR 29960; *Commission Statement on Certain Provisions of Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants,* Exchange Act Release No. 84511 (Oct. 31, 2018), 83 FR 55486 (Nov. 6, 2018).

[932] *See Trade Acknowledgment and Verification of Security-Based Swap Transactions,* 81 FR 39808.

[933] *See Applications by Security-Based Swap Dealers or Major Security-Based Swap Participants for Statutorily Disqualified Associated Persons to Effect or Be Involved in Effecting Security-Based Swaps,* 84 FR 4906.

[934] *See, e.g., ISDA Margin Survey 2012* (May 2012).

[935] A bank SBSD or MSBSP will be subject to the capital and margin requirements of its prudential regulator. *See Prudential Regulator Margin and Capital Adopting Release,* 80 FR 74840.

[936] *See, e.g.,* Regulation (EU) No. 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories (July 4, 2012).

[937] *See* section VI.A.1. of this release.

[938] *See Entity Definitions Adopting Release,* 77 FR 30596; *Application of ''Security-Based Swap Dealer'' and ''Major Security-Based Swap Participant'' Definitions to Cross-Border Security-Based Swap Activities,* 79 FR 47278.

[939] Though the Commission's SBSD and MSBSP registration rules are effective, compliance will not be required until the Commission has adopted other rules applicable to these entities. *See* section III of this release discussing effective and compliance dates.

[940] *See Applications by Security-Based Swap Dealers or Major Security-Based Swap Participants for Statutorily Disqualified Associated Persons to Effect or Be Involved in Effecting Security-Based Swaps,* 84 FR 4906; *see also* section VI.B.1.b. of this release. The Commission's estimate of the number of SBSDs is based on data obtained from the Depository Trust & Clearing Corporation Derivatives Repository Limited Trade Information Warehouse (''DTCC–TIW''), which consists of data regarding the activity of market participants in the single-name CDS market during 2017.

[941] *See Applications by Security-Based Swap Dealers or Major Security-Based Swap Participants for Statutorily Disqualified Associated Persons to Effect or Be Involved in Effecting Security-Based Swaps,* 84 FR 4906.

[942] *See Security-Based Swap Transactions Connected With a Non-U.S. Person's Dealing Activity That Are Arranged, Negotiated, or Executed by Personnel Located in a U.S. Branch or Office of an Agent; Security-Based Swap Dealer De Minimis Exception,* 81 FR at 8605.

broker-dealer industry.[943] However, because the Exchange Act's definition of ''security'' did not include security-based swaps until the definition was amended by the Dodd-Frank Act, dealing activity in security-based swaps did not require registration with the Commission as a broker-dealer. Therefore, these entities were not subject to the broker-dealer capital and segregation requirements of the Commission or the margin requirements of the Federal Reserve and the SROs. Moreover, existing broker-dealer capital and segregation requirements made it relatively costly for broker-dealers to trade security-based swaps.[944] As a result, security-based swap transactions have often been effected via entities that are affiliated with broker-dealers, but not via broker-dealers themselves.

The Commission is adopting requirements that apply to MSBSPs. An entity is an MSBSP if it is not an SBSD but nonetheless either: (1) Maintains a ''substantial position'' in security-based swaps for any of the major security-based swap categories; (2) has outstanding security-based swaps that create substantial counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets; or (3) is a ''financial entity'' that is ''highly leveraged'' relative to the amount of capital it holds (and that is not subject to capital requirements established by an appropriate federal banking agency) and maintains a ''substantial position'' in outstanding swaps or security-based swaps in any major category.[945] As with SBSDs, such entities have previously operated without the Commission's direct supervision (unless separately required to register as a broker-dealer). Based on available transaction data, the Commission has previously estimated that five or fewer entities currently active in the security-based swap market may ultimately register as MSBSPs.[946]

Because many of the entities that may register as SBSDs or MSBSPs are subsidiaries of U.S. and international bank holding companies, the baseline is affected by the relevant Federal Reserve regulations currently applicable at the consolidated bank holding company level,[947] as well as current foreign regulations of security-based swaps.

The amendments and rules being adopted today are primarily focused on security-based swap activities of stand-alone broker-dealers and nonbank SBSDs and MSBSPs. However, certain aspects of the amendments and rules being adopted will also affect the treatment of swaps such as interest rate swaps or CDS on broad-based security indices. For example, entities that are registered with the Commission as nonbank SBSDs but who also participate in the swap market will account for the swap positions in their capital calculations under the requirements being adopted today. Therefore, the Commission's analysis (and the baseline thereto) focuses on security-based swaps, but considers the broader swap market where appropriate.

The Commission's analysis of the state of the current security-based swap market is based on data obtained from the DTCC–TIW, particularly data regarding the activity of market participants in the single-name CDS market during the period from 2008 to 2017.[948] Although the capital, segregation, and margin rules being adopted today apply to all security-based swaps, not just single-name CDS, single-name CDS represent a significant portion of the security-based swap market.[949]

Although the Commission believes the DTCC–TIW data to be sufficient for characterizing the baseline state of the security-based swap market, the complexity of the U.S. regulatory structure presents difficulties in drawing inferences from this baseline. The security-based swap market is dominated by a small number of global financial firms.[950] These firms typically have considerable flexibility in structuring their activities. Such firms may choose to house their security-based swap dealing activities in one of several affiliated entities; the degree to which the rules and amendments being adopted today will apply will depend on these choices. If such activities are placed in a bank SBSD or MSBSP, such as a federally insured depository institution, the capital and margin rules being adopted today will not apply.[951] Conversely, if these activities are instead housed in an affiliated (U.S.) nonbank SBSD, the requirements being adopted today will apply in full. Thus, the requirements' impact will depend on firms' choice of organizational structure, which, in turn, will depend, in part, on the requirements' relative attractiveness compared to those of other regulators.

Available information about the global OTC derivatives market suggests that swap transactions, in contrast to security-based swap transactions, dominate trading activities, notional amounts, and market values.[952] The BIS estimates that the total notional amounts outstanding and gross market value of global OTC derivatives were $532 trillion and $11.0 trillion, respectively, as of the end of 2017. Of these totals, the BIS estimates that foreign exchange contracts, interest rate contracts, and commodity contracts comprised 97% of the total notional amount and 92% of the gross market value. CDS, including index CDS, comprised 1.8% of the total notional amount and 2.9% of the gross market value. Equity-linked contracts, including forwards, swaps and options, comprised an additional 1.2% of the total notional amount and 5.3% of the gross market value. Because the capital, margin, and segregation rules being adopted today for SBSDs and MSBSPs would apply to dealers and participants in the security-based swap market, they are expected to affect a substantially smaller portion of the U.S. OTC derivatives market than the capital, margin, and segregation rules of the CFTC and the prudential regulators for swap dealers and major swap participants.[953] Moreover, many of the

[943] The current state of the broker-dealer industry is affected by, among other things, market practice and relevant SRO regulations, as well as margin rules set by the Federal Reserve (*i.e.,* Regulation T).

[944] For example, because the segregation rules in the United States were stricter than those in the United Kingdom, prime-brokerage services were often provided through London-based broker-dealer affiliates. *See* Kenneth R. French et. al., *The Squam Lake Report: Fixing the Financial System* (2010).

[945] *See* 17 CFR. 240.3a67–1.

[946] *See Applications by Security-Based Swap Dealers or Major Security-Based Swap Participants for Statutorily Disqualified Associated Persons to Effect or Be Involved in Effecting Security-Based Swaps,* 84 FR at 4925.

[947] *See* 12 CFR 225, Appendix A.

[948] *See Applications by Security-Based Swap Dealers or Major Security-Based Swap Participants for Statutorily Disqualified Associated Persons to Effect or Be Involved in Effecting Security-Based Swaps,* 84 FR at 4924–25 (describing the features of the DTCC–TIW, including CDS transactions that are not part of the data).

[949] *See Applications by Security-Based Swap Dealers or Major Security-Based Swap Participants for Statutorily Disqualified Associated Persons to Effect or Be Involved in Effecting Security-Based Swaps,* 84 FR at 4924 n. 245 (providing a breakdown of the global security-based swap market and indicating that single-name CDSs represent approximately 59% of this market in terms of gross notional outstanding at the end of 2017).

[950] *See, e.g., ISDA Margin Survey 2012.*

[951] The capital and margin requirements adopted today apply to nonbank SBSDs and MSBSPs, but the segregation requirements adopted today apply to both bank and nonbank SBSDs and MSBSPs. Bank SBSDs are subject to the prudential regulators' capital and margin requirements. *See Prudential Regulator Margin and Capital Adopting Release,* 80 FR 74840.

[952] *See* BIS, *OTC derivatives statistics at end-December 2017* (May 2018).

[953] *See Prudential Regulator Margin and Capital Adopting Release,* 80 FR 74840; *CFTC Margin Adopting Release,* 81 FR 636; *CFTC Capital Proposing Release,* 81 FR 91252. The effect of the Commission's capital rules on the U.S. OTC derivatives markets potentially will be more significant depending on the number of CFTC-

participants in these markets may choose to engage in security-based swap transactions through their banking subsidiaries, further reducing the impact of the Commission's requirements.[954]

1. Market Participants

Transaction data from the DTCC–TIW indicates that security-based swap dealing activity is concentrated among a few dozen entities. In addition to these entities, thousands of other participants appear as counterparties to security-based swaps in the Commission's sample, and include, but are not limited to, investment companies, pension funds, private hedge funds, sovereign entities, and industrial companies. A detailed discussion of security-based swap market participants can be found in the Commission's release regarding applications with respect to statutory disqualifications.[955]

a. Dealing Structures

SBSDs use a variety of business models and legal structures to engage in dealing business for a variety of legal, tax, strategic, and business reasons.[956] Dealers may use a variety of structures in part to reduce risk and enhance credit protection based on the particular characteristics of each entity's business.

Bank and nonbank holding companies may use subsidiaries to deal with counterparties. Further, dealers may rely on multiple sales forces to originate security-based swap transactions. For example, a U.S. bank dealer may use a sales force in its U.S. home office to originate security-based swap transactions in the United States and use separate sales forces spread across foreign branches to originate security-based swap transactions with counterparties in foreign markets.

In some situations, an entity's performance under a security-based swap transaction may be supported by a guarantee provided by an affiliate. More generally, guarantees may take the form of a blanket guarantee of an affiliate's performance on all security-based swap contracts, or a guarantee may apply only to a specific transaction or counterparty. Guarantees may give counterparties to the dealer direct recourse to the holding company or another affiliate for its dealer-affiliate's obligations under security-based swap transactions for which that dealer-affiliate acts as counterparty.

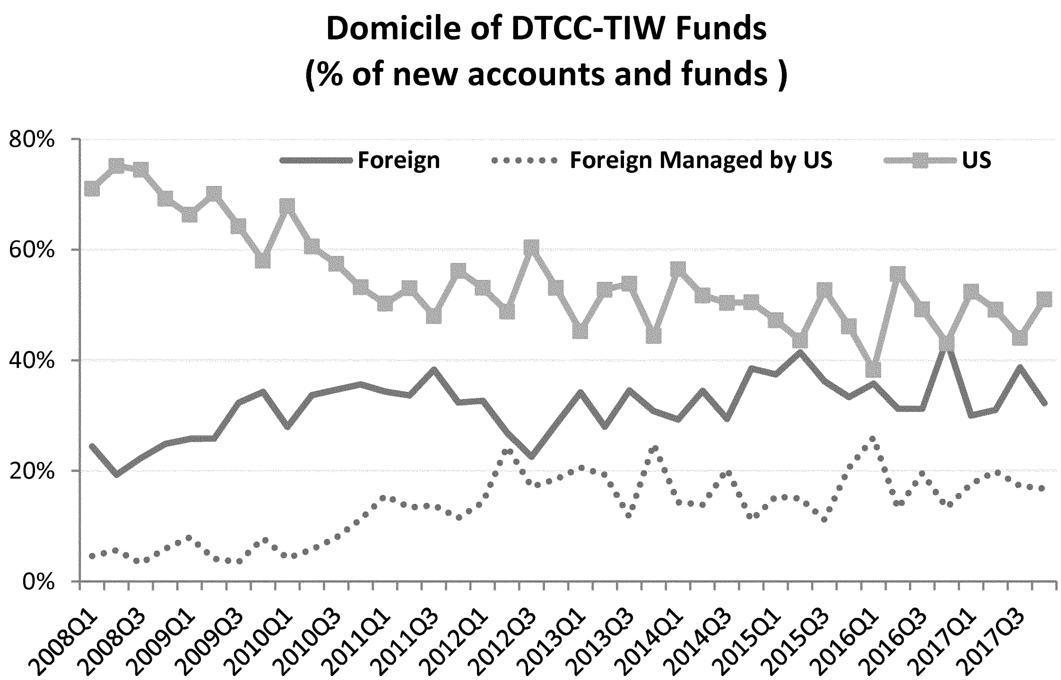
registered dealers that also register as nonbank SBSDs, given the application of the capital requirements to the entire business of such dually-registered firms.

[954] Section 716 of the Dodd-Frank Act significantly limited the security-based swap activities of insured depository institutions, effectively requiring that such activities be pushed out into affiliated nonbank SBSDs registered with the Commission. Section 630 of the Consolidated and Further Continuing Appropriations Act of 2015 eliminated most of Section 716's limitations; excepting structured financed swaps, insured depository institutions may directly engage in security-based swap activity. *See* Public Law 113–235 § 630.

[955] *See Applications by Security-Based Swap Dealers or Major Security-Based Swap Participants for Statutorily Disqualified Associated Persons to Effect or Be Involved in Effecting Security-Based Swaps,* 84 FR at 4925–26.

[956] *See Application of* ''*Security-Based Swap Dealer*'' *and* ''*Major Security-Based Swap Participant*'' *Definitions to Cross-Border Security-Based Swap Activities; Republication,* 79 FR at 47283.

Figure 1: The percentage of (1) new accounts with a domicile in the United States (referred to as "US"), (2) new accounts with a domicile outside the United States (referred to as "Foreign"), and (3) new accounts outside the United States but managed by a U.S. person, account of a foreign branch of a U.S. person, and accounts of a foreign subsidiary of a U.S. person (collectively referred to as "Foreign Managed by US").[957] Unique, new accounts are aggregated each quarter and percentages are computed on a quarterly basis, from January 2008 through December 2017.



b. Security-Based Swap Market Participant Domiciles

As depicted in Figure 1, domiciles of new accounts participating in the market have shifted over time. It is unclear whether these shifts represent changes in the types of participants active in this market, changes in reporting, or changes in transaction volumes in particular underliers. For example, the percentage of new entrants that are foreign accounts increased from 24.4% in the first quarter of 2008 to 32.3% in the last quarter of 2017, which may reflect an increase in participation by foreign account holders in the security-based swap market, though the total number of new entrants that are foreign accounts decreased from 112 in the first quarter of 2008 to 48 in the last quarter of 2017.[958] Additionally, the percentage of the subset of new entrants that are foreign accounts managed by U.S. persons increased from 4.6% in the first quarter of 2008 to 16.8% in the last quarter of 2017, and the absolute number rose from 21 to 25, which also may reflect more specifically the flexibility with which market participants can restructure their market participation in response to regulatory intervention, competitive pressures, and other stimuli.[959] At the same time, apparent changes in the percentage of new accounts with foreign domiciles may also reflect improvements in reporting to the DTCC–TIW by market participants, an increase in the percentage of transactions between U.S. and non-U.S. counterparties, and/or increased transactions in single-name CDS on U.S. reference entities by foreign persons.[960]

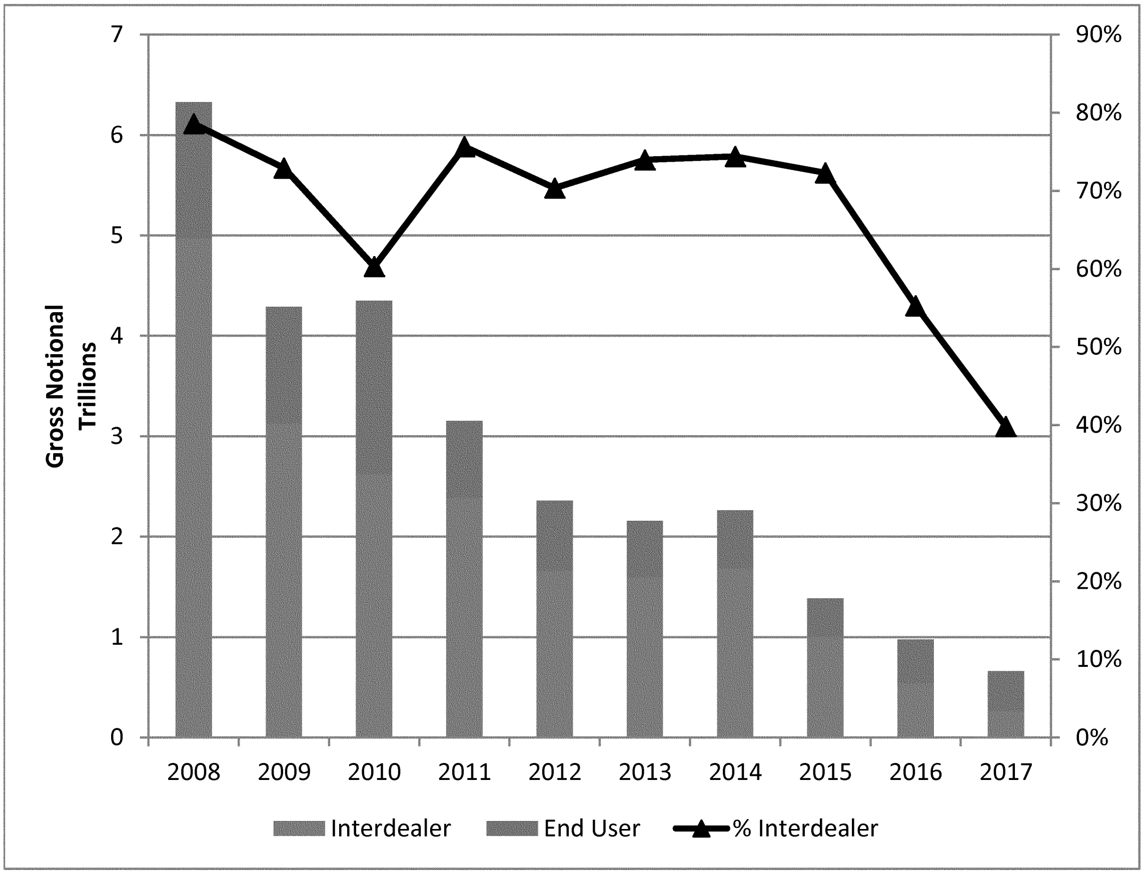
[957] Following publication of the Warehouse Trust Guidance on CDS data access, the DTCC–TIW surveyed market participants, asking for the physical address associated with each of their accounts (*i.e.*, where the account is organized as a legal entity). This address is designated the registered office location by the DTCC–TIW. When an account does not report a registered office location, the Commission has assumed that the settlement country reported by the investment adviser or parent entity to the fund or account is the place of domicile. This treatment assumes that the registered office location reflects the place of domicile for the fund or account.

[958] These estimates were calculated by Commission staff using DTCC–TIW data.

[959] *See* Charles Levinson, *U.S. banks moved billions in trades beyond the CFTC's reach,* Reuters, Aug. 21, 2015, *available at http://www.reuters.com/article/2015/08/21/usa-banks-swaps-idUSL3N10S57R20150821*. The estimates of 21 and 25 were calculated by Commission staff using DTCC–TIW data.

[960] The available data do not include all security-based swap transactions but only transactions in single name CDS that involve either: (1) At least one account domiciled in the United States (regardless of the reference entity); or (2) single-name CDS on a U.S. reference entity (regardless of the domicile of the counterparties).

Figure 2: Global, notional trading volume in North American corporate single-name CDS by calendar year and the fraction of volume that is interdealer.



c. Security-Based Swap Market: Levels of Security-Based Swap Trading Activity

As noted above, firms that act as dealers play a central role in the security-based swap market. Based on an analysis of 2017 single-name CDS data from the DTCC–TIW, accounts of those firms that are likely to exceed the security-based swap dealer *de minimis* thresholds and trigger registration requirements intermediated transactions with a gross notional amount of approximately $2.9 trillion, approximately 55% of which was intermediated by the top five dealer accounts.[961] A commenter stated that security-based swap dealing activity is largely concentrated in U.S. and foreign banks, foreign dealers, OTC derivatives dealers, and ''stand-alone SBSDs,'' and that stand-alone broker-dealers are not significant participants.[962]

These dealers transact with hundreds or thousands of counterparties. Approximately 21% of accounts of firms expected to register as SBSDs and observable in the DTCC–TIW have entered into security-based swaps with over 1,000 unique counterparty accounts as of year-end 2017.[963] Another 25% of these accounts transacted with 500 to 1,000 unique counterparty accounts; 29% transacted with 100 to 500 unique accounts; and 25% of these accounts intermediated security-based swaps with fewer than 100 unique counterparties in 2017. The median dealer account transacted with 495 unique accounts (with an average of approximately 570 unique accounts). Non-dealer counterparties transacted almost exclusively with these dealers. The median non-dealer counterparty transacted with two dealer accounts (with an average of approximately 3 dealer accounts) in 2017.

Figure 2 describes the percentage of global, notional transaction volume in North American corporate single-name CDS reported to the DTCC–TIW from January 2008 through December 2017, separated by whether transactions are between two ISDA-recognized dealers (interdealer transactions) or whether a transaction has at least one non-dealer counterparty.

Figure 2 also shows that the portion of the notional volume of North American corporate single-name CDS represented by interdealer transactions has remained fairly constant through 2015 before falling from approximately 72% in 2015 to approximately 40% in 2017. This fall corresponds to the availability of clearing to non-dealers. Interdealer transactions continue to represent a significant portion of trading activity even as notional volume has declined over the past 10 years,[964] from

[961] The Commission staff analysis of DTCC–TIW transaction records indicates that approximately 99% of single-name CDS price-forming transactions in 2017 involved an ISDA-recognized dealer.

[962] *See* SIFMA 11/19/2018 Letter.

[963] Many dealer entities and financial groups transact through numerous accounts. Given that individual accounts may transact with hundreds of counterparties, the Commission infers that entities and financial groups may transact with at least as many counterparties as the largest of their accounts.

[964] The start of this decline predates the enactment of the Dodd-Frank Act and the proposal of security-based swap rules thereunder.

more than $6 trillion in 2008 to less than $700 billion in 2017.[965]

Against this backdrop of declining North American corporate single-name CDS activity, about half of the trading activity in North American corporate single-name CDS reflected in the analyzed dataset was between counterparties domiciled in the United States and counterparties domiciled abroad, as shown in Figure 3 below. Using the self-reported registered office location of the DTCC–TIW accounts as a proxy for domicile, Commission staff estimates that only 12% of the global transaction volume by notional volume between 2008 and 2017 was between two U.S.-domiciled counterparties, compared to 49% entered into between one U.S.-domiciled counterparty and a foreign-domiciled counterparty and 39% entered into between two foreign-domiciled counterparties.[966]

If one considers the number of cross-border transactions instead from the perspective of the domicile of the corporate group (*e.g.,* by classifying a foreign bank branch or foreign subsidiary of a U.S. entity as domiciled in the United States), the percentages shift significantly. Under this approach, the fraction of transactions entered into between two U.S.-domiciled counterparties increases to 34%, and to 51% for transactions entered into between a U.S.-domiciled counterparty and a foreign-domiciled counterparty.

By contrast, the proportion of activity between two foreign-domiciled counterparties drops from 39% to 15%. This change in respective shares based on different classifications suggests that the activity of foreign subsidiaries of U.S. firms and foreign branches of U.S. banks accounts for a higher percentage of security-based swap activity than the activity of U.S. subsidiaries of foreign firms and U.S. branches of foreign banks. It also demonstrates that financial groups based in the United States are involved in an overwhelming majority (approximately 85%) of all reported transactions in North American corporate single-name CDS.

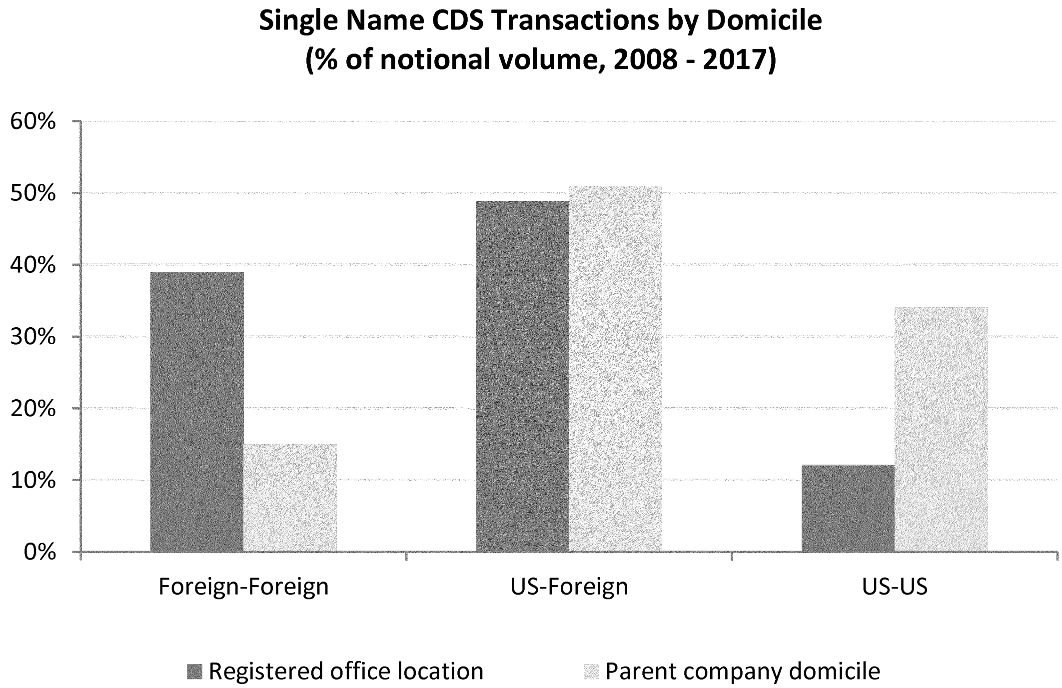
Financial groups based in the United States are also involved in a majority of interdealer transactions in North American corporate single-name CDS. Of the 2017 transactions in North American corporate single-name CDS between two ISDA-recognized dealers and their branches or affiliates, 94% of transaction notional volume involved at least one account of an entity with a U.S. parent.

In addition, a majority of North American corporate single-name CDS transactions occur in the interdealer market or between dealers and foreign non-dealers, with the remaining portion of the market consisting of transactions between dealers and U.S.-person non-dealers. Specifically, 60% of North American corporate single-name CDS transactions involved either two ISDA-recognized dealers or an ISDA-recognized dealer and a foreign non-dealer. Approximately 39% of such transactions involved an ISDA-recognized dealer and a U.S.-person non-dealer.

[965] This estimate is lower than the gross notional amount of $7.2 trillion noted above as it includes only the subset of single-name CDS referencing North American corporate documentation, as discussed above.

[966] For purposes of this discussion, Commission staff has assumed that the registered office location reflects the place of domicile for the fund or account, but it is possible that this domicile does not necessarily correspond to the location of an entity's sales or trading desk. *See Application of Certain Title VII Requirements to Security-Based Swap Transactions Connected With a Non-U.S. Person's Dealing Activity That Are Arranged, Negotiated, or Executed by Personnel Located in a U.S. Branch or Office or in a U.S. Branch or Office of an Agent,* Exchange Act Release No. 74834 (Apr. 29, 2015), 80 FR 27452 (May 13, 2015).

Figure 3: The fraction of notional volume in North American corporate single-name CDS between (1) 2 U.S.-domiciled accounts, (2) one U.S.-domiciled account and one non-U.S.-domiciled account, and (3) two non-U.S.-domiciled accounts, computed from January 2008 through December 2017.



d. Open Positions

Based on analysis of data from the DTCC–TIW, Table 1 describes the gross notional amount of open positions in non-cleared single-name CDS between different types of market participants (*i.e.,* ''accounts'') at the end of 2017. Gross notional amount of open positions between two types of market participants is the sum of the notional amounts in U.S. dollars of all outstanding CDS contracts between the two types of market participants.

At the end of 2017, the gross notional amount of open positions between ISDA-recognized dealers far exceeded the gross notional amount of open positions between all other types of market participants. In particular, the gross notional amount of open positions between ISDA-recognized dealers (''interdealer'') was approximatively $1.25 trillion in non-cleared single-name CDS contracts and $557 billion in non-cleared index CDS contracts. The gross notional amount of open positions other than interdealer was approximatively $525 billion in non-cleared single-name CDS contracts and just over $1 trillion in non-cleared index CDS contracts.

Banks and private funds were among the most active market participants that were not ISDA-recognized dealers. The gross notional amount of open positions between ISDA-recognized dealers and banks was approximatively $184 billion in non-cleared single-name CDS contracts and $113 billion in non-cleared index CDS contracts. Similarly, the gross notional amount of open positions between ISDA-recognized dealers and private funds was approximatively $176 billion in non-cleared single-name CDS contracts and $410 billion in non-cleared index CDS contracts.

TABLE 1—GROSS NOTIONAL AMOUNT OF DEALER-INTERMEDIATED OPEN POSITIONS IN NON-CLEARED CDS AT THE END OF 2017

[Billions of U.S. dollars]

	Single-name CDS	Index CDS
ISDA-Recognized Dealers	1,252	557
Banks	184	113
Insurance Companies	20	30
Private Funds	176	410
Registered Investment Companies	24	62
Non-financial Corporations	<1	<1
DFA Special Entities	4	4
Foreign Sovereign	6	18
Finance Companies	1	<1
Others	100	187

TABLE 1—GROSS NOTIONAL AMOUNT OF DEALER-INTERMEDIATED OPEN POSITIONS IN NON-CLEARED CDS AT THE END OF 2017—Continued

[Billions of U.S. dollars]

	Single-name CDS	Index CDS
Others/Unclassified	<1	188.57

Dealing entities that are likely to register as SBSDs generally have significant open positions in the single-name CDS market. For each dealing entity that is expected to register as an SBSD and for which DTCC–TIW positions data are available as of the end of September 2017, the Commission identifies the cleared and non-cleared single-name CDS positions that the entity holds against its counterparties. The Commission then calculates the aggregate gross notional amount of each entity's open single-name CDS positions. For these 23 dealing entities, the mean, median, maximum, and minimum aggregate gross notional amount are respectively, $219 billion, $115 billion, $902 billion, and $3 billion. The standard deviation in aggregate gross notional amounts is $242 billion.

These entities also engage in dealing activity in the swap market. The aggregate gross notional amounts of their open positions in the swap market have a mean of $11,725 billion, a median of $10,244 billion, a minimum of $72 billion, a maximum of $45,264 billion, and a standard deviation of $10,496 billion.[967] To gauge the relative significance of single-name CDS open positions, the Commission expresses each entity's single-name CDS aggregate gross notional amount as a percentage of its combined swaps and single-name CDS aggregate gross notional amount. The mean, median, maximum, and minimum percentages are respectively 1.34%, 1.23%, 0.03%, and 5.39%. The standard deviation is 1.13%.

e. Cross-Market Participation

The numerous financial markets are integrated, often attracting the same market participants that trade across corporate bond, swap, and security-based swap markets, among others. In a prior release, the Commission discussed the hedging opportunities across the single-name CDS and index CDS markets and how such hedging opportunities in turn influence the extent to which participants that are active in the single-name CDS market are likely to be active in the index CDS market.[968]

2. Counterparty Credit Risk Mitigation

In contrast to the securities markets, counterparty credit risk represents a major source of risk to participants in the OTC security-based swap market.[969] For example, in a CDS transaction, the first party, the protection buyer, agrees to pay the second party, the protection seller, a periodic premium for a set time period in exchange for the protection seller agreeing to pay some amount in the event of the occurrence of a given credit event during the same period. The ongoing reciprocal obligations of the parties in such transactions expose each to ongoing reciprocal counterparty credit risk.

Currently, security-based swap market participants mitigate counterparty credit risk by: (1) Using a central counterparty (''CCP'') such as a clearing agency or DCO to clear a trade; (2) using standardized netting agreements between counterparties; (3) performing portfolio compression to minimize counterparty exposure; and (4) requiring margin (*i.e.,* collateral). Below is a brief discussion of the extent to which market participants make use of each of these practices in the CDS market, which comprises the majority of security-based swap transactions.

a. Clearing

Central clearing through a CCP provides a method for dealing with the counterparty credit risk inherent in security-based swap transactions. Where a clearing agency provides CCP services, clearance and settlement of security-based swap contracts replaces bilateral counterparty exposures with exposures against the clearing agency providing CCP services.[970] Using a CCP to centrally manage credit risk can reduce the monitoring costs and counterparty credit risk of both parties to the original transaction. A centralized clearing structure, when widely adopted, also maximizes the opportunities for netting offsetting contracts thus reducing collateral requirements in centrally-cleared transactions. It can also improve price discovery and financial stability

Although central clearing offers a number of advantages, it is not without limitations. For example, ''bespoke'' or otherwise illiquid contracts are not amenable to clearing. Widespread adoption of central clearing in security-based swap markets would raise the systemic importance of CCPs.

The ratio of the aggregate notional amount of outstanding CDS contracts cleared through CCPs to the aggregate notional amount of all outstanding CDS contracts has been increasing steadily since 2010.[971] In 2017, this ratio peaked at 27.5%, representing a significant increase over 2016 (21.8%), 2015 (17.1%), 2014 (14.6%), 2013 (13.13%), 2012 (9.75%), 2011 (9.55%), and 2010 (7.36%).[972] Limiting attention to just single-name CDS contracts (*i.e.,* excluding index CDS and multi-name non-index CDS) provides a less consistent picture. While the percentage of single-name CDS contracts that were cleared has increased from 36% in 2010 to 40% in 2017, the upward trend has not been uniform, with a local peak in 2011 (46%) followed by a decline in

[967] The Commission obtained these entities' open positions in interest rate swaps, currency swaps, and index CDS from the CFTC.

[968] *See Applications by Security-Based Swap Dealers or Major Security-Based Swap Participants for Statutorily Disqualified Associated Persons to Effect or Be Involved in Effecting Security-Based Swaps,* 84 FR at 4927.

[969] *See* Robert R. Bliss and Robert S. Steigerwald, *Derivatives Clearing and Settlement: A Comparison of Central Counterparties and Alternative Structures,* Economic Perspectives 30, no. 4.

[970] *See Standards for Covered Clearing Agencies,* 81 FR 70786.

[971] 2010 is the first year the BIS' OTC derivatives market surveys separate out CDS market activity by counterparty, including CCPs. *See* BIS, *OTC derivatives market activity in the second half of 2010* (May 2011).

[972] *See* BIS, *OTC derivatives statistics at end-December 2017* (May 2018), BIS, *OTC derivatives statistics at end-December 2016* (May 2017), BIS, *OTC derivatives statistics at end-December 2015* (May 2016); BIS, *OTC derivatives statistics at end-December 2014* (Apr. 2015); BIS, *OTC derivatives statistics at end-December 2013* (May 2014); BIS, *OTC derivatives statistics at end-December 2012* (May 2013); BIS, *OTC derivatives statistics at end-December 2011* (May 2012); BIS, *OTC derivatives market activity in the second half of 2010* (May 2011). For each year, the original ratio is obtained from Table 4 (replaced by Table D10.1 beginning with 2015) of the statistical releases and is calculated by dividing the CCPs' outstanding aggregate notional amount by the total outstanding aggregate notional amount, with the result divided by two (a contract submitted for clearing to a CCP is replaced, post-novation, by two contracts (with the same notional value as the original contract) between the CCP and each of the original counterparties).

2012 (45%) and 2013 (37%), an increase in 2014 (43.5%) and 2015 (48%), and then another decline in 2016 (47%) and 2017 (40%).[973]

b. Netting Agreements

Netting agreements between counterparties can mitigate counterparty risk by allowing the positive exposure of counterparty A to counterparty B in a transaction to offset the positive exposure of counterparty B to counterparty A in another transaction. Such offsets are made possible through master netting agreements (''MNAs'').[974]

One way to measure the degree of netting in a set of positions is with the ''net-to-gross ratio,'' the ratio of the absolute value of the sum of the marked-to-market values of the positions after all product-specific netting agreements (cross-product agreements are excluded) are given effect, to the sum of the positions' absolute marked-to-market values. The more the gains on some positions offset losses on others, the lower the ratio. On an aggregate basis (*i.e.,* across all market participants), the net-to-gross ratio for security-based swaps positions was 27% in 2015. This is a significant increase compared to 2014 (23%) and 2013 (21%), and a marginal increase compared to 2012 (24%) and 2011 (26%).[975]

On a disaggregated basis, there is substantial variation in the degree of netting across different market participants. For instance, in 2015, the ratio of net market value to gross market value was as low as 18% and 20% for CCPs and dealers, respectively, and as high as 78% for insurance companies.[976] These differences in the net-to-gross ratio across different types of market participants reflect differences in their participation in the security-based swap market.

c. Portfolio Compression

Portfolio compression reduces counterparty risk through the termination of early redundant derivatives trades without changing the net exposure of any of the counterparties. The amount of redundant notional amount eliminated through portfolio compression declined steadily over the years, from more than $30 trillion in 2008[977] and more than $15 trillion in 2009, to $9.8 trillion in 2010, $6.4 trillion in 2011, and $4.1 trillion in 2012.[978]

d. Margin

Participants in the security-based swap market may mitigate counterparty risk by collecting collateral through margin assessment under an active collateral agreement.[979] The Commission lacks regulatory data on the use of collateral by participants in the security-based swap and swap markets.[980] Thus, the Commission's quantitative understanding of margin practices in these markets is largely based on the ISDA's annual margin surveys. These surveys suggest that: (1) The use of collateral has generally increased over the last decade; (2) collateral practices vary by type of market participant and counterparty; (3) segregation of collateral is not widespread; and (4) use of central clearing is increasing.[981]

The statistics in the margin surveys suggest that the use of collateral in security-based swap and swap transactions generally increased in the period from the end of 2002 through the end of 2012.[982] At the end of 2002, 53% of fixed income derivatives transactions and 30% of credit derivatives transactions were subject to a credit support agreement (''CSA''); by 2009, the percentages were 63% and 71%, respectively.[983] By 2012, similar statistics indicated that 79% of fixed income derivative transactions and 83% of credit derivative transactions were subject to CSAs.[984] With respect to non-cleared transactions, the 2012 percentages of fixed income derivative trades and credit derivative trades subject to a CSA were 73% and 79%, respectively.

While the industry margin surveys suggest that the prevalence of CSAs in derivative transactions increased over time, they provide less recent information about collateralization levels and their cross-sectional characteristics. The ISDA reports that, in 2010, an estimated 73% of aggregate OTC derivatives exposures were collateralized.[985] According to the ISDA, collateralization levels in 2010 varied considerably depending on the type of counterparty.[986] Collateralization of exposures to sovereigns was very limited (18%). Collateralization of exposures to hedge funds was much more extensive (160%),[987] reflecting a greater tendency to collect initial margin from those participants. In between these extremes were collateralization levels of current

[973] These percentages are obtained from Table 4 (replaced by Table D10.1 beginning with 2015) of the statistical releases, by dividing the CCPs' outstanding aggregate notional amount for single-name CDS by the CCPs' outstanding aggregate notional amount for all CDS contracts.

[974] Under the ISDA Master Agreement, netting can take two forms: (1) Settlement (or payment) netting, which is the process of combining offsetting cash flow obligations between solvent counterparties into a single net payment; and (2) close-out netting, which is the process of terminating and netting the marked-to-market values of all outstanding transactions when one of the counterparties becomes insolvent. The former is optional, while the latter is a contractual obligation under the ISDA Master Agreement.

[975] *See* BIS, *OTC derivatives statistics at end-December 2015;* BIS, *OTC derivatives statistics at end-December 2014;* BIS, *OTC derivatives statistics at end-December 2013.*

[976] *See* BIS, *OTC derivatives statistics at end-December 2015;* BIS, *OTC derivatives statistics at end-December 2014;* BIS, *OTC derivatives statistics at end-December 2013.*

[977] *See* TriOptima, triReduce Statistics, *available at http://www.trioptima.com/resource-center/statistics/triReduce.html.* The amount of portfolio compression as reported by TriOptima, a provider of third-party portfolio compression services.

[978] ISDA, *OTC Derivatives Market Analysis Year-End 2012* (June 2013, rev. Aug. 9, 2013). 2012 is the last year when ISDA reported aggregate compression statistics.

[979] A collateral agreement specifies the terms for the use of collateral to support a bilateral derivatives trade. According to the ISDA, a collateral agreement is active when: (1) There is an open exposure with active trades beneath it, regardless of whether collateral has been collected or delivered for any of the trades; and (2) collateral has actually been collected or delivered. *See ISDA Margin Survey 2015.* In contrast, inactive collateral agreements are those that have been executed and have no current outstanding exposure, or those that show no current activity but may be used to trade at some point in the future. Cleared OTC derivatives trades are generally subject to collateral agreements specified by the CCP.

[980] In the proposing release, the Commission requested data and information from commenters to assist it in analyzing the economic consequences of the proposed rules; no additional data was provided. *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70300. *See also Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53019–20.

[981] The discussion in this section of the release is based on the *ISDA Margin Survey 2009* (Apr. 15, 2009), *ISDA Margin Survey 2010* (Aug. 15, 2010), *ISDA Margin Survey 2011* (Apr. 14, 2011), *ISDA Margin Survey 2012, ISDA Margin Survey 2013* (June 21, 2013), *ISDA Margin Survey 2014* (Apr. 10, 2014), and *ISDA Margin Survey 2015.* The format of these reports has not remained constant over time. Consequently, certain statistics are only available in the earlier surveys.

[982] *See ISDA Margin Survey 2009* at Table 4.2; *ISDA Margin Survey 2010* at Table 3.3; *ISDA Margin Survey 2011* at Table 3.2; *ISDA Margin Survey 2012* at Table 3.2; ISDA, *ISDA Margin Survey 2013* at Table 3.4.

[983] *See ISDA Margin Survey 2009* at Table 4.2. This table reports the fraction of transactions (cleared and non-cleared) subject to a CSA.

[984] *See ISDA Margin Survey 2013* at Table 3.4. Due to methodological changes, the 2002 through 2009 statistics and the 2012 statistics are not directly comparable. Comparable statistics were not reported in more recent surveys.

[985] *See ISDA Margin Survey 2011* at Table 3.3. Statistics based on derivatives type (*e.g.,* credit derivatives) were not provided. More recent ISDA margin surveys do not report these statistics.

[986] In this discussion, collateralization level means the ratio of collateral to current exposure.

[987] The 160% collateralization level for hedge funds indicates that on average, current exposures to hedge funds were fully collateralized and that some additional margin covering potential future exposures (*i.e.,* initial margin) was also collected.

exposures to mutual funds (100%), banks and broker-dealers (79%), pension funds (71%), insurance companies (68%), energy and/or commodity firms (37.2%), non-financial firms (37%), and special purpose vehicles (19%). The statistics for 2009 reveal a similar pattern.[988] These collateralization level patterns are consistent with the following stylized facts: (1) A counterparty's exposure to a special purpose vehicle is generally not covered to any significant extent; (2) counterparties do not generally require initial margin from dealers, banks, pension funds, and insurance companies, but will collect variation margin in certain cases or on an ad-hoc basis; (3) counterparties require hedge funds to post variation margin and initial margin; (4) counterparties require variation margin from mutual funds, but generally do not require mutual funds to post initial margin; (5) non-financial end-users are generally not required to post margin.[989]

An ISDA margin survey provides some evidence about the asset composition of collateral. According to this survey, in 2014, of the collateral received/(delivered) by survey respondents to cover initial margin, 55.4%/(64.7%) was in cash, 24.2%/(11.1%) was in government securities, and the rest was in other securities. In addition, of the collateral received/(delivered) to cover variation margin, 77.2%/(75.3%) was in cash, 16.3%/(21.4%) was in government securities, and the rest was in other securities. Finally, of the collateral received/(delivered) to cover commingled initial and variation margin, 71.7%/(76.4%) was in cash, 12%/(20.9%) was in government securities, and the rest was in other securities.[990]

The margin surveys also suggest that collateral for non-cleared derivatives is generally not segregated. According to an ISDA margin survey, where initial margin is collected, ISDA members reported that most (72%) was commingled with variation margin and not segregated, and only 5% of the amount received was segregated with a third-party custodian.[991]

Finally, an ISDA margin survey also reports a significant increase in the number of active collateral agreements for client's cleared trades. Specifically, 2014 saw a 67.1% increase in collateral agreements covering client's cleared trades over the previous year.[992] This significant increase is most likely due to the introduction of the clearing mandates in 2013 under the Dodd-Frank Act in the US.[993]

In response to a commenter's suggestion,[994] the Commission has supplemented its analysis of the ISDA margin surveys with an analysis of initial margins estimated for dealer CDS positions. For each dealing entity that is expected to register as an SBSD, the Commission uses DTCC–TIW data as of the end of September 2017 to identify the single-name and index CDS positions that the entity holds against its counterparties. For each dealing entity, the Commission then calculates the initial margin amount[995] from its single-name and index CDS positions with each counterparty by using historical CDS price movements[996] from five one-year samples: 2008, 2011, 2012, 2017, and 2018. The Commission believes the 2008, 2011, and 2012 samples are likely to capture stressed market conditions, while the 2017 and 2018 samples are likely to capture normal market conditions. For each sample and each dealing entity, the Commission then calculates the risk margin amount (*i.e.,* initial margin amounts) of its cleared and non-cleared CDS positions by summing up the initial margins calculated above across all counterparties. Table 2 Panel A below reports a number of statistics, such as minimum, maximum, mean, standard deviation, and the quartiles of the distribution, that summarize the distribution of the dealers' risk margin amounts for each sample.

The Commission can make a number of observations from Table 2 Panel A. The risk margin amounts vary across the five annual samples. Risk margin amounts tend to be larger in 2008 and 2017, but smaller in 2011, 2012, and 2018. For example, the mean risk margin amount in 2008 and 2017 are $768 million and $507 million, respectively, while the mean risk margin amount in 2011, 2012, and 2018 range between $260 and $329 million. The risk margin amounts also vary across dealing entities, suggesting that these entities may hold single-name and index CDS positions with different levels of risk. For example, in the 2008 sample, risk margin amounts range from a minimum of $9.89 million to a maximum of $3,302.12 million. The variation in risk margin amounts across dealing entities, as measured by the standard deviation, also changes across the five annual samples. The standard deviation is higher in 2008 and 2017 and lower in 2011, 2012, and 2018.

The Commission repeats the preceding analysis using only interdealer CDS positions (*i.e.,* calculating risk margin amounts for single-name and index CDS positions held by a dealing entity against another dealing entity). Table 2 Panel B reports statistics summarizing the distribution of these interdealer risk margin amounts for each sample. A key result from Table 2 Panel B is that interdealer risk margin amounts are significantly smaller than risk margin amounts based on single-name and index CDS positions held by a dealer against all its counterparties. For example, in Table 2 Panel A, the mean risk margin amount ranges between $260 million and $768 million, while in Table 2 Panel B, the mean risk margin amount ranges between $8.4 million and $23.1 million. Interdealer risk margin amounts tend to be larger in 2008 and 2017, but smaller in 2011, 2012, and 2018. Interdealer risk margin amounts also vary across different pairs of dealing entities, suggesting that these entities may hold single-name and index CDS positions with different levels of risk. The variation in interdealer risk margin amounts across different pairs of dealing entities, as measured by the standard deviation, also changes across the five annual samples.

[988] *See ISDA Margin Survey 2010* at Table 3.3.

[989] *See generally ISDA Margin Survey 2011; ISDA Margin Survey 2012.* The results of the surveys, however, could be substantially different if limited only to U.S. participants, because the data contained in the surveys is global. *See id.* For example, 47% of the institutions responding to the ISDA margin survey published in 2012 were based in Europe, the Middle East, or Africa, and 31% were based in the Americas. *See ISDA Margin Survey 2012* at Chart 1.1.

[990] *See ISDA Margin Survey 2015* at Table 7.

[991] *See ISDA Margin Survey 2012.* The survey also notes that while the holding of the independent amount (initial margin) and variation margin together continued to be the industry standard both contractually and operationally, the ability to segregate had been made increasingly available to counterparties over the previous three years on a voluntary basis, and had led to 26% of the independent amounts received and 27.8% of independent amounts delivered being segregated in some respects. *See id.* at 10. *See also* ISDA, *Independent Amounts,* Release 2.0 (Mar. 1, 2010).

[992] *See ISDA Margin Survey 2015.* The ISDA also reported that the number of active agreements for house cleared trades was 258 for 2014, which was a decline of 21.3% compared to 2013.

[993] The CFTC mandate regarding clearing of certain index CDS came into effect on March 11, 2013. *See Clearing Requirement Determination Under Section 2(h) of the CEA,* 77 FR 74284 (Dec. 13, 2012).

[994] *See* SIFMA 11/19/2018 Letter (suggesting that the Commission provide data or analysis to support its proposed 8% margin factor, which depended, in part, on the total amount of initial margin calculated by the nonbank SBSD with respect to cleared and non-cleared security-based swaps).

[995] The Commission calculates initial margin using the methodology described in Darrell Duffie, Martin Scheicher, and Guillaume Vuillemey, *Central Clearing and Collateral Demand,* Journal of Financial Economics 116, no. 2, 237–256 (May 2015).

[996] These price movements are derived from historical pricing data on single-name CDS contracts. The data are purchased from ICE Data Services.

Table 2: Risk Margin Amounts. This table reports summary statistics of risk margin amounts for the single-name and index CDS positions held by dealers against all counterparties (Panel A) and risk margin amounts for the single-name and index CDS positions held by dealers against other dealers (Panel B) as of the end of September 2017. Risk margin amounts are in millions of dollars. The summary statistics are Min (minimum), P25 (first quartile/25th percentile), P50 (second quartile/50th percentile), P75 (third quartile/75th percentile), Max (maximum), Mean, and Std (standard deviation).

PANEL A: RISK MARGIN AMOUNTS FOR SINGLE-NAME AND INDEX CDS POSITIONS HELD BY DEALERS AGAINST ALL COUNTERPARTIES

Year	Min	P25	P50	P75	Max	Mean	Std
2008	9.89	255.73	488.50	673.46	3302.12	767.76	817.96
2011	7.43	95.46	188.56	449.53	1377.82	329.30	381.85
2012	6.67	80.60	154.86	321.10	1137.43	260.05	295.31
2017	1.39	138.58	385.75	600.70	1487.74	507.48	472.19
2018	2.82	95.99	204.94	376.68	1380.57	316.00	350.30

PANEL B: RISK MARGIN AMOUNTS FOR SINGLE-NAME AND INDEX CDS POSITIONS HELD BY DEALERS AGAINST OTHER DEALERS

Year	Min	P25	P50	P75	Max	Mean	Std
2008	0.01	3.35	10.00	29.98	170.89	21.81	28.39
2011	0.00	1.27	3.28	10.56	100.38	10.32	16.56
2012	0.00	0.92	3.34	8.97	64.82	8.45	12.43
2017	0.00	0.50	3.08	17.23	528.61	23.07	60.24
2018	0.00	0.75	3.83	11.84	67.07	9.46	14.07

3. Global Regulatory Efforts

In 2009, the G20 leaders—whose membership includes the United States, 18 other countries, and the European Union—addressed global improvements in the OTC derivatives market. They expressed their view on a variety of issues relating to OTC derivatives contracts. In subsequent summits, the G20 leaders have returned to OTC derivatives regulatory reform and encouraged international consultation in developing standards for these markets.[997]

Many SBSDs likely will be subject to foreign regulation of their security-based swap activities that is similar to regulations that may apply to them pursuant to Title VII of the Dodd-Frank Act, even if the relevant foreign jurisdictions do not classify certain market participants as ''dealers'' for regulatory purposes. Some of these regulations may duplicate, and in some cases conflict with, certain elements of the Title VII regulatory framework.

Foreign legislative and regulatory efforts have generally focused on five areas: (1) Moving OTC derivatives onto organized trading platforms; (2) requiring central clearing of OTC derivatives; (3) requiring post-trade reporting of transaction data for regulatory purposes and public dissemination of anonymized versions of such data; (4) establishing or enhancing capital requirements for non-centrally cleared OTC derivatives transactions; and (5) establishing or enhancing margin and other risk mitigation requirements for non-centrally cleared OTC derivatives transactions. Foreign jurisdictions have been actively implementing regulations in connection with each of these categories of requirements. A number of major foreign jurisdictions have initiated the process of implementing margin and other risk mitigation requirements for non-centrally cleared OTC derivatives transactions.[998]

Notably, the European Parliament and the European Council have adopted the European Market Infrastructure Regulation (''EMIR''), which includes provisions aimed at increasing the safety and transparency of the OTC derivatives market. EMIR mandates the European Supervisory Authorities (''ESAs'') to develop regulatory technical standards specifying margin requirements for non-centrally cleared OTC derivative contracts.[999] The ESAs have developed, and in October 2016 the European Commission adopted, these regulatory technical standards.[1000]

Several jurisdictions have also taken steps to implement the Basel III recommendations governing capital requirements for financial entities, which include enhanced capital charges for non-centrally cleared OTC derivatives transactions.[1001] Moreover, as discussed above, subsequent to the publication of the proposing release, the BCBS and IOSCO issued the BCBS/IOSCO Paper. The BCBS/IOSCO Paper recommended (among other things): (1) That all financial entities and systemically important non-financial

[997] *See, e.g., The G20 Toronto Summit Declaration* (June 27, 2010) at paragraph 25; *Cannes Summit Final Declaration—Building Our Common Future: Renewed Collective Action for the Benefit of All* (Nov. 4, 2011) at paragraph 24.

[998] In November 2018, the Financial Stability Board reported that 16 member jurisdictions participating in its thirteenth progress report on OTC derivatives market reforms had in force margin requirements for non-centrally cleared derivatives. A further 4 jurisdictions made some progress leading to a change in reported implementation status during the reporting period. *See* Financial Stability Board, *OTC Derivatives Market Reforms Thirteenth Progress Report on Implementation* (Nov. 19, 2018), *available at http://www.fsb.org/wp-content/uploads/P191118-5.pdf.*

[999] The ESAs are the European Banking Authority, European Insurance and Occupational Pensions Authority, and European Securities and Markets Authority.

[1000] *See* ESAs, *Final Draft Regulatory Technical Standards on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP under Article 11(15) of Regulation (EU) No 648/2012* (Mar. 8, 2016). *See also* Commission Delegated Regulation (EU) 2016/2251 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards for risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty (Oct. 4, 2016).

[1001] In November 2018, the Financial Stability Board reported that 23 of the 24 member jurisdictions participating in its thirteenth progress report on OTC derivatives market reforms had in force interim standards for higher capital requirements for non-centrally cleared transactions. *See* Financial Stability Board, *OTC Derivatives Market Reforms Thirteenth Progress Report on Implementation* (Nov. 19, 2018).

entities exchange variation and initial margin appropriate for the counterparty risk posed by such transactions; (2) that initial margin should be exchanged without provisions for ''netting'' and held in a manner that protects both parties in the event of the other's default; and (3) that the margin regimes of the various regulators should interact so as to be sufficiently consistent and non-duplicative.[1002]

4. Capital Regulation

It is difficult to precisely delineate a baseline for capital requirements and capital levels in the security-based swap market. As discussed in prior sections, the entities that participate in this market may be subject to several overlapping regulatory regimes, including Federal Reserve capital standards at the bank holding company level,[1003] bank capital standards of the OCC and FDIC that apply to bank security-based swap entities,[1004] as well as the net capital requirements applicable to stand-alone broker-dealers. In addition, many entities in this space may be subject to the capital requirements applicable to FCMs, as well to the regimes of foreign regulators.[1005] Finally, certain entities may not be subject to any (direct) capital requirements under the baseline. In the discussion that follows, the relevant aspects of the capital regimes applicable to the various entities operating in the security-based swap market are reviewed, and their relation to the baseline is noted. The discussion focuses on the capital treatment of market risk arising from an entity's proprietary positions in security-based swap transactions specifically, and OTC derivative transactions generally as well as the capital treatment of credit risk arising from exposures to counterparties in OTC derivative transactions.

a. Commission-Registered Broker-Dealers

As described in the prior section, security-based swap dealing activity is concentrated in a small number of large financial firms.[1006] Historically, these firms have not undertaken their security-based swap activities and OTC derivative transactions through Commission-registered broker-dealers. Rather, the dealing activity of these financial firms was housed either in its bank affiliates, its unregistered nonbank affiliates, or in affiliated foreign entities. These arrangements reflected the lack of a legal requirement to house such activities in entities regulated by the Commission, the potential disadvantage in the capital treatment of these activities under Rule 15c3–1,[1007] as well as restrictions on the use of customers' collateral under the Commission's customer protection rule.[1008]

In 1998, the Commission established a program for broker-dealers that operate as OTC derivatives dealers. The program, among other things, permitted OTC derivatives dealers to use internal models to compute capital charges for market and credit risk. In 2004, the Commission extended the use of such models to broker-dealers subject to consolidated supervision with the adoption of alternative net capital requirements for ANC broker-dealers. Today, only a small fraction of broker-dealers are ANC broker-dealers; however, these few ANC broker-dealers are large and account for nearly all of the assets held by Commission-supervised broker-dealers. The capital requirements being adopted today for nonbank SBSDs, including permitting nonbank SBSDs to elect to use models to compute net capital, are modeled on the Commission's net capital rule currently applicable to broker-dealers.

The existing broker-dealer net capital requirements are codified in Rule 15c3–1 and seven appendices to Rule 15c3–1. Specifically, Rule 15c3–1 requires broker-dealers to maintain a minimum level of net capital (meaning highly liquid capital) at all times. Paragraph (a) of 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; and (2) a computation of the amount of net capital the broker-dealer is maintaining. The minimum net capital requirement is the greater of a fixed-dollar amount specified in the rule and an amount determined by applying 1 of 2 financial ratios: The 15-to-1 ratio or the 2% debit item ratio. Large broker-dealers that dominate the industry use the 2% debit item ratio.

Requirements for computing net capital are set forth in paragraph (c)(2) of Rule 15c3–1, which defines the term ''net capital.'' The first step in a net capital calculation is to compute the broker-dealer's net worth under GAAP. Next, the broker-dealer must make certain adjustments to its net worth. These adjustments are designed to leave the firm in a position in which each dollar of unsubordinated liabilities is matched by more than a dollar of highly liquid assets. There are fourteen categories of net worth adjustments required by the rule, including the application of haircuts.[1009] Broker-dealers use either standardized haircuts or model-based haircuts that are comprised of market and credit risk charges.

Market Risk Charges

The internal models used by ANC broker-dealers and OTC derivatives dealers to compute market risk charges must meet certain qualitative and quantitative requirements under Appendix E or F that parallel requirements for U.S. banking agencies under Basel II.[1010] The use of internal

[1002] One commenter noted that since 2015, the prudential Regulators, CFTC, and a number of foreign regulators have adopted margin requirements that implement the framework in the BCBS/IOSCO Paper. *See* SIFMA 11/19/2018 Letter.

[1003] These standards are based on the Basel II and Basel III framework. *See* BCBS, *Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework—Comprehensive Version* (June 2006), *available at http://www.bis.org/publ/bcbs128.htm;* BCBS, *Basel III: A global regulatory framework for more resilient banks and banking systems* (June 2011), *available at http://www.bis.org/publ/bcbs189.pdf.*

[1004] *See Prudential Regulator Margin and Capital Adopting Release,* 80 FR 74840.

[1005] The Commission expects that most entities that will register with the Commission and become subject to these final capital, margin, and segregation rules have registered with the CFTC as swap entities or with the Commission as broker-dealers. The Commission has previously estimated that, of the total 55 entities expected to register with the Commission as an SBSD or MSBSP, 35 will be registered with the CFTC as swap dealers or major swap participants. *See Registration Process for Security-Based Swap Dealers and Major Security-Based Swap Participants,* 80 FR at 49000.

[1006] *See* section VI.A. of this release.

[1007] OTC derivatives dealers and ANC broker-dealers have been permitted to use internal models to compute net capital since 1998 and 2004, respectively. *See OTC Derivatives Dealers,* 63 FR 59362; *Alternative Net Capital Requirements for Broker-Dealers That Are Part of Consolidated Supervised Entities,* 69 FR 34428. However, this has not led to increased dealing in security-based swaps by broker-dealers.

[1008] The existing possession or control and customer reserve account requirements of Rule 15c3–3 as applied to initial margin held for security-based swaps has made it disadvantageous for broker-dealers to deal in security-based swaps as compared to entities (such as unregulated dealers) that were not subject to these requirements. The requirements of Rule 15c3–3 are designed to protect customers by preventing broker-dealers from using customer assets to finance any part of their business unrelated to servicing customer securities activities. Unregulated entities would not be subject to these restrictions and could freely use collateral received from security-based swap transactions in their business, including to finance proprietary activities.

[1009] *See* paragraphs (c)(2)(i) through (xiv) of Rule 15c3–1.

[1010] *See generally OTC Derivatives Dealers,* 63 FR 59362; *Alternative Net Capital Requirements for Broker-Dealers That Are Part of Consolidated Supervised Entities,* 69 FR 34428. The requirements for banks were subsequently enhanced by the prudential regulators with the implementation of capital requirements consistent with the Basel III framework. *See Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based models to compute market risk charges can substantially reduce the deductions to the market value of proprietary positions as compared to standardized haircuts. Consequently, large broker-dealers that dominate the industry rely on internal models rather than the standardized haircuts to compute net capital. However, ANC broker-dealers and OTC derivative dealers (*i.e.,* dealers using internal models to compute net capital) are subject to higher fixed-dollar minimum capital requirements than broker-dealers using the standardized haircuts. Under existing paragraph (a)(7) of Rule 15c3–1, ANC broker-dealers are required to maintain tentative net capital of not less than $1 billion and net capital of not less than $500,000,000. In addition, ANC broker-dealers are required to provide notice to the Commission if their tentative net capital falls below $5 billion. For OTC derivative dealers, under existing paragraph (a)(5) of Rule 15c3–1, the corresponding fixed-dollar minimums are $100 million in tentative net capital and $20 million in net capital.

Credit Risk Charges

For ANC broker-dealers, the credit risk charge is the sum of 3 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 50% of the firm's tentative net capital.[1011] The OTCDD credit risk model is similar to the ANC credit risk model except that the former does not include a portfolio concentration charge.[1012]

b. Banking Entities

As described in previous sections, the security-based swap market is dominated by a small number of global financial firms. Of the firms expected to register with the Commission as SBSDs, the Commission believes that most will, in the near-term, be subsidiaries of a U.S. bank holding company and therefore be subject to consolidated supervision by the Federal Reserve. Nonbank SBSDs and MSBSPs will be subject not only to the Commission's capital requirements but also indirectly to the capital standards applicable at their parent bank holding companies. For the purposes of satisfying the capital requirements at the bank holding company level, the OTC derivatives positions booked under any consolidated bank subsidiary are accounted for in the capital computation of the holding company. The bank holding companies' consolidated bank subsidiaries also are subject to direct capital requirements of the prudential regulators and indirect capital requirements applicable to their parent bank holding companies. Below is a discussion of the relevant aspects of the capital regime for bank holding companies as it relates to security-based swap positions (and OTC derivative positions in general).

In July 2013, the Federal Reserve and OCC adopted a final rule that implements in the U.S. the Basel III regulatory capital reforms from the BCBS and certain changes to the existing capital standards required by the Dodd-Frank Act.[1013] These rules generally strengthened the capital regime for bank holding companies and banks (collectively, ''banks'') by increasing both the quality and the quantity of bank regulatory capital.[1014]

The bank capital regime for OTC derivative transactions prescribes the capital treatment of the transactions' market risk and credit risk exposures. Banks with significant presence in the security-based swap market tend to be large global firms that employ the internal models methodology to compute charges for market risk. The quantitative requirements for these models resemble in many respects those applicable to the market risk models of ANC broker-dealers and OTC derivative dealers.[1015]

Banks calculate market risk capital charges using a model with a one-tailed 99% confidence interval.[1016] These charges are subject to specific risk add-ons and backtesting adjustments.[1017] Following adoption of the Basel III framework by the prudential regulators, these capital requirements were strengthened; they now include an additional ''stressed VaR'' floor to the capital charge, as well as potentially binding leverage ratios.[1018]

Capital charges for a bank's credit risk exposure to its OTC derivative counterparties are based on the RWA framework. In general, under the RWA framework, the capital requirement for a credit exposure is 8% times the RWA-equivalent amount of the credit exposure. Under the 2013 capital rule, large banking organizations (*i.e.,* the type of organizations that dominate dealing in the security-based swap market) are required to calculate capital requirements using the advanced approaches.[1019] In the advanced approaches, the RWA-equivalent of a counterparty exposure is calculated according to the internal rating-based (''IRB'') capital formula, where the bank's internal credit risk model along with the bank's estimates of the probability of default and the loss-given default is used to calculate the effective risk weight on the exposure amount.

Under the advanced approach, the exposure amount (exposure at default (''EAD'')) for an OTC derivative transaction may be calculated under either the current exposure method (''CEM'') or using the internal models method (''IMM''), with the latter being subject to regulatory approval.[1020] Under the current exposure method, the capital charge is the sum of the current exposure and potential future exposure. The potential future exposure is calculated as the product of the

Capital Rule, and Market Risk Capital Rule, 78 FR 62018 (Oct. 11, 2013).

[1011] *See* paragraph (c) of Rule 15c3–1e.

[1012] *See* paragraph (d) of Rule 15c3–1f.

[1013] *See Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule,* 78 FR 62018.

[1014] *See Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule,* 78 FR 62018. Among other things, the new rules implemented a revised definition of regulatory capital, a new common equity tier 1 minimum capital requirement, a higher minimum tier 1 capital requirement, and, for banking organizations subject to the advanced approaches risk-based capital rules, a supplementary leverage ratio The new rules also amended the methodologies for determining risk-weighted assets (''RWAs'').

[1015] *See Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74876.

[1016] This discussion assumes that the bank is subject to market risk capital charges. Banking organizations with aggregate trading assets and liabilities that exceed $1 billion or 10% of total assets are subject to the market risk rule. *See Risk-Based Capital Standards: Market Risk,* 61 FR 47358 (Sept. 6, 1996).

[1017] *See* 12 CFR 3.122(i)(4)(iii); 12 CFR 3.131.

[1018] *See Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-Weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule,* 78 FR 62018.

[1019] *See id.*

[1020] The OCC, Federal Reserve, and the FDIC have issued a notice of proposed rulemaking to provide an updated framework for measuring derivative counterparty credit exposure. The proposed rule would replace the existing CEM with the Standardized Approach for Counterparty Credit Risk (SA–CCR) for banks subject to the advanced approaches, while permitting smaller banks to use CEM or SA–CCR. *See Standardized Approach for Calculating the Exposure Amount of Derivative Contracts,* 83 FR 64660 (Dec. 17, 2018). *See also Proposed Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements,* 83 FR 66024 (Dec. 21, 2018).

derivative's notional amount and a conversion factor that depends on the risk and maturity of the transaction. The conversion factors range from 0% to 15% and are specified in the regulations.[1021] For a group of transactions within the same asset class that are covered by a qualifying master netting agreement, the current exposure for the group is calculated on a net basis. Potential future exposure for a group of transactions subject to a qualifying master netting agreement is calculated as the sum of *gross* potential future exposures (*i.e.,* no netting), multiplied by a factor that is a function of the net-to-gross ratio (''NGR'') of current exposures.[1022] For banks that engage in off-setting transactions, the NGR is typically far lower than one, permitting some netting benefits.[1023]

Banks are allowed to recognize a broad set of collateral as credit risk mitigants in calculating credit risk charges.[1024] They may use either the simple approach or the collateral haircut approach to reduce credit risk capital charges. Under the simple approach, the risk weight of a collateralized credit exposure to an OTC derivative counterparty is replaced with the risk weight of the collateral posted by that counterparty. Under this approach, subject to certain exceptions, the risk weight assigned to the collateralized portion of the exposure must be at least 20%.[1025] Under the collateral haircut approach, the risk weight of the counterparty exposure does not change, but the exposure amount is adjusted by the haircut-adjusted value of the collateral received. Banks using the advanced approach to calculate RWA may use internal models to compute these haircuts, otherwise regulatory haircuts are used.[1026]

Accounting rules now generally require banks to take into account the creditworthiness of an OTC derivative counterparty in determining the fair value of an OTC derivative position. During the financial crisis, approximately two-thirds of credit losses on OTC derivative positions were the result of accounting adjustments rather than outright counterparty defaults.[1027] Subsequently, Basel III requirements as implemented by the prudential regulators introduced capital charges for potential accounting losses resulting from such credit valuation adjustments (''CVA'') due to an increase in credit risk of the counterparty. Banks that are subject to the advanced approach have to calculate a CVA capital charge using either the advanced CVA approach, if the bank is approved to use this method, or the simple CVA approach. The former relies on a bank's internal credit models while the latter uses a combination of supervisory risk weights, external ratings, and the bank's credit-risk calculations.[1028]

c. CFTC-Registered Entities

Starting in October 2012, swap dealers and major swap participants were required to provisionally register with the CFTC. However, as of now, neither swap dealers nor major swap participants are subject to any capital requirements, unless they are also registered as FCMs.[1029]

CFTC Rule 1.17 requires FCMs to maintain adjusted net capital in excess of a minimum adjusted net capital amount. The rule prescribes a net liquid assets test similar to the broker-dealer net capital rule. The CFTC defines adjusted net capital as liquid assets net of liabilities, after taking into account certain capital deductions for market and credit risk. The minimum net adjusted capital depends, among other things, on the margin amount of the client-cleared OTC swap positions.

With respect to the treatment of OTC derivatives positions, an FCM is required to account for an OTC derivatives position by first marking-to-market the position and then deducting (adding) the full amount of the loss (collateralized portion of the gain) from (to) its adjusted net capital. In addition, an FCM also has to take a capital charge for the market risk of its OTC derivatives position. Paragraph (c) of CFTC Rule 1.17 allows FCMs registered with the Commission as an ANC broker-dealer to compute this capital charge using models approved by the Commission.

5. Margin Regulation

The baseline regulatory regime for margin regulation of security-based swaps is the phase-in of regulations adopted by U.S. prudential regulators, foreign regulators, and the CFTC, as well as the broker-dealer SRO margin rules.

a. Prudential Regulators, CFTC, and Foreign Regulators

Prudential Regulators

In October 2015, the U.S. prudential regulators adopted new rules to address minimum margin requirements for bank swap dealers, major swap participants, SBSDs, and MSBSPs with respect to non-cleared security-based swaps and swaps.[1030] For these entities, the margin rules became effective on April 1, 2016, with compliance phased-in over 4 years beginning in September 2016. The rules impose initial and variation margin requirements on bank SBSDs, MSBSPs, swap dealers, and major swap participants for non-cleared security-based swaps and swaps.

Bank SBSDs, MSBSPs, swap dealers, and major swap participants are required to collect and post variation and initial margin from (to) certain counterparties. Initial margin must be collected in the form of cash or other eligible collateral. Variation margin must be collected on a daily basis and be in the form of cash for a transaction with an SBSD, MSBSP, swap dealer, or major swap participant, or cash or other eligible collateral for a transaction with a financial end user. These bank entities are also required to both collect and post initial margin for transactions with

[1021] *See Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-Weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule,* 78 FR 62018, at Table 19.

[1022] The potential future exposure for the group equals $((0.4 + 0.6 \times NGR) \times AGross)$, where AGross is aggregate gross potential future exposure for positions subject to a qualifying master netting agreement, and NGR is the ratio of net current exposure to gross current credit exposure for the group.

[1023] *See Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule,* 78 FR 62018.

[1024] Generally, the credit risk of the collateral must not be positively correlated with the credit risk of the collateralized exposure. The set of eligible collateral has been broadened to include investment grade corporate debt securities and publicly traded equity securities. 78 FR at 62107.

[1025] 78 FR 62018. One exception is when the collateral consists of ''cash on deposit,'' in which case the risk weight is 0%. Another exception is when the collateral is a sovereign that qualifies for a 0% risk weight under the general risk weight provision and it is subject to certain haircuts or account maintenance practices, in which case the risk weight can be either 0% or 10%.

[1026] *See* 78 FR at 62239.

[1027] *See* BCBS, *Basel Committee finalizes capital treatment for bilateral counterparty credit risk* (June 2011), *available at http://www.bis.org/press/p110601.pdf.*

[1028] *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule,* 78 FR at 62134.

[1029] The CFTC re-proposed capital requirements for swap dealers and major swap participants in 2016. *See CFTC Capital Proposing Release,* 81 FR 91252. The current capital requirements for FCMs make it particularly costly for FCMs to engage in OTC CDS. For this reason, traditionally, OTC CDS have been conducted outside of FCMs, in affiliated entities. *See Capital Requirements of Swap Dealers and Major Swap Participants,* 76 FR 27802.

[1030] *See Prudential Regulator Margin and Capital Adopting Release,* 80 FR 74840.

SBSDs, MSBSPs, swap dealers, major swap participants, and with financial end users that have material swaps exposure (*i.e.,* gross notional exposure in excess of $8 billion). Initial margin must be computed using standardized haircuts or an approved model. The initial margin is to be computed on a daily basis but its exchange is not required if it falls below a consolidated $50 million threshold. The rules further require that the initial margin collected or posted by bank SBSDs, MSBSPs, swap dealers, and swap participants be segregated with a third-party custodian and prohibit its re-hypothecation. The rules provide an exception to the initial margin requirements in transactions involving an affiliated entity: In such cases, initial margin need not be posted to an affiliated financial end user with material swaps exposure.

In December 2015, the CFTC adopted new rules that address margin requirements for nonbank swap dealers and major swap participants with respect to non-cleared swaps.[1031] Similar to the prudential regulators' final rules, the rules became effective on April 1, 2016, with compliance phased-in over 4 years beginning in September 2016. The rules are similar to the final margin rules of the prudential regulators. However, with respect to affiliates, swap dealers and major swap participants need to collect or post initial margin under certain conditions.

Foreign entities, including foreign subsidiaries of U.S. entities that transact in the security-based swap market fall under a variety of foreign regulations, principally those of regulators in certain European countries. European regulators have adopted or proposed a series of regulations covering mandatory clearing of OTC derivatives as well as margin requirements for those derivatives not subject to the mandatory clearing requirement.[1032]

Currently, the European regulations require central clearing of certain security-based swap transactions involving parties that are not covered by exemptions from the clearing requirement.[1033] Exemptions include certain inter-affiliate transactions, as well as transactions involving non-financial counterparties with gross notional values of OTC derivative transactions that fall below the regulatory clearing thresholds. These clearing requirements are currently being phased in and will take full effect by mid-2019.

The European margin rules on non-cleared security-based swap transactions will apply to entities with gross notional values for OTC derivatives of more than €8 billion. Such entities will generally have an obligation to collect and post margin.[1034]

Entities subject to the European rules will be required to collect and post variation margin for non-cleared security-based transactions with other covered entities, financial counterparties, as well as non-financial counterparties that fall above the clearing thresholds. Variation margin will have to be exchanged on a daily basis, subject to certain *de minimis* exceptions.

Entities subject to the European rules (*i.e.,* those with gross notional values for OTC derivatives of more than €8 billion) will also be required to exchange initial margin. The requirement to collect initial margin will not apply if the initial margin amount is less than €50 million. Initial margin is limited to cash and other high quality assets. The amount of initial margin may be computed using a model that satisfies certain technical criteria. The initial margin amount must be recomputed under conditions enumerated in the regulations; in practice this will generally be on a daily basis. The party collecting initial margin must ensure that the collateral received is segregated either through a third-party custodian, or through other legally binding arrangements. Re-hypothecation of initial margin is not permitted. The rules further require that the collecting party provide the posting party the option to segregate its initial margin from the assets of other posting counterparties.

While the minimum margin requirements adopted by the prudential regulators, CFTC, and foreign regulators will not be completely phased in until September 2020, there is already some evidence on how market participants are reacting to these requirements. A June 2017 survey on dealer financing terms noted that some of the survey respondents indicated that their clients' transaction volume or their own transaction volume in non-cleared swaps decreased somewhat over the period of September 2016 to June 2017.[1035] However, the respondents reported no changes in the prices that they quote to their clients in non-cleared swaps over this period. This evidence indicates that some dealers responded to margin requirements by reducing the level of intermediation services they provided to other market participants on an non-cleared basis. One-fifth of the survey respondents also reported that they would be less likely to exchange daily variation margin with mutual funds, exchange-traded funds, pension plans, endowments, and separately managed accounts established with investment advisers due primarily to lack of operational readiness (*e.g.,* the need to establish or update the necessary credit support annexes to cover daily exchange of variation margin) over this period. Two-fifths of the survey respondents also reported that the volume of mark and collateral disputes on variation margin has increased somewhat over this period. Furthermore, the survey noted that there is variation among respondents with respect to the number of days it takes to resolve a mark and collateral dispute on variation margin, with ⅓ reporting less than two days, while ⅗ reporting more than two days but less than a week, on average.

In addition, the ISDA margin survey covering 2017 documents the amount and type of collateral collected and posted by the 20 firms with the largest non-cleared derivatives exposures (''phase-one'' firms), that were subject to the first phase of the new margin regulations for non-cleared derivatives in the US, Canada, and Japan from September 2016, and Europe from February 2017. The survey distinguishes between initial margin collected or posted by the phase-one firms to comply with the new margin requirements (''regulatory initial margin'') and other initial margin collected or posted by these firms (''discretionary initial margin''). At the end of 2017, phase-one firms collected and posted regulatory initial margin in the amount of $73.7 billion and $75.2 billion, respectively. Relative to the end of the first quarter of 2017, these amounts reflect a 58% and 59% increase, respectively. The similarity in these two amounts may reflect the two-way initial margin requirement applicable to phase-one

[1031] *See CFTC Margin Adopting Release,* 81 FR 636.

[1032] *See* Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories (July 4, 2012).

[1033] Starting on February 9, 2017, certain iTraxx Europe Index CDS became subject to the clearing obligation. *See* Commission Delegated Regulation (EU) 2016/592 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on the clearing obligation (Mar. 1, 2016).

[1034] *See* Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories (July 4, 2012).

[1035] *See* Yesol Huh, Division of Research and Statistics, Board of Governors of the Federal Reserve System, *The June 2017 Senior Credit Officer Opinion Survey on Dealer Financing Terms, available at https://www.federalreserve.gov/data/scoos/files/scoos_201706.pdf.*

firms. In contrast, at the end of 2017, phase-one firms collected and posted $56.9 billion and $6.4 billion, respectively, in discretionary initial margin. These amounts reflect a decline in the level of initial margin collected and posted by phase-one firms of 6% and 61%, respectively, relative to the end of the first quarter of 2017. The large discrepancy between these two rates is probably the result of phase-one firms continuing to collect initial margin on a discretionary basis for transactions that are not yet within the scope of the new margin requirements as more counterparties to whom phase-one firms post discretionary initial margin become subject to the new margin requirements (*e.g.,* phase two of the implementation started in September 2017).

The survey also reports the amount of variation margin collected and posted by phase-one firms. At the end of the 2017, phase-one firms collected and posted $893.7 billion and $631.7 billion, respectively, in variation margin, including both regulatory and discretionary.

Of the regulatory initial margin posted, 85.3% consisted of government securities; while 14.7% consisted of other securities. Similarly, of the discretionary initial margin posted, 39.8% was in government securities, 37% in cash, and, 23.2% in other securities. In contrast, of the variation margin posted, 85.8% was in cash, followed by 12.1% in government securities, and, finally, 2.1% in other securities.

The ISDA margin survey covering 2018 applies the methodology of the ISDA margin survey covering 2017 but also expands the set of surveyed firms to include not just the 20 phase-one firms described above, but also firms that were subject to the new margin regulations from September 2017 (''phase-two firms'') and September 2018 (''phase-3 firms''), respectively.[1036] At the end of 2018, phase-one firms collected and posted regulatory initial margin in the amount of $83.8 billion and $83.2 billion, respectively. Relative to the end of 2017, these amounts reflect a 14% and 11% increase, respectively. At the end of 2018, phase-one firms collected and posted $74.1 billion and $10.1 billion, respectively, in discretionary initial margin. These amounts have increased by 30% and 57%, respectively, relative to the end of 2017. The 4 phase-two and 3 phase-3 firms that participated in the survey collected $4.8 billion of initial margin at the end of 2018, of which $2.2 billion is regulatory initial margin and $2.6 billion is discretionary initial margin.

At the end of 2018, phase-one firms collected and posted $858.6 billion and $583.9 billion, respectively, in variation margin, including both regulatory and discretionary. Relative to the end of 2017, these amounts represent a 4% and 8% decrease for variation margin collected and posted, respectively.

At the end of 2018, of the regulatory initial margin posted, 88.4% consisted of government securities while 11.6% consisted of other securities. Of the discretionary initial margin posted, 42% was in government securities, 44.4% in cash, and, 13.6% in other securities. Of the variation margin posted, 86.5% was in cash, followed by 12% in government securities, and, finally, 1.5% in other securities.

b. Broker-Dealer Margin Rules

Broker-dealers are subject to margin requirements in Regulation T promulgated by the Federal Reserve, in rules promulgated by the SROs, and, with respect to security futures, in rules jointly promulgated by the Commission and the CFTC.[1037]

Although the Dodd-Frank Act expanded the definition of ''security'' to include security-based swaps and in so doing expanded the applicability of the aforementioned rules and regulations to security-based swap transactions, the Commission has issued a series of exemptive orders exempting security-based swaps from, among other things, the margin requirements of Regulation T.[1038]

6. Segregation

Existing market practice under the baseline is for dealers generally not to segregate initial margin related to OTC derivative transactions. An ISDA margin survey reports that in 2010, 71% of initial margin received was comingled with variation margin.[1039] Of the remaining 29%, 9% was segregated on the books of the dealer,[1040] 6% was segregated with a custodian, and 14% was subject to tri-party arrangements.[1041] For large dealers, on average 89% of collateral received was eligible for re-hypothecation, while 74% of collateral received was actually re-hypothecated.[1042]

The Dodd-Frank Act amended the Exchange Act to establish segregation requirements for cleared and non-cleared security-based swaps. Section 3E(b) of the Exchange Act provides that, for cleared security-based swaps, the money, securities, and property of a security-based swap customer 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. However, Section 3E(c)(1) of the Exchange Act also provides that, for cleared security-based swaps, customers' money, securities, and property may, for convenience, be commingled and deposited in the same one or more accounts with any bank, trust company, or clearing agency. Section 3E(c)(2) further provides that, notwithstanding Section 3E(b), in accordance with such terms and conditions as the Commission may prescribe by rule, regulation, or order, any money, securities, or property of the security-based swaps customer of a broker, dealer, or security-based swap dealer described in Section 3E(b) may be commingled and deposited as provided in Section 3E with any other money, securities, or property received by the broker, dealer, or security-based swap dealer and required by the Commission to be separately accounted for and treated and dealt with as belonging to the security-based swaps customer of the broker, dealer, or security-based swap dealer.

Section 3E(f) of the Exchange Act establishes a program by which a counterparty to non-cleared security-based swaps with an SBSD or MSBSP can elect to have initial margin held at an independent third-party custodian (individual segregation). 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 report to the counterparty on a quarterly basis stating

[1036] ISDA received responses from four phase-two firms (out of the six in scope) and three phase-three firms (out of the eight firms in scope). *See ISDA Margin Survey Year-End 2018* (Apr. 2019) at p.5.

[1037] *See* 12 CFR 220.1, *et seq.;* FINRA Rules 4210 through 4240; CBOE Rules 12.1–12.12; 17 CFR 242.400 through 406. *See also Capital, Margin, and Segregation Proposing Release,* 77 FR at 70259 (discussing broker-dealer margin rules and equity requirements).

[1038] See section III.C. of this release (discussing the exemption orders).

[1039] *See ISDA Margin Survey 2011* at Table 2.3

[1040] *See id.* The ISDA survey does not define what it means for margin to be ''segregated on the books of the dealer.'' Therefore, it is not certain that margin segregated in this manner would substantially satisfy the omnibus segregation requirements of Rule 18a–4, as adopted.

[1041] *See id.* The ISDA survey does not define what it means for margin to be ''segregated with custodian'' and ''tri-party.'' Therefore, it is not certain that margin segregated in this manner would substantially satisfy the individual segregation requirements of Section 3E(f) of the Exchange Act or the requirements in Rule 18a–4, as adopted, relating to third-party custodians.

[1042] *ISDA Margin Survey 2011* at Table 2.4.

that the firm's back office procedures relating to margin and collateral requirements are in compliance with the agreement of the counterparties. The Exchange Act also provides that the segregation requirements for non-cleared security-based swaps do not apply to variation margin payments, so that the right of an SBSD or MSBSP counterparty to require individual segregation applies only to initial and not variation margin.

The statutory provisions of Sections 3E(b) and (f) of the Exchange Act are self-executing. The baseline incorporates these self-executing provisions in the Exchange Act.

7. Historical Pricing Data

The profits and losses of a security-based swap position depend on the fluctuations in risk factors, other than counterparty risks, that are relevant to the position. The cumulative exposure of the position to these risk factors is commonly referred to as the market risk of the position. For entities subject to capital requirements, the market risk of their trading books (and corresponding market risk charges the trading book positions incur) may affect the amount of capital that they have available to establish new trades. Stand-alone broker-dealers must maintain capital to cover the market risk of their trading portfolios. The use of standardized haircuts is a common method for calculating the amount of capital necessary to cover the market risk of a position.[1043]

One commenter suggested that the Commission conduct further economic analysis to confirm that the standardized haircuts proposed for security-based swaps are appropriately tailored to the risk the relevant positions present. The commenter further suggested that the analysis should be based on quantitative data regarding the security-based swap and swap markets since the enactment of the Dodd-Frank Act.[1044] In response to these comments, the Commission is providing additional support to the discussion in the proposal[1045] by analyzing historical pricing data for single-name and index CDS contracts.[1046] Specifically, the analysis uses historical pricing data to estimate the losses stemming from historical price movements of security-based swap and swap positions and compares those estimated losses with the Commission's proposed standardized haircuts for CDS that are security-based swaps or swaps. The Commission analyzes historical prices in several one-year samples: 3 samples that are likely to capture stressed market conditions (2008, 2011, and 2012), and two samples that are likely to capture normal market conditions (2017 and 2018).[1047]

For each day of each sample, the Commission assigns each single-name CDS contract to the appropriate cell in the grid set forth in paragraph (c)(2)(vi)(P)(*1*)(*i*) of Rule 15c3–1, as amended.[1048] The Commission then calculates the 10-day change in the value of the contract based on the historical pricing data for that contract and expresses the change as a percentage of the notional value of the contract. The Commission repeats this process for each day of the sample for all single-name CDS contracts with historical pricing data to generate a distribution of 10-day value changes for each cell in the grid set forth in paragraph (c)(2)(vi)(P)(*1*)(*i*) of Rule 15c3–1. The Commission estimates the extreme, but plausible loss for each cell as the loss that is only exceeded by 1% of the observations in that cell.[1049] The Commission summarizes the distribution of such extreme but plausible losses for all cells in the grid by calculating the minimum, maximum, mean, standard deviation, and the quartiles of the distribution. The Commission reports the summary statistics for each sample in Panel A of Table 3. In Panel B of Table 3, the Commission reports the summary statistics of extreme but plausible losses on long credit default swap positions.

To analyze extreme, but plausible losses experienced by CDS referencing broad-based securities indices (''index CDS''), the Commission repeats the analyses of Panels A and B but uses historical pricing data on index CDS contracts and the maturity and spread combinations set forth in (b)(2)(i)(A) of Rule 15c3–1b, as amended. The Commission reports the summary statistics of extreme, but plausible losses on short index CDS and long index CDS in Panels C and D of Table 3, respectively.

The summary statistics for CDS provide a number of findings as reflected in Table 3, Panels A and B. For both short and long positions, the mean and median losses vary across the five annual samples. The biggest mean and median losses occurred in 2008, possibly a reflection of severe market stresses experienced in that year. Short CDS positions tend to experience larger losses than long CDS positions. For example, the mean losses on short positions are larger than those on long positions for each of the five annual samples. Losses on short CDS positions also tend to be more variable than losses on long CDS positions. The standard deviation, which captures the extent to which losses deviate from the mean, is higher for short positions than for long positions in all five annual samples.

The summary statistics for index CDS provide broadly similar findings, although differences exist as reflected in Table 3, Panels C and D. For both short and long index CDS positions, the mean and median losses vary across the five annual samples. Short index CDS positions have the highest mean and median losses in 2008. In contrast, long index CDS positions have the highest mean and median losses in 2012. Compared to long positions, short positions tend to experience larger losses in 2008 and 2011, but smaller losses in 2012, 2017, and 2018. For example, in 2008 the mean losses on short and long positions are 17.1% and 4.7%, respectively; in 2012 the mean losses on short and long positions are 2.4% and 5.1%, respectively. For two of the five annual samples (2008 and 2018), losses on short index CDS positions tend to be more variable than losses on long index CDS positions based on the standard deviation. For the other 3 annual samples, long index CDS positions tend to have more variable losses than short index CDS positions.

Table 3: Extreme But Plausible Losses Based on Historical CDS Pricing Data. This table reports summary statistics of the distribution of extreme, but plausible losses stemming from historical price movements that could have impacted credit default swap positions. Losses are in percentages. The

[1043] *See, e.g.,* Rule 15c3–1; *Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework—Comprehensive Version* (June 2006); *Basel III: A global regulatory framework for more resilient banks and banking systems* (June 2011); *CFTC Capital Proposing Release,* 81 FR 91252.

[1044] *See* SIFMA 11/19/2018 Letter.

[1045] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70311–12.

[1046] The pricing data were purchased from ICE Data Services.

[1047] With respect to including data from 2008, the Commission acknowledges the commenter's suggestion that quantitative data since the enactment of the Dodd-Frank Act should be used. However, the Commission believes that the inclusion of 2008 data is justified because the stressed market conditions in that year would help ensure that the analysis does not underestimate the riskiness of security-based swap positions. Therefore, the Commission has retained 2008 data in the analysis. At the same time, most of the data used in the analysis (*i.e.,* 2011, 2012, 2017, and 2018) are from the period since the enactment of the Dodd-Frank Act.

[1048] The Commission assigns the single-name CDS contracts based on the length of time to maturity and midpoint spread on the CDS (*i.e.,* the average of the basis point spread bid and offer on the CDS).

[1049] In other words, only 1% of the observations experienced losses that are larger than the extreme but plausible loss.

summary statistics are Min (minimum), P25 (first quartile/25th percentile), P50 (second quartile/50th percentile), P75 (third quartile/75th percentile), Max (maximum), Mean, and Std (standard deviation).

SINGLE-NAME CREDIT DEFAULT SWAPS

Year	Min	P25	P50	P75	Max	Mean	Std
Panel A: Short Positions							
2008	0.85	6.08	12.10	20.55	71.89	18.49	19.08
2011	0.33	2.94	6.30	11.37	40.89	10.41	11.42
2012	0.00	1.52	3.54	6.26	27.93	6.56	8.11
2017	0.07	1.63	4.44	8.46	71.92	11.24	17.66
2018	0.09	2.33	5.15	9.54	41.35	9.40	11.04
Panel B: Long Positions							
2008	0.15	1.53	4.36	9.52	46.72	7.90	9.72
2011	0.22	1.52	3.49	6.53	19.06	5.34	5.37
2012	0.23	1.38	3.38	6.57	19.18	5.23	5.30
2017	0.08	1.58	3.21	5.75	23.22	5.13	5.31
2018	0.05	1.16	3.32	6.40	20.39	5.18	5.67

INDEX CREDIT DEFAULT SWAPS

Year	Min	P25	P50	P75	Max	Mean	Std
Panel C: Short Positions							
2008	1.51	2.98	8.02	24.09	87.24	17.06	20.48
2011	0.26	1.61	3.31	5.88	12.46	4.01	3.09
2012	0.19	0.98	1.78	3.15	6.91	2.38	1.92
2017	0.00	0.39	0.76	1.54	3.83	1.12	1.07
2018	0.00	0.34	1.01	2.18	4.50	1.46	1.30
Panel D: Long Positions							
2008	0.00	0.34	1.90	3.59	36.85	4.74	9.24
2011	0.12	1.04	2.08	4.04	30.37	3.83	5.80
2012	0.07	1.33	3.51	4.65	44.16	5.07	8.65
2017	0.10	0.52	1.80	4.74	9.33	2.81	2.60
2018	0.00	0.21	0.66	1.53	3.16	0.91	0.85

B. Analysis of the Final Rules and Alternatives

Prior to the passage of the Dodd-Frank Act, the non-cleared security-based swap and swap markets were characterized by opaque and complex bilateral exposure networks. As a result, it was not possible for market participants to accurately ascertain counterparty exposures to other market participants. Moreover, because counterparties did not demand margin in support of transactions, nor were such margins required by regulation, there was considerable potential for market participants to develop large exposures to their counterparties. As a result of these large exposures, the failure of a market participant could undermine the financial condition of its counterparties, leading to sequential counterparty failure. Moreover, the possibility of large exposures when combined with uncertainty about where such potential exposures lie could cause markets to quickly become illiquid when doubts about the viability of even one of the major participants surfaced. Specifically, counterparties might be unwilling to extend credit or to trade with each other.

Title VII of the Dodd-Frank Act established a new regulatory framework for U.S. markets in security-based swaps and swaps. The Dodd-Frank Act requires all sufficiently standardized swaps to be cleared through a CCP. However, the Dodd-Frank Act does not subject all transactions to the mandatory clearing requirement. Section 764 of the Dodd-Frank Act requires the Commission to adopt rules imposing margin and capital requirements on such ''non-cleared'' security-based swap transactions when the transactions are undertaken by entities subject to the Commission's oversight [1050] and for which there is no prudential regulator. These requirements are intended to offset the greater risk to the entity and the financial system from such transactions.

In formulating the new rules and amendments to existing rules being adopted today (collectively the ''final rules''), the Commission has considered the potential benefits of reducing 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. It has also taken into account the potential costs to firms, the financial markets, and the U.S. financial system of complying with capital, margin, and segregation requirements. The Commission also considered related requirements that have been adopted or proposed by other U.S. and foreign financial regulators.

The current broker-dealer capital, margin, and segregation requirements serve as the template for the final rules. However, the Commission recognized that there may be other appropriate approaches to establishing capital, margin, and segregation requirements—including, for example, requirements

[1050] These entities include nonbank SBSDs and MSBSPs.

based on the proposed or adopted capital, margin, and segregation standards of the prudential regulators or the CFTC. In determining the appropriate capital, margin, and segregation requirements—whether based on current broker-dealer rules or other alternative approaches—the Commission has assessed and considered a number of different approaches, and the Commission recognizes that determinations it has made could have a variety of economic consequences for the relevant firms, markets, and the financial system as a whole.

The capital, margin, and segregation requirements being adopted today by the Commission are broadly intended to work in tandem to improve the resilience of the market for security-based swaps. The margin requirements are designed to reduce a dealer's uncollateralized counterparty exposures from non-cleared security-based swap positions and the potential losses from such exposures in the event of counterparty failure. In cases where a nonbank SBSD is not required to collect margin (*i.e.,* the counterparty or the security-based swap transaction is subject to an exception in Rule 18a–3), capital requirements are designed to complement the margin requirements to reduce the nonbank SBSD's risk of failure due to potential losses from uncollateralized exposures. Specifically, capital requirements are designed to enhance the safety and soundness of nonbank SBSDs and reduce the likelihood of sequential dealer failure by setting capital standards that adjust dynamically with the risk of exposures in security-based swaps. In addition, the capital and margin requirements work together to reduce the incentives of market participants to engage in excessive risk-taking strategies, restrict their implicit leverage through non-cleared security-based swap transactions, and reduce the potential cost advantage of non-cleared transactions relative to cleared transactions, and thereby encourage clearing. Finally, the segregation requirements are designed to complement the margin and capital requirements by helping ensure that the collateral posted by a counterparty is adequately protected and readily available to be returned if the nonbank SBSD fails.

The Commission acknowledges that the new requirements of the final rules will impose direct costs on the individual firms. These direct costs could lead to potentially significant collective costs for the security-based swap market and the financial system. For example, 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 swap market, increasing transaction costs, and harming price discovery. These, in turn, can impose 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 capital formation.

Several commenters discussed the absence of an economic analysis in the 2018 comment reopening. A commenter stated that the Commission ''offered no economic analysis of the proposed changes or of the original proposals despite the now very different regulatory context.'' [1051] Another commenter noted significant changes to security-based swap market since the original 2012 proposal, stating that ''the cost-benefit analysis conducted by the Commission in 2012 is simply out of date.'' [1052] Other commenters voiced similar concerns.[1053] In addition, a number of commenters had specific concerns about the impact of the adopted rules on individual firms, market participants, and society in general, and requested that the economic analysis address these concerns.[1054]

The Commission is sensitive to the issues raised by commenters. As noted in the 2018 comment reopening, the 2012 proposals contained an analysis of the potential economic consequences, and the Commission sought further comment on that analysis, including changes to the baseline. The economic analysis in this adopting release takes into consideration the changes to the baseline since 2012 and, relative to the economic analysis in the 2012 proposing release, provides a more thorough and complete discussion of the issues involved because it has been informed by commenters and addresses the issues they raised. In particular, the analysis takes into consideration market trends and changes to market practices, the regulatory environment, and regulatory data to identify the appropriate baseline. The analysis also evaluates the costs and the benefits of the final rules and their impact on the efficiency, competition, and capital formation relative to this baseline.

In addition, as discussed in the 2018 comment reopening, the Commission proposed the amendments in 2012, extended the comment period once, reopened the comment period in connection with the cross-border release and proposed an additional security-based swap nonbank capital requirement in 2014. In the 2012 proposal, 2013 proposal and 2014 proposal, the Commission described the potential economic consequences, including the baseline against which the proposed rules and amendments may be evaluated, the potential costs and benefits, reasonable alternatives, and the potential effects on efficiency, competition and capital formation. The Commission also has issued other releases related to Title VII rulemakings since 2014. The economic analysis from 2012 was brought forward and made more current by these later releases.

With respect to the magnitude of the economic impact of the final rules, it is generally difficult to quantify certain benefits and costs that may result from them. For example, although the adverse spillover effects of defaults on liquidity and valuations were evident during the financial crisis, it is difficult to quantify the 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 future sequential counterparty failures. Similarly, although capital, margin, or segregation requirements may, among other things, affect liquidity and transaction costs in the security-based swap market, 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 compounded by the availability of limited public and regulatory data related to the security-based swap market, in general, and to security-based swap market participants in particular, all of which could assist in quantifying certain benefits and costs. In light of these challenges, much of the discussion of the final rules in this economic analysis will remain qualitative in nature, although where possible the economic analysis attempts to quantify these benefits and costs. The

[1051] *See* Better Markets 11/19/2018 Letter.

[1052] *See* SIFMA 11/19/2018 Letter.

[1053] *See* Citadel 11/19/2018 Letter; Harrington 11/19/2018 Letter; ICI 11/19/2018 Letter; ISDA 11/19/2018 Letter; MFA/AIMA 11/19/2018 Letter; SIFMA AMG 11/19/2018 Letter; SIFMA 11/19/2018 Letter.

[1054] *See* American Council of Life Insurers 11/19/2018 Letter; Better Markets 11/19/2018 Letter; Citadel 11/29/2018 Letter; FIA 11/18/2019 Letter; Harrington 11/19/2018 Letter; ICI 11/19/2018 Letter; IIB 11/19/2018 Letter; ISDA 11/19/2018 Letter; MFA/AIMA 11/19/2018 Letter; Morgan Stanley 11/19/2018 Letter; SIFMA AMG 11/19/2018 Letter; SIFMA 11/19/2018 Letter.

inability to quantify certain benefits and costs, however, does not mean that the overall benefits and costs of the final rules are any less significant.

In addition, as noted above, the final rules include a number of specific quantitative requirements, such as numerical thresholds, limits, deductions, and ratios. These quantitative requirements have not been derived directly from econometric or mathematical models, but are based on the Commission's prior experience and understanding of the markets, and by rules promulgated by the CFTC and SROs. 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. Where possible, the Commission supplements the qualitative discussion of these requirements with quantitative analysis of historical data.

1. The Capital Rules for Nonbank SBSDs—Rules 15c3–1 and 18a–1

As noted earlier, dealers and major participants in the non-cleared security based swap market are generally not subject to capital requirements. Given the central role played by these entities, the lack of a capital standard may raise concerns about the continued safety and soundness of these firms and the provision of liquidity in this market. Such concerns can destabilize the market in the event of a dealer failure, especially in times of economic stress. The new capital rules are intended to alleviate such concerns by imposing capital standards for nonbank SBSDs that are designed to adjust dynamically with the risk of their security-based swap exposures. In this section, the Commission first describes the mechanics of the new capital requirements, and then discusses in detail the benefits and the costs associated with these requirements.

a. Overview

The key features of Rule 18a–1, as adopted and Rule 15c3–1, as amended, are regulatory minimum levels of capital, capital charges for posting margin, capital charges in lieu of collecting margin, methods for computing haircuts for security-based swaps and swaps, and risk management procedures. Each of these features is considered in turn.

i. Minimum Net Capital Requirements

The minimum requirements consist of a fixed-dollar component and a variable component. These components differ across different types of nonbank SBSDs, and for nonbank SBSDs that are also registered as broker-dealers.

As described in detail in section II.A.2.a. of this release, nonbank SBSDs authorized to use models are subject to minimum tentative net capital and net capital requirements. Nonbank SBSDs not authorized to use models are subject to minimum net capital requirements (but not minimum tentative net capital requirements). The minimum tentative net capital requirement for an ANC broker-dealer, including an ANC broker-dealer SBSD, is $5 billion and the minimum net capital requirement is the greater of $1 billion or the applicable existing financial ratio amount (the 15-to-1 ratio or 2% debit item ratio) plus the 2% margin factor. The tentative net capital requirement for a stand-alone SBSD authorized to use models (including a firm registered as an OTC derivatives dealer) is $100 million and the minimum net capital requirements is the greater of $20 million or the 2% margin factor. The minimum net capital requirement for a broker-dealer SBSD not authorized to use models is the greater of $20 million or the applicable existing financial ratio amount (the 15-to-1 ratio or 2% debit item ratio) plus the 2% margin factor. The minimum net capital requirement for a stand-alone SBSD not approved to use internal models is the greater of a $20 million or the 2% margin factor.

The 2% margin factor will remain level for 3 years after the compliance date of the rule. After 3 years, the multiplier could increase to not more than 4% by Commission order, and after 5 years the multiplier could increase to not more than 8% by Commission order if the Commission had previously issued an order raising the multiplier to 4% or less. The final rules further provide that the Commission will consider the capital and leverage levels of the firms subject to these requirements as well as the risks of their security-based swap positions and provide notice before issuing an order raising the multiplier. This approach will enable the Commission to analyze the impact of the new requirement.

ii. Capital Charge for Posting Initial Margin

As described in detail in section II.A.2.b.i. of this release, if a broker-dealer or nonbank SBSD delivers initial margin to another SBSD or other counterparty, it must take a capital charge in the amount of the posted collateral. The Commission is providing interpretive guidance as to how a broker-dealer or nonbank SBSD can avoid taking this capital charge. Under the guidance, initial margin provided by the broker-dealer or nonbank SBSD to a counterparty need not be deducted from net worth when computing net capital if:

- The initial margin requirement is funded by a fully executed written loan agreement with an affiliate of the broker-dealer or nonbank SBSD;
- The loan agreement provides that the lender waives re-payment of the loan until the initial margin is returned to the broker-dealer or nonbank SBSD; and
- The liability of the broker-dealer or the nonbank SBSD to the lender can be fully satisfied by delivering the collateral serving as initial margin to the lender.

Nonbank SBSDs and broker-dealers may apply this guidance to security-based swap and swap transactions.

iii. Capital Deductions in Lieu of Margin

As described in detail in section II.A.2.b.ii. of this release, broker-dealers and nonbank SBSDs will be required to take a deduction for under-margined accounts because of a failure to collect margin required under Commission, CFTC, clearing agency, DCO, or DEA) rules (*i.e.,* a failure to collect margin when there is no exception from collecting margin). These firms also will be required to take deductions when they elect not to collect margin pursuant to exceptions in the margin rules of the Commission and the CFTC for non-cleared security-based swaps and swaps, respectively. For firms that are not approved to use models, these deductions for electing not to collect margin must equal 100% of the amount of margin that would have been required to be collected from the security-based swap or swap counterparty in the absence of an exception. These deductions can be reduced by the value of collateral held in the account.

Regarding the capital charges for initial margin collected but segregated with a third-party custodian, the final rule contains a provision that allows a nonbank SBSD to avoid taking a capital deduction or the alternative credit risk charge for the initial margin collected but held with a third-party custodian as long as certain conditions are satisfied.

iv. Standardized Haircuts for Security-Based Swaps

As described in detail in section II.A.2.b.iii. of this release, a nonbank SBSD will be required to apply standardized haircuts to its proprietary positions (including security-based swap and swap positions), unless the Commission has approved its use of model-based haircuts. The standardized haircuts for positions—other than security-based swaps and swaps—generally are the pre-existing standardized haircuts required by Rule 15c3–1. With respect to security-based swaps and swaps, the Commission is prescribing standardized haircuts tailored to those instruments. In the case of a cleared security-based swap and swap, the standardized haircut is the applicable clearing agency or DCO margin requirement. For a non-cleared CDS, the standardized haircut is set forth in two grids (one for security-based swaps and one for swaps) in which the amount of the deduction is based on two variables: The length of time to maturity of the CDS contract and the amount of the current offered basis point spread on the CDS. For other types of non-cleared security-based swaps and swaps, the standardized haircut generally is the percentage deduction of the standardized haircut that applies to the underlying or referenced position multiplied by the notional amount of the security-based swap or swap.

v. Credit Risk Charges

As described in detail in section II.A.2.b.v. of this release, ANC broker-dealers and stand-alone SBSDs authorized to use models may take credit risk charges instead of the deductions in lieu of margin discussed in section II.A.2.b.ii. of this release. More specifically, an ANC broker-dealer (including a firm registered as an SBSD) and a stand-alone SBSD approved to use models for capital purposes can apply a credit risk charge with respect to uncollateralized exposures arising from derivatives instruments, including exposures arising from not collecting variation and/or initial margin pursuant to exceptions in the non-cleared security-based swap and swap margin rules of the Commission and CFTC, respectively. In applying the credit risk charges, ANC broker-dealers (including firms registered as SBSDs) are subject to a portfolio concentration charge that has a threshold equal to 10% of the firm's tentative net capital. Under the portfolio concentration charge, the application of the credit risk charges to uncollateralized *current* exposure across all counterparties arising from derivatives transactions is limited to an amount of the current exposure equal to no more than 10% of the firm's tentative net capital. The firm must take a charge equal to 100% of the amount of the firm's aggregate current exposure in excess of 10% of its tentative net capital. Stand-alone SBSDs, including SBSDs operating as OTC derivatives dealers, are not subject to a portfolio concentration charge with respect to uncollateralized current exposure.

vi. Risk Management Procedures

As described in detail in section II.A.2.c. of this release, nonbank SBSDs will be required to comply with the risk management provisions of Rule 15c3–4 as if they were OTC derivatives dealers. The risks of trading security-based swaps—including market, credit, operational, and legal risks—are similar to the risks faced by OTC derivatives dealers in trading other types of OTC derivatives.[1055]

b. Benefits and Costs of the Capital Rules for Nonbank SBSDs

The OTC market for security-based swaps as it exists today is characterized by complex networks of bilateral exposures. At the center of these networks are the dealers, who are the main liquidity providers to this market. The networks are fairly opaque; market participants have little or no knowledge about a dealer's uncollateralized exposure to any given counterparty or the dealer's ability to withstand potential losses from such exposure. In times of market stress, uncertainty about the safety and soundness of the dealers may hinder the efficient allocation of capital between market participants. For instance, in the event of a dealer or a major participant failure, uncertainty about the uncollateralized exposures of the surviving dealers to the failed entity and their ability to withstand potential losses from such exposures may discourage some market participants from seeking new transactions with the surviving dealers. This ''run'' by the market participants on the surviving dealers may cause some of these dealers to fail. Sequential dealer failure would have a significant negative impact on the provision of liquidity in this market, and may ultimately cause the security-based swap market to break down.

The safety and soundness of the dealer, including its ability to withstand losses from its trading activity depends ultimately on the dealer's capital. As noted earlier, there are no market-imposed capital standards in the market for non-cleared security-based swaps.

Some of the dealers in this market are affiliated with broker-dealers, but are not subject to the capital requirements applicable to broker-dealers. In addition, a majority of the dealers are organized as subsidiaries of bank holding companies and, while they may not be subject to direct capital requirements, they are indirectly subject to capital requirements imposed on their bank holding company parent. Some dealers are not affiliated with a broker-dealer or have a parent bank holding company and, consequently, are not subject to direct or indirect capital requirements.

Given that most of the dealers in this market are affiliated with institutions that are subject to capital regulation, it is likely that these dealers are organized as dealing structures designed to efficiently deploy capital. Such capital-efficient dealing structures may not voluntarily maintain capital buffers that adjust with the risk of their exposures, such as to minimize the risk of their own failure and the cost of externalities caused by such failure. Dealers currently not subject to direct capital regulation may choose capital levels and capital assets that, while privately optimal, are too low and too illiquid from a market stability perspective.

The final capital rules in this adopting release impose a capital standard on nonbank SBSDs. This capital standard requires that, among other things, a nonbank SBSD maintain a minimum level of net capital that adjusts dynamically with the risk of its exposure in security-based swap market and that promotes the liquidity of the firm. This capital standard is intended to enhance the safety and soundness of nonbank SBSDs by reducing their incentives to engage in excessive risk-taking, by increasing their ability to withstand losses from their trading activity, and by reducing the risk of sequential counterparty failure. The Commission acknowledges, however, that the new capital requirements may impose direct costs on nonbank SBSDs, and indirect costs on the rest of the market participants.

Due to the opacity of the market for non-cleared security-based swaps, dealers currently may have an incentive to engage in excessive risk-taking behavior. As a result, aside from reputational concerns, the market, as it exists today, lacks mechanisms that would force dealers to internalize the cost of the negative externalities created by their excessive risk-taking behavior.

The final capital rules require nonbank SBSDs to allocate additional liquid capital for any new security-based swap position, cleared or non-cleared. Specifically, nonbank SBSDs will need to maintain net capital (and, for firms authorized to use models, tentative net capital) levels that are no less than their minimum fixed-dollar

[1055] For example, individually negotiated OTC derivatives, 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.

requirements. Further, once their ratio-based minimum net capital requirements equal or exceed their fixed-dollar minimum net capital requirements, nonbank SBSDs will have to increase their minimum net capital to enter a new cleared or non-cleared security-based swap position (*i.e.,* because the amount required under the 2% margin factor will increase). In addition, the nonbank SBSD will have to take a capital charge against the market risk of the position (*e.g.,* risk of that a change in value or default of the reference entity will cause a mark-to-market loss for the security-based swap position). Furthermore, to the extent that the credit exposure is uncollateralized (*e.g.,* the counterparty is subject to a margin collection exception), the nonbank SBSD will also have to take a capital deduction to act as a buffer against potential losses from replacing or closing out the position in the event of the counterparty's failure. These capital charges increase with the risk of the position. In particular, these capital charges may discourage risk-taking. A reduction in risk-taking by nonbank SBSDs would arise because the firms will have to allocate capital to account for the market and credit exposures created by their trading positions. In some instances, reduced risk-taking may represent an intended economic consequence of the final rules, for example, if it manifests as a lower propensity to establish large directional positions in security-based swaps that may impose negative externalities on other market participants (*e.g.,* such positions may not take into account the cost of the SBSD's potential failure on its counterparties). In other cases, however, reduced risk taking could impede market functioning by, for example, increasing the compensation that nonbank SBSDs demand to intermediate transactions between other market participants, potentially impairing efficient risk sharing.

The requirements of the final margin rule may further discourage risk-taking behavior among nonbank SBSDs. For instance, the final margin rule requires that nonbank SBSDs post variation margin to all their counterparties that are not subject to a variation margin exception. In particular, a nonbank SBSD will have to post more variation margin to a counterparty as the counterparty's current exposure to the dealer increases. Here too, reductions in nonbank SBSD risk-taking may reflect margin requirements that cause nonbank SBSDs to appropriately internalize more of the costs their activities impose on other market participants, even as these margin requirements potentially curtail efficient reallocation of risk by market participants.

In general, by requiring nonbank SBSDs to allocate capital in an amount that scales up with the size of the security-based swap positions, and by requiring nonbank SBSDs to post variation margin whenever they create an exposure, the capital and margin requirements of the final capital and margin rules and amendments are intended to reduce a nonbank SBSD's incentive to engage in excessive risk-taking behavior in the market for non-cleared security-based swaps.

Similarly, due to the opacity of the market for security-based swaps, currently, it is not always clear whether a dealer is financially sound. In particular, it is not clear whether dealers are adequately capitalized to withstand losses from their trading activity. The final capital rules impose a capital standard on nonbank SBSDs. As discussed above, this capital standard requires a nonbank SBSD to allocate capital against the market and credit exposures created by a security-based swap position, which would permit the nonbank SBSD to cover potential losses stemming from these exposures. These capital charges are designed to help a nonbank SBSD manage losses from its trading activities in cases where the nonbank SBSD cannot rely entirely on collateral.

Moreover, by imposing a capital standard on nonbank SBSDs that complements the requirements of the final margin rule, the capital and margin requirements of the final capital and margin rules and amendments are intended to increase a nonbank SBSD's viability, including its ability to withstand potential losses from its trading activity. In general, when a counterparty to a non-cleared security-based swap transaction fails, the dealer may want to replace the position. To this end, under the final capital and margin rules, a nonbank SBSD will be able to rely on the collateral posted by the counterparty prior to its default (*e.g.,* variation and initial margin) and the capital that the nonbank SBSD allocated at the outset and throughout the life of the position (*e.g.,* the capital charges against the market and credit exposure created by the position). If in the aftermath of the counterparty's failure the market exposure of the position continues to deteriorate, the collateral that the dealer collected from the counterparty prior to its default may not be enough to offset the replacement cost of the position. In this case the nonbank SBSD may incur losses on the position. However, the nonbank SBSD's losses would be limited by the capital that the nonbank SBSD was required to allocate by way of a capital charge to support the position prior to the counterparty's default as well as the increase in the minimum net capital amount that reflects the exposure of the position and that the nonbank SBSD is required to maintain at all times (*e.g.,* the incremental adjustment to the 2% margin factor resulting from the position).

Finally, due to the opacity of the market for security-based swaps, dealers do not know other dealers' exposures outside the positions that they have in common. In particular, losses from trading activity may cause a dealer to fail, which in turn, may cause losses for surviving counterparty dealers and precipitate their failure. In other words, the market for security-based swaps as it exists today is subject to the risk of sequential dealer failure.

Because the final margin rule would require nonbank SBSDs to collect variation margin but not initial margin from other nonbank SBSDs and financial market intermediaries, nonbank SBSDs would have credit exposures to each other that may not be fully collateralized (*i.e.,* no inter-dealer exchange of initial margin). However, the final capital rules and amendments work in tandem with the final margin rules to impose a capital standard on nonbank SBSDs that requires them to allocate capital against the market and credit exposures created by the inter-dealer positions, and further increase their minimum net capital by an amount that is proportional to the exposure created by the positions. This capital buffer is designed to help a nonbank SBSD withstand potential losses from replacing inter-dealer positions that expose the dealer to uncollateralized credit exposure, because of the absence of inter-dealer collection of initial margin. In addition, while nonbank SBSDs are not required to collect initial margin from each other, they are not prohibited from doing so.

Thus, by requiring nonbank SBSDs to allocate capital that scales up with the risk of the inter-dealer credit exposures (whether or not collateralized), the capital and margin requirements of the final capital and margin rules and amendments are expected to reduce the likelihood that the losses at one nonbank SBSD impact the other nonbank SBSD. In turn, the final capital and margin rules, taken together, should reduce the risk of sequential dealer failure.

The final capital rules and amendments will impose direct compliance costs on nonbank SBSDs. To be adequately capitalized, SBSDs will have to ensure that their net capital is larger than the required minimum net capital. An SBSD will have to calculate its net capital by taking capital charges against their tentative net capital for the uncollateralized exposures created by their trading activity. As noted earlier, the minimum net capital, through the 2% margin factor, as well as the capital charges (*i.e.,* standardized or model-based haircuts) scale up with a nonbank SBSD's trading activity in the security-based swap market. Thus, the new capital requirements directly constrain a nonbank SBSD's trading activity, and the profits that the nonbank SBSD expects to generate from such activity. In turn, these capital constraints may limit the provision of liquidity in the market for non-cleared security-based swaps, and the resulting reduction in price discovery may, in turn, impose a cost on market participants.

The Commission has made two significant modifications to the final capital rules for nonbank SBSDs. First, as discussed above in section II.A.2.b.v. of this release, the Commission has modified Rule 18a–1 so that it no longer contains a portfolio concentration charge that is triggered when the aggregate current exposure of the stand-alone SBSD to its derivatives counterparties exceeds 50% of the firm's tentative net capital.[1056] This means that stand-alone SBSDs that have been authorized to use models will not be subject to this limit on applying the credit risk charges to uncollateralized current exposures related to derivatives transactions. The second significant modification is an alternative compliance mechanism.

The Commission acknowledges that under these two modifications a stand-alone SBSD will be subject to: (1) A capital standard that is less rigid than Rule 15c3–1 in terms of imposing a net liquid assets test (in the case of firms that will comply with Rule 18a–1); or (2) a capital standard that potentially does not impose a net liquid assets test (in the case of firms that will operate under the alternative compliance mechanism and, therefore, comply with the CFTC's capital rules). Accordingly, this will mean that the final rules may not enhance these firms' liquidity position to the same degree as they will for broker-dealer SBSDs. As a result, the risk that a stand-alone SBSD may not be able to self-liquidate in an orderly manner will be higher relative to broker-dealer SBSDs. However, stand-alone SBSDs will likely engage in a more limited business than broker-dealers, including broker-dealer SBSDs. Thus, they will likely be less significant participants in the overall securities markets. For example, they will not be dealers in the cash securities markets or the markets for listed options and they will not maintain custody of cash or securities for retail investors in those markets. Given their limited role, the Commission believes that it is appropriate to more closely align the requirements for stand-alone SBSDs with the requirements of the CFTC and the prudential regulators.

As a result of these modifications, stand-alone SBSDs will likely be able to comply with the final rules at a lower cost than broker-dealer SBSDs. First, a stand-alone SBSD will not be subject to a portfolio concentration charge if its aggregate current exposures to derivatives counterparties exceed 10% of its tentative net capital, reducing its overall capital requirement, and attendant costs, under the final rules. Second, stand-alone SBSDs would be permitted to comply solely with CFTC capital rules if they meet the conditions of the alternative compliance mechanism. While this may preserve stand-alone SBSDs' ability to intermediate transactions in the security-based swap market, it may also shift competition among nonbank SBSDs in favor of stand-alone SBSDs.

One commenter argued that the Commission failed to provide an analysis showing the economic impact of the proposed rules on investors, systemic stability, and crisis prevention.[1057] Another commenter argued that the Commission should analyze the operational risks and concerns associated with not maintaining adequate levels of capital.[1058] Finally, a commenter recommended that the Commission provide an economic analysis in a final rulemaking to justify changes to Rule 15c3–1.[1059]

In response to these commenters, the analysis provided in the adopting release addresses the effects of the final capital rules and amendments on the safety and soundness of nonbank SBSDs, including the risk of sequential dealer failure. As noted in the discussion above, the analysis starts with a discussion of the problems that may arise in OTC markets when dealers are not subject to explicit capital or margin requirements. In particular, it notes that lack of adequate capitalization or collateralization may encourage excessive risk taking, may cause a dealer to fail, and may result in sequential dealer failure. The discussion also describes how the final capital rules and amendments work together with the final margin rules to address these issues. The analysis that follows discusses in more detail the costs and benefits associated with specific capital requirements in the final capital rules for both stand-alone and broker-dealer SBSDs as well as other market participants and attempts to provide quantitative estimates whenever possible.

i. Minimum Net Capital Requirements

As noted above, the minimum capital requirements contain both a minimum fixed-dollar component and a variable component (the 2% margin factor).[1060] The fixed-dollar component sets a lower bound on the amount of tentative and net capital that a nonbank SBSD must hold, as applicable. The variable component sets a lower bound on the amount of capital for a nonbank SBSD that scales up with the security-based swap activity of the dealer. These two components are likely to affect a nonbank SBSD differently based on the volume of its security-based swap activity. For instance, a nonbank SBSD that engages in limited amount of security-based swap activity will likely care more about the fixed-dollar component than the variable component. On the other hand, a nonbank SBSD that engages in substantial amount of security-based swap activity will likely care more about the variable component than the fixed-dollar component. More generally, the design of these two components of minimum capital requirements will likely affect the entry costs in the nonbank SBSD industry, and the distribution of firms, by activity, within this industry. The analysis below focuses on these two aspects when identifying the main costs and the benefits associated with the design of the minimum capital requirements.

The $20 million fixed-dollar minimum net capital requirement for nonbank SBSDs (other than firms that are ANC broker-dealers) is consistent with the $20 million fixed-dollar minimum requirement applicable to

[1056] *See* paragraph (e)(2) of Rule 18a–1, as adopted. *See also Capital, Margin, and Segregation Proposing Release,* 77 FR at 70244 (proposing a portfolio concentration charge in Rule 18a–1 for stand-alone SBSDs).

[1057] *See* Better Markets 11/19/2018 Letter.

[1058] *See* Harrington 11/19/2018 Letter.

[1059] *See* Morgan Stanley 11/19/2018 Letter.

[1060] As discussed above, the 2% margin factor for all nonbank SBSDs will remain level for 3 years from the compliance date of the rule, and the rule prescribes a process by which the Commission, by order, could increase the 2% multiplier thereafter.

OTC derivatives dealers under paragraph (a)(5) of Rule 15c3–1, and is therefore already familiar to certain market participants. OTC derivatives dealers are limited purpose broker-dealers that are authorized to trade in certain derivatives, including security-based swaps, and use internal models to calculate net capital. They also are required to maintain minimum tentative net capital of $100 million. These current fixed-dollar minimums have been the capital standards for OTC derivative dealers for 20 years. A commenter supported the Commission's thresholds for the fixed-dollar component of the minimum capital requirements stating that they are generally consistent with the capital requirements for OTC derivatives dealers.[1061]

Stand-alone SBSDs not authorized to use models will be required to maintain minimum net capital of the greater of $20 million or the 2% margin factor.[1062] The $20 million fixed-dollar minimum net capital requirement for these SBSDs is substantially higher than the fixed-dollar minimums in Rule 15c3–1 currently applicable to broker-dealers that are not authorized to use models.[1063] In cases where the 2% margin factor results in a net capital requirement greater than $20 million, the total net capital requirement for these nonbank SBSDs will be greater than $20 million minimum requirement for OTC derivatives dealers as well. The more stringent minimum net capital requirement of the greater of $20 million or the 2% margin factor for stand-alone SBSDs not approved to use models reflects that these firms to a greater extent than broker-dealers that are not SBSDs, 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 other types of securities. Moreover, stand-alone SBSDs, unlike OTC derivative dealers, have direct customer relationships and have custody of customer funds. Therefore, the failure of a stand-alone SBSD would have a broader adverse impact on a larger number of market participants, including customers and counterparties. Relatively higher capital requirements for stand-alone SBSDs as compared to broker-dealers and OTC derivatives dealers (which will not be subject to the 2% margin factor, unless they are also registered as a nonbank SBSD or ANC broker-dealer) are intended to mitigate these relatively more substantial risks.

Consequently, a benefit of these heightened minimum capital requirements is that they should enhance the safety and soundness of the nonbank SBSDs not authorized to use models, and, indirectly, should reduce the cost of counterparty failure that market participants internalize when transferring credit risk in the security-based swap market.

Stand-alone SBSDs authorized to use models will be required to maintain minimum net capital of the greater of $20 million or the 2% 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 generally lead to market and credit risk charges that are substantially lower than the standardized haircuts and 100% capital deductions, respectively.[1064] As a consequence, the minimum tentative net capital requirement for firms using models is intended to provide an additional assurance of adequate capital to reflect this concern and to account for risks that may not be fully captured by the models.

Under the amendments to paragraph (a)(7) of Rule 15c3–1, ANC broker-dealers, including ANC broker-dealer SBSDs, will 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 2% margin factor. These requirements are higher than current requirements for ANC broker-dealers in a number of ways. First, the inclusion of a 2% margin factor represents an additional capital requirement that reflects, and scales with, an ANC broker-dealers' security-based swap activities. Second, the final rules increase the existing tentative net capital requirement of $1 billion and net capital requirement of $500 million.

These higher minimum capital requirements for ANC broker-dealers (as compared with the requirements for other types of broker-dealers) reflect the substantial and diverse range of business activities engaged in by these entities and their importance as intermediaries in the securities markets. Further, the heightened capital requirements reflect the fact that, as noted above, 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 models may not capture all risks.[1065]

One commenter argues that allowing certain nonbank SBSDs to use models for the purpose of calculating net capital could give these dealers a competitive advantage over the rest of nonbank SBSDs not authorized to use models.[1066] This commenter further argues that models routinely fail in a crisis and, importantly, they may encourage dealers to engage in additional risk-taking by permitting dealers to use models to lower their minimum required regulatory capital. As noted above, nonbank SBSDs that are approved to use internal models are subject to more stringent capital requirements than nonbank SBSDs that do not use internal models. In particular, ANC broker-dealer SBSDs are subject to a much higher minimum net capital requirement than broker-dealer SBSDs that do not use internal models, with a fixed-dollar component of $1 billion versus a fixed-dollar component of $20 million. Furthermore, both stand-alone SBSDs using internal models and ANC broker-dealers are subject to a tentative net capital requirement that does not apply to broker-dealer SBSDs that do not use internal models. These heightened capital requirements are designed to accommodate potential losses associated with higher trading activity, including losses induced by model failure. In other words, to the extent that a nonbank SBSD's model underestimates exposures, on occasion, and to the extent that some of these exposures result in losses for the

[1061] *See* SIFMA 2/22/2013 Letter.

[1062] This 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,* 81 FR 91252.

[1063] For example, a broker-dealer that carries customer accounts has a fixed-dollar minimum net capital requirement of $250,000; a broker-dealer that does not carry customer accounts but engages in proprietary securities trading (defined as more than 10 trades per year) has a fixed-dollar minimum net capital requirement of $100,000; and a broker-dealer that does not carry accounts for customers or otherwise receive or hold securities or cash for customers, and does not engage in proprietary trading activities, has a fixed-dollar minimum net capital requirement of $5,000. *See* paragraph (a)(2) of Rule 15c3–1.

[1064] *See, e.g., Alternative Net Capital Requirements for Broker-Dealers That Are Part of Consolidated Supervised Entities,* 69 FR at 34455 (stating that the "major benefit for the broker-dealer" of using an internal model "will be lower deductions from net capital for market and credit risk"). *See also OTC Derivatives Dealer Release,* 63 FR 59362. Given the significant benefits of using models in reducing the capital required for security-based swap positions, it is likely that for new entrants to capture substantial volume in security-based swaps they will need to use models.

[1065] *See Alternative Net Capital Requirements for Broker-Dealers That Are Part of Consolidated Supervised Entities,* 69 FR 34428.

[1066] *See* Systemic Risk Council 1/24/2013 Letter.

nonbank SBSD using the model, the heightened capital requirements for the nonbank SBSD should help absorb these losses.

The use of internal models for the purpose of calculating net capital should permit nonbank SBSDs to significantly reduce the amount of capital that they have to allocate to support their trading activity (*e.g.,* the capital charges for the market and credit risk of a position). This capital savings may increase the trading capacity of nonbank SBSDs that are authorized to use internal models, which, in turn, may increase liquidity provision in the security-based swap market. This benefit together with the heightened capital requirements for this type of nonbank SBSD potentially offsets some of the potential costs associated with the impact on competition of permitting certain nonbank SBSDs to use internal models for the purpose of calculating net capital. In addition, the final capital rules include a provision that grants a nonbank SBSD temporary use of a provisional model that has been approved by certain other regulators, while the nonbank SBSD has an application pending for its internal model. Under certain conditions, this provision could facilitate dealing structures that currently rely on internal models approved by other regulators to continue to use their models after they register as nonbank SBSDs, while their application for approval to use an internal model for the purposes of the final capital rules is pending.[1067]

Finally, as discussed above, the final margin and capital rules would cause nonbank SBSDs to internalize a significant portion of the negative externalities associated with a nonbank SBSD's potential risk-taking behavior that could arise under the baseline.[1068] Nonbank SBSDs may pass on some of these costs to their customers and counterparties.

Based on financial information reported by the ANC broker-dealers in their FOCUS Reports filed with the Commission, the five current ANC broker-dealers maintain capital levels in excess of these increased minimum requirements. Further, under paragraph (a)(7)(ii) of Rule 15c3–1, ANC broker-dealers are currently required to notify the Commission if their tentative net capital falls below $5 billion. The Commission uses this notification provision 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 under Rule 17a–11. 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.

The increases to the minimum tentative and minimum net capital requirements in the final capital rules may not present a material cost to the current ANC broker-dealers because, currently, they already hold more tentative and net capital than the new minimum requirements. The more relevant number is the increase in the early warning notification threshold from $5 billion to $6 billion. The new ''early warning'' threshold for ANC broker-dealers of $6 billion in tentative net capital is modeled on a similar requirement for OTC derivatives dealers. The existing early warning requirement for OTC derivatives dealers under paragraph (c)(3) of Rule 17a–11 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 (*i.e.,* the early warning threshold for tentative net capital is $120 million).

Based on the Commission staff's supervision of the ANC broker-dealers, the current ANC broker-dealers report tentative net capital levels that are generally well in excess of $6 billion threshold. As a result, the costs to the ANC broker-dealers to comply with the new minimum tentative net capital requirement are not expected to be material. However, these costs may be prohibitive to prospective registrants that are not already ANC broker-dealers and that wish to register as broker-dealer SBSDs using internal models (*i.e.,* ANC broker-dealers). As discussed below in this section, 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 fixed-dollar-amount components, the minimum net capital requirements also include the 2% margin factor.[1069] This variable component is intended to establish a minimum capital requirement that scales with the level of the nonbank SBSD's security-based swap activity.

The 2% margin factor is similar to an existing requirement in the CFTC's net capital rule for FCMs, and the CFTC's proposed capital requirements for swap dealers and major swap participants registered as FCMs.[1070] Under the process set forth in the final rules, the 2% multiplier will remain level for 3 years after the compliance date of the rule. After 3 years, the multiplier could increase to not more than 4% by Commission order, and after 5 years the multiplier could increase to not more than 8% by Commission order if the Commission had previously issued an order raising the multiplier to 4% or less. The process sets an upper limit for the multiplier of 8% (the day-1 multiplier under the proposed rules) and requires the issuance of two successive orders to raise the multiplier to as much as 8% (or an amount between 4% and 8%).

The 2% margin factor will provide a nonbank SBSD with a buffer of liquid capital that should complement the SBSD's capital charges against the market and credit risk associated with its exposures from transacting in security-based swaps. This capital buffer would be useful in situations where unanticipated losses on a security-based swap position exceed the value of the collateral that the SBSD collects or the capital charges that the SBSD takes against the exposures created by the position. Such situations may arise when the standardized or model-based haircuts that apply to the exposures created by a security-based swap position or the collateral collected to cover that exposure are not large enough to cover the actual losses from the position.[1071] In the case of cleared security-based swap positions, the 2% margin factor will also create a capital

[1067] *See* paragraph (a)(7)(ii) of Rule 15c3–1e, as amended; paragraph (d)(5)(ii) of Rule 18a–1, as adopted.

[1068] While it is likely that a counterparty may demand compensation (*e.g.,* better pricing terms) for the credit risk associated with a security-based swap position with a nonbank SBSD, the counterparty's other counterparties may not have sufficient information about indirect exposures to the nonbank SBSD to also demand compensation for these indirect risks.

[1069] The 2% margin factor will be additive to the existing Rule 15c3–1 ratio-based minimum net capital requirement for an ANC broker-dealer. Therefore, the cost impact to an ANC broker-dealer will depend on whether and how much the 2% margin factor increases that ANC broker-dealer's minimum net capital requirement relative to the existing ratio-based minimum net capital requirements in Rule 15c3–1 in the baseline as well as the amount of excess net capital the firm maintains.

[1070] *See CFTC Capital Proposing Release,* 81 FR at 91306. The 8% calculation under the CFTC's proposal relates to cleared and non-cleared swaps or futures transactions, as well as cleared and non-cleared security-based swaps, whereas the 2% margin factor in Rule 15c3–1, as amended, and Rule 18a–1, as adopted, is based on cleared and non-cleared security-based swaps.

[1071] Situations where actual losses exceed model-based haircuts are instances of model risk.

buffer that a nonbank SBSD with credit exposure to a CCP could access in the scenario that a CCP fails. This capital buffer should improve the financial stability of a nonbank SBSD, because the final capital rule and amendments do not require that a nonbank SBSD collect initial margin from a CCP or take a capital deduction for margin posted to a CCP.

The 2% margin factor will also provide a nonbank SBSD with a buffer of liquid capital that may be needed in situations where the SBSD cannot access in a timely manner the initial margin collected from a failing counterparty, but that is not under the SBSD's control (*e.g.,* the collateral is either re-hypothecated or segregated at a third-party custodian, in the case of non-cleared security-based swaps, or posted with a CCP, as part of the SBSD's client clearing business in the case of a cleared security-based swap). The nonbank SBSD could rely on the liquid capital provided by the 2% margin factor to offset some of the replacement or liquidation costs of the positions with the failed counterparty, before it takes possession of, and potentially liquidates, the failing counterparty's collateral. Furthermore, the nonbank SBSD will be able to recover in whole or in part the portion of the 2% margin factor that it used as a temporary source of liquidity, after it liquidates the recovered collateral.

As noted above, absent the capital buffer created by the 2% margin factor, a nonbank SBSD may be short on liquid capital precisely at the time when the value of this capital is high (*e.g.,* when markets are stressed and SBSDs face unanticipated losses on their positions that exceed the capital charges associated with the positions). To raise the needed liquid capital, on demand, nonbank SBSDs may face significant costs (*e.g.,* the SBSD may have to engage in a ''fire sale'' of assets that it would not sell otherwise), which could destabilize the SBSD. The 2% margin factor is intended to ensure that nonbank SBSDs have a buffer of liquid capital at all times, and reduce the need to source liquid capital at times when such capital is needed. As a result, the 2% margin factor should improve the financial stability of nonbank SBSDs, and therefore benefit market participants that rely on liquidity provided by nonbank SBSDs.

In summary, the 2% margin factor is intended to ensure that nonbank SBSDs have needed liquid capital in situations where collateral collected or capital charges may not fully cover the actual losses from a security-based swap positions. As a consequence, the 2% margin factor should improve the safety and soundness of nonbank SBSDs, which ultimately, should benefit market participants that rely on liquidity provided by nonbank SBSDs.

However, the 2% margin factor likely also will impose direct costs on nonbank SBSDs, as the dealer may have to either access the capital markets or restructure illiquid assets and liabilities on its balance sheet to ensure that it stays above the minimum net capital threshold established by this requirement. Furthermore, the 2% margin factor scales up with a nonbank SBSD's security-based swap activity, and increases with each new security-based swap position, regardless of the direction of the position, whether the SBSD hedges the position, or whether the SBSD collects initial margin on the position. For instance, if the nonbank SBSD enters into two similar positions but in opposite directions (*i.e.,* zero net market risk) and with different counterparties, the SBSD will have to allocate capital towards the 2% margin factor for each of the two positions. Similarly, if the nonbank SBSD collects initial margin on the position, it still has to allocate capital towards the 2% margin factor for that position.

The 2% margin factor may have an initial impact on nonbank SBSDs with legacy security-based swap positions. As noted above, nonbank SBSD may have margin requirements that are sufficiently large that the 2% margin factor plus the Rule 15c3–1 financial ratio, if applicable, yields a net capital requirement that exceeds the fixed-dollar minimums specified in Rules 15c3–1 and 18a–1, as applicable. Under the final rules, these nonbank SBSDs will have to allocate additional capital towards the 2% margin factor for each new security-based swap position, as well as for all its legacy security-based swap positions. Firms that anticipate a large initial impact of the 2% margin factor due to their legacy positions may change their behavior prior to the implementation date of the final capital rules to avoid registration as a nonbank SBSD or to mitigate costs associated with being subject to the nonbank SBSD capital rules once it is required to register. Specifically, these firms may have an incentive to reduce their security-based swap activity in the run-up to the implementation date. However, lower security-based swap activity may result in reduced liquidity provision in the security-based swap market, which may manifest in higher prices for market participants. From this perspective, the application of the 2% margin factor to legacy positions may impose indirect costs on market participants.

Nevertheless, as noted above, the final rule and amendments permit a phase-in over time of the margin factor. As a result, the impact of the margin factor on nonbank SBSDs would be smaller at the outset of the implementation, and then become progressively larger if the Commission chooses to increase the requirement's percent multiplier. The rate of increase of the impact of the margin factor is limited by the final rules, because the Commission can use the process set forth in the rules to, at most, double the margin factor after 3 years and, at most, double the margin factor again after 5 years. Moreover, under the process in the final rules, the percent multiplier for the margin factor can be raised to no more than 8%, limiting the overall impact of the margin factor on nonbank SBSDs. The initial multiplier in the final rules is similar to an existing minimum net capital requirement for broker-dealers, namely the 2% debit item ratio.

In addition, for a given position with a given counterparty, a firm that is authorized to use a margin model would generally allocate less capital for that position towards the 2% margin factor than a firm that is not authorized to use a margin model. Firms that are not authorized to use a margin model would have to calculate the 2% margin factor using standardized haircuts for the initial margin calculation with respect to the non-cleared security-based swap. In contrast, firms that are approved to use a margin model would be permitted to calculate the 2% margin factor using the margin model. The Commission expects that most firms would seek approval to use models for the purpose of calculating net capital and initial margin requirements for non-cleared security-based swap transactions with counterparties.

The 2% margin factor of the final capital rules may also impose additional costs on nonbank SBSDs due to regulatory uncertainty. Because the Commission, after 3 years, could use the process in the final rules to increase the multiplier to not more than 4% by order, and, the Commission, after 5 years, could increase the multiplier to not more than 8% by order (if the Commission had previously issued an order raising the multiplier to 4% or less), firms face uncertainty about when or if the new increase in the margin factor would take place, and whether they would have the additional capital needed to meet the requirement. However, the Commission also could modify any of the new requirements being adopted today (including the 2% margin factor) by rule amendment.

Relative to the proposed capital rules, the final capital rules also reduce the costs to nonbank SBSDs due to overlapping regulatory requirements. As discussed above, one of the components of the 2% margin factor addresses cleared security-based swaps. Nonbank SBSDs that are also registered as FCMs with the CFTC will also have to comply with the CFTC's capital requirements for FCMs with respect to cleared swaps and security-based swaps. These requirements are based on the initial margin calculated by the clearing agency or DCO. In contrast, the 2012 proposal required that nonbank SBSDs allocate capital towards the proposed 8% margin factor for a cleared security-based swap in an amount equal to 8% times the maximum of the initial margin calculated by the clearing agency and the capital deductions that the SBSD would have to take were this position proprietary. However, the final capital rules require that nonbank SBSDs allocate capital towards the 2% margin factor for a cleared security-based swap in an amount equal to the initial margin calculated by the clearing agency times the 2% margin factor requirement. Thus, the 2% margin factor requirement for cleared security-based swaps aligns more closely with the CFTC's existing and proposed capital requirements (*i.e.,* because risk margin amount for a cleared security-based swap is based solely on the initial margin calculated by the clearing agency).

In general, firms may pass on some of the capital costs arising from complying with the 2% margin factor requirement to their counterparties in the form of higher prices. As a result, the 2% margin factor may impose indirect costs on market participants.

A number of commenters raised concerns about the proposed 8% margin factor requirement. A commenter suggested that the Commission replace the proposed requirement with an alternative requirement modeled on the 2% debit items ratio in Rule 15c3–1.[1072] Another commenter stated that a minimum capital requirement that is scalable to the volume, size, and risk of a nonbank SBSD's activities would be consistent with the safety and soundness standards mandated by the Dodd-Frank Act and the Basel Accords and would be comparable to the requirements established by the CFTC and the prudential regulators.[1073] The commenter, however, expressed concern that the proposed 8% margin factor was not appropriately risk-based.[1074] The commenter also suggested that, if the proposed 8% margin factor is retained, the Commission should exclude security-based swaps that are portfolio margined with swaps or futures in a CFTC-supervised account.[1075] Another commenter believed that a broker-dealer dually registered as an FCM should be subject to a single risk margin amount calculated pursuant to the CFTC's rules, since the CFTC calculation incorporates both security-based swaps and swaps.[1076] A commenter suggested modifying the proposed definition of the risk margin amount to reflect the lower risk associated with central clearing by ensuring that capital requirements for cleared security-based swaps are lower than the requirements for equivalent non-cleared security-based swaps.[1077] Other commenters argued that the proposed 8% margin factor may undermine existing regulatory standards for security-based swaps and swaps.[1078] Another commenter argued that the Commission should identify the areas of divergence and assess the impact of conflicting rules on entities that are registered with the Commission and the CFTC.[1079] Finally, a commenter questioned the usefulness of the proposed 8% margin factor arguing that it does not serve a purpose outside the capital charges that a firm would have to take against the market and credit exposures from its trading activity.[1080]

Commenters also addressed the modifications to the proposed rule text in the 2018 comment reopening pursuant to which the input for cleared security-based swaps in the risk margin amount would be determined solely by reference to the amount of initial margin required by clearing agencies (*i.e.,* not be the greater of those amounts or the amount of the haircuts that would apply to the cleared security-based swap positions). Some commenters supported the potential rule language modifications.[1081] Other commenters opposed them.[1082] A commenter opposing the modifications stated that the ''greater of'' provision creates a backstop to protect against the possibility that varying margin requirements across clearing agencies and over time could be insufficient to reflect the true risk to an SBSD arising from its customers' positions.[1083] Another commenter believed that eliminating the haircut requirement may incentivize clearing agencies to compete on the basis of margin requirements.[1084]

The Commission acknowledges the commenters' concerns about the potential impact of the 2% margin factor requirement. In response to concerns about the proposed requirement being inconsistent with the 2% debit item ratio requirement for broker-dealers, the final capital rules could phase in the margin factor over time, as discussed above in section II.A.2.a. of this release, and set the initial multiplier for the margin factor at 2%. The phase-in of the margin factor over time will result in an initial impact on the capital costs of the nonbank SBSDs that is lower than the impact that would have resulted if the multiplier had initially been 8%, as proposed. However, the final rules will result in lower initial levels of minimum net capital, relative to the 2012 proposal. As discussed above, lower levels of minimum net capital may negatively impact a nonbank SBSD's safety and soundness.

In response to concerns about the proposed 8% margin factor not being appropriately risk-based, as discussed above, the final 2% margin factor is designed to complement the capital charges that nonbank SBSDs would be required to take against the uncollateralized exposures created by their security-based swap positions. The 2% margin factor will cause capital charges and net capital requirements (beyond the fixed dollar minimum capital requirements) to increase as the nonbank SBSD's exposures increase and thus should be sensitive to the risk of the firm's exposures.

In response to concerns about potential costs of the proposed 8% margin factor requirement due to regulatory overlap, the Commission modified the proposed 8% margin factor in the final capital rules such that the risk margin amount for cleared security-

[1072] *See* SIFMA 11/19/2018 Letter.

[1073] *See* SIFMA 2/22/2013 Letter.

[1074] *See* SIFMA 2/22/2013 Letter. SIFMA suggested two approaches: One for nonbank SBSDs authorized to use models and one for nonbank SBSDs not authorized to use models. Under the first approach, the risk margin amount would be a percent of the firm's aggregate model-based haircuts. The second approach was a credit quality adjusted version of the proposed 8% margin factor.

[1075] *See* SIFMA 11/19/18 Letter.

[1076] *See* Morgan Stanley 11/19/2018 Letter.

[1077] *See* MFA 2/22/2013 Letter. *See also* OneChicago 11/19/18 Letter.

[1078] *See* FIA 11/19/2018 Letter; MFA/AIMA 11/19/2018 Letter; Morgan Stanley 11/19/2018 Letter; SIFMA 2/22/2013 Letter.

[1079] *See* Citadel 11/19/2018 Letter.

[1080] *See* SIFMA 2/22/2013 Letter.

[1081] *See* ICI 11/19/18 Letter; MFA/AIMA 11/19/2019 Letter; SIFMA 11/19/2018 Letter.

[1082] *See* Americans for Financial Reform Education Fund Letter; Better Markets 11/19/2018 Letter; Rutkowski 11/20/2018 Letter.

[1083] *See* Better Markets 11/19/2018 Letter.

[1084] *See* Americans for Financial Reform Education Fund Letter.

based swaps equals the initial margin calculated by the clearing agency. This modification aligns more closely the final capital rules with the CFTC's existing and proposed capital requirements, and therefore should reduce the potential costs arising from regulatory overlap on cleared security-based swaps. The proposed requirement to calculate the margin amount for cleared security-based swaps based on the haircuts that would apply to the position would have reduced the SBSD's exposure to CCP margin requirements, due, for example, to requirements established in response to competition among CCPs. However, as noted further below, because nonbank SBSDs would have likely passed on the additional capital costs of the proposed requirement to their counterparties, the proposed requirement could have reduced market participants' incentives to clear security-based swaps.

With respect to the portfolio margining concern, the Commission plans to coordinate further with CFTC on the issue.

In general, it is difficult to quantify the costs of the minimum capital requirements on nonbank SBSDs. However, for ANC broker-dealers, who will experience an increase in both in the early warning level and in the minimum tentative net capital and net capital requirements, one can provide preliminary estimates of this cost by comparing the fixed components of the minimum capital requirements against the firm's current levels of net capital. This exercise will provide an indication of the costs of complying with the minimum capital requirements of the final capital rule and amendments for ANC broker-dealers and for broker-dealer SBSDs.

Based on FOCUS Report information as of year-end 2017, approximatively 16 broker-dealers, including the current ANC broker-dealers, maintain tentative net capital in excess of $5 billion, approximately 48 broker-dealers maintain tentative net capital in excess of $1 billion, approximately 191 broker-dealers maintain tentative net capital in excess of $100 million, and approximately 446 broker-dealers maintain net capital in excess of $20 million.

Although the increase in minimum capital and early warning requirements for ANC broker-dealers will not affect firms that already have this classification (*i.e.,* the 5 ANC broker-dealers), it does reduce the number of additional firms (from 44 to 11, according to FOCUS Report data) that currently qualify for this designation (*i.e.,* broker-dealers with tentative net capital in excess of $1 billion that are not ANC broker-dealers). Each of the 11 broker-dealers that have tentative net capital in excess of $5 billion but less than $6 billion and are not ANC broker-dealers will have to raise at most $1 billion in additional capital to be able to clear the early warning threshold and to be eligible to register as ANC broker-dealer or as an ANC broker-dealer SBSD. This amount increases to a maximum of $5 billion for each of the 44 broker-dealers that have tentative net capital in excess of $1 billion but less than $6 billion and that wants to register as ANC broker-dealer or as an ANC broker-dealer SBSD. Thus, the potential cost of registering as an ANC broker-dealer or as an ANC broker-dealer SBSD could be large, especially for broker-dealers that currently maintain tentative net capital levels below $5 billion and/or net capital levels below $1 billion. A broker-dealer may avoid these costs by choosing to register as a nonbank SBSD that is not authorized to use models or by limiting its security-based swap trading activity to the point where it does not need to register as an SBSD. A firm that is not a broker-dealer could avoid these costs by registering as a stand-alone SBSD.

In general, absent the minimum net capital requirements, there might be greater opportunities for more competition among entities that are engaging in dealing activities in the security-based swap market, which in turn might lower transaction costs and increase liquidity in this market.

However, higher minimum capital requirements for ANC broker-dealers, including ANC broker-dealer SBSDs, are intended to mitigate the risk of disruptions to financial markets by supporting the scale and scope of activities that these entities engage in. An ANC broker-dealer SBSD will be able to engage in the entire spectrum of activities that are traditionally associated with large ANC broker-dealers, including prime brokerage services, securities lending, financing assets for clients (*e.g.,* financing securities on margin). The ability to use internal models for the purpose of calculating net capital further allows ANC broker-dealers, including ANC broker-dealer SBSDs, to engage in these activities at a scale that is far larger than that of non-ANC broker-dealers. The same applies to the security-based swap market, where ANC broker-dealers, including ANC broker-dealer SBSDs, can enter into new transactions at a lower cost compared to broker-dealers and nonbank SBSDs that do not use internal models. Two reasons underpin this conclusion. First, the model-based haircuts for market risk exposure on a security-based swap position are typically much smaller than the standardized haircuts for the same position. Second, an ANC broker-dealer that holds both cash securities positions and security-based swap positions (or otherwise offsetting positions) can further reduce these model-based haircuts by taking advantage of the natural hedge between these two types of instruments within a portfolio.

Relative to broker-dealers and nonbank SBSDs that do not use internal models, ANC broker-dealers, including those registered as SBSDs, can enter security-based swap transactions at lower cost and therefore may trade in larger volumes. However, more volume could expose an ANC broker-dealer, including an ANC broker-dealer SBSD, to either a higher incidence of losses or an increase in the size of the losses. The former could happen when more volume is achieved by expanding the portfolio of security-based swaps, while the latter could happen when more volume is achieved by increasing the size of the positions. Generally speaking, a broker-dealer or an SBSD that neutralizes both the market risk of all its security-based swap positions (*i.e.,* it hedges or book-matches all its security-based swap positions) and the counterparty risk (*e.g.,* by collecting variation and initial margin) should have minimal remaining exposure to losses on its portfolio of security-based swap positions. In contrast, when neither market risk nor counterparty risk is neutralized, the broker-dealer or the SBSD may be exposed to losses from its security-based swap positions. As discussed in more detail below, an ANC broker-dealer, including an ANC broker-dealer SBSD, may not fully neutralize counterparty risk for its positions with counterparties that are subject to a margin collection exception, because ANC broker-dealers, including ANC broker-dealers SBSDs, are allowed to take the alternative credit risk charge, as applicable, instead of the 100% capital deduction for transactions in derivatives instruments with counterparties, including uncollected margin from these counterparties. The alternative credit risk charge is typically much smaller than the 100% capital deduction, and therefore an ANC broker-dealer, including an ANC broker-dealer SBSD, may incur losses from exposure to counterparty risk. These losses could scale up with the ANC broker-dealer's trading activity on security-based swap market. In addition, as discussed above, an ANC broker-dealer may also incur losses from exposure to market risk from security-based swap positions that are subject to a margin collection exception or that are not book-matched, and these losses could also scale up with the ANC broker-dealer's trading activity.

The potential losses from security-based swap trading activity are on top of the losses that an ANC broker-dealer may incur from its activities that are not related to trading in security-based swap market (*e.g.,* swap market). The 2% margin factor requirement will create a capital buffer to cover potential losses from security-based swap trading activity that is sensitive to the risks arising from security-based swap exposures. It does not increase with respect to swaps activity. However, swaps will be subject to the model-based haircuts applied by ANC broker-dealers and uncollateralized exposures arising from swap transactions will be subject to the credit risk charges. Moreover, to the extent an ANC broker-dealer engages in more than a *de minimis* amount of swap activity, it will need to register as a swap dealer and be subject to the CFTC's minimum capital requirements when they are adopted and with the CFTC's margin rules for non-cleared swaps.

Two commenters argue that the fixed component of the final capital rules will act as a barrier to entry for prospective dealers that want to register as ANC broker-dealers, and could force incumbent dealers that cannot maintain these minimum capital requirements to exit the industry.[1085] As discussed above and at the beginning of the section, less conservative capital requirements for ANC broker-dealers could compromise the safety and soundness of this type of broker-dealer. The use of models allows ANC broker-dealers to economize on the regulatory capital required to open and maintain positions in the security-based swap market, which, in turn, allows them to trade in larger volumes compared to other broker-dealers. However, more volume could expose ANC broker-dealers to more overall losses, and therefore ANC broker-dealers should maintain higher levels of capital compared to other types of broker-dealers. In addition, since losses from trading activity in the security-based swap market add to the losses that ANC broker-dealers may incur from other activities unrelated to security-based swap market, the capital requirements for ANC broker-dealer SBSDs should be at least as conservative as the capital requirements for ANC broker-dealers under Rule 15c3–1.

The higher minimum net capital thresholds for ANC broker-dealers in the final capital rule and amendments could be regarded as a barrier to entry for broker-dealers that want to register as ANC broker-dealer, regardless of whether they engage in security-based swap dealing activity. As noted above, the minimum net capital requirements for ANC broker-dealers can impose substantial costs on non-ANC broker-dealers that want to register as ANC broker-dealers, relative to the baseline. For example, any non-ANC broker-dealers with tentative net capital below $5 billion and that want to register as an ANC broker-dealer would need to raise enough capital to meet the $6 billion early warning threshold in the final capital rules.

The higher minimum capital requirements for ANC broker-dealers may be a barrier to entry for prospective nonbank SBSDs that want to register as ANC broker-dealers. However, to the extent that potential new entrants are able to operate effectively in these markets as stand-alone SBSDs (*i.e.,* SBSDs that are not registered as broker-dealers), they will be eligible for lower minimum capital requirements and able to compete for security-based swap dealing business without the heightened requirements for ANC broker-dealers. For instance, a stand-alone SBSD could seek the Commission's approval to use an internal model for the purpose of calculating its net capital. The Commission believes that most nonbank SBSDs will seek approval to use an internal model for this purpose.

As discussed above in section VI.A. of this release, 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 446 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.[1086] At the same time, the minimum capital requirements could discourage entry by entities other than the approximately 446 broker-dealers that already have capital in excess of the required minimums.

One commenter suggested that the Commission provide a detailed quantitative analysis of the costs associated with capital requirements for nonbank SBSDs.[1087] Other commenters suggested that the Commission provide an analysis that supports the quantitative requirements of the proposed 8% margin factor.[1088] However, in order to provide a reliable quantitative analysis of these costs, the Commission would have to make significant assumptions about individual firms' ultimate organizational structure. In particular, the Commission would have to make assumptions about how much of U.S. security-based swap dealing activity would eventually be housed in nonbank SBSDs rather than in bank SBSDs not subject to the Commission's capital rules. In addition, the Commission would have to make further assumptions about the number of nonbank SBSDs that register as stand-alone SBSDs, as opposed to broker-dealer SBSDs. Such assumptions are highly speculative in nature. Moreover, the minimum capital requirements may not bind for all nonbank SBSDs; any estimate of capital costs would depend on assumptions about the amount of capital that those entities assumed to register as nonbank SBSDs currently carry.[1089]

[1085] *See* Better Markets 1/23/2013 Letter; MFA 2/23/2013 Letter.

[1086] According to the most recent version (*i.e.,* 2017) of the Focus Report statistics that the Commission publishes on a periodic basis, carrying broker-dealers are financed with 5.4% equity capital and 94.6% liabilities, on average. Of these liabilities, 34.7% consist of repurchase agreements, 10.9% consist of other non-subordinated debt, and 3% consist of subordinated debt. The other non-subordinated debt includes publicly issued commercial paper and corporate bonds. The average overnight Treasury GC repo rate from a daily survey of the primary dealers for 2017 was 90 basis points. These estimates are derived from the data on the overnight Treasury GC repo primary dealers survey rate collected by the Federal Reserve Bank of New York on a daily basis, *available at https://www.newyorkfed.org/medialibrary/media/markets/HistoricalOvernightTreasGCRepoPriDealerSurvRate.xlsx.* In contrast, the average 3-month AA-rated financial commercial paper rate for 2017 was 106 basis points. These rates provide an incomplete but informative picture of the costs that broker-dealers face in raising new capital.

[1087] *See* Sutherland Letter.

[1088] *See* FIA 11/19/2018 Letter; Morgan Stanley 11/19/2018 Letter; SIFMA 11/19/2018 Letter.

[1089] In addition, under the final rules, minimum capital requirements vary across entities that are authorized to use models and entities that use standardized haircuts; any estimates of the costs associated with capital requirements for nonbanks SBSDs require the Commission to make assumptions about the number of entities the Commission approves to use models in the future. In section IV.C. of this release, the Commission estimates that out of 25 estimated nonbank SBSDs, 14 will use models to calculate model-based haircuts (10 ANC broker-dealer SBSDs and 4 stand-alone SBSDs). The Commission expects that 8 nonbank SBSDs (6 broker-dealer SBSDs and 2 stand-alone SBSDs) will use standardized haircuts. The Commission expects the remaining 3 stand-alone SBSDs to elect the alternative compliance mechanism under Rule 18a-10. Even with these

Continued

In response to these comments, with respect to the proposed 8% margin factor, section VI.A.2. of this release contains an analysis of the risk margin amount of current dealers based on their current level of trading activity. The Commission has used this analysis to provide a range of estimates for the potential costs of complying with the final 2% margin factor requirement, under certain assumptions.

The first of these assumptions is that, at the time when the final rules are implemented, a dealer that would register as nonbank SBSD has a level of trading activity (*i.e.,* legacy transactions) that falls within the range of trading activity currently observed among current dealers. Because it is uncertain which of the current dealers will register as nonbank SBSDs, and because risk margin amounts vary widely across dealing entities, this assumption allows the Commission to focus on the costs of the requirement on the average nonbank SBSD from its legacy security-based swap positions at the time of the implementation produced by the range of trading activity currently observed among current dealers.

The second and third assumptions are related to net capital requirements. The second assumption is that current dealers will be required to hold more capital as a result of the 2% margin factor (and the Rule 15c3–1 financial ratio, if applicable,) than the fixed-dollar amounts of $20 million (for all stand-alone SBSDs, and for broker-dealer SBSDs not authorized to use models) and $1 billion (for broker-dealer SBSDs authorized to use models) because their security-based swap positions are sufficiently large or risky. In other words, likely nonbank SBSDs have sufficient levels of security-based swap positions that the 2% margin factor is relevant for calculation of required net capital. The third assumption is that dealers that are likely to register as nonbank SBSDs currently maintain only enough capital to cover the market and credit risk exposures of their positions, so that current levels of net capital represent the minimum level of net capital required under the baseline. Because the final capital rules also require that a nonbank SBSD take capital charges with respect to the market and credit risk exposures from its legacy transactions, this assumption allows the Commission to focus on the impact of legacy transactions on the minimum net capital, generally, and the final 2% margin factor, specifically.

Under these assumptions, the Commission estimates the initial capital impact of the 2% margin factor (*i.e.,* percent multiplier set to 2%) on a nonbank SBSD to range from $0.03 million to $66.04 million, depending on the year and on where the SBSD's level of trading activity from legacy transactions falls within the range of trading activity currently observed among current dealers. Within this range, the average initial capital impact of the 2% margin factor can be estimated in each sample year and the average impact is between $5.2 million and $15.35 million. However, the precision of the estimate of the average initial capital impact of the 2% margin factor varies significantly over the sample years. For example, the $5.2 million estimate has the highest precision with the shortest 95% confidence interval, namely $2.74 million to $7.67 million. In contrast, the $15.35 million estimate has the lowest precision with the longest 95% confidence interval, namely $8.52 million to $22.19 million.[1090]

A nonbank SBSD will have to compare the initial capital impact of the 2% margin factor against the fixed component of the minimum net capital requirement to determine the amount of capital it needs to comply with the minimum capital requirement. For example, for a stand-alone SBSD, the capital needed to comply with the minimum net capital requirement will be the greater of $20 million or the 2% margin factor.

Similarly, if the percent multiplier of the margin factor requirement increases by f% from the initial percent multiplier, 2%, or other interim percent multiplier, the additional capital impact of the requirement on nonbank SBSDs due to this increase would be the initial capital impact of the requirement estimated above multiplied by f/2. For example, if the percentage multiplier increases from 2% to 3% (*i.e.,* f = 1), the additional capital impact on SBSDs due to this change equals the initial capital impact estimated above multiplied by 0.5.

In addition, and to further respond to comments, a more limited analysis that focuses exclusively on registered broker-dealers that would potentially register as broker-dealer SBSDs (*e.g.,* because the security-based swap dealing affiliate of a broker-dealer is folded into the broker-dealer, which then registers as a broker-dealer SBSD) can provide an indication of the costs. As discussed above, if the 5 ANC broker-dealers were to consolidate their SBSD subsidiaries and register as an ANC broker-dealer SBSD, they would incur no additional capital requirements because their current capital levels already exceed the early warning tentative net capital threshold of $6 billion. An additional 11 broker-dealers that have between $5 billion and $6 billion in tentative net capital but are not ANC broker-dealers could register as nonbank ANC broker-dealer SBSDs. Assuming that all these 11 broker-dealers do so, their total additional tentative net capital shortfall is capped at $11 billion. Of the remaining broker-dealers whose tentative net capital range between $1 billion and $5 billion, it is not clear if any of them would consider registering as a nonbank ANC broker-dealer SBSD. To the extent that one such broker-dealer does register, its potential tentative net capital shortfall would range between $1 billion and $5 billion.

One commenter believed that the proposed rule would impose costs that are disproportionate to the risks of security-based swap dealing activity.[1091] More specifically, this commenter believed that the proposed 8% margin factor would require the maintenance of resources far in excess of the risks posed by an SBSD's exposures, and that the 100% deduction for collateral held by third-party custodians and legacy account positions were excessive, and inconsistent with other regulators. This commenter stated that, at the time of the letter, the ANC broker-dealers have

estimates, the Commission would need to make assumptions about the distribution of dealing activity across bank and nonbank SBSDs, as well as the amount of capital these nonbank SBSDs currently carry. Given this uncertainty, the Commission does not believe that its estimates of the numbers of registered SBSDs would assist in producing reliable estimates of capital costs.

[1090] The Commission calculates the range for the initial capital impact of the 2% margin factor by multiplying the minimum and maximum risk margin amounts across sample years in Table 2, Panel A, of Section VI.A.2. of this release by 2%. For example, $66.04 million equals 2% multiplied by the maximum risk margin amount over the sample years (*i.e.,* $3,303.12 million). The Commission calculates the range for the average initial capital impact of the 2% margin factor by multiplying the average risk margin amount in each sample year by 2%. For example, the average initial capital impact of the 2% margin factor based on the 2008 sample is $15.35 million and equals 2% multiplied by the average risk margin amount for that sample year (*i.e.,* $767.76 million). Assuming that the risk margin amounts are approximately normally distributed, the Commission calculates the 95% confidence interval around an estimate by subtracting (for the lower end of the interval) or adding (for the upper end of the interval) 1.96 multiplied by the standard error of the mean, which is defined as the standard deviation for the sample divided by the square root of the sample size. Each of the annual samples has the same size, namely 22. For example, the lower end of the 95% confidence interval for $15.35 million estimate is $8.52 million and equals $15.35 million—1.96 * (2% * $817.96 million)/√22. Similarly, the upper end of that interval is $22.19 million and equals $15.35 million + 1.96 * (2% * $817.96 million)/√22.

[1091] *See* SIFMA 2/22/2013 Letter.

preliminarily projected that, in light of the severity of these requirements, the amount of capital that would be required for the single business line of security-based swap dealing under the proposal would exceed $87 billion, the amount of capital currently devoted to all of those firms' securities businesses combined, including investment banking, prime brokerage, market making, and retail brokerage.[1092]

In response to this commenter, as noted above, the 2% margin factor would be relevant for nonbank SBSDs that engage in an amount of security-based swap activity that requires more supporting capital than the fixed-dollar minimum capital thresholds. As discussed at the beginning of this section, these types of nonbank SBSDs are instrumental for the overall liquidity provision in the security-based swap market, and, given their centrality in this market, they have to be adequately capitalized. To this end, the 2% margin factor is intended to ensure that the minimum capital requirements of these central SBSDs scale proportionally with their trading activity. As further noted above, the 2% margin factor also will help address the issue of funding the replacement cost or close-out costs of a nonbank SBSD's positions with a failed counterparty, when the margin collected from the counterparty is temporarily unavailable or was not collected because of an exception in the margin rules.

With regard to the commenter's estimated $87 billion in capital needed for the ANC broker-dealers to become compliant with the final capital rules, most of these costs were the result of the proposed 100% capital deduction for initial margin collected but held at third-party custodians, the proposed 100% capital deduction for initial margin posted away, and the proposed 100% capital deduction for uncollateralized legacy security-based swaps. Modifications to the final rules should help reduce the costs to the ANC broker-dealers of becoming compliant with the new requirements. The final capital rules contain a provision that allows nonbank SBSDs to avoid any capital deduction for initial margin held at a third-party custodian under certain conditions. Similarly, this release contains guidance with respect to Rules 15c3–1 and 18a–1 for a method by which the nonbank SBSD could fund the initial margin posted to a counterparty through an affiliate and avoid taking a 100% deduction for initial margin posted away. Finally, under the final rules, an ANC broker-dealer (including an ANC broker-dealer SBSD) and a stand-alone SBSD approved to use models for capital purposes can apply a credit risk charge with respect to uncollateralized exposures arising from transactions in derivatives instruments, including exposures arising from not collecting variation and/or initial margin pursuant to exceptions in the non-cleared security-based swap and swap margin rules of the Commission and CFTC, respectively. In particular, the final rule, unlike the proposed rule, allows ANC broker-dealer SBSDs to avoid taking a 100% capital deduction in lieu of margin for legacy security-based swaps and instead take an alternative credit risk charge.[1093] This credit risk charge is usually much smaller than the 100% capital charge, which should further reduce the costs to the ANC broker-dealers of becoming compliant with the capital requirements of nonbank SBSDs.

ii. Capital Charge for Posting Initial Margin

As discussed above, if a nonbank SBSD delivers initial margin to another SBSD or other counterparty, it must take a capital deduction in the amount of the posted collateral.[1094] This capital deduction will increase the nonbank SBSD's transaction costs because the nonbank SBSD will incur a cost to obtain the capital to account for the deduction, a cost that it need not incur in the absence of such a deduction. To the extent that nonbank SBSDs pass on the increased transaction costs to their customers in the form of higher prices for liquidity provision, those customers could incur higher costs when transacting with nonbank SBSDs in the security-based swap market. The degree to which the increased transaction costs could be passed on to customers depends in part on the intensity of competition for liquidity provision in the security-based swap market. If competition for liquidity provision is strong, nonbank SBSDs may pass on a smaller portion of the increased costs to customers in order to stay competitive. Conversely, if competition for liquidity provision is more limited, nonbank SBSDs may pass on a larger portion of the increased costs to customers. The effects discussed above could be mitigated if nonbank SBSDs avoid the capital deduction by following the Commission's interpretive guidance as discussed above in section II.A.2.b.i. of this release. In addition to the preceding, the capital deduction could affect the competition between nonbank SBSDs and bank SBSDs, as discussed below in section VI.D.2. of this release.

iii. Capital Deductions in Lieu of Margin

The final capital rules and amendments require that nonbank SBSDs take capital deductions in lieu of margin with respect to non-cleared security-based swap transactions when the SBSD has failed to collect required margin or has elected to not collect margin pursuant to an exception in the margin rules of the Commission or the CFTC. Deductions in lieu of margin are designed to address the risks associated with exposures to counterparties and may incentivize the nonbank SBSD to collect margin even when it is not required to do so under the rules. In general, the capital deductions in lieu of margin for uncollateralized exposures from security-based swap or swap positions will be 100% of the amount of the uncollected margin (*i.e.,* dollar for dollar). However, nonbank SBSDs approved to use internal models for the purpose of calculating net capital will be allowed to take a model-based credit risk charge as an alternative to the 100% capital deduction. As discussed below

[1092] The commenter stated that the six SIFMA member firms who operate as ANC broker-dealers estimated the amount capital currently devoted to their securities businesses by determining the amount of capital, after deductions for non-allowable assets and capital charges, necessary for them to have net capital in excess of the early warning level specified in Rule 17a–11. However, the majority of the estimated costs flowed from the proposed 100% capital deduction for initial margin collected but held at third-party custodians, the proposed 100% capital deduction for initial margin posted away, and the proposed 100% capital deduction for uncollateralized legacy security-based swaps. As discussed above in section II.A. of this release and further below, the final rules include significant modifications to these requirements, as proposed.

[1093] As discussed above, for non-cleared security-based swaps and swaps, a capital deduction in lieu of margin must be taken when the SBSD elects not to collect margin under an exception in the Commission's rule for non-cleared swaps (including the exception for legacy security-based swaps) or an exception for initial margin for swap transactions under the CFTC's margin rules. These capital deductions in lieu of margin are for 100% of the amount of margin that would have been collected. However, a nonbank SBSD authorized to use models can apply a credit risk charge rather than take this deduction (which may result in significantly less than a 100% deduction). An ANC broker-dealer, including an ANC broker-dealer SBSD, must take a portfolio concentration charge for uncollateralized current exposures to the extent the amounts to which the credit risk charges are applied, in the aggregate, exceed 10% of the firm's tentative net capital. A 100% capital charge will apply to the amount that exceeds 10% of the firm's tentative net capital.

[1094] Furthermore, under the final capital rules, stand-alone broker-dealers and nonbank SBSDs may treat margin collateral posted to a clearing agency for cleared security-based swaps or to a DCO for cleared swaps as a ''clearing deposit'' and, therefore, not deduct the value of the collateral from net worth when computing net capital. *See* paragraph (c)(2)(iv)(E)(*3*) of Rule 15c3–1, as amended; paragraph (c)(1)(iii) of Rule 18a–1, as adopted.

in section VI.B.1.b.v. of this release, these credit charges could be substantially smaller than the comparable 100% capital deductions.

The final capital rules do not require that nonbank SBSDs take a capital deduction for the difference between clearing agency or DCO margin requirements for customers' cleared security-based swaps and the haircuts that would apply to those positions if they were proprietary positions, as was proposed.[1095]

As discussed above in section II.A.2.b.ii. of this release, broker-dealers and nonbank SBSDs will be required to take a deduction for under-margined accounts because of a failure to collect margin required under Commission, CFTC, clearing agency, DCO, or designated examining authority rules (*i.e.,* a failure to collect margin when there is no exception from collecting margin). Nonbank SBSDs are also required to take capital deductions in lieu of margin when an exception to the final margin rule applies, such as where the initial margin falls below the $50 million threshold or the counterparty is a financial market intermediary. In addition, the Commission modified the final capital rules from the proposal such that nonbank SBSDs will be required to take capital deductions in lieu of margin with respect to uncollected margin on swap positions that are subject to a variation or initial margin exception in the rules of the CFTC. The Commission has also added an exception in the final rule that allows a nonbank SBSD to treat initial margin with respect to a non-cleared security-based swap or swap held at a third-party custodian as if the collateral were delivered to the nonbank SBSD and, thereby, avoid taking the capital deduction for failing to hold the collateral directly.

As discussed above, the final capital rules are designed to enhance the safety and soundness of nonbank SBSDs by requiring them to take capital deductions in situations where collateral is not available to cover counterparty exposures. The capital buffer created by capital deduction or charge is designed to complement the capital buffer created by other capital requirements (*e.g.,* minimum net capital) to permit a nonbank SBSD to cover losses from uncollateralized exposures. The capital deduction and charges are also designed to incentivize a nonbank SBSD to collect margin.

The capital deduction in lieu of margin or credit risk charge is intended to perform a particularly important function in an SBSD's non-cleared security based transactions with financial market intermediaries, including with other nonbank SBSDs. A capital deduction in lieu of margin or credit risk charge is required for uncollateralized exposures to other financial market intermediaries from non-cleared security-based swap positions that are subject to an exception of the final margin rule. For transactions with financial market intermediaries, the final margin rule requires that nonbank SBSDs collect and post variation margin but not collect initial margin from these types of counterparties. This means that nonbank SBSDs will have credit exposure (*i.e.,* potential future exposure) to financial market intermediaries, including other nonbank SBSDs, from non-cleared security-based swap transactions. In the event that a financial market intermediary counterparty fails, the nonbank SBSD would have to bear the potential costs of replacing or closing out the positions with the failed counterparty, and, therefore, incur potential losses. Because these positions could be large (*e.g.,* as noted in section VI.A.1.d. of this release, interdealer positions are generally large), the losses that a nonbank SBSD may face as a result of a failed financial market intermediary counterparty could be large, and could eventually precipitate the demise of the nonbank SBSD. Imposing capital deductions in lieu of margin is intended to increase the likelihood that the nonbank SBSD has a buffer of capital to absorb potential losses from uncollateralized exposures to the failed financial market intermediary counterparty. These capital deductions are designed to increase with the size of the positions with the failed counterparty and provide the nonbank SBSD with a capital buffer against potential losses from replacing or closing out these positions. Furthermore, for every new non-cleared and uncollateralized security-based swap position with a financial market intermediary, a nonbank SBSD will be required to increase its net capital (or have sufficient excess net capital) to accommodate the capital deductions resulting from the uncollateralized exposures created by the new position. In other words, a nonbank SBSD cannot enter a new non-cleared security-based swap position with a financial market intermediary that creates uncollateralized exposures without increasing its net capital or having sufficient excess net capital.

The capital deductions for uncollateralized security-based swap exposures to financial market intermediaries create a capital buffer against potential losses from such exposures, and, therefore, reduce the risk of a nonbank SBSD's failure and the potential for sequential SBSD failure. As a result, these deductions and charges should enhance the safety and soundness of the nonbank SBSDs and, therefore, provide an important benefit for market participants that rely on liquidity provision and other services provided by nonbank SBSDs. However, the requirement to take capital deductions in lieu of margin against uncollateralized exposures from security-based swap transactions with financial market intermediaries may impose costs on nonbank SBSDs to the extent that reallocating capital from other activities or raising additional capital to support the SBSD's security-based swap trading activity is costly. These costs could increase a nonbank SBSD's costs of hedging non-cleared security-based swap positions, relative to the baseline. Nonbank SBSDs generally rely on financial market intermediaries to hedge their market risk exposures from non-cleared security-based swaps with other market participants. If transacting with financial market intermediaries becomes more costly, nonbank SBSDs would face higher hedging costs, relative to the baseline. Nonbank SBSDs may pass on these hedging costs to the market participants that access the market for security-based swaps through nonbank SBSDs. Because market participants can access this market through market intermediaries that are not nonbank SBSDs, competitive pressure may limit the extent to which nonbank SBSDs could pass on their potentially higher hedging costs to the market participants.

Nonbank SBSDs will also have to take capital deductions in lieu of margin for uncollateralized exposures from swaps that are subject to an exception in the margin rules of the CFTC. Absent these capital deductions or charges, potential losses from uncollateralized swap exposure to counterparties that are subject to an exception in the margin rules of CFTC may destabilize a nonbank SBSD even if the SBSD is adequately capitalized with respect to its dealing activity in the security-based swap market. Thus, capital deductions for uncollateralized swap exposures create a capital buffer against potential losses from uncollateralized swap positions that should enhance the safety and soundness of a nonbank SBSD that

[1095] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70245–46. *See also Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53009–10.

engages in swap activity. This potential enhancement should benefit the market participants that rely on liquidity provision and other services provided by nonbank SBSDs.

However, the requirement to take capital deductions for uncollateralized swap exposures will also impose costs on nonbank SBSDs, because reallocating capital from other activities to support the SBSD's swap trading activity or raising additional capital is generally costly. These costs may put a nonbank SBSD at a competitive disadvantage compared to a swap dealer that is not a nonbank SBSD and that is not required to take similar capital deduction by the rules of the CFTC. However, under certain conditions, a stand-alone SBSD that engages in limited security-based swap activity may be permitted to use the alternative compliance mechanism to the capital, margin, and segregation requirements of the CEA and the CFTC's rules in lieu of complying with Rules 18a–1, 18a–3, and 18a–4. These rules may not have provisions for such capital charges.

The final capital rules will also require that nonbank SBSDs take a capital deduction in lieu of margin or credit risk charge for legacy security-based swap and swap positions. This requirement is designed to ensure that the nonbank SBSD's credit risk exposures from legacy security-based swap and swap positions are either collateralized (*i.e.,* required variation and initial margin has been collected) or uncollateralized but supported with adequate capital (*i.e.,* the capital deduction in lieu of margin or credit risk charge). Absent this requirement, nonbank SBSDs would be exposed to uncollateralized credit risk from these legacy positions without any compensating capital buffer, which, in turn, would compromise the effectiveness of the final capital rules post implementation.

The requirement could impose costs on some nonbank SBSDs with legacy security-based swap and swap positions because reallocating capital from other activities or raising new capital to support these legacy positions is generally costly. These potential costs generally scale up with the size of the legacy positions.[1096] As discussed above in section VI.A.1.e. of this release, certain dealers that may register as nonbank SBSDs carry large legacy swap positions. The capital deductions on the swap legacy positions and the new swap positions that these firms would face if they were to register as nonbank SBSDs may impact these firms' decision whether to register as nonbank SBSDs, particularly if they plan to maintain a level of swap trading activity similar to the current one. In particular, some firms may choose to register as nonbank SBSDs but keep the swap trading activity outside the SBSD structure. This potential separation of trading activity between security-based swaps and swaps may reduce the benefits that firms currently enjoy from managing risk exposures from these activities on a centralized basis. However, as discussed below, the inter-affiliate exception to the final margin rule for initial margin may offset the change in the benefits from centralized risk management. Alternatively, some firms may choose to maintain a level of security-based swap activity that is sufficiently low to meet the conditions necessary to operate under the alternative compliance mechanism.[1097] As discussed below, nonbank SBSDs that make use of the alternative compliance mechanism will be subject to a different capital, margin, and segregation regime that may offer different protections to the market participants that access the security-based swap market through nonbank SBSDs that us the mechanism relative to nonbank SBSDs that do not. If this difference is not reflected in prices, some market participants may be overpaying for transacting in the security-based swap market (*e.g.,* SBSDs that are subject to different regimes that offer different levels of protection charging their counterparties similar prices).

Nonbank SBSDs that expect to face large costs due to their legacy security-based swap and swap positions may reduce these costs by reassigning a portion of their legacy positions to SBSDs that are subject to a regulatory regime that does not impose these type of capital deductions (*e.g.,* bank SBSDs), prior to the final capital rules and amendments taking effect, as long as such transactions are feasible (*i.e.,* the cost associated with reassigning the legacy positions does not dominate the legacy capital deduction or charge for the position).

The legacy capital deduction for a nonbank SBSD could cause a nonbank SBSD to renegotiate its legacy security-based swaps and swaps with its counterparties immediately after the final capital rules take effect. The incentives of the two parties to renegotiate a legacy security-based swap or swap would depend on the costs of replacing the legacy transaction with the new transaction and how the new transaction would be treated under the final capital and margin rules as compared with the legacy transaction. In particular, if the net effect of these two factors leaves both parties better off, the parties would have an incentive to renegotiate.

The requirement that nonbank SBSDs take a capital deduction in lieu of margin or credit risk charge for their legacy security-based swap and swap positions also reduces the aggregate demand for collateral that nonbank SBSDs would otherwise need to meet the requirements of the final margin rule. Absent such a requirement, counterparties to nonbank SBSDs' security-based swap positions would have to post variation and initial margin at the same time—namely, at the time when the final rules and amendments take effect. This systemic call for margin could be potentially destabilizing for those counterparties that have large legacy security-based swap positions.

Two commenters argued that capital deductions, including those for legacy accounts, impose costs on nonbank SBSDs, which may be passed on, directly or indirectly, to the nonbank SBSD's counterparties.[1098] Other commenters argued that the legacy account deduction is inconsistent with the capital regimes of the prudential regulators and the proposed capital regime of the CFTC, and would result in unwarranted variations in regulated entities' capital requirements, which could lead to market fragmentation.[1099]

In response to these commenters' concerns, to the extent that nonbank SBSDs expect to face large costs due to their legacy security-based swap and swap positions, these SBSDs may reduce these costs by reassigning a portion of their legacy positions to SBSDs that are subject to a regulatory regime that does not impose these type of capital deductions (*e.g.,* bank SBSDs). Furthermore, under certain conditions, a nonbank SBSD may be able to make use of the alternative compliance mechanism and therefore potentially

[1096] If the nonbank SBSD is reallocating capital from other activities to support its legacy positions, the cost to the firm is the opportunity cost associated with those other activities. This cost scales up with the amount of capital being reallocated. If the nonbank SBSD is raising new capital to support its legacy positions, the cost to the firm is the cost of capital that investors demand in return for their capital and the costs associated with underwriting the financial instruments that facilitate the transfer of capital from investors to the firm. Some of these costs (*e.g.,* the cost of capital) scale up with the amount of capital being transferred.

[1097] *See* section II.D. of this release (discussing these conditions and their economic impact).

[1098] *See* PIMCO Letter; SIFMA 2/22/2013 Letter.

[1099] *See* Morgan Stanley 2/22/2013 Letter.

avoid taking capital deductions for legacy positions. This means of avoiding the deductions or charges will depend on whether the CFTC's final capital rules for swap dealers do not include such deductions.

The Commission estimates that most nonbank SBSDs will be authorized to use internal models and therefore will take the credit risk charges instead of the capital deductions in lieu of margin. Under the assumption that dealers that are likely to register as nonbank SBSDs currently maintain only enough capital to cover the market risk exposures of their positions and that they maintain a level of trading activity (*i.e.,* legacy transactions) that falls within the range of trading activity currently observed among current dealers, the Commission estimates that the initial impact of the credit risk charges on a nonbank SBSD to range between 0 and $253.73 million. Within this range, the average initial capital impact of capital charges for credit risk exposures can be estimated in each sample year and the average impact is between $0.41 million and $11.07 million. However, the precision of the estimate of the average initial capital impact of capital charges for credit risk exposures varies significantly over the sample years. For example, among the estimates in the range above, the $0.41 million estimate has a shorter 95% confidence interval, and therefore higher precision, namely $0.32 million to $0.49 million, while the $11.07 million estimate has a longer 95% confidence interval, and therefore lower precision, namely $6.73 million to $15.42 million.[1100]

Nonbank SBSDs will also be required to take a capital deduction in lieu of margin or credit risk charge for initial margin collateral that a counterparty chooses to segregate with an independent third-party custodian if the conditions for qualifying for the exception from taking the charge are not met. These conditions may impose costs on a firm. For example, one condition requires that that the nonbank SBSD must maintain written documentation of its analysis that the tri-party custodial agreement is legal, valid, binding, and enforceable agreement under the laws of all relevant jurisdictions, including in the event of bankruptcy, insolvency, or a similar proceeding of any of the parties to the agreement. However, these conditions are designed so that existing agreements with counterparties entered into for the purposes of the third-party custodian and documentation rules of the CFTC and the prudential regulators will suffice for purposes of the final rule.

Those nonbank SBSDs that do not qualify for the exception will have to take a capital deduction for the initial margin collateral held at a third-party custodian, which they will likely pass on to the counterparties that elect to segregate initial margin in this manner. This cost, if large, may undermine the benefits associated with safeguarding the collateral from a potential default by the nonbank SBSD, and may reduce the appeal of the individual segregation option relative to other options (*e.g.,* omnibus segregation). However, market participants may avoid this cost by choosing to trade with a nonbank SBSD that qualifies for the exception, with a nonbank SBSD that elects to use the alternative compliance mechanism, or with a bank SBSD.

Several commenters suggested that the Commission should eliminate the capital deduction in lieu of margin for margin collateral held at a third-party custodian noting that customers will ultimately incur the additional cost, and the proposed capital charge would make electing individual segregation prohibitively expensive.[1101] Another commenter believed that applying the deduction would also make such collateral arrangements prohibitively expensive, frustrating Congress's clear intention that such arrangements should be available to counterparties.[1102] Several commenters noted that the SBSDs would simply pass on the capital charge to the counterparties, which would undermine the benefits of third-party segregation.[1103] Some commenters suggested that, at a minimum, the capital charge should be waived where custodian arrangements meet robust legal and operational criteria to ensure the nonbank SBSD's access to collateral in the event of counterparty default.[1104] One commenter stated that the third-party custodian deduction would make nonbank SBSDs uncompetitive and would result in huge disparities in capital requirements for bank and nonbank SBSDs engaged in identical market activities.[1105] Two commenters expressed concerns with the implementation costs of the provision, generally, and the inclusion of a legal opinion, specifically.[1106]

In response to commenters' concerns regarding the impact of the capital deduction for margin collateral held at a third-party custodian, as discussed above, the final capital rules contain a provision that will allow nonbank SBSDs to avoid taking this capital deduction all together, if they meet certain conditions. In particular, this provision will make third-party segregation a viable option for market participants that prefer to access the security-based swap market using a nonbank SBSD that qualifies for the exception.

Furthermore, in response to commenters' concerns regarding the potential conditions for the exception that were asked about in the 2018 comment reopening, in the final rule, the Commission has balanced the potential difficulties in obtaining a legal opinion of outside counsel with the need for the broker-dealer or nonbank SBSD to enter into a custodial agreement that will operate as intended under the relevant laws. Therefore, the final rules do not require the broker-dealer or nonbank SBSD to obtain a legal opinion of outside counsel. Instead, the final rules require the

[1100] The Commission calculates the range for the initial capital impact of the capital charges for credit risk exposures by multiplying the minimum and the maximum risk margin amounts across sample years in Table 2, Panel B, of section VI.A.2. of this release with the lower bound and upper bound of the range of estimates for the size of the credit risk charge as a fraction of the 100% capital deduction calculated in section II.B.1.b.v. of this release (*i.e.,* 4.8% and 48%). For example, $253.73 million equals 48% multiplied by the maximum risk margin amount over the sample years (*i.e.,* $528.61 million). The Commission calculates the range for the average initial capital impact of the capital charges for credit risk exposures by multiplying the average risk margin amount in each sample year with the upper and lower bounds of the range of estimates for the size of the credit risk charge as a fraction of the 100% capital deduction. For example, the average initial capital impact of the capital charges for credit risk exposures based on the 2017 sample is $11.07 million and equals the average risk margin amount for that sample year (*i.e.,* $23.07 million) multiplied by the upper bound of the range above (*i.e.,* 48%). Assuming that the risk margin amounts are approximately normally distributed, the Commission calculates the 95% confidence interval around an estimate by subtracting (for the lower end of the interval) or adding (for the upper end of the interval) 1.96 multiplied by the standard error of the mean, which is defined as the standard deviation for the sample divided by the square root of the sample size. Each of the annual samples has approximatively the same size, namely 170. For example, the lower end of the 95% confidence interval for the $11.07 million estimate is $6.73 million and equals $11.07 million − 1.96 * (48% * $60.24 million)/√170. Similarly, the upper end of that interval is $15.42 million and equals $11.07 million + 1.96 * (48% * $60.24 million)/√170.

[1101] *See* AIMA 2/22/2013 Letter; American Benefits Council, et al. 5/19/2014 Letter; Financial Services Roundtable Letter; ICI 12/5/2013 Letter; MFA 2/22/2013 Letter; MFA 2/24/2014 Letter; Morgan Stanley 2/22/2013 Letter; SIFMA AMG 2/22/2013 Letter; SIFMA 2/22/2013 Letter.

[1102] *See* ICI 12/5/2013 Letter; MFA 2/24/2014 Letter; Morgan Stanley 2/22/2013 Letter.

[1103] *See* American Council of Life Insurers 11/19/2018 Letter; ICI 11/19/2018 Letter; SIFMA 11/19/2018 Letter.

[1104] *See* ICI 12/5/2013 Letter; MFA 2/24/2014 Letter; Morgan Stanley 10/29/2014 Letter; SIFMA 2/22/2013 Letter.

[1105] *See* SIFMA 2/22/2013 Letter.

[1106] *See* ICI 11/24/2014 Letter; SIFMA AMG 11/19/2018 Letter.

broker-dealer or nonbank SBSD to maintain written documentation of its analysis that in the event of a legal challenge the relevant court or administrative authorities would find the account control agreement to be legal, valid, binding, and enforceable under the applicable law, including in the event of the receivership, conservatorship, insolvency, liquidation, or a similar proceeding of any of the parties to the agreement. This documentation requirement will benefit the parties involved by reducing legal uncertainty about whether and when such an agreement is binding, and mitigating the risk of litigation (and its associated costs) among parties to the agreement. Absent such requirement, the costs associated with such litigation could be passed on to the party to the agreement that requested individual segregation (*e.g.,* the counterparty to a nonbank SBSD), potentially increasing the cost of electing this form of segregation.

The final capital rules will also require nonbank SBSDs to take a capital deduction in lieu of margin or credit risk charge for uncollected initial margin amounts from commercial end users, sovereign entities, the BIS, the European Stability Mechanism, and certain multilateral development banks. In addition, the final rule and amendments also require that nonbank SBSDs take a capital deduction in lieu of margin or credit risk charge with respect to unsecured receivables arising from electing not to collect variation margin from commercial end users, the BIS, the European Stability Mechanism, and certain multilateral development banks.

Finally, the final capital rules will also require nonbank SBSDs to take a capital deduction in lieu of margin or credit risk charge for electing not to collect initial margin under other exceptions in the margin rules for non-cleared security-based swaps and swaps, such as the $50 million initial margin threshold exception of Rule 18a–3.

A nonbank SBSD will also be required to take a capital deduction in lieu of margin or credit risk charge for uncollateralized credit risk exposure created by non-cleared security-based swaps with an affiliate (*i.e.,* pursuant to an initial margin exception for affiliates). Parent companies of nonbank SBSDs may rely on inter-affiliate transactions to manage risk exposures within the organization. For example, a nonbank SBSD and a bank affiliate that share the same parent may have exposure to the same entity as a result of dealing in security-based swaps and as a result of extending credit (*e.g.,* loans), respectively. The parent may decide to minimize its overall exposure to the entity by having the nonbank SBSD and the bank affiliate enter into a security based swap with each other (*i.e.,* an inter-affiliate transaction). This centralized management of risk exposures may benefit the parent and its affiliates. The requirement that nonbank SBSDs take a capital deduction in lieu of margin or credit risk charge for inter-affiliate security-based swap transactions may impose costs on nonbank SBSD—such as costs associated with reallocating capital from other activities or from raising new capital—that may reduce the benefits associated with managing risk exposures on a centralized basis.

Nonbank SBSDs will likely pass on the potential costs associated with these capital deductions or charges to these counterparties. Some counterparties may prefer to incur this cost and enter an uncollateralized transaction rather than incurring the opportunity cost of reallocating capital from other activities (*e.g.,* productive capital) to finance margin collateral and enter a collateralized transaction. Market participants, however, may be able to avoid these indirect costs of transacting with a nonbank SBSD entirely by accessing the security-based swap market through SBSDs that are not subject to similar capital deductions, such as a bank SBSD or a nonbank SBSD that is subject to the alternative compliance mechanism. Thus, competitive pressure from these SBSDs may limit the extent to which a nonbank SBSD is able to pass on the costs associated with these capital deductions to their counterparties.

At the same time, uncollateralized exposures from inter-affiliate security-based swaps may expose a nonbank SBSD to the failure of its affiliates. While some of the affiliates may themselves be subject to regulatory capital and margin requirements, others may not (*e.g.,* a hedge fund affiliate). In particular, some affiliates may operate with minimal levels of capital that, while privately optimal, may not be adequate for the level of risk associated with their positions. The failure of such an affiliate may destabilize a nonbank SBSD that has an uncollateralized exposure to this affiliate. The requirement to take a capital deduction for uncollateralized inter-affiliate exposures should reduce the likelihood that the failure of a counterparty that is an affiliate of the nonbank SBSD may cause the SBSD to fail. From this perspective, the requirement may enhance the safety and soundness of a nonbank SBSD that engages in inter-affiliate transactions, which, in turn, may benefit the market participants that rely on liquidity provision and other services provided by nonbank SBSDs.

iv. Standardized Haircuts for Security-Based Swaps

Standardized haircuts are applied to a firm's proprietary positions, and deducted from tentative net capital to calculate the firm's net capital. Nonbank SBSDs may apply model-based haircuts to positions for which they have been authorized by the Commission to use models. For all other types of positions, a nonbank SBSDs must use the standardized haircuts.

The standardized CDS haircut grids in the final rules are unchanged relative to the 2012 proposal; however, in the final rule, they are only applied to non-cleared CDS. The number of maturity and spread categories in the grids for single-name and index CDS are based on staff's experience with the maturity grids for other securities in Rule 15c3–1 and, in part, on FINRA Rule 4240. The standardized haircuts for cleared security-based swaps and swaps will be the applicable clearing agency margin or DCO margin requirements.

The offsets recognized under the standardized haircut approach for calculating net capital may permit a nonbank SBSD that relies on this approach to deploy the capital savings that are the result of these offsets in other areas of operations more efficiently, as well as enhance operational efficiencies.

The benefit of the standardized haircut approach of measuring market risk, besides its inherent simplicity, is that, compared to the model-based approach, 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 internal models are an integral part, or capital levels to support the use of internal models. Therefore, the standardized haircut approach, in turn, may improve customer protections and reduce the likelihood of a nonbank SBSD's failure compared to the model-based approach. In addition, a standardized haircut approach may reduce costs for the nonbank SBSD compared to the model-based approach related to the risk of failing to observe or correct a problem with the use of internal models that could adversely impact the firm's financial condition, because the use of internal models will require the allocation by the nonbank SBSD of additional firm resources and personnel.

Conversely, if the standardized haircuts are too conservative, security-based swap business may face increased transaction costs and be unable to engage security-based swap transactions. This would reduce liquidity, and reduce the availability of security-based swaps, including for risk mitigation by financial market intermediaries and end users.

The standardized haircut approach for calculating net capital in the final rules, like other types of standardized haircuts, will likely require a higher amount of capital to support open security-based swap positions in contrast to the model-based approach. While the standardized haircuts, including the non-cleared CDS grids, recognize certain offsets, standardized haircuts generally result in higher capital charges because the standardized approaches do not recognize all ways in which a nonbank SBSD might offset its exposures, and impose a relatively conservative charge for the remaining (net) exposure. The higher capital charges resulting from using the standardized haircuts 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 security-based swaps in general will likely choose to use the more cost-efficient models to measure and manage the risks of their positions over time. Moreover, while the standardized approach may result in higher haircuts, ANC broker-dealers and stand-alone SBSDs that will use the model-based approach will be subject to higher minimum capital requirements and ongoing monitoring with respect to their use of and governance over the models.

One commenter expressed concerns with the magnitude of the standardized haircuts relative to the model-based haircuts and suggested that the Commission perform a more thorough review of the standardized haircuts required by the proposed CDS grids based on empirical data on historical volatility and loss given default.[1107] The commenter also suggested that the Commission conduct further economic analysis to confirm that the standardized haircuts are appropriately tailored to the risk of the relevant positions and suggested that the analysis should be based on quantitative data regarding the security-based swap and swap markets since the enactment of the Dodd-Frank Act.[1108] In response to the commenters, the standardized haircut grids in the final rules are based on existing Rule 15c3–1 and, in part, on FINRA Rule 4240, and will apply to non-cleared CDS. Furthermore, as discussed above in section VI.A.7 of this release, the Commission has provided an analysis of the extreme but plausible losses on CDS positions observed from historical data.[1109] The Commission uses this analysis to measure the extent to which the extreme but plausible loss in a cell is covered by the associated standardized haircut. To this end, the Commission calculates the loss divided by the standardized haircut, which is referred to as the ''loss coverage ratio.'' If this ratio is smaller than or equal to 1, then the standardized haircut covers the loss. If this ratio is larger than 1, then the haircut does not fully cover the loss. The Commission summarizes the distribution of loss coverage ratios for all cells in the grid by calculating a number of statistics, including the mean, standard deviation, and the range. The Commission reports the summary statistics for each year sample in Table 4. Panels A and B of Table 4 focus on short and long CDS positions that reference single-name obligors, while panels C and D of Table 4 focus on short and long CDS positions that reference broad-based securities indexes. For each panel the Commission uses the standardized haircut grids, as specified by the final rules.

With respect to short CDS referencing single-name obligors (Table 4, Panel A), the mean of the loss coverage ratio is below one in all annual samples except the 2008 sample. In response to the commenter, based on this analysis, the standardized haircuts would not, on their own, cover losses similar to the losses of short single-name CDS positions in the 2008 sample. However, with the exception of 2008, the standardized haircuts are sufficiently large to cover the losses of these positions, on average. The average loss coverage ratio in the 2011–2018 samples ranges from 38% to 59%. For 2008, the average loss coverage ratio is 1.07 meaning that the average loss in 2008 exceeds the appropriate haircut by about 7%. For long CDS referencing single-name obligors (Table 4, Panel B), the average loss coverage ratio ranges from 55% to 82%. This result suggests that the proposed haircuts for long CDS referencing single-name obligors are sufficiently large to cover the losses of these positions, on average. Moreover, the requirements in the final capital rules to mark-to-market the value of positions in computing net capital and to maintain the required minimum amount of net capital at all times are designed to ensure that a firm maintains sufficient regulatory capital during periods of volatility.

With respect to CDS referencing a broad-based securities index, the results are qualitatively similar, but the magnitudes are slightly different. For instance, while the average loss coverage ratio is usually not as high as for single-name CDS in the 2011–2018 samples (*i.e.,* the standardized haircuts are more likely to cover losses), the average loss coverage ratio exceeded that for single-name CDS in the 2008 sample (*e.g.,* on the short positions). Further, in contrast to the single-name CDS, the maximum loss coverage ratio can be less than one for CDS referencing a broad-based securities index.

Table 4: Analysis of the Proposed Haircut Grids. This table reports summary statistics of the distribution of loss coverage ratio, which is the extreme but plausible loss divided by the standardized haircut. The summary statistics are Min (minimum), P25 (first quartile/25th percentile), P50 (second quartile/50th percentile), P75 (third quartile/75th percentile), Max (maximum), Mean, and Std (standard deviation).

Single-Name Credit Default Swaps							
Year	Min	P25	P50	P75	Max	Mean	Std
Panel A: Short Positions							
2008	0.43	0.76	0.84	1.13	4.04	1.07	0.64
2011	0.22	0.39	0.45	0.49	2.01	0.56	0.38
2012	0.00	0.21	0.25	0.31	1.86	0.38	0.37
2017	0.07	0.20	0.31	0.44	4.11	0.59	0.86

[1107] *See* SIFMA 2/22/2013 Letter.

[1108] *See* SIFMA 11/19/2018 Letter.

[1109] *See* section VI.A.7. of this release.

Year	Min	P25	P50	P75	Max	Mean	Std
Single-Name Credit Default Swaps							
2018	0.09	0.25	0.36	0.49	2.46	0.52	0.50
Panel B: Long Positions							
2008	0.22	0.41	0.59	0.78	6.23	0.82	0.89
2011	0.20	0.43	0.50	0.58	2.39	0.59	0.38
2012	0.18	0.43	0.52	0.58	2.21	0.59	0.36
2017	0.16	0.39	0.47	0.55	1.85	0.56	0.34
2018	0.10	0.33	0.42	0.56	1.99	0.55	0.41
Index Credit Default Swaps							
Panel C: Short Positions							
2008	0.19	0.31	0.37	2.52	17.61	2.98	4.79
2011	0.07	0.21	0.33	0.43	1.56	0.37	0.27
2012	0.05	0.18	0.21	0.25	0.42	0.21	0.09
2017	0.00	0.05	0.09	0.15	0.27	0.11	0.07
2018	0.00	0.06	0.16	0.21	0.29	0.15	0.09
Panel D: Long Positions							
2008	0.00	0.13	0.37	0.54	2.63	0.54	0.71
2011	0.20	0.30	0.45	0.53	1.82	0.49	0.32
2012	0.02	0.45	0.53	0.71	2.65	0.65	0.48
2017	0.01	0.22	0.49	0.73	1.02	0.48	0.29
2018	0.00	0.09	0.20	0.32	0.46	0.20	0.14

This analysis shows that the maximum loss coverage ratio exceeds 1 in all sample years for CDS positions referencing single-name obligors. However, this is not always the case for CDS positions referencing an index. These results suggest that the standardized haircuts in the final rules are generally not set at the most conservative level, as losses on some positions exceed the corresponding standardized haircuts. The standardized haircuts are intended to strike a balance between being sufficiently conservative to cover losses in most cases, including stressed market conditions, and being sufficiently nimble to allow dealers to operate efficiently in all market conditions. In response to the commenter, based on the results of the analysis, as described above, the Commission believes that the standardized haircuts in the final rules take into account this tradeoff. The standardized haircut grids are designed to produce margin amounts that generally scale with risk of the underlying positions, and are designed to capture the relative risk of the underlying positions across maturity and credit spread. Finally, the standardized haircut grids for non-cleared CDS are based on well-established haircuts prescribed in Rule 15c3–1and FINRA Rule 4240, haircuts that have been used by broker-dealers for many years.

In the final rules, the standardized haircuts for cleared security-based swaps and swaps are based on clearing agency margin requirements. This will impose direct costs on nonbank SBSDs that clear proprietary security-based swaps and swaps. For example, these costs will impact nonbank SBSDs that make a market in security-based swaps and/or swaps, and hedge some of their market risk exposure to their counterparties by entering into cleared security-based swap or swap positions. A nonbank SBSD that makes a market in non-cleared CDS and that has some residual market risk exposure (*e.g.,* the nonbank SBSD is not running a flat trading book) could hedge some of that exposure by entering into a cleared index CDS (*i.e.,* a swap) on its own account. Applying standardized haircuts to cleared positions will make this type of hedging activity more costly relative to the baseline. To offset the costs imposed by this requirement, SBSDs may charge counterparties more for providing liquidity in the security-based swap market. In particular, the costs to market participants of trading in these markets may be higher, relative to the baseline.

However, the costs associated with the standardized haircuts for cleared security-based swaps would be in part mitigated by the use of model-based haircuts as an alternative to the standardized haircuts. Specifically, ANC broker-dealers and stand-alone SBSDs approved to use internal models would be allowed to use the model-based haircuts. As noted above, model-based haircuts can be substantially smaller than standardized haircuts. Furthermore, as noted above, the Commission believes that most nonbank SBSDs will seek approval to use internal models for capital purposes, including for the calculation of model-based haircuts of cleared and non-cleared security-based swap and swap positions.

v. Credit Risk Charges

Section VI.B.1.b.iii. of this release analyzes the benefits and costs associated with the capital deductions in lieu of margin. These benefits and costs associated with the capital deductions in lieu of margin depend on whether the ANC broker-dealer or stand-alone SBSD will be allowed to take the alternative model-based credit risk charge. Since the credit risk charge is substantially smaller than the 100% capital deduction, an ANC broker-dealer or stand-alone SBSD that is authorized to use internal models and that takes the alternative credit risk charge instead of the capital deduction in lieu of margin will face substantially lower costs compared to a broker-dealer or nonbank SBSD that is not using internal models and that has to take the 100% capital deduction.[1110]

[1110] *See* section II.A.2.b.v. of this release (discussing the calculation of the model-based credit risk charge); section II.B.2.a.i. of this release (discussing the calculation of the model-based initial margin requirement). The alternative credit risk charge can range from approximatively 4.8% to

Continued

While the alternative credit risk charge may allow ANC broker-dealers and nonbank SBSDs to economize on the direct costs associated with capital charges in lieu of margin, it also provides less of a buffer against potential losses compared to the 100% capital deduction. The 100% capital deduction for the uncollateralized credit risk exposure created by a security-based swap or swap position provides a capital buffer that is similar in size with the margin requirement of the position that the ANC broker-dealer or stand-alone SBSD will calculate for the counterparty. In contrast, the alternative credit risk charge for the uncollateralized exposure of the same position provides a capital buffer that could be substantially smaller than the margin requirement of the position. Thus, in general, the capital buffer created by the 100% capital deduction could be substantially more effective against potential losses from an uncollateralized exposure compared to the capital buffer created by the alternative credit risk charge. Everything else equal, the likelihood of the failure of an ANC broker-dealer or stand-alone SBSD because of losses from uncollateralized exposures is smaller if the firm takes the 100% capital deduction against this exposure compared to the alternative credit risk charge.

In addition, and as a corollary, compared to a nonbank SBSD that is not using internal models, an ANC broker-dealer or stand-alone SBSD that is approved to use internal models, and that takes the alternative credit risk charge, will allocate less capital ex-ante (when the counterparty is solvent) but may potentially require more capital ex-post (when the counterparty is insolvent). From this perspective, the net capital of an ANC broker-dealer or stand-alone SBSD that is approved to use internal models is more sensitive to the risk of counterparty failure. However, as discussed above, ANC broker-dealers and stand-alone SBSDs that are approved to use internal models are subject to higher minimum capital requirements.

Finally, as discussed above, in applying the credit risk charges, ANC broker-dealers (including ANC broker-dealer SBSDs) are subject to a portfolio concentration charge that has a threshold equal to 10% of the firm's tentative net capital. Under the portfolio concentration charge, the application of the credit risk charges to uncollateralized *current* exposure across all counterparties arising from derivatives transactions is limited to an amount of the current exposure equal to no more than 10% of the firm's tentative net capital. The firm must take a charge equal to 100% of the amount of the firm's aggregate current exposure in excess of 10% of its tentative net capital. Stand-alone SBSDs, including SBSDs operating as OTC derivatives dealers, are not subject to a portfolio concentration charge with respect to uncollateralized current exposure. However, all these entities (*i.e.,* ANC Broker-dealers, ANC broker-dealer SBSDs, stand-alone SBSDs, and stand-alone SBSDs that also are registered as OTC derivatives dealers) are subject to a concentration charge for large exposures to single a counterparty that is calculated using the existing methodology in Rule 15c3–1e.[1111]

Currently, dealing entities affiliated with ANC broker-dealers are among the largest in terms of level of trading activity in the security-based swap and swap markets.[1112] If these dealing entities are currently registered with the CFTC as swap dealers, major swap participants or FCMs, their market and credit risk exposures from certain legacy security-based swap and swap positions will have to be collateralized per CFTC's margin rules. However, these margin rules have exceptions such that not all exposures from legacy positions have to be collateralized (*e.g.,* security-based swaps and swaps with counterparties that are not a ''covered swap entity'' or ''financial end user,'' as defined by the CFTC's margin rules).[1113] To the extent that these dealing entities will register as ANC broker-dealers or ANC broker-dealer SBSDs, the requirement to cap the use of the alternative credit risk charge for capital charges in lieu of margin to 10% of an ANC broker-dealer's tentative net capital as a portfolio concentration charge could impose costs on these broker-dealers. More generally, the 10% cap requirement may impose additional costs on a dealer that has uncollateralized market risk exposure from legacy and new security-based swap and swap positions in excess of the 10% cap and that chooses to register as ANC broker-dealer or both ANC broker-dealer and SBSD rather than other forms of nonbank SBSD, including stand-alone SBSDs approved to use models. ANC broker-dealers may pass on a portion of these additional costs to their counterparties, and therefore, the requirement may increase the costs of transacting in security-based swaps and swaps for market participants that access these markets through ANC broker-dealers. However, competitive pressure may limit the extent to which ANC broker-dealers may be able to pass on these additional costs to their counterparties. For instance, stand-alone SBSDs that are not subject to this requirement may be able to offer better prices compared to ANC broker-dealers that are subject to this requirement. As a corollary, if a dealing entity expects the additional costs to be large, the requirement may reduce the entity's incentives to engage in security-based swap dealing activity that would trigger a requirement to register as an ANC broker-dealer SBSD.

As discussed above, the 10% cap requirement will limit the extent to which an ANC broker-dealer, including an ANC broker-dealer SBSD, can make use of the alternative credit risk charge in lieu of the 100% capital deduction. As a result, the capital buffer that an ANC broker-dealer will have to hold as a result of the 10% cap requirement is larger than the capital buffer that the ANC broker-dealer would hold, absent this requirement. Because a larger capital buffer allows ANC broker-dealers to better withstand potential losses from uncollateralized market risk exposures, the requirement is intended to enhance the safety and soundness of ANC broker-dealers and therefore benefit market participants.

vi. Risk Management Procedures

Nonbank SBSDs will be required to comply with Rule 15c3–4, which currently applies to OTC derivatives dealers and ANC broker-dealers. Rule 15c3–4 requires firms to, among other things, 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. These requirements may help nonbank SBSDs better monitor the risk of their operations, and it may help reduce the risk of significant

48% of the 100% capital deduction in lieu of margin, depending on the multiplication factor used to calculate the maximum potential exposure, which ranges between 3 and 4, and the credit risk weight of the counterparty. The lower end of the range (*i.e.,* 4.8%) is calculated as the product between the lowest multiplication factor (*i.e.,* 3), and a credit risk weight of 20%, and 8%. The upper end of the range (*i.e.,* 48%) is calculated as the product between the highest multiplication factor (*i.e.,* 4) and a credit risk weight of 150%, and 8%.

[1111] Stand-alone SBSDs (including firms that also are registered as OTC derivatives dealers) are subject to Rule 18a–1, which includes a counterparty concentration charge that parallels the existing in charge in Rule 15c3–1e.

[1112] *See* section VI.A.1. of this release.

[1113] *See CFTC Margin Adopting Release,* 81 FR 636. In certain cases, FCMs may have to take capital charges against uncollateralized security-based swap and swap positions. *See* section VI.A.4.c. of this release (discussing the capital requirements for FCMs).

losses from unmonitored positions.[1114] Nonbank SBSDs may incur costs in documenting their risk management procedures and updating their information technology systems to meet these requirements. These costs could vary significantly among nonbank SBSDs depending on their size, the degree to which their risk management systems are already documented, and the types of business they engage in.[1115]

c. Alternatives Considered

The 2012 proposal discussed the benefits and the costs of the proposed net liquid assets test capital standard for nonbank SBSDs. A number of commenters suggested several other alternatives to this standard. In this section, the Commission discusses alternative capital standards that were either proposed or suggested by commenters.

i. Bank Standard

One commenter argued that the bank capital standard should be used for nonbank SBSDs, and was concerned that the proposed capital requirements for nonbank SBSDs were not comparable to those proposed by other U.S. regulators and that modeling the capital standards on the broker-dealer capital standard was not appropriate.[1116] As discussed above in section II.A.1. of this release, the Commission has made two significant modifications to the final capital rules for nonbank SBSDs that reduce some of the differences between the final capital rules for nonbank SBSDs and the capital rules of the prudential regulators (and the CFTC). First, as discussed above in section II.A.2.b.v. of this release, the Commission has modified Rule 18a–1 so that it no longer contains a portfolio concentration charge that is triggered when the aggregate current exposure of a stand-alone SBSD to its derivatives counterparties exceeds 50% of the firm's tentative net capital.[1117] This means that stand-alone SBSDs that have been authorized to use models will not be subject to this limit on applying the credit risk charges to uncollateralized current exposures related to derivatives transactions. This includes uncollateralized current exposures arising from electing not to collect variation margin for non-cleared security-based swap and swap transactions under exceptions in the margin rules of the Commission and the CFTC (which is generally consistent with the margin rules of the prudential regulators). The credit risk charges are based on the creditworthiness of the counterparty and can result in charges that are substantially lower than deducting 100% of the amount of the uncollateralized current exposure.[1118] This approach to addressing credit risk arising from uncollateralized current exposures related to derivatives transactions is generally consistent with the treatment of such exposures under the capital rules for banking institutions.[1119]

The second significant modification is the alternative compliance mechanism. As discussed above in section II.D. of this release, the alternative compliance mechanism will permit a stand-alone SBSD that is registered as a swap dealer and that predominantly engages in a swaps business to comply with the capital, margin, and segregation requirements of the CEA and the CFTC's rules in lieu of complying with the Commission's capital, margin, and segregation requirements.[1120] The CFTC's proposed capital rules for swap dealers that are FCMs would retain the existing capital framework for FCMs, which imposes a net liquid assets test similar to the existing capital requirements for broker-dealers.[1121] However, under the CFTC's proposed capital rules, swap dealers that are not FCMs would have the option of complying with: (1) A capital standard based on the capital rules for banks; (2) a capital standard based on the Commission's capital requirements in Rule 18a–1; or (3) if the swap dealer is predominantly engaged in non-financial activities, a capital standard based on a tangible net worth requirement.

Notwithstanding the modification to Rule 18a–1 described above, the rule continues to be modeled in large part on the broker-dealer capital rule. For example, as is the case with Rule 15c3–1, most unsecured receivables (aside from uncollateralized current exposure relating to derivatives transactions) will not count as allowable capital. Moreover, fixed assets and other illiquid assets will not count as allowable capital. Consequently, stand-alone SBSDs subject to Rule 18a–1 (*i.e.,* firms that do not operate under the alternative compliance mechanism) will remain subject to certain requirements designed to promote their liquidity. Additionally, broker-dealer SBSDs will be subject to Rule 15c3–1 and the stricter (as compared to Rule 18a–1) net liquid assets test it imposes.

Several factors have influenced the Commission's decision not to use a bank capital standard for nonbank SBSDs. First, a nonbank SBSD's role of dealing in security-based swaps and performing market-making activity is fundamentally different from a bank's central role of making loans and taking deposits. Second, banks have access to sources of liquidity and support that nonbank SBSDs do not have access to, such as retail deposits and central bank support. Finally, like the bank standard, the net liquid test capital standard is also risk-based, as nonbank SBSDs will be required to take capital charges that are proportionate to the risk exposures from their trading activity, and the 2% margin factor for calculating the minimum net capital requirement is tied directly to the credit risk of the nonbank SBSD's exposures from trading activity.

The adopted capital standard has a number of similarities and differences compared to the bank capital standard. Under the current bank capital standard, bank SBSDs would also have to allocate capital for their exposures with other covered entities, including other dealers. The capital that supports a bank SBSD's dealing activities in the OTC markets is determined in accordance with the prudential regulators' rules on banks' capital adequacy. These rules require that bank SBSDs calculate a risk weight amount for each of their exposures, including exposures to non-cleared security-based swaps. Furthermore, the rules require that bank SBSDs calculate an additional risk weight amount for the exposure created through the posting of initial margin to collateralize a non-cleared security-based swap. However, both of these risk weight amounts are likely to be small. The dealer's exposure to a covered-entity counterparty is collateralized by the initial margin that the counterparty has to post with a third-party custodian (for the benefit of the dealer), and the risk weight of this exposure reflects almost entirely the risk weight of the collateral—usually minimal. Similarly, by posting initial margin, the dealer creates an exposure to the third-party custodian holding the collateral. Exposures to custodian banks usually have low risk weight.

The capital that bank SBSDs have to allocate for their non-cleared security-based swaps equals the sum of the two risk weight amounts calculated above multiplied by a factor—usually 8%.

[1114] *See* Barnard Letter.

[1115] *See* section VI.C. of this release.

[1116] *See* Morgan Stanley 2/22/2013 Letter.

[1117] *See* paragraph (e)(2) of Rule 18a–1, as adopted. *See also Capital, Margin, and Segregation Proposing Release,* 77 FR at 70244 (proposing a portfolio concentration charge in Rule 18a–1 for stand-alone SBSDs).

[1118] *See* paragraph (e)(2) of Rule 18a–1, as adopted.

[1119] *See OTC Derivatives Dealers,* 63 FR at 59384–87.

[1120] *See* Rule 18a–10, as adopted.

[1121] *See CFTC Capital Proposing Release,* 81 FR 91252.

Thus, the capital that a bank SBSD has to allocate to support a non-cleared security-based swap is relatively small, and likely of the same order of magnitude as the capital that a nonbank SBSD would have to allocate for a similar exposure. However, unlike the nonbank SBSD, the bank SBSD still has to post away the initial margin. The posting of collateral will ''consume'' the bank SBSD's capital, and gives nonbank SBSD a comparative advantage in terms of capital efficiency, to the extent their counterparty is not an entity that is required to collect initial margin from them.

While collateral posting makes dealing under a bank SBSD structure costly, the cost of funding such collateral is likely smaller for these dealers compared to nonbank SBSDs. Unlike nonbank SBSDs, bank SBSDs may have access to less costly sources of collateral funding, including deposits and central bank mechanisms.

ii. Harmonization with the CFTC

As discussed above in section II.A.1. of this release, several commenters argued that the Commission should harmonize its rules with the CFTC and other regulatory bodies that have finalized their capital and/or margin rules.[1122] One commenter suggested that the Commission coordinate with the CFTC and, as appropriate, the prudential regulators to assure that each agency's respective capital rules are harmonized and do not have the unintended effect of impairing the ability of broker-dealers that are dually registered as FCMs to provide clearing services for security-based swaps and swaps.[1123] Differences between these final capital rules and any final rules adopted by the CFTC could mean that nonbank SBSDs that are also registered with the CFTC as swap dealers would need to perform two different calculations to determine whether they satisfy their respective capital standards. The difficulties and inefficiencies associated with satisfying both standards could cause some firms to separate nonbank SBSDs from nonbank swap dealers. Thus, relative to the adopted rule, an approach that prioritized greater regulatory harmonization might have mitigated the costs borne by nonbank SBSDs.

Although the Commission has declined to fully harmonize its rules with the CFTC's proposed approach to capital for the reasons described above, the final rules eliminate or modify many of the provisions in the proposed rules that commenters identified as posing particular challenges to firms registered as both SBSDs and swap dealers. Moreover, the alternative compliance mechanism should achieve the same benefits as full harmonization for a subset of firms that will register as SBSDs by permitting those stand-alone SBSDs that are likely to be most affected by differences between the Commission's rules and the CFTC's rules to comply with the capital, margin, and segregation requirements of the CEA and the CFTC's rules (if they meet certain conditions).

iii. Tangible Net Worth Test

Several commenters were concerned about the differences between the risk-based capital standards used for banks, and the transaction volume based broker-dealer capital standard.[1124] One commenter suggested that the Commission apply a tangible net worth test to nonbank SBSDs, claiming that it is ''particularly appropriate for entities that have not been prudentially regulated before and effectively protects against any losses in the event of a potential liquidation.''[1125]

As mentioned in section II.A.1., the Commission believes that a tangible net worth test would give incentives to nonbank SBSDs to hold illiquid, higher yielding assets to meet the requirement, which would undermine the Commission's goal of promoting liquidity for SBSDs. In addition, a nonbank SBSD will not also have the support of retail deposits or central bank support. Thus, the Commission is adopting the broker-dealer capital standard for nonbank SBSDs.

iv. Standardized Haircuts for Cleared Security-Based Swap and Swap Positions

The Commission proposed that the standardized haircuts for cleared and non-cleared security-based swaps be calculated the same way. The proposed standardized haircut for a CDS was determined using one of two maturity grids: one for a CDS that is a security-based swap and the other for a CDS that is a swap.[1126] For a security-based swap that is not a CDS, the proposed standardized haircuts required multiplying the notional amount of the security-based swap by the amount of the standardized haircut that applied to the underlying position pursuant to the pre-existing provisions of Rule 15c3–1.[1127] In addition, under the proposal, firms authorized to use internal models were allowed to use model-based haircuts instead of the standardized haircuts.

The final capital rules differ from the proposed rules in terms of how broker-dealers and nonbank SBSDs must calculate standardized haircuts for cleared security-based swaps and swaps. Namely, the Commission is modifying the proposed standardized haircut requirements for cleared security-based swaps and swaps to require that the amount of the deduction will be the amount of margin required by the CCP where the position is cleared.[1128] However, an ANC broker-dealer and stand-alone SBSD authorized to use a model can calculate model-based haircuts instead of standardized haircuts for positions for which the firm has been approved to use the model.

As an alternative to the final capital rules, the Commission could have taken the proposed approach with respect to standardized haircuts for cleared security-based swaps and swaps. The Commission analyzes below the economic impact of this alternative. Requiring SBSDs to take the proposed standardized haircuts for cleared proprietary security-based swap and swap positions could create a larger capital buffer against the market risk of a cleared position if the proposed standardized haircuts were more conservative than the margin requirements of the CCPs. As a result, the proposed approach could increase the safety and soundness of SBSDs, which would benefit the market participants in the security-based swap and swap markets, all things being equal. At the same time, however, to the extent the proposed standardized haircuts were more conservative, generally, than the margin requirements of the CCPs, the proposed approach would have resulted in relatively higher capital requirements for cleared security-based swap and swap positions. This could have discouraged broker-dealers and nonbank SBSDs from engaging in cleared security-based swap and swap transactions if the firms believed their capital could be deployed more profitably. Alternatively, nonbank SBSDs would likely have passed the costs associated higher capital requirements under this alternative to

[1122] *See* Citadel 11/19/18 Letter; Financial Services Roundtable Letter; FIA 11/19/2018 Letter; Morgan Stanley 11/19/2018 Letter.

[1123] *See* FIA 11/19/2018 Letter.

[1124] *See* section II.A.1. of this release.

[1125] *See* Sutherland Letter.

[1126] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70232–34, 70248–49.

[1127] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 70234–36.

[1128] *See* paragraph (c)(2)(vi)(O) of Rule 15c3–1, as amended; paragraph (b)(1) of Rule 15c3–1b, as amended; paragraph (c)(1)(vi)(A) of Rule 18a–1, as adopted; paragraph (b)(1) of Rule 18a–1b, as adopted.

their customers, increasing the relative costs of cleared transactions.

Adopting standardized haircuts based on clearing agency and DCO margin requirements is consistent with the treatment of futures products and potentially consistent with the standardized haircuts the CFTC ultimately will adopt. Differences in the capital treatment of these positions under the Commission's and the CFTC's rules could have caused broker-dealers and nonbank SBSDs to be subject to overlapping regulatory regimes if they were registered as FCMs or swap dealers in terms of calculating standardized haircuts for cleared security-based swaps and swaps. This could have imposed costs on broker-dealers and SBSDs if the proposed standardized haircuts were larger than the margin amount required by the CCP where the position is cleared. These costs could have further reduced the incentives of broker-dealers and nonbank SBSDs to clear security-based swap and swap positions.

Finally, cleared security-based swaps and swaps differ from non-cleared security-based swaps and swaps in ways that could have made the capital charges using the proposed standardized haircuts for cleared security-based swaps and swaps inappropriately high. In particular, as counterparties to cleared OTC derivatives contracts, CCPs must meet risk management standards that support the orderly liquidation of portfolios in the event of clearing member default and mitigate the risk of CCP default. In addition, regulatory standards as well as private incentives encourage CCPs to offer to clear products that are sufficiently liquid to enable CCPs to replace positions they hold against defaulting members without substantial price impact.

v. 1% Minimum Standardized Haircut for Interest Rate Swaps

Under the final rules being adopted today, the standardized haircuts for non-cleared interest rate swaps are determined using the maturity grid for U.S. government securities in paragraph (c)(2)(vi)(A) of Rule 15c3–1.[1129] Moreover, the standardized haircuts for non-cleared security-based swaps and swaps (other than CDS) being adopted today permit a broker-dealer and nonbank SBSD to reduce the deduction by an amount equal to any reduction recognized for a comparable long or short position in the reference security under the standardized haircuts in Rule 15c3–1.[1130] The standardized haircuts in paragraph (c)(2)(vi)(A) of Rule 15c3–1 permit a broker-dealer to take a capital charge on the net long or short position in U.S. government securities that are in the same maturity categories in the rule. This treatment will apply to interest rate swaps. The standardized haircut for non-cleared interest rate swaps can be no less than ⅛ of 1% of a long position that is netted against a short position in the case of a non-cleared swap with a maturity of 3 months or more.[1131] The standardized haircuts in paragraph (c)(2)(vi)(A) of Rule 15c3–1 require a 0% haircut for the unhedged amount of U.S. government securities that have a maturity of less than 3 months. Therefore, the standardized haircuts for interest rate swaps will treat hedged and unhedged positions with maturities of less than 3 months identically in that there will be no haircut applied to the positions. The minimum standardized haircut for hedged interest rate swaps with a maturity of 3 months or more will be ⅛ of 1%.

The proposed haircut for interest rate swaps had a floor of 1% (whereas U.S. government securities with a maturity of less than 9 months are subject to haircuts of ¾ of 1%, ½ of 1%, or 0% depending on the time to maturity). The proposed 1% floor is an alternative to the minimum standardized haircut for non-cleared interest rate swaps in the final rules. A commenter opposed the proposed 1% minimum standardized haircut for interest rate swaps as being too severe.[1132] Based on an analysis of sample positions, this commenter believed that the proposed 1% minimum standardized haircut would result in market risk charges that are nearly 35 times higher than charges without the 1% minimum.[1133]

The Commission is persuaded that the 1% minimum haircut was too conservative, particularly when applied to tightly hedged positions such as those in the commenter's examples. A minimum standardized haircut for non-cleared interest rate swaps that was too conservative could have unduly increased the transaction costs of broker-dealers and nonbank SBSDs that engage in these types of swaps. To the extent that these entities passed on these increased costs to their customers in the form of higher prices to liquidity provision, the ability of their customers to use interest rate swaps for risk mitigation could have been impaired. In addition, by raising their prices for liquidity provision, broker-dealers and nonbank SBSDs could have become less competitive than other liquidity providers that are not subject to the Commission's capital rules.

However, the Commission continues to believe that a minimum haircut should be applied to non-cleared interest rate swaps. A minimum haircut for non-cleared interest rate swaps will help enhance the safety and soundness of broker-dealers and nonbank SBSDs by reducing their incentives to engage in excessive risk-taking, by increasing their ability to withstand losses from their trading activity, and by reducing the risk of sequential counterparty failure. It also will account for potential differences between the movement of interest rates on U.S. government securities and interest rates upon which the non-cleared interest rate swap payments are based. The Commission believes the final rules for standardized haircuts for non-cleared security-based swaps strike an appropriate balance in terms of addressing commenters' concerns that the proposed minimum was too conservative and the objective of enhancing the safety and soundness of nonbank SBSDs. Thus, the Commission believes that the adopted approach is preferable to the alternative.

vi. Same Control and Opinion of Counsel Conditions for Avoiding Capital Charge When Collateral is Held by an Independent Third-Party Custodian as Initial Margin

The Commission asked in the 2018 comment reopening whether there should be an exception to taking the deduction for initial margin collateral held by an independent third-party custodian pursuant to Section 3E(f) of the Act or Section 4s(l) of the CEA under conditions that promote the SBSD's ability to promptly access the collateral if needed.[1134] Specifically, the Commission sought comment on whether there should be such an exception under the following conditions: (1) The custodian is a bank; (2) the nonbank SBSD enters into an agreement with the custodian and the counterparty that provides the nonbank SBSD with the same control over the collateral as would be the case if the nonbank SBSD controlled the collateral

[1129] *See* paragraph (b)(2)(ii)(A)(*3*) of Rule 15c3–1b, as amended; paragraph (b)(2)(ii)(A)(*3*) of Rule 18a–1b, as adopted.

[1130] *See* paragraph (c)(2)(vi)(P)(*2*) of Rule 15c3–1, as amended; paragraph (b)(2)(ii)(B) of Rule 15c3–1b, as amended; paragraph (c)(1)(vi)(B)(*2*) of Rule 18a–1, as adopted; paragraph (b)(2)(ii)(B) of Rule 18a–1b, as adopted.

[1131] *See* paragraph (b)(2)(ii)(A)(*3*) of Rule 15c3–1b, as amended; paragraph (b)(2)(ii)(A)(*3*) of Rule 18a–1b, as adopted.

[1132] *See* SIFMA 2/22/2013 Letter.

[1133] *See* SIFMA 11/19/2018 Letter.

[1134] *See Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53011–12.

directly; and (3) an opinion of counsel deems the agreement enforceable.

As discussed above in section II.A.2.b.ii. of this release, the Commission agrees with commenters that the ''same control'' language could create practical obstacles that would make it difficult to execute an account control agreement that would be sufficient to avoid the capital charge when initial margin is held by a third-party custodian. Moreover, even if such an agreement could be executed, existing agreements that are in place in accordance with the third-party custodian and documentation requirements of the CFTC and the prudential regulators likely would need to be re-drafted to meet the requirements of the potential condition. Doing so would be a costly and burdensome process. Some commenters opposed the condition requiring a legal opinion of outside counsel on the basis of cost and impracticability, arguing it is inconsistent with market practice and operationally burdensome to implement. The Commission acknowledges that requiring an opinion of counsel could have been a costly burden. To the extent that the counterparties of nonbank SBSDs bore at least part of the costs associated with the re-drafting of account control agreements and the acquisition of an opinion of counsel, they would have incurred higher costs in transacting in the security-based swap market, which could have reduced their participation in this market. These effects could have been strengthened if the nonbank SBSDs bore part of the costs associated with the re-drafting of account control agreements and the acquisition of an opinion of counsel, and passed on those costs to their counterparties in the form of higher prices for liquidity provision. In light of these concerns, the Commission believes that the adopted approach is preferable to this alternative.

vii. Requiring a Nonbank SBSD To Take a Capital Deduction for the Margin Difference

The Commission proposed a deduction that applied if a nonbank SBSD collects margin 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 the nonbank SBSD (*i.e.,* the collected margin was less than the amount of the standardized or model-based haircuts, as applicable).[1135] This proposed requirement was designed to account for the risk of the counterparty defaulting by requiring the nonbank SBSD to maintain capital in the place of collateral in an amount that is no less than required for a proprietary position. It also was designed 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. In the 2018 comment reopening, the Commission asked whether this proposed rule change should be modified to include a risk-based threshold under which the deduction need not be taken, and provided modified rule text to apply the deduction to cleared swap transactions.[1136]

In light of comments received and for reasons discussed further below, the final rules will not require a nonbank SBSD to deduct the margin difference for each account it carries that holds cleared security-based swaps or swaps. Consequently, this approach is analyzed below as an alternative.

As discussed above in section II.A.2.b.ii. of this release, commenters raised a number of concerns with the proposed capital deduction for the difference between the haircuts and CCP margin requirements for cleared security-based swaps and swaps and with potential threshold discussed in the 2018 comment reopening. In light of these concerns, the Commission has supplemented the analysis of the capital deduction in the proposing release[1137] by analyzing the potential direct costs associated with the capital charge for the margin difference for each account carried by the nonbank SBSD that holds cleared security-based swaps or swaps. To estimate the capital charge under this alternative, Commission staff examined initial margin requirements[1138] for customer accounts carried by 11 registered broker-dealers[1139] that hold cleared security-based swap and swap positions. The Commission staff also reviewed initial margin requirements for a range of hypothetical single-name and index CDS that were calculated using clearing agency initial margin methodology[1140] and ISDA's SIMM™ model. Assuming that the SIMM™ model initial margin calculations reasonably approximate the initial margin requirements that would apply if the hypothetical security-based swap and swap positions were proprietary, the resulting margin difference—expressed as a ratio of the SIMM™ initial margin requirements to the clearing agency initial margin requirements—ranges from a minimum of 0.57 to a maximum of 2, depending on the direction of the hypothetical security-based swap and swap positions.[1141] Commission staff applied these ratios to the initial margin requirements for customer accounts to estimate an upper bound for the capital charge. At the maximum ratio of 2, the aggregate capital charge would be $4,644.55 million[1142] or 422.23 million[1143] per broker-dealer.

Under this alternative, nonbank SBSDs would likely have passed on the costs associated with this capital charge to their clients, either in the form of higher prices or by demanding that clients post collateral in excess of the amounts set by the CCPs. As a result, the proposed capital charge may have increased the cost of clearing security-based swaps or swaps for market participants who wish to clear such transactions through nonbank SBSDs. Instead of passing on costs associated with the capital charge to clients, nonbank SBSDs may have chosen to limit their client clearing services to those security-based swap and swap products that are less likely to attract the capital charge. These responses from nonbank SBSDs may have reduced the incentive of market participants to engage in centrally cleared security-

[1135] *See Capital, Margin, and Segregation Proposing Release,* 77 FR at 7045–47.

[1136] *See Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53009. More specifically, the Commission requested comment on whether the rule should provide that the deduction need not be taken if the difference between the clearing agency margin amount and the haircut is less than 1% (or some other amount) of the SBSD's tentative net capital, and less than 10% (or some other amount) of the counterparty's net worth, and the aggregate difference across all counterparties is less than 25% (or some other amount) of the counterparty's tentative net capital.

[1137] See *Capital, Margin, and Segregation Proposing Release,* 77 FR at 70312–13.

[1138] These initial margin requirements were calculated as of October 2, 2017, based on clearing agency data.

[1139] These 11 registered broker-dealers are clearing members of a CCP. These broker-dealers are entities that will likely register as SBSDs or are affiliated with entities that will likely register as SBSDs.

[1140] This is the initial margin methodology of the clearing agency that provided the initial margin requirements examined by Commission staff.

[1141] A ratio of 0.57 for a position means that the associated SIMM™ initial margin requirement is 57% of the associated clearing agency initial margin requirement. Conversely, a ratio of 2 means that the SIMM™ initial margin requirement is 200% of the clearing agency initial margin requirement. When the ratio is greater than 1, there would be a capital charge under this alternative.

[1142] The aggregate capital charge is calculated as $4,644.55 million (total initial margin requirements for customer accounts) × (2 − 1) = $4,644.55 million.

[1143] The capital charge per registered broker-dealer is calculated as $4,644.55 million / 11 registered broker-dealers = $422.23 million.

based swap or swap transactions.[1144] Further, CCPs are generally required to meet minimum margin standards under the rules of most jurisdictions. These minimum standards—to the extent they prohibit a ''race to the bottom'' by a CCP in terms of the margin it requires from clearing members—would limit the likelihood of a margin difference and the associated capital deduction.

While the proposed capital deduction would have imposed a cost on nonbank SBSDs and ultimately, their clients, the Commission acknowledges it could have enhanced the safety and soundness of nonbank SBSDs, and in turn promoted financial stability. Indeed, absent this proposed requirement, a nonbank SBSD may collect margin from the client that is just enough to satisfy the CCP's margin requirements. This CCP-bound margin may not always adequately capture the risk of the position, relative to the margining standards of nonbank SBSDs. For example, if CCPs weaken their margin standards as a way to compete among themselves, and, if this competition turns into a ''race to the bottom,'' the initial margin that a CCP would assess at the outset of a trade would have to reflect, in part, this competitive pressure and, as a result, may not adequately capture the risk of the cleared position.[1145] Because the nonbank SBSD would have to fulfil any CCP-bound margin calls that the insolvent client was not able to fulfill, resulting in an unexpected draw on the nonbank SBSD's capital, the proposed requirement was intended to provide a capital buffer (in the form of a capital deduction for the margin difference) against such potential losses, potentially allowing the nonbank SBSD to better withstand a client default. The main beneficiaries of the enhanced safety and soundness of the nonbank SBSD as a result of the requirement would have been market participants, in particular those market participants that employ the services of the nonbank SBSD.

2. The Capital Rule for Nonbank MSBSPs—Rule 18a–2

As discussed above in section II.A.3. of this release, Rule 18a–2 will prescribe capital requirements for nonbank MSBSPs that are not also registered as broker-dealers and will require them to hold at all times positive tangible net worth. Nonbank MSBSPs are also required to comply with Rule 15c3–4 with respect to their security-based swap and swap activities.

a. Benefits and Costs of the Capital Rule for Nonbank MSBSPs

The entities that are expected to register as nonbank MSBSPs typically engage in both security-based swap activities and other business activities. These other business activities could be commercial in nature (*e.g.,* manufacturing, energy, transportation), and require that firms pre-commit capital in advance (*i.e.,* capital that is generally not liquid). In contrast, security-based swap activities (like other securities activities) are more opportunistic in nature and require liquid capital.

The requirement that nonbank MSBSPs maintain positive tangible net worth will allows these entities to offset losses in their security-based swap positions with capital that is tied to other business activities. In particular, a nonbank MSBSP does not need to hold liquid capital beyond what is necessary to support its security-based swap activities. Since capital tied to other business activities counts toward regulatory capital, the requirement should result in more efficient use of capital, which would be a clear benefit for nonbank MSBSPs.

While the requirement may allow a nonbank MSBSP to engage in security-based swap activities without having to reallocate its capital inefficiently, it may also lead to situations where the nonbank MSBSP may fail to be compliant with the final margin rule and, thereby, create risk for counterparties that rule is designed to protect. Under Rule 18a–3, as adopted, a nonbank MSBSP is required to post collateral to cover current exposure of counterparties to the nonbank SBSD if the transaction is not subject to an exception in the rule. Consider a situation where a nonbank MSBSP has losses on its non-cleared security-based swap positions (*i.e.,* gains for the counterparty) that are in excess of its liquid capital. If its productive capital cannot be liquidated right away, then the nonbank MSBSP may not have collateral available to post to the counterparty to cover the counterparty's current exposure to the nonbank SBSD. In this case, the nonbank SBSD would be in violation of Rule 18a–3, as adopted, and, as a consequence, the counterparty with the gains would be at risk.

However, as discussed above, Rule 18a–2, as adopted, has a provision that requires nonbank MSBSPs to comply with Rule 15c3–4. To the extent that a nonbank MSBSP has effective risk management controls in place, it should be able limit the number of situations where potential losses on its positions exceed its buffer of liquid capital.

b. Alternatives Considered

An alternative to the positive tangible net worth standard is the net liquid assets test standard. The main difference between these two approaches is that under the former nonbank MSBSPs are allowed to count capital tied to other business activities towards regulatory capital, while under the latter they are not to the extent the capital is illiquid. Thus, the net liquid assets test standard is substantially more conservative as nonbank MSBSPs would now need to set aside more liquid capital to support their non-cleared security-based swap trading activities. To the extent that nonbank MSBSPs obtain their liquid capital by scaling down their business activities, the alternative leads to less efficient allocation of capital and imposes significant costs on nonbank MSBSPs.

3. The Margin Rule—Rule 18a–3

a. Overview

As discussed above in section II.B.1. of this release, Rule 18a–3, as adopted, will establish margin requirements for nonbank SBSDs and nonbank MSBSPs with respect to transactions with counterparties in non-cleared security-based swaps.

i. Nonbank SBSDs

Rule 18a–3 prescribes margin requirements for nonbank SBSDs with respect to non-cleared security-based swaps. The rule requires a nonbank SBSD to perform two calculations with respect to each account of a counterparty as of the close of business each day: (1) The amount of current exposure in the account of the

[1144] This reduction in the incentives to clear a security-based swap or a swap transaction may have been limited by a number of factors, including but not limited to: (1) Any mandatory clearing determinations for security-based swaps by the Commission under Section 763(a) of the Dodd-Frank Act; (2) any mandatory clearing determinations for swaps by the CFTC under Section 723(a) of the Dodd-Frank Act; (3) the margin requirements for non-cleared security-based swaps and swaps; (4) the segregation regime of initial margin posted by the customer to collateralize a non-cleared security-based swap or swap; and (5) the presence of financial market intermediaries that are clearing members and that are not directly subject to the requirements of the proposed capital rule and amendments (*e.g.,* banks).

[1145] Market participants have often raised concerns about the adverse effects of a race to the bottom in initial margin standards among CCPs. *See, e.g.,* Futures & Options World (FOW), *OTC Derivatives Clearing Roundtable.* There is also some preliminary evidence of the adverse effects of competition on margin standards among CCPs in the futures markets. *See* Nicole Abbruzzo and Yang-Ho Park, *An Empirical Analysis of Futures Margin Changes: Determinants and Policy Implications, Finance and Economics Discussion Series,* Divisions of Research & Statistics and Monetary Affairs, Federal Reserve Board (2014–86), *available at https://www.federalreserve.gov/econresdata/feds/2014/files/201486pap.pdf.*

counterparty (also known as variation margin); and (2) the initial margin amount for the account of the counterparty (also known as potential future exposure or initial margin). Variation margin is calculated by marking the position to market. Initial margin must be calculated by applying the standardized haircuts prescribed in Rule 15c3–1 or Rule 18a–1 (as applicable). However, a nonbank SBSD may apply to the Commission for authorization to use a model (including an industry standard model) to calculate initial margin. Broker-dealer SBSDs must use the standardized haircuts (which include the option to use the more risk sensitive methodology in Appendix A to Rule 15c3–1) to compute initial margin for non-cleared equity security-based swaps (even if the firm is approved to use a model to calculate initial margin). Stand-alone SBSDs may use a model to calculate initial margin for non-cleared equity security-based swaps (and potentially equity swaps if portfolio margining is implemented by the Commission and CFTC), provided the account of the counterparty does not hold equity security positions other than equity security-based swaps (and potentially equity swaps).

Rule 18a–3 requires a nonbank SBSD to collect collateral from a counterparty to cover a variation and/or initial margin requirement. The rule also requires the nonbank SBSD to deliver collateral to the counterparty to cover a variation margin requirement. The collateral must be collected or delivered by the close of business on the next business day following the day of the calculation, except that the collateral can be collected or delivered by the close of business on the second business day following the day of the calculation if the counterparty is located in another country and more than four time zones away. Further, collateral to meet a margin requirement must consist of cash, securities, money market instruments, a major foreign currency, the settlement currency of the non-cleared security-based swap, or gold. The fair market value of collateral used to meet a margin requirement must be reduced by the standardized haircuts in Rule 15c3–1 or 18a–1 (as applicable), or the nonbank SBSD can elect to apply the standardized haircuts prescribed in the CFTC's margin rules. The value of the collateral must meet or exceed the margin requirement after applying the standardized haircuts. In addition, collateral being used to meet a margin requirement must meet conditions specified in the rule, including, for example, that it must have a ready market, be readily transferable, and not consist of securities issued by the nonbank SBSD or the counterparty.

There are exceptions in Rule 18a–3 to the requirements to collect initial and/or variation margin and to deliver variation margin. A nonbank SBSD need not collect variation or initial margin from (or deliver variation margin to) a counterparty that is a commercial end user, the BIS, the European Stability Mechanism, or a multilateral development bank identified in the rule. Similarly, a nonbank SBSD need not collect variation or initial margin (or deliver variation margin) with respect to a legacy account (*i.e.,* an account holding security-based swaps entered into prior to the compliance date of the rule). Further, a nonbank SBSD need not collect initial margin from a counterparty that is a financial market intermediary (*i.e.,* an SBSD, a swap dealer, a broker-dealer, an FCM, a bank, a foreign broker-dealer, or a foreign bank) or an affiliate. A nonbank SBSD also need not hold initial margin directly if the counterparty delivers the initial margin to an independent third-party custodian. Further, a nonbank SBSD need not collect initial margin from a counterparty that is a sovereign entity if the nonbank SBSD has determined that the counterparty has only a minimal amount of credit risk.

The rule also has a threshold exception to the initial margin requirement. Under this exception, a nonbank SBSD need not collect initial margin to the extent that the initial margin amount when aggregated with other security-based swap and swap exposures of the nonbank SBSD and its affiliates to the counterparty and its affiliates does not exceed $50 million. The rule also would permit an SBSD to defer collecting initial margin from a counterparty for two months after the month in which the counterparty does not qualify for the $50 million threshold exception for the first time. Finally, the rule has a minimum transfer amount exception of $500,000. Under this exception, if the combined amount of margin required to be collected from or delivered to a counterparty is equal to or less than $500,000, the nonbank SBSD need not collect or deliver the margin. If the initial and variation margin requirements collectively or individually exceed $500,000, collateral equal to the full amount of the margin requirement must be collected or delivered.

ii. Nonbank MSBSPs

Rule 18a–3 also prescribes margin requirements for nonbank MSBSPs with respect to non-cleared security-based swaps. The rule requires a nonbank MSBSP to calculate variation margin for the account of each counterparty as of the close of each business day. The rule requires the nonbank MSBSP to collect collateral from (or deliver collateral to) a counterparty to cover a variation margin requirement. The collateral must be collected or delivered by the close of business on the next business day following the day of the calculation, except that the collateral can be collected or delivered by the close of business on the second business day following the day of the calculation if the counterparty is located in another country and more than four time zones away. Further, the variation margin must consist of cash, securities, money market instruments, a major foreign currency, the security of settlement of the non-cleared security-based swap, or gold. The rule has an exception pursuant to which the nonbank MSBSP need not collect variation margin if the counterparty is a commercial end user, the BIS, the European Stability Mechanism, or one of the multilateral development banks identified in the rule (there is no exception from delivering variation margin to these types of counterparties). The rule also has an exception pursuant to which the nonbank MSBSP need not collect or deliver variation margin with respect to a legacy account. There also is a $500,000 minimum transfer amount exception to the collection and delivery requirements for nonbank MSBSPs.

b. Benefits and Costs of the Margin Rule

As noted earlier, the market for non-cleared security-based swaps as it exists today is fairly opaque. Market participants have little or no knowledge about a dealer's uncollateralized exposure to a failed counterparty and the dealer's ability to withstand potential losses from such exposure. When a dealer fails, uncertainty about the uncollateralized exposures of the surviving dealers to the failed dealer and their safety and soundness may discourage some market participants from entering transactions with the surviving dealers. In turn, this uncertainty may hinder the efficient allocation of capital in this market.

In the market for non-cleared security-based swaps and in the market for OTC derivatives generally, collateral is the means for mitigating counterparty credit risk.[1146] Counterparties can collateralize a transaction by exchanging variation and initial margin. The regular exchange of variation margin between counterparties limits the potential for

[1146] *See* section VI.A.5. of this release.

one party in an OTC derivative transaction to build up a large ''current exposure'' to the other. The current exposure of counterparty A to counterparty B is the amount that counterparty B would be obligated to pay counterparty A if all the OTC derivatives contracts between the two parties were terminated (*i.e.,* it is the net amount of the current receivable from counterparty B). A positive current exposure of counterparty A to counterparty B implies a zero current exposure of counterparty B to counterparty A. The exchange of variation margin between two parties represents the settlement of profits and losses resulting from some subset of derivative transactions between those parties.

In the absence of significant market frictions and under suitable conditions, requiring the exchange of variation margin at a suitably high frequency can limit the probability that a counterparty exposure grows beyond a set level.[1147] However, in many instances, this may not be the case. In particular, market frictions in the CDS market, especially in times of stress, can result in liquidity shortages that prevent timely replacement of defaulted CDS positions. Delays in the replacement of such defaulted positions or closing out the positions can lead to losses for the non-defaulting party. Moreover, the occurrence of unexpected credit-related events at the reference entity can precipitate a counterparty default. For example, a seller of credit protection may itself enter financial distress as a result of a downgrade of the reference entity. Under such conditions, the exchange of variation margin may—by itself—be inadequate at limiting counterparty credit risk as unexpected credit events at the reference entity can contribute to both the development of current exposures to a counterparty and its default.

Such concerns provide the economic rationale for requiring initial margin. The exchange of initial margin is intended to limit ''potential future exposures'' (*i.e.,* losses resulting from the costs of replacing transactions with a failed counterparty). The potential future exposure of counterparty A to counterparty B is an estimate of the amount that the current exposure of counterparty A to counterparty B could increase before the position can be liquidated in the event of B's default. Generally, both parties in an OTC derivatives transaction will have positive potential future exposures to each other. By collecting initial margin amounts to cover these potential future exposures, market participants can reduce the costs associated with re-establishing their positions with a failed counterparty.

However, initial margin may be less effective in circumstances where the prevalent market practice is to not exchange initial margin and where there is no regulatory requirement that market participants do so. If only a limited number of inter-dealer exposures are collateralized with initial margins, and absent a capital regime for dealers that is sufficiently conservative to cover losses from positions that are not collateralized with initial margin, the failure of one dealer may still trigger the sequential failure of other dealers. Uncertainty about the uncollateralized exposures of the surviving dealers to the failed dealer and their ability to withstand losses from such exposures may erode the confidence of market participants in the safety and soundness of the surviving dealers. In times of stress, this uncertainty may cause the market to break down; market participants may suddenly ''run'' on the surviving firms due to uncertainty about their uncollateralized exposure to the failed dealer.

Thus, if the exchange of initial margin is not an adopted market practice or is not mandated by regulation, or if capital requirements for dealers are not sufficiently conservative to cover losses from positions that are not collateralized with initial margin, market participants may face additional uncertainty about the safety and soundness of the surviving dealers, which, in times of stress, may lead to a market shutdown.

A number of commenters argue that an approach based on the exchange of initial margin may prevent an inappropriate build-up of systemic risk within the financial system, which they argue would be more consistent with the intent of the Dodd-Frank Act.[1148] A commenter argued that it would be inappropriate to allow a nonbank SBSD to have non-cleared security-based swap exposure to another SBSD without any requirement to collect initial margin or to take a capital charge to recognize the risk in the non-cleared security-based swap and in the counterparty.[1149] Other commenters noted that the prudential regulators have explicitly required bank SBSDs to collect initial margin from other SBSDs and argued that the Commission should do so as well, and that the Commission should maximize harmonization with rules already implemented by the CFTC and the prudential regulators.[1150] Finally, one commenter criticized the Commission for making these proposals despite the fact that insufficient margin and capital were two of the triggers of the financial crisis.[1151]

The Commission agrees with the commenters that allowing dealers to enter non-cleared security-based swap exposures without having to collect initial margin or take a capital deduction for the credit risk of exposure may increase risk in the financial system, which may increase the risk of sequential dealer failure. This is why the final capital rules impose a capital deduction or credit risk charge when a nonbank SBSD elects not to collect initial margin under an exception in the Commission's final margin rule or the margin rules of the CFTC. In addition, there is a trade-off in terms of the benefits of requiring a nonbank SBSD to collect initial margin from another financial market intermediary: Namely, the liquidity of the delivering firm is reduced by the amount of initial margin posted to the nonbank SBSD. Thus, while the initial margin collected by the nonbank SBSD enhances the firm's safety and soundness, the delivery of liquid capital by the other financial market intermediary diminishes that firm's safety and soundness because it cannot use the delivered liquid capital to protect itself from losses or to meet liquidity demands.

Moreover, the final margin rule is intended to enhance the safety and soundness of nonbank SBSDs in the market for non-cleared security-based swaps by reducing the uncertainty about uncollateralized exposures to a failed counterparty. The requirement to exchange variation margin is intended to reduce a nonbank SBSD's potential losses stemming from uncollateralized market risk exposures, and the risk of nonbank SBSD failure as a result of

[1147] This follows under the assumption of, among other things, frictionless markets in which a defaulted position can be immediately replaced. In other words, if frequent exchange of variation margin guarantees that a market participant has collected enough margin to replace an outstanding position, markets for collateral assets are sufficiently liquid to permit sales with no price impact, and derivatives markets are sufficiently liquid to permit replacement of an outstanding position with no price impact, the market participant would be indifferent to whether her counterparty defaults or not, because she would be able to replace her outstanding position with the counterparty instantly without taking on any market risk.

[1148] *See* Americans for Financial Reform Education Letter; Barnard Letter; Citadel 11/19/2018 Letter; Council for Institutional Investors Letter.

[1149] *See* OneChicago 2/19/2013 Letter.

[1150] *See* Americans for Financial Reform Education Fund Letter; Citadel 11/19/2018 Letter; Rutkowski 11/20/2018 Letter.

[1151] *See* Better Markets 11/19/2018 Letter.

these potential losses. Further, the requirement that nonbank SBSDs collect initial margin from their counterparties that are not subject to an exception to the margin rule is intended to reduce a nonbank SBSD's potential losses stemming from uncollateralized credit risk exposures, and therefore reduce the risk of nonbank SBSD failure as a result of these potential losses.

However, the final margin rule includes a number of exceptions to the requirement that nonbank SBSDs collect variation and/or initial margin from counterparties, such as the exception from the requirement to collect variation or initial margin in transactions with commercial end users and the exception from the requirement to collect initial margin in transactions with other financial market intermediaries. The Commission acknowledges, however, as noted by a number of commenters, that financing additional collateral can also impose certain costs on parties in non-cleared security-based swap transactions, as well as potentially reduce liquidity in that market. In cases where an exception to the final margin rule applies and nonbank SBSDs have uncollateralized exposures from security-based swap transactions, the final capital rules and amendments require nonbank SBSDs to take capital deductions or credit risk charges against such uncollateralized exposures. While this approach may leave nonbank SBSDs with residual uncollateralized exposures, because capital deductions and credit risk charges against uncollateralized credit exposures can be much lower than the initial margin appropriate for such exposures, this approach may benefit nonbank SBSDs and market participants more generally, by supporting nonbank SBSD liquidity provision and promoting the liquidity and therefore the safety and soundness of nonbank SBSDs to the extent it relieves them from having to post initial margin to other nonbank SBSDs.

As described in the baseline, reliable information about counterparty exposures in the non-cleared security-based swap market is not currently publicly observable. Because market participants generally lack reliable information about their counterparty's exposure to a failed dealer or major participant, the failure of a dealer or major participant in these markets can lead to questions about the continued viability of other firms. It is generally not possible for market participants to reliably estimate the size of other participants' exposures to a failing firm. Uncertainty can cause market participants to cease trading with participants suspected of having had large exposures to the failed entity. This can precipitate the demise of suspect firms. By constraining uncollateralized counterparty exposures, margin requirements reduce the likelihood of sequential dealer failure.

To reduce these exposures, the final rule requires nonbank SBSDs to collect variation margin on a daily basis from other financial market intermediaries, including other SBSDs. Under the baseline, non-cleared security-based swap transactions are typically covered by agreements outlining the rights of the parties to make margin calls; however, such agreements may not require the contracting parties to exchange variation margin on a daily basis.[1152] Therefore, dealers may defer making margin calls during relatively benign market conditions, and make margin demands only when conditions deteriorate or when doubts about specific counterparties surface. This can destabilize markets and lead to contagion. By requiring daily collection or delivery of variation margin in inter-dealer trades, the final rule will limit the buildup of uncollateralized inter-dealer exposures. This will help ensure that, at all times, the immediate losses of a nonbank SBSD resulting from its non-cleared security-based swap exposures to a failing financial market intermediary are limited to a one-day change in the value of its positions with the failing firm.[1153]

While the inter-dealer exchange of variation margin may reduce the immediate losses from exposure to a failed dealer, this form of collateralization is usually not enough to isolate a dealer against potential losses from re-establishing or closing out the positions with a failed dealer. As noted earlier, such losses are usually covered by initial margin. The final margin rule does not require nonbank SBSDs to collect initial margin from other financial market intermediaries, including other SBSDs. While the rule does not preclude nonbank SBSDs from collecting initial margin from other financial market intermediaries, in general, the Commission does not expect most inter-dealer transactions to be collateralized with initial margin. However, as discussed above in section II.A.2.b.ii. of this release, the final capital rules will require nonbank SBSDs to take a capital deduction or credit risk charge for these inter-dealer uncollateralized exposures. In addition, the final capital rules require dealers to increase their minimum net capital by a factor proportional to the initial margin that would cover such exposures (when the margin factor amount equals or exceeds its fixed-dollar requirement). The additional capital that a surviving nonbank SBSD will have to allocate to support inter-dealer transactions that are not collateralized with initial margin will act as a buffer against potential losses from replacing or closing out the positions with a failed firm, and reduce the surviving nonbank SBSD's risk of default. To this end, while surviving nonbank SBSDs may still incur losses from replacing or closing out positions with defaulting counterparties that were not collateralized with initial margin, the final capital rules are designed to reduce the likelihood that such losses will lead to their failure. Thus, the final capital rules complement the margin requirements to limit the risk of sequential dealer failure in this market. By reducing the uncertainty about uncollateralized exposures to a failed dealer, and by reducing the risk of sequential dealer failure, the margin requirements together with the capital requirements should enhance the safety and soundness of the dealers in times of stress. Further, as discussed above, the exception from collecting initial margin from other financial market intermediaries involves a trade-off between the benefits that initial margin provides the collecting firm and the costs (including the loss of liquid capital) that such a requirement imposes on the delivering firm.

While the scale of the above benefits is difficult to quantify, it can be broadly characterized as a function of the size of the affected transactions and the degree to which a dealer's private incentives in those transactions may create uncollateralized exposures that reduce the stability of the market for security-based swaps. In the non-cleared security-based swap market, inter-dealer transactions represent a significant portion of transactions.[1154] Industry surveys indicate that on average, these transactions are partly collateralized (*i.e.,* margin for current or potential future exposure is not always collected).[1155] This collateralization practice, while limited, is consistent with major dealer defaults being rare and resulting from certain aggregate shocks. Dealer failures resulting from aggregate shocks could impose significant negative externalities on the financial system. If dealers were to fully

[1152] *See, e.g.,* ISDA, *User's Guide to the ISDA 1994 Credit Support Annex,* 1994.

[1153] Although the immediate losses are limited to a one-day net change in the value of the positions, eventual losses may be more significant due to the surviving dealer's inability to replace defaulted positions in a timely manner.

[1154] *See* section VI.A.1.d of this release.

[1155] *See* section VI.A.2.d of this release.

margin their inter-dealer transactions, including collecting initial margin from other dealers, the negative externalities associated with a dealer failure would be significantly reduced, resulting in improvements to financial stability. However, fully-margining inter-dealer transactions would impose costs on dealers because delivering margin collateral may reduce a dealer's available liquid capital and, therefore, the extent to which the dealer can provide liquidity to the market. Improvements to financial stability, on one hand, and higher costs associated with liquidity provision on the other hand could have offsetting effects on the overall economy. While dealers may pass on some of these costs to other security-based swap market participants through increased spreads or reduced liquidity provision, these costs generally may reduce a dealer's incentives to fully-margin its transactions with other dealers. Thus, private incentives alone may be insufficient to result in margin arrangements that improve the stability of the market for security-based swaps and the benefit of regulations can be significant.

The requirement to collect variation and initial margin from non-excepted counterparties is likely to generate qualitatively similar but quantitatively smaller benefits. The requirement should significantly limit the extent to which a nonbank SBSD can build a large uncollateralized exposure to a non-excepted counterparty, and therefore, significantly reduce the likelihood of the SBSD's failure due to potential losses from such exposure. However, although defaults among certain non-excepted counterparties may be more common, their defaults tend to be idiosyncratic and the negative externalities of these failures are less significant compared to those that result from a financial market intermediary's failure.

Margin requirements—initial margin requirements in particular—can also constrain risk-taking. As noted above, currently, nonbank dealers may collateralize some portion of the exposures created by their positions.[1156] In general, depending on the margin arrangements with the counterparties, a dealer may maintain a buffer of pledgeable assets to satisfy expected margin calls from the counterparties over a given period. In the absence of regulatory margin requirements, privately-negotiated margin requirements may be limited, resulting in small expected margin calls from the counterparties.[1157] This may likely result in a buffer of pledgeable assets that is small relative to the size of the exposures created by the dealer's derivatives book. Conversely, regulatory margin requirements, by imposing more extensive margin requirements, increase expected margin calls; the increased expected margin calls necessitate a larger buffer of pledgeable assets to support the same derivatives book. As pledgeable collateral must be funded, margin requirements link the expansion of a firm's derivatives book, and therefore the amount of risk it takes, more closely to its ability to obtain funding. In particular, regulatory margin requirements may reduce a dealer's ability to create uncollateralized exposures, and, therefore, limit its ability to take on risk.

The margin rule should further contribute to financial stability by limiting effective leverage in the non-cleared security-based swap market. By requiring nonbank SBSDs to exchange variation margin and to collect initial margin from non-commercial counterparties when the amount exceeds the initial margin threshold, the rule increases the collateral required to support non-cleared security-based swap transactions, limiting the effective leverage of such transactions. One commenter noted that the economic analysis should consider the impact of the final rules on market participants' ability to build up leverage through non-cleared security-based swaps.[1158] Absent the need to post margin, financial entities such as dealers, hedge funds, insurance companies, and banks are relatively unconstrained in the size of their security-based swap exposures.[1159] Failure of a large financial entity or of a group of smaller financial entities with significant derivatives exposures could lead to large dealer losses, dealer failures, or significant market dislocations. The rule limits the potential impact of financial entities' defaults by: (1) Reducing the probability of their occurrence; (2) reducing their scale; and (3) reducing losses to nonbank SBSDs from transaction with the defaulted counterparties. The first two effects follow from reductions in such firms' leverage. The third effect follows from a nonbank SBSD's ability to collateralize its exposures from the positons with a financial entity counterparty, prior to the default of the counterparty.

As noted above, under the final rule, a nonbank SBSD can defer collecting initial margin for up to two months following the month in which a counterparty no longer qualifies for the fixed-dollar $50 million threshold exception for the first time. This one-time deferral is designed to provide the counterparty with sufficient time to take the steps necessary to begin posting initial margin pursuant to the final rule. Thus, the deferral should support the benefits of the initial margin requirement discussed above by ensuring that counterparties have enough time to execute agreements, establish processes for exchanging initial margin, and take other steps to comply with the initial margin requirement. A nonbank SBSD that chooses to use the one-time deferral will continue to take a capital deduction in lieu of margin or credit risk charge. As noted above, the requirement to take this capital deduction or charge may impose costs on SBSDs and may create benefits for market participants.[1160] These costs could be limited to the extent that the nonbank SBSD and its counterparty have an existing agreement and processes that can be readily modified to incorporate the $50 million threshold and thus help shorten the deferral period.

Regulatory margin requirements on non-cleared transactions make them relatively less attractive vis-à-vis similar cleared transactions, and thereby encourage the use of cleared transactions. Cleared contracts significantly reduce the contagion risk inherent in bilateral contracts. When an OTC derivatives contract between two counterparties is submitted for clearing, it is replaced by two new contracts: Separate contracts between the CCP and each of the two original counterparties. At that point, the original counterparties no longer have credit risk exposures to each other. Instead, both are left with a

[1156] *See* section VI.A.2.d. of this release.

[1157] Although private incentives may be sufficient to require margin under certain circumstances, private incentives alone need not result in margin exchange policies that are optimal from a social perspective. In general, privately negotiated margin policies do not take account of the systemic risk externalities of uncollateralized counterparty exposures and are therefore expected to result in margin policies that require too little margin. *See, e.g.,* Viral V. Acharya, Aaditya M. Iyer, and Rangarajan K. Sundaram, *Risk-Sharing and the Creation of Systemic Risk* (New York University Stern School of Business, Working Paper (2015), *available at http://pages.stern.nyu.edu/~sternfin/vacharya/public_html/pdfs/2015-01-23_SystemicRiskCreation.pdf.*

[1158] *See* Better Markets 11/19/2018 Letter.

[1159] For example, hedge funds are not generally subject to regulatory capital requirements. Therefore, in the absence of a requirement to post initial margin, the scale of their derivatives exposures is not directly constrained by available capital.

[1160] *See* section VI.B.1.b.iii. of this release.

credit risk exposure to the CCP.[1161] Structured and operated appropriately, CCPs can improve the management of counterparty risk, reduce uncertainty, and provide additional benefits such as multilateral netting of trades.[1162] However, prudent risk management at CCPs will generally take the form of requirements on participants to frequently post initial and variation margin and requirements to contribute to a general guarantee fund.[1163] These measures impose costs on counterparties to cleared transactions. These costs can be avoided through non-cleared transactions if regulatory margin requirements are absent or the costs of regulatory margin requirements are lower.

By imposing regulatory margin requirements on nonbank SBSDs for non-cleared security-based swap transactions that, in large part, mirror certain margin requirements imposed by a clearinghouse on its participants, namely to collect variation and initial margin, the rule decreases the cost advantage of non-cleared security-based swap transactions relative to central clearing. For parties that derive sufficiently large private benefits from their collateral and who generally prefer to transact with more limited use of margin, the rule's requirements may, at the margin, increase the costs of non-cleared security-based swap transactions relative to cleared security-based swap transactions, encouraging these parties to clear their security-based swap transactions. Insofar as the final margin rule causes previously non-cleared transactions to be cleared, an important net benefit of the rule is promoting central clearing.

The final margin rule should also improve the information set for regulatory oversight of nonbank SBSDs and MSBSPs. The rule requires nonbank SBSDs and MSBSPs to perform margin 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. Even if the counterparty is not required to deliver collateral, the calculations will 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.[1164]

The principal costs resulting from the final margin rule arise from the requirement on a nonbank SBSD to collect initial margin from non-excepted counterparties to which the SBSD has a significant exposure (*i.e.,* an exposure that is above the $50 million initial margin threshold under the rule). As noted above, currently, nonbank dealers do not always collect initial margin from their counterparties on non-cleared security-based swap transactions.[1165] Thus, by requiring the collection of initial margin, absent an exception, the rule has the effect of increasing the demand for a market participant's unpledged collateral, and thereby raises the cost of engaging in non-cleared security-based swap transactions. This can reduce the efficiency of risk sharing through the non-cleared security-based swap market. The increased cost is also likely to lead to a reduction in the quantity of transactions. Reductions in the quantity of transactions can have negative implications for market liquidity, price discovery and on dealer profitability.[1166] Similarly, the additional margin required under the rule can reduce the availability of collateral for other transactions and limit the effective leverage of participants in the non-cleared security-based swap market. Finally, by reducing effective leverage, the requirements may reduce the profitability (*e.g.,* the expected returns) of investment strategies that currently take advantage of the leverage created by uncollateralized exposures in this market.

Several commenters argued that initial margin is unnecessary, and potentially counterproductive.[1167] One commenter believed that in lieu of initial margin, systemic risk could be effectively mitigated by daily variation margining with zero thresholds, implementation of appropriate capital requirements, and mandatory clearing of liquid standardized security-based swaps.[1168] The Commission believes that while all of the aforementioned mechanisms can play an important role in maintaining financial stability, they do not fully address it. In particular, as noted earlier, due to various market frictions, variation margin alone does not offer adequate protection against unexpected counterparty defaults in times of stress when such defaults are precipitated by the counterparty's losses in the same positions, and liquidity is scarce.[1169]

Another commenter argued that the Commission should not accept claims that the full margining of security-based swap transactions will make it difficult to use them for hedging purposes, or will shrink the size of the global security based swap market.[1170] This commenter also argued that the use of uncollateralized or under-collateralized security-based swaps does not reduce risk, it increases it, even if users claim the security-based swaps are ''hedges.'' This commenter also believed that to the degree the unregulated security-based swap market in place prior to the Dodd-Frank Act was overleveraged, it was also too large because full social costs of the market were not incorporated into user decisions.

Several comments raised concerns about certain technical aspects of the proposed initial margin calculation. Some commenters asked the

[1161] *See* Stephen Cecchetti, Jacob Gyntelberg, and Mark Hollanders, *Central Counterparties for Over-the-counter Derivatives,* BIS Quarterly Review (Sept. 2009).

[1162] *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 market could economize both on margin and non-margin resources). *See also Process for Submissions of Security-Based Swaps,* 77 FR at 41602.

[1163] *See Standards for Covered Clearing Agencies,* 81 FR 70786.

[1164] *See Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers; Capital Rule for Certain Security-Based Swap Dealers,* 79 FR at 25206.

[1165] *See* section VI.A.2.d. of this release.

[1166] Concerns with these costs were highlighted by several commenters. One commenter believed the proposed initial margin requirement would severely impact liquidity in the non-cleared security-based swap market and make non-cleared security-based swaps significantly more expensive because of the costs of initial margin. This commenter stated that these costs include not only the costs of the actual initial margin but also the operational burdens of complex daily posting and reconciliation of initial margin. This commenter stated that the OTC derivatives market is critical to the functioning of the overall economy and provided examples of non-clearable security-based swaps that the commenter believed are critical to key sectors of the global economy that would be harmed by the imposition of initial margin requirements. *See* ISDA 1/23/13 Letter.

[1167] A commenter asserted that ''VM, with daily collection (subject to limited exceptions for illiquid collateral) and zero thresholds, effectively protects against accumulated and unrealized losses in over-the-counter (''OTC'') derivatives positions.'' *See* ISDA 1/23/2013 Letter. Another commenter stated that ''[r]igorous variation margin requirements have the potential to significantly reduce systemic risk by eliminating the accumulation of uncollateralized current exposures while avoiding the potentially destabilizing and pro-cyclical effects of initial margin . . .'' *See* SIFMA 2/23/2013 Letter.

[1168] *See* ISDA 1/23/13 Letter.

[1169] As discussed earlier in this section, liquidity shortages during times of market stress can prevent timely replacement of defaulted CDS positions, and delays in replacement can lead to losses for the non-defaulting counterparty. Moreover, the occurrence of unexpected credit-related events at the reference entity can precipitate a counterparty default. Under such conditions, the exchange of variation margin may—by itself—be inadequate at limiting counterparty credit risk as unexpected credit events at the reference entity can contribute to both the development of current exposures to a counterparty and its default.

[1170] *See* Americans for Financial Reform Letter.

Commission to revise the standardized haircuts (which would be used to calculate initial margin if the firm was not authorized to use a model) to better reflect the historical market volatility and losses given default associated with CDS positions. A few commenters argued that methods (*e.g.,* using a model) other than the Appendix A methodology should be permitted to calculate initial margin for equity security-based swaps.[1171] One commenter stated that the Appendix A methodology is inadequate and inefficient for a proper initial margin calculation and does not sufficiently recognize portfolio margining.[1172] This commenter also stated that the Appendix A methodology does not incorporate critical factors such as volatility, and, as a result, initial margin on equity security-based swaps would likely be insufficient in times of stressed markets (in contrast to a model-based approach). Another commenter raised concerns that applying the Appendix A methodology would result in initial margin requirements that are substantially less sensitive to the economic risks of a security-based swap portfolio than a model-based approach, and suggested the Commission permit a nonbank SBSD to use either the Appendix A methodology or an internal model to compute the initial margin amount for equity security-based swaps.[1173] Another commenter requested that the Commission permit the use of models for both debt and equity security-based swaps.[1174]

In response to commenters' concerns regarding the use of the Appendix A methodology to compute initial margin for equity security-based swaps, the Commission modified the final margin rule to permit a stand-alone SBSD to use a model to calculate initial margin for non-cleared equity-based security-based swaps, provided the account does not hold equity security positions other than equity security-based swaps and equity swaps.[1175] Permitting the model-based approach under these limited circumstances strikes an appropriate balance in terms of addressing commenters' concerns and maintaining regulatory parity between the cash equity and the equity security-based swap markets.

Broker-dealer SBSDs will not be permitted to use a model to compute initial margin for equity security-based swaps. The Commission has also considered the objections of commenters to requiring the use of the Appendix A methodology to calculate the initial margin amount for non-cleared equity security-based swaps (rather than permitting a model).[1176] While the Commission agrees that the Appendix A methodology has certain limitations, particularly with respect to recognizing offsets arising from correlated positions, it notes that the use of models in this context is unlikely to address these limitations, and moreover, can introduce additional problems. Due to the volatility of equity returns, correlations in these returns are difficult to estimate without significant modeling assumptions. To the extent that parties in security-based swap transactions wish to minimize the total amount of initial margin devoted to such transactions, incentives to adopt optimistic assumptions can lead to models that overestimate negative correlations, underestimate positive correlations, and lead to inadequate margin levels. These are some of the reasons why the final capital and margin rules impose qualitative and quantitative requirements on the use of models and why the final capital rules impose higher capital requirements for (and increased monitoring of) nonbank SBSDs that use models.

In addition, the Commission recognizes the concerns commenters raised about the historical accuracy of the standardized haircuts. As discussed sections VI.A.7. and VI.B.1.iv. of this release, the Commission has provided an analysis that compares the standardized haircuts to the actual losses on credit default swap positions observed from historical data. In response to the commenters, the Commission notes that the standardized haircut grids for non-cleared CDS in the final rules are based on existing Rule 15c3–1 and, in part, on FINRA Rule 4240. The Commission further notes that in the analysis for CDS positions referencing single-name obligors, the maximum loss on a position scaled by its corresponding haircut—the so-called loss coverage ratio—exceeds 1 in all sample years. However, this is not always the case in the analysis for CDS positions referencing an index. These results suggest that the standardized haircuts in the final rules are generally not set at the most conservative level, as losses on some positions exceed the corresponding standardized haircuts. In general, haircuts are intended to strike a balance between being sufficiently conservative to cover losses in most cases, including in stressed market conditions, and being sufficiently nimble to allow dealers to operate efficiently in all market conditions. Based on the results of the analysis, as described above, the Commission believes that the standardized haircuts in the final rules take into account this tradeoff.[1177]

Several commenters argued against the adoption of initial margin requirements for certain types of counterparties. One commenter believed that substantial initial margin requirements could impose significantly greater costs on life insurers and suggested that dealers and major participants in the security-based swap market have the flexibility to determine whether and to what extent life insurers should be required to pledge initial margin to financial firms.[1178] One commenter argued that, as proposed, the initial margin requirements will ''severely challenge the resiliency of the financial system and will severely curtail the use of non-cleared swaps for hedging.'' [1179] Another commenter believed that the initial margin requirement is a new and costly requirement for most financial end users, while the variation margin requirement may undermine the ability of an end-user to negotiate the best terms for a security-based swap.[1180] This commenter stated that a survey found that a 3% initial margin requirement on the S&P 500 companies could be expected to reduce capital spending by $5.1 billion to $6.7 billion, and that United States would lose 100,000 to 130,000 jobs from both direct and indirect effects. One commenter urged the Commission to except counterparties with material swaps exposure of less than $8 billion from the margin requirements to be consistent with the margin rules adopted by the prudential regulators, the CFTC, and non-U.S. regulators.[1181] Other commenters opposed margin requirements for certain types of

[1171] *See* ISDA 1/23/2013 Letter; SIFMA 2/22/2013 Letter.

[1172] *See* ISDA 1/23/2013 Letter.

[1173] *See* SIFMA 2/22/2013 Letter.

[1174] *See* SIFMA AMG 2/22/2013 Letter.

[1175] *See* paragraph (d)(2)(ii) of Rule 18a–3, as adopted.

[1176] Nonbank SBSDs may also use the non-portfolio based standardized approach to calculate the haircut/margin for equity security-based swaps. In most cases, the deduction is the notional amount of the equity security-based swap multiplied by the deduction (haircut) that would apply to the underlying instrument referenced by the equity security-based swap.

[1177] As discussed above in section VI.B.1. of this release, a standardized haircut grid calibrated to historical volatilities and recoveries will generally not be accurate going forward, due to variation in volatilities and recoveries over time.

[1178] *See* American Council of Life Insurers 2/22/2013 Letter.

[1179] *See* ISDA 1/23/13 Letter.

[1180] *See* Coalition for Derivatives End-Users 2/22/2013 Letter.

[1181] *See* ICI 11/19/2018 Letter.

transactions. One commenter opposed margin requirements for inter-affiliate transactions and stated that this requirement would cause artificial and inefficient capital allocation for end-users, increase consumer costs, and undermine efficiencies that end-users currently realize through centralized treasury units.[1182] Another commenter argued that nonprofit sovereign institutions should be granted an exception to the posting of margin requirement because these institutions do not trade for profit-seeking reasons and they benefit from explicit or implicit guarantees from their sovereign governments.[1183] In addition, the commenter argued that the Commission's requirement to collect margin from this type of institution is not consistent with the margin requirements adopted by the CFTC and the prudential regulators.[1184]

Several commenters provided estimates of the additional collateral that would be required to satisfy the proposed rules.[1185] One commenter estimated that the potential impact of initial margin requirements assuming the use of models and a zero threshold, would be $1.7 trillion for universal two-way margin and $1.2 trillion for dealer only collection, as proposed by the Commission.[1186] This commenter also estimated that under proposed Alternative A (nonbank SBSDs exchange only variation margin) the total initial margin requirements would drop to $500 billion, assuming full use of models.

This commenter stated that its member firms have estimated that the liquidity demands associated with mandatory initial margin requirements are likely to range between approximately $1.1 trillion (if dealers are not required to collect initial margin from each other) to $3 trillion (if dealers must collect initial margin from each other) to $4.1 trillion (if dealers must post initial margin to non-dealers).[1187] Moreover, in stressed conditions, the commenter estimated that initial margin amounts collected by firms that use internal models could increase by more than 400%. A final commenter requested that multilateral development banks be exempt from the Commission's regulatory margin requirements, noting specifically that the International Bank for Reconstruction ''could face a potential posting requirement over the medium term of $20–30 billion under plausible scenarios,'' with a ''possible cost of carry in the range of $40–90 million per year,'' which could be problematic, given that none of the multilateral development banks have access to a liquidity facility of last resort.[1188]

Estimates of the aggregate impact of the Commission's margin rule are subject to two major uncertainties. First, as discussed below in section VI.D.2. of this release, the aggregate impact of the Commission's margin rule will largely depend on the SBSD organizational structure chosen by the large banking groups that dominate security-based swap trading activity. To the extent that security-based swap trades continue to be conducted primarily through entities subject to the prudential regulators' supervision (*i.e.,* bank SBSDs), relatively few transactions will be subject to the Commission's margin rules. To the same extent, the additional collateral required, and the costs associated with this additional collateral will, in the aggregate, be minimal. If however, security-based swap trading migrates to nonbank affiliates (*i.e.,* nonbank SBSDs), the aggregate impact of the rule could be considerably larger to the extent it imposes requirements that differ from the requirements of the prudential regulators' margin rules. Second, as discussed below in section VI.B.4. of this release, the aggregate amount of collateral required to satisfy the final margin rule will also depend on counterparties' choices with respect to segregation. The Exchange Act provides counterparties of nonbank SBSDs a choice of several alternatives to the segregation of their initial margin, including the option to waive segregation (though only affiliated counterparties can waive segregation in the case of a stand-alone broker-dealer or broker-dealer SBSD). As discussed below in section VI.B.4. of this release, when segregation is waived, the private costs associated with the requirement to collect initial margin can be significantly reduced as the SBSD collecting said initial margin would obtain the benefit of using the collected collateral in its operations.

One commenter[1189] suggested that the Commission estimate the additional collateral required to satisfy the margin requirements. However, as noted above, the collateral required to satisfy the Commission's rule will depend in large part on the business decisions of entities currently operating in the security-based swap market. To estimate the eventual collateral demand resulting from the Commission's new margin rule, the Commission would have to make significant assumptions about individual firms' ultimate organizational structure. In particular, the Commission would have to make assumptions about how much of U.S. security-based swap dealing activity would eventually be housed in nonbank SBSDs, rather than in bank SBSDs not subject to the Commission's margin rule; such assumptions would be highly speculative. Further, estimates of collateral demand resulting from the Commission's margin rule would also be significantly affected by market participant's contracting arrangements with respect to segregation of collateral. Because the Commission's new rules do not prevent re-hypothecation of collateral and permit the waiving of segregation, counterparties' choices in these areas will ultimately play a major role in determining the additional collateral demand; the Commission does not have information on the private contracting arrangements of counterparties or the preferences for particular segregation regimes that would allow for meaningful estimates of the use of segregation and re-hypothecation.

Finally, to obtain estimates for the entire security-based swap market, the Commission would have to make significant assumptions about unobserved security-based swap activity (*i.e.,* those transactions that are not single-name CDS). Although the Commission has provided estimates of the scale of such activity, such broad estimates are generally inadequate for quantifying the collateral required to support this activity under the final margin rule: To do so with some degree of accuracy would require detail on the non-CDS positions at the counterparty

[1182] *See* Coalition for Derivatives End-Users 2/22/2013 Letter.

[1183] *See* KFW Bankengruppe Letter.

[1184] *See CFTC Margin Final Release,* 81 FR at 696 (providing that the term ''financial end user'' (meaning an entity from whom margin must be collected) does not generally include any counterparty that is: A sovereign entity, a multilateral development bank, the BIS, a captive finance company that qualifies for the exemption from clearing under Section 2(h)(7)(C)(iii) of the Commodity Exchange Act and implementing regulations, or a person that qualifies for the affiliate exemption from clearing pursuant to Section 2(h)(7)(D) of the Commodity Exchange Act or Section 3C(g)(4) of the Securities Exchange Act and implementing regulations). *See also Prudential Regulator Margin and Capital Final Release,* 80 FR at 74855.

[1185] *See* ISDA 1/23/2013 Letter; SIFMA 3/12/2014 Letter; SIFMA 2/22/2013 Letter.

[1186] *See* ISDA 1/23/13 Letter.

[1187] *See* SIFMA 2/22/2013 Letter.

[1188] *See* World Bank Letter. In response to these comments, in the final rule, the Commission is adopting additional exceptions from the margin rule for the BIS, European Stability Mechanism, multilateral development banks, sovereign entities that have minimal credit risk, and affiliates. *See* Rule 18a–3, as adopted. These modifications to the final rule should alleviate commenters' concerns to some extent regarding the overall impact of the rule.

[1189] *See* ISDA 1/23/13 Letter.

level of entities that will register as nonbank SBSDs.[1190] Because the Commission would have to make several layers of assumptions that cannot be rigorously justified with available data, the Commission does not believe that attempts to quantify the cost of the final margin rule would provide reliable estimates of the true collateral demand resulting from it.

The final rule's requirements for the collection and posting of variation margin by nonbank SBSDs and MSBSPs may also lead to additional collateral funding costs for participants in the non-cleared security-based swap market. These costs, however, are likely to be of a smaller magnitude. Unlike segregated initial margin, variation margin does not ''consume'' collateral: Variation margin posted by one party can be used to satisfy margin requirements of the party collecting it. Moreover, the amount of required variation margin reflects the receiving party's mark-to-market gain (receivable) and delivering party's mark-to-market loss (payable) on the transaction. The exchange of variation margin settles the daily mark-to-market change in the value of the position (*i.e.,* it settles the receivable and payable). However, to the extent that collateral other than U.S. dollars or short-term U.S. government securities is used to meet a variation margin requirement, the final margin rule requires haircuts to be applied to the collateral. These haircuts could impose an incremental need to hold additional collateral to meet variation margin requirements. The Commission expects that cash and U.S. government securities (which require no or minimal haircuts) will predominantly be used to meet variation margin requirements and, therefore, the aggregate additional collateral required as a result of the haircuts should not be substantial.[1191] Thus, imposing variation margin requirements on security-based swap transactions where variation margin has not previously been collected may not significantly increase the overall amount of collateral required to support those transactions. However, the knowledge that variation margin must be posted on a daily basis can be expected to result in affected parties maintaining larger buffer stocks of unpledged collateral to ensure that margin calls can be satisfied.[1192] While this can indirectly increase the amount of collateral that is required to support such transactions and in so doing increase their cost, this effect is likely to be limited as the regular exchange of variation margin is a relatively common market practice under the baseline.

The impact of the Commission's margin rules on the non-cleared security-based swaps is expected to be qualitatively similar to the impact of the prudential regulators' margin rules for non-cleared security-based swaps and swaps and the CFTC's margin rules on non-cleared swaps. Quantitatively however, the scale of the impact will be much less significant. As of the end of 2017, non-cleared security-based swap positions represented less than 2% of the outstanding non-cleared swap positions.[1193] Nevertheless, if the Commission's final margin rule makes trading in the security-based swap market prohibitively expensive, the cost of this lost investment opportunity to market participants that currently are very active in the security-based swap market would be very significant.

The additional collateral funding costs resulting from the Commission's final margin rule are mitigated by the broad range of eligible collateral permitted by the rule, which may consist of cash, securities, money market instruments, a major foreign currency, the settlement currency of the non-cleared security-based swap, or gold. 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,[1194] takes advantage of efficiencies that result from correlations between securities and security-based swaps.[1195] One commenter supported the use of a broad range of collateral noting that it is important that the Commission recognize that the proposed rules could impose significantly greater costs on life insurers due to the potential narrowing of the securities categories eligible to be used as margin.[1196] Another commenter supported the Commission's broad approach to permissible collateral, arguing that a narrower approach could increase costs and liquidity pressures on market participants by increasing demand for and placing undue pressure on the supply of such collateral.[1197] However, another commenter believed that the collateral requirements under the proposal would nonetheless significantly increase the cost of using non-cleared security-based swaps, penalizing end users, including the pension plans, mutual funds and other vehicles for which commenter serves as a fiduciary.[1198]

The final margin rule is generally modeled on broker-dealer margin rules in terms of establishing an ''account equity'' requirement; requiring nonbank SBSDs to collect collateral to meet the requirement; and allowing a range of securities for which there is a ready market to be used as collateral. This approach promotes consistency with existing rules, which will generally reduce the implementation costs for entities with affiliates already subject to the Commission's broker-dealer financial responsibility rules, and the broker-dealer margin rules. It also facilitates the ability to provide portfolio margining of security-based swaps with other types of securities, and in particular single-name CDS with bonds

[1190] In this and other Title VII releases, the Commission has stated its belief that single-name CDS data are sufficiently representative of the security-based swap market to directly inform the analysis of the current state of the market. Moreover, in prior releases, the Commission has used its estimate that single-name CDS represent 82% of the total security-based swap market to make inferences about unobserved security-based swap activity. *See Trade Acknowledgment and Verification of Security-Based Swap Transactions,* 81 FR 39808. In those cases, a specific regulatory requirement—as well as the cost of the requirement—did not depend on the nature of the particular security-based swap. For example, security-based swap entities must provide trade acknowledgments to their counterparties for all security-based swaps. The requirement does not vary with the type of security-based swap. In contrast, margin requirements vary across security-based swaps. For example, initial margin requirements for non-cleared CDS that reference a narrow-based security index vary with the maturity and credit spread of the contract, as well as whether the dealer is approved to use models. As another example, broker-dealer SBSDs are not permitted to use models to calculate initial margin requirements for equity security-based swaps. Thus, in contrast to previous releases, any estimate of collateral costs will depend greatly on the composition of unobserved activity.

[1191] *See ISDA Margin Survey 2012* at 8, Table 2.1.

[1192] *See Central Clearing and Collateral Demand,* Journal of Financial Economics 116, no. 2, 237–256.

[1193] This figure is based on global notional amounts of swaps outstanding. *See* BIS, *OTC derivatives outstanding,* Tables D5.1 and D5.2.

[1194] *See* 12 CFR 220.1 *et seq.* (Regulation T); FINRA Rule 4210 (SRO margin rule); CBOE Rule 12.3 (SRO margin rule).

[1195] An ISDA margin survey states, with regard to the types of assets used as collateral, that the use of cash and government securities as collateral remained predominant, constituting 90.4% of collateral received and 96.8% of collateral delivered. *See ISDA Margin Survey 2012* at 8, Table 2.1.

[1196] *See* American Council of Life Insurers 2/22/2013 Letter (arguing that ''[n]arrow limits on the types of permitted collateral could greatly impair liquidity in the derivatives marketplace and thwart constructive risk management'').

[1197] *See* SIFMA 2/22/2014 Letter.

[1198] *See* PIMCO Letter (suggesting two modifications to the proposed margin rule to mitigate costs: (1) Model-based margin calculations should be based on a shorter liquidation period; and (2) the required haircuts on collateral should be adjusted to expand the range of collateral that can effectively be used).

referenced by the CDS. This consistent approach can also reduce the potential for regulatory arbitrage and lead to simpler interpretation and enforcement of applicable regulatory requirements across U.S. securities markets.

Finally, the Commission has modified the final margin rule in response to commenters' concerns about the rule excluding collateral types that are permitted by the CFTC and the prudential regulators. As noted above, the final rule permits cash, securities, money market instruments, a major foreign currency, the settlement currency of the non-cleared security-based swap, or gold to serve as eligible collateral.[1199] This will avoid the operational burdens of having different sets of collateral that may be used with respect to a counterparty depending on whether the nonbank SBSD is entering into a security-based swap (subject to the Commission's rule) or a swap (subject to the CFTC's rule) with the counterparty. It also will avoid potential unintended competitive effects of having different sets of collateral for non-cleared security-based swaps under the margin rules for nonbank SBSDs and bank SBSDs. Finally, by giving the option of aligning with the requirements of the CFTC and the prudential regulators, the final rule should avoid the necessity of amending existing collateral agreements that may specifically reference the forms of margin permitted by those requirements.

c. Alternatives Considered

i. Alternative B: Inter-Dealer margin

As discussed above in section II.B.2.b.i. of this release, the Commission proposed two alternatives (Alternatives A and B) with respect to inter-dealer margin requirements. Under Alternative A, a nonbank SBSD would need to collect variation margin but not initial margin from the other SBSD. Under alternative B, a nonbank SBSD would be required to collect variation and initial margin from the other SBSD and the initial margin needed to be held at a third-party custodian.

Alternative B was generally consistent with the recommendations in the BCBS/IOSCO Paper and the margin rules of the CFTC, prudential regulators, and European authorities in that it would have required nonbank SBSDs to exchange initial (in addition to variation margin). Further, it was consistent with the margin rules of the CFTC and the prudential regulators in that it would have required that initial margin be held at an unaffiliated third-party custodian.[1200] The BCBS/IOSCO Paper recommends that ''[i]nitial margin collected should be held in such a way as to ensure that (i) the margin collected is immediately available to the collecting party in the event of the counterparty's default, and (ii) the collected margin must be subject to arrangements that protect the posting party to the extent possible under applicable law in the event that the collecting party enters bankruptcy.''[1201] The EU's margin rule requires the collecting counterparty to provide the posting counterparty with the option to segregate its collateral from the assets of the other posting counterparties.[1202]

Alternatives A and B would have required nonbank SBSDs to collect variation *and* initial margin from non-excepted counterparties. Therefore, both alternatives would protect nonbank SBSDs from the consequences of one of these counterparties defaulting. However, because Alternative B would have required a nonbank SBSD also to collect variation *and* initial margin from an SBSD counterparty and segregate it with an independent third-party custodian, this alternative would have provided greater protection to nonbank SBSDs from the consequences of one of these counterparties defaulting than Alternative A. By providing greater protection against the consequences of non-excepted counterparties and SBSDs defaulting, Alternative B would have further reduced the likelihood of sequential dealer failure as a result of defaulting counterparties relative to Alternative A. This would have enhanced the safety and soundness of nonbank SBSDs in terms of this risk. As noted earlier in this release, most of the benefits of this enhancement would accrue to market participants that rely on nonbank SBSDs for liquidity provision in security-based swap market and other services.

However, Alternative B would likely impose more costs than Alternative A. As discussed above, there is a trade-off in terms of the benefits of requiring a nonbank SBSD to collect initial margin from another financial market intermediary: Namely, the liquidity of the delivering firm is reduced by the amount of initial margin posted to the nonbank SBSD. Thus, while the initial margin collected by the nonbank SBSD enhances the firm's safety and soundness, the delivery of liquid capital by the other financial market intermediary diminishes that firm's safety and soundness because it cannot use the delivered liquid capital to protect itself from losses or to meet liquidity demands. Thus, Alternative B would have reduced the safety and soundness of nonbank SBSDs in terms of this risk. In addition, the requirement that the initial margin be segregated at a third-party custodian could have contributed to the instability of the nonbank SBSD for whom the initial margin was posted if the initial margin was not immediately available to the nonbank SBSD upon the default of the SBSD counterparty.[1203] During periods of general market unrest, even a brief delay in access to liquid collateral, could increase instability.[1204] Further, Alternative B's negative impact on nonbank SBSDs' liquidity could have reduced their ability to trade in non-cleared security-based swaps. Nonbank SBSDs likely would have passed on these costs to other market participants who, in turn, may have had less of an incentive to trade in the security-based swap market.

In summary, although Alternative B would provide greater protection against a defaulting SBSD counterparty, it would also impose more costs on dealers and other market participants, relative to Alternative A.

ii. Third-Party Segregation Requirements

The final margin rules of the CFTC and the prudential regulators generally require that initial margin to be held at a third-party custodian. The purpose of using a third-party custodian is to have

[1199] *See* paragraph (c)(4)(i)(C) of Rule 18a–3, as adopted. The additional collateral requirements in the final rule are discussed below.

[1200] *See Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74863; *CFTC Margin Adopting Release,* 81 FR 636.

[1201] *See* BCBS/IOSCO Paper at 20 (''There are many different ways to protect provided margin, but each carries its own risk. For example, the use of third-party custodians is generally considered to offer the most robust protection, but there have been cases where access to assets held by third-party custodians has been limited or practically difficult. The level of protection would also be affected by the local bankruptcy regime, and would vary across jurisdictions.'').

[1202] The margin rules of the European Union require that initial margin be segregated on the books and records of a third-party holder or custodian; or via other legally binding arrangements so that the initial margin is protected from the default or insolvency of the collecting counterparty. Where cash is collected as initial margin, it must be deposited with an unaffiliated third-party holder or custodian or with a central bank. Initial margin cannot be re-hypothecated.

[1203] For example, the defaulting SBSD counterparty could claim that the secured nonbank SBSD is not entitled to access the initial margin held by the third-party custodian and bring a court action to bar such access. The resolution of this claim in court could substantially delay the secured nonbank SBSD's access to the collateral.

[1204] Importantly, as discussed below in section VI.B.4. of this release, the ultimate market effects will also depend on the approach adopted by market participants with regard to the segregation of initial margin.

the initial margin held in a manner that is bankruptcy-remote from the secured party. The Commission's final margin rule does not require that initial margin posted by a counterparty to the nonbank SBSD be held at a third-party custodian. However, Section 3E(f) of the Exchange Act provides counterparties the right to elect to have the initial margin they post to a nonbank SBSD to be held at an independent third-party custodian. Given the limited use of third-party segregation under existing market practice in security-based swap transactions, the circumstances in which third-party segregation is elected may be limited.

As an alternative, the Commission's margin rule could have required that initial margin posted to nonbank SBSDs be held at a third-party custodian. This would have provided more counterparties (*i.e.,* ones that would not have otherwise elected to have their initial margin held at a third-party custodian) with the benefit of having their initial margin protected from the consequences of the nonbank SBSD's bankruptcy. The main benefit of such an approach would be that the return of the initial margin to the counterparty would not be subject to the delay caused by having to make a claim in a bankruptcy proceeding and the subsequent processing of that claim.

However, mandating (rather than permitting) initial margin to be held at a third-party custodian would entail costs. For example, under existing market practice, initial margin is not typically employed in inter-dealer transactions; rather, it is largely limited to dealer transactions with non-dealer counterparties, where the non-dealers are the parties posting initial margin.[1205] Non-dealer counterparties typically have not required that initial margin they post to dealers be held at a third-party custodian. This may reflect a preference for granting dealers more flexibility with respect to the use of their collateral over its safety, given the added costs associated with establishing and maintaining tri-party custodial arrangements and potentially imposed by dealers when they cannot directly hold the initial margin. Mandating that initial margin be held at a third-party custodian could increase these costs.

iii. Eligible Collateral

The margin rules of the CFTC and the prudential regulators permit the following types of assets to serve as collateral: (1) Cash; (2) U.S. Treasury securities; (3) certain securities guaranteed by the U.S.; (4) certain securities issued or guaranteed by the European Central Bank, a sovereign entity, or the BIS; (5) certain corporate debt securities; (6) certain equity securities contained in major indices; (7) certain redeemable government bond funds; (7) a major foreign currency; (8) the settlement currency of the non-cleared security-based swap or swap; or (9) gold.[1206] The Commission's final margin rule permits cash, securities, money market instruments, a major foreign currency, the settlement currency of the non-cleared security-based swap, or gold. Consequently, unlike the margin rules of the CFTC and the prudential regulators, the Commission's final margin rule does not list the specific types of securities that can serve as eligible collateral. However, the Commission's final margin rule requires, among other things, that the collateral have a ready market.

In addition, the margin rules of the CFTC and the prudential regulators generally require that cash be used to meet a variation margin requirement in a transaction between dealers. The Commission's final margin rule does not place this limit on the collateral that must be used to meet a variation margin requirement.

As an alternative, the Commission could have specifically identified the types of securities that can serve as collateral and could have required that cash be used to meet a variation margin requirement of a financial market intermediary.

A benefit of this alternative is that with respect to the cash collateral requirement for variation margin in inter-dealer transactions it would limit the potential for losses resulting from liquidating non-cash collateral in times of stress, reduce the likelihood of fire-sale dynamics, and reduce uncertainty and disputes with respect to collateral valuation.[1207] A second benefit is that it would more closely align the Commission's margin rule with the margin rules of the CFTC and the prudential regulators. Commenters supported such consistency. One commenter urged consistency so that different rules would not apply to economically related transactions, or to transactions involving different types of counterparties, which could, in turn, lead to increased costs for end users.[1208] Another commenter requested that the Commission develop a list of permissible collateral that is consistent across jurisdictions to ''improve the efficiency of the derivatives market.'' [1209] These comments were aimed at the Commission's proposed margin rule. The Commission's final margin rule has been modified to permit the types of collateral that are eligible under the margin rules of the CFTC and the prudential regulators as discussed above in section II.B.2.b.i. of this release.

On the other hand, the alternative approach could increase demand for the types of securities enumerated in the margin rules of the CFTC and the prudential regulators and potentially cause shortages in their supply.[1210] Moreover, such forms of collateral may not be readily available to counterparties wishing to engage in non-cleared security-based swap transactions, significantly restricting their ability to engage in such transactions, and limiting the ability of these markets to facilitate risk transfer in the economy.

A commenter identified 3 adverse consequences of limiting collateral in the manner of the CFTC and the prudential regulators.[1211] First, the commenter argued that investors may be forced to hold unnecessarily low-yielding securities. Second, the commenter argued that the securities that investors will be forced to deliver as initial margin may be different from the transactions or portfolios hedged by the security-based swap, thereby creating undesirable basis risk and running counter to clients' desire to match benchmark composition. Third, the commenter argued that investors seeking to avoid this unnecessary cost or basis risk may look to ''collateral transformation'' approaches to convert holdings to assets that satisfy the posting requirements. The commenter argued that these collateral transformations will typically include haircuts on securities that will create additional costs for the funding component of the transformation.

The Commission broadly agrees with this commenter and believes that the alternative could unduly restrict the ability of entities to participate in the security-based swap market. It also could impede the ability to portfolio

[1205] *See* section VI.A.2.d. of this release.

[1206] *See Prudential Regulator Margin and Capital Adopting Release,* 80 FR at 74870; *CFTC Margin Adopting Release,* 81 FR at 701–2.

[1207] *See* 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.

[1208] *See* SIFMA AMG 2/22/2013 Letter.

[1209] *See* ISDA 2/5/2014 Letter.

[1210] *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.*

[1211] *See* PIMCO Letter.

margin security-based positions with related securities positions. Further, by granting participants in security-based swap transactions the flexibility to post a wider range of securities, the Commission's final margin rule may reduce the collateral costs for participants in the security-based swap market. Finally, the ready market requirement and collateral haircuts are designed to ensure that the collateral adequately covers the credit exposures that variation and initial margin are designed to address.

iv. Excluding Certain Assets From List of Eligible Collateral

The Commission's proposed margin rule permitted cash, securities, and money market instruments to serve as collateral to meet variation and initial margin requirements. Therefore, unlike the margin rules of the CFTC and the prudential regulators, it did not permit a major foreign currency, the settlement currency of the non-cleared security-based swap, or gold from serving as collateral. The margin rules of the CFTC and the prudential regulators permit major foreign currencies, the currency of settlement for the security-based swap, and gold to serve as eligible collateral. The Commission's final margin rule has been modified to permit the types of collateral that are eligible under the margin rules of the CFTC and the prudential regulators as discussed above in section II.B.2.b.i. of this release.

As an alternative, the Commission's margin rule could have continued to exclude a major foreign currency, the settlement currency of the non-cleared security-based swap, or gold from serving as collateral. However, differences between the sets of permitted collateral under the margin rules of the Commission and the CFTC and the prudential regulators could have imposed operational burdens on a nonbank SBSD. For example, a nonbank SBSD that is registered as a swap dealer would have been required to adhere to a different set of permitted collateral depending on whether it was entering into a security-based swap (subject to the Commission's rule) or a swap (subject to the CFTC's rule) with the counterparty. In addition, the nonbank SBSD and its counterparties would likely have had to incur costs to amend existing collateral agreements that may specifically reference the forms of margin permitted by CFTC and prudential requirements.

Further, prudential regulators permitting major foreign currencies, the currency of settlement for the security-based swap, and gold to serve as collateral (while the Commission did not) would have meant that a bank SBSD and its counterparties had more options when sourcing for permitted collateral compared to a nonbank SBSD. This greater range of options, in turn, could have allowed the bank SBSD to obtain eligible collateral at lower cost than a nonbank SBSD, even if both entities were entering into economically equivalent non-cleared security-based swap transactions. This could have allowed bank SBSDs to gain a competitive advantage over nonbank SBSDs.

In light of the operational burden, costs, and competitive disparity associated with the alternative, the Commission believes that final margin rule, which permits a major foreign currency, the settlement currency of the non-cleared security-based swap, and gold to serve as eligible collateral, is preferable to the alternative.

v. Not Permitting the Option To Use Collateral Haircuts Adopted by CFTC and Prudential Regulators

As discussed above in section II.B.2.b.i. of this release, the Commission's proposed margin rule provided that the fair market value of securities and money market instruments held in the account of a counterparty needed to be reduced by the amount of the standardized haircuts the nonbank SBSD would apply to the positions pursuant to the proposed capital rules for the purpose of determining whether the level of equity in the account met the minimum margin requirements. The proposed haircuts and the haircuts in the margin rules of the CFTC and the prudential regulators (which are based on the recommended standardized haircuts in the BCBS/IOSCO Paper) are largely comparable. However, there were differences. In order to promote greater harmonization with the margin rules of the CFTC and the prudential regulators, the Commission's final margin rule provides nonbank SBSDs with the option of choosing to use the standardized haircuts in the capital rules or the standardized haircuts in the CFTC's margin rule.

As an alternative, the Commission could have adopted the proposed requirement that did not provide the option to use the standardized haircuts in the CFTC's margin rule. However, this could have imposed operational burdens on nonbank SBSDs. For example, a nonbank SBSD that was also registered as a swap dealer would have been required to adhere to a different set of collateral haircuts depending on whether it was entering into a security-based swap (subject to the Commission's rule) or a swap (subject to the CFTC's rule) with the counterparty. In addition, the nonbank SBSD and its counterparties would likely have had to incur costs to amend existing collateral agreements that may specifically reference the haircuts in the margin rules of the CFTC and the prudential regulators.

This alternative also could have resulted in competitive disparities between bank SBSDs and nonbank SBSDs. To the extent that the prudential regulators' collateral haircuts result in more favorable treatment of a counterparty's collateral, the counterparty might have preferred to trade with a bank SBSD rather than with a nonbank SBSD, even if both SBSDs are equally attractive liquidity providers in all other respects. Thus, the alternative could have allowed bank SBSDs to gain a competitive advantage over nonbank SBSDs.

The Commission believes that final margin rule, which provides nonbank SBSDs with the option of using the CFTC's collateral haircuts, is preferable to the alternative as it will avoid the operational burdens, costs, and competitive disparities discussed above.

vii. Risk-Based Threshold

In the 2018 comment reopening, the Commission requested comment on whether it would be appropriate to establish a risk-based threshold where a nonbank SBSD would not be required to collect initial margin from a counterparty to the extent the amount does not exceed the lesser of: (1) 1% of the SBSD's tentative net capital; or (2) 10% of the net worth of the counterparty.[1212] As an alternative, the Commission could have adopted this risk-based initial margin threshold instead of the fixed-dollar $50 million initial margin threshold.

One commenter was concerned that, were the Commission to adopt an initial margin threshold tied to counterparty net worth, nonbank SBSDs would effectively be required to collect initial margin from all in-scope counterparties because they would be unable to confirm that the calculated initial margin amounts had not crossed the 10% net worth threshold. The commenter believed that such a requirement would put nonbank SBSDs at a significant competitive disadvantage relative to bank SBSDs and foreign SBSDs.[1213] The commenter also noted that the 1% tentative net capital threshold would effectively

[1212] *Capital, Margin, and Segregation Comment Reopening,* 83 FR at 53013.

[1213] *See* SIFMA 11/19/2018 Letter.

increase the prices offered by smaller nonbank SBSDs to counterparties relative to their competitors. Additionally, the commenter pointed out that the costs of overhauling systems and re-documenting initial margin agreements to incorporate the proposed thresholds would have a disproportionate impact on smaller firms, since such costs do not generally scale to a firm's size. These substantial disadvantages would likely reduce the ability of smaller nonbank SBSDs to attract counterparties, which would cause greater market concentration and less efficient pricing. A commenter argued that the Commission did not explain its views on why a counterparty-specific unsecured threshold (*e.g.,* $50 million) should be rejected in favor of a measure that would relate to a percentage of the nonbank SBSD's tentative net capital, which captures counterparty exposures only indirectly, or the counterparty's overall net worth unrelated to a specific counterparty relationship.[1214]

In response to the comments above, the Commission is adopting a fixed $50 million initial margin threshold below which initial margin need not be collected.[1215] This fixed threshold is consistent with the threshold adopted by the prudential regulators. Having a more consistent threshold will minimize potential competitive disparities and address operational concerns raised by commenters. The Commission recognizes that a fixed-dollar threshold (as opposed to a scalable threshold) does not necessarily bear a relation to the financial condition of the nonbank SBSD and its counterparty. To address this consequence, as discussed above, and as suggested by a commenter, a nonbank SBSD will be required to take a capital deduction in lieu of margin or credit risk charge if it does not collect initial margin pursuant to the fixed-dollar $50 million threshold exception. Furthermore, the nonbank SBSD will be required to establish, maintain, and document procedures and guidelines for monitoring counterparty risk. Consequently, the Commission does not believe the fixed-dollar $50 million threshold exception will unduly increase systemic risk as suggested by a commenter.

[1214] *See* Better Markets 11/19/2018 Letter.

[1215] *See* paragraph (c)(1)(iii)(G) of Rule 18a–3, as adopted.

4. The Segregation Rules—Rules 15c3–3 and 18a–4

a. Overview

As discussed above in section II.C. of this release, Section 3E(b) of the Exchange Act provides that, for cleared security-based swaps, the money, securities, and property of a security-based swap customer 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. However, Section 3E(c)(1) of the Exchange Act also provides that, for cleared security-based swaps, customers' money, securities, and property may, for convenience, be commingled and deposited in the same one or more accounts with any bank, trust company, or clearing agency. Section 3E(c)(2) further provides that, notwithstanding Section 3E(b), in accordance with such terms and conditions as the Commission may prescribe by rule, regulation, or order, any money, securities, or property of the security-based swaps customer of a broker, dealer, or security-based swap dealer described in Section 3E(b) may be commingled and deposited as provided in Section 3E with any other money, securities, or property received by the broker, dealer, or security-based swap dealer and required by the Commission to be separately accounted for and treated and dealt with as belonging to the security-based swaps customer of the broker, dealer, or security-based swap dealer.

Section 3E(f) of the Exchange Act establishes a program by which a counterparty to non-cleared security-based swaps with an SBSD or MSBSP can elect to have initial margin held at an independent third-party custodian (individual segregation). 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 report to the counterparty on a quarterly basis stating that the firm's back office procedures relating to margin and collateral requirements are in compliance with the agreement of the counterparties. The statutory provisions of Sections 3E(b) and (f) are self-executing.

The Commission is adopting omnibus segregation rules pursuant to which money, securities, and property of a security-based swap customer relating to cleared and non-cleared security-based swaps must be segregated but can be commingled with money, securities, or property of other customers. The omnibus segregation requirements for stand-alone broker-dealers and broker-dealer SBSDs are codified in amendments to Rule 15c3–3. The omnibus segregation requirements for stand-alone SBSDs (including those also registered as OTC derivatives dealers) and bank SBSDs are codified in Rule 18a–4.

The omnibus segregation requirements are mandatory with respect to money, securities, or other property that is held by a stand-alone broker-dealer or SBSD and that relate to cleared security-based swap transaction (*i.e.,* customers cannot waive segregation). With respect to non-cleared security-based swap transactions, the omnibus segregation requirements are an alternative to the statutory provisions discussed above pursuant to which a counterparty can elect to have initial margin individually segregated or waive segregation. With respect to non-cleared security-based swap transactions, the omnibus segregation requirements are an alternative to the statutory provisions discussed above pursuant to which a counterparty can elect to have initial margin individually segregated or waive segregation. However, under the final omnibus segregation rules for stand-alone broker-dealers and broker-dealer SBSDs codified in Rule 15c3–3, counterparties that are not an affiliate of the firm cannot waive segregation. Affiliated counterparties of a stand-alone broker-dealer or broker-dealer SBSD can waive segregation. Under Section 3E(f) of the Exchange Act and Rule 18a–4, all counterparties (affiliated and non-affiliated) to a non-cleared security-based swap transaction with a stand-alone or bank SBSD also can waive segregation The omnibus segregation requirements are the ''default'' requirement if the counterparty does not elect individual segregation or to waive segregation (in the cases where a counterparty is permitted to waive segregation).

Under the final segregation rules, an SBSD or stand-alone broker-dealer must maintain a security-based swap customer reserve account to segregate cash and/or qualified securities in an amount equal to the net cash owed to security-based swap customers. The SBSD or stand-alone broker-dealer must at all times maintain, through deposits into the account, cash and/or qualified securities in amounts computed weekly in accordance with the formula set forth in the rules. In the case of a broker-dealer, this account must be separate from the reserve accounts it maintains for traditional securities customers and broker-dealers.

The formula in the final segregation rules requires the SBSD or stand-alone broker-dealer to add up various credit items (amounts owed to security-based swap customers) and debit items (amounts owed by security-based swap customers). If, under the formula, credit items exceed debit items, the SBSD or stand-alone broker-dealer must maintain cash and/or qualified securities in that net amount in the security-based swap customer reserve account. For purposes of the security-based swap reserve account requirement, qualified securities are: Obligations of the United States; obligations fully guaranteed as to principal and interest by the United States; and, subject to certain conditions and limitations, general obligations of any state or a political subdivision of a state that are not traded flat and are not in default, are part of an initial offering of $500 million or greater, and are issued by an issuer that has published audited financial statements within 120 days of its most recent fiscal year end.

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. SBSDs and MSBSPs must provide this notice in writing to a duly authorized individual prior to the execution of the first non-cleared security-based swap transaction with the counterparty occurring after the compliance date of the rule. SBSDs also must obtain subordination agreements from a counterparty that affirmatively elects to have initial margin held at a third-party custodian or that waives segregation.

The final segregation rules modify the proposed definition of ''excess securities collateral'' to exclude securities collateral held in a ''third-party custodial account'' as that term is defined in the rules.[1216] The final segregation rules also incorporate the definition of ''third-party custodial account'' that was included in the 2018 comment reopening but with modifications suggested by the commenters to broaden the definition to include domestic registered clearing organizations and depositories and foreign supervised banks, clearing organizations, and depositories.[1217] The final segregation rules also modify the proposed definition of ''qualified registered security-based swap dealer account'' to remove the limitation that the account be held at an unaffiliated SBSD.

MSBSPs collect initial margin from security-based swap counterparties under a house margin requirement are subject to Section 3E(f) of the Exchange Act under the baseline, which—as discussed above—establishes a program by which a counterparty to non-cleared security-based swaps with an MSBSP can elect to have initial margin held at an independent third-party custodian.

b. Benefits and Costs of the Segregation Rules

Under the baseline, the Section 3E(b) of the Exchange Act provides that, for cleared security-based swaps, the money, securities, and property of a security-based swap customer 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. Therefore, under the baseline, stand-alone broker-dealers and SBSDs must segregate collateral for cleared security-based swaps and, therefore, the benefits of segregation (*i.e.,* protecting initial margin) will accrue to market participants to the extent they clear security-based swaps through stand-alone broker-dealers and SBSDs. However, the Section 3E(c)(1) of the Exchange Act also provides that, for cleared security-based swaps, customers' money, securities, and property may, for convenience, be commingled and deposited in the same one or more accounts with any bank, trust company, or clearing agency. The Commission's final omnibus segregation rules will permit stand-alone broker-dealers and SBSDs to commingle customers' initial margin for cleared security-based swaps. Therefore, these entities will benefit from the efficiencies and lower costs of treating initial margin for cleared security-based swaps in this manner as compared to individually segregating each customer's initial margin. The benefits of these efficiencies and lower costs will accrue to market participants in the form of quicker executions of cleared security-based swap transactions and lower transaction fees.

Stand-alone broker-dealers and SBSDs will incur costs to develop systems, controls, and procedures to comply with the omnibus segregation requirements and to operate those systems, controls, and procedures. These costs may be passed on to market participants to the extent they clear security-based swaps through stand-alone broker-dealers and SBSDs. However, these costs will be lower than the costs that would have been incurred under the baseline segregation requirement for cleared security-based swaps because it would not have permitted commingling of customers' initial margin. Thus, under the baseline, the stand-alone broker-dealers and SBSDs would have needed to develop and operate systems, controls, and procedures to individually segregate each customer's initial margin in separate accounts. This would have been a much more complex undertaking than it will be to develop and operate systems to comply with the omnibus segregation requirements where commingling customers' initial margin in a single account is permitted.

With respect to non-cleared security-based swaps, the final omnibus segregation rules are not mandatory. Counterparties that are affiliates of the stand-alone broker-dealer or broker-dealer SBSD with whom they are transacting the non-cleared security-based swap can potentially elect individual segregation, omnibus segregation, or to waive segregation. Counterparties (regardless of whether they are affiliates) potentially can elect any of these alternatives if they are a counterparty to a non-cleared security-based transaction with a stand-alone or bank SBSD. Counterparties that are *not* affiliates of the stand-alone broker-dealer or broker-dealer SBSD with whom they are transacting the non-cleared security-based swap can potentially elect either individual segregation or omnibus segregation (they cannot waive segregation).

Therefore, the direct benefits and costs of the Commission's final omnibus segregation rules as applied to non-cleared security-based swap transactions will depend, in large part, on the entities with whom counterparties choose to transact: Stand-alone broker-dealers and broker-dealer SBSDs (where the option to waive segregation is not available to non-affiliates) or stand-alone and bank SBSDs (where the option to waive segregation is potentially available to all counterparties and where the option for the stand-alone or bank SBSD to operate

[1216] *See* paragraph (p)(1)(ii)(B) of Rule 15c3–3, as amended; paragraph (a)(2)(ii) of Rule 18a–4, as adopted.

[1217] *See* paragraph (p)(1)(viii) of Rule 15c3–3, as amended; paragraph (a)(10) of Rule 18a–4, as adopted.

under the exemption from the omnibus segregation rules is available).

Because segregation (individual or omnibus) is mandatory when a non-affiliated counterparty enters into a non-cleared security-based swap with a stand-alone broker-dealer or broker-dealer SBSD, and because omnibus segregation is the default requirement for a stand-alone SBSD or bank SBSD, the final rules could incrementally increase the amount of collateral that is segregated for non-cleared security-based swaps. The amount of this increase will depend on whether counterparties elect individual segregation or, if permitted, to waive segregation. It also will depend on whether counterparties elect to transact with stand-alone or bank SBSDs operating under the exemption to the omnibus segregation requirements or with stand-alone SBSDs operating pursuant to the alternative compliance mechanism. If counterparties elect these alternatives to omnibus segregation, the final rules (themselves) will have a limited impact on the amount of collateral that is segregated. However, if they do increase the amount of collateral that is segregated, SBSDs may pass these costs to market participants.

However, these costs may be limited. In general, the Commission expects most non-cleared security-based swap dealing will be conducted by stand-alone and bank SBSDs (where waiver by non-affiliated counterparties will be permitted). This is because the Commission expects that dealers in non-cleared security-based swaps will organize themselves as stand-alone SBSDs to take advantage of the more favorable capital requirements applicable to stand-alone SBSDs under the final rules (*i.e.,* the absence of a portfolio concentration charge and the ability to use the alternative compliance mechanism).

Furthermore, the Commission expects that dealers in non-cleared security-based swaps will generally seek exemption from the omnibus segregation requirements in Rule 18a–4, which is available to stand-alone and bank SBSDs. While qualifying for the exemption means they will not be able to clear security-based swap transactions for others, the Commission does not believe that will discourage dealers in non-cleared security-based swaps from organizing as stand-alone or bank SBSDs to take advantage of the exemption.[1218] Moreover, the Commission does not believe that an entity will register solely as an SBSD to clear security-based swap transactions for others, given the relative size of the cleared security-based swap market as compared to the cleared swap market. Therefore, entities that want to clear security-based swaps will also want to clear swaps and, therefore, need to register as FCMs. This creates a strong incentive to effect brokered cleared transactions through entities that are dually registered as broker-dealers and FCMs, and to deal in non-cleared transactions in stand-alone SBSDs and swap dealers.

Finally, based on FOCUS information, the Commission believes that the broker-dealers most active in dealing in non-cleared security-based swaps will trade mostly with affiliates that will be permitted to waive segregation under the final omnibus segregation rule for stand-alone broker-dealers and broker-dealer SBSDs. For these reasons, the Commission does not expect the limitation in Rule 15c3–3 that prohibits a non-affiliated counterparty from waiving segregation will significantly increase the amount of collateral segregated for non-cleared security-based swap transactions.

In the context of transactions where the waiver limitation does not apply, the benefits and costs of the final segregation rule will depend on whether counterparties elect individual segregation or to waive segregation under Section 3E(f) of the Exchange Act, or, alternatively, elect to have their initial margin held directly by the stand-alone broker-dealer or SBSD subject to the omnibus segregation requirements. Thus, in evaluating the costs and benefits of the final segregation rules, the Commission considers the implications of optionality on the segregation choices of market participants, and the impact of those choices on the costs and benefits of the rules. In this regard, available information suggests that customer assets related to security-based swap transactions are currently not consistently segregated from dealer proprietary assets. With respect to non-cleared security-based swaps, available information suggests that there is no uniform segregation practice but that collateral for most accounts is not segregated.[1219] According to an ISDA margin survey, where independent amounts (initial margin) are collected, ISDA members reported that most (72%) was commingled with variation margin and not segregated, and less than 5% of the amount received was segregated with a third party-custodian.[1220]

As a general matter, more restrictive segregation regimes (*i.e.,* individual segregation, omnibus segregation, or similar privately negotiated arrangements) provide more protection to the posting party. However, they ''lock up'' collateral to varying degrees, restricting its use by the collecting party, and raise the overall cost of the transaction. Avoiding segregation can lower the costs of the transaction by permitting the recipient of collateral to obtain benefits from its use. However, collateral that is not segregated may be difficult to recover when the holder of the collateral is in distress. Thus, the absence of segregation can potentially contribute to instability in times of stress.

In response to the 2018 comment reopening, one commenter recommended that the Commission not impose the omnibus segregation requirements on bank SBSDs, foreign SBSDs, stand-alone SBSDs, and OTC derivatives dealers that do not clear for customers.[1221] This commenter argued that the proposed omnibus segregation requirements could conflict with bank liquidation or resolution, may cause jurisdictional disputes, and are not consistent with the Exchange Act. In addition, this commenter stated that omnibus segregation requirements would impair hedging and funding activities for stand-alone SBSDs and OTC derivatives dealers because the exclusions related to the use of excess securities collateral admit only a narrow range of hedging activities. In particular, the commenter was concerned that a failure to recognize hedging strategies using instruments other than security-based swaps would create undue regulatory incentives to transact using one type of instrument versus another.

[1218] In particular, to clear swaps for others, a swap dealer must be registered as an FCM under the CFTC's rules. The FCM capital rule prescribes a net liquid asset test similar to the broker-dealer net capital rule (Rule 15c3–1). Bank swap dealers in particular appear to avoid clearing swaps for customers (and limit their swap dealing activities to non-cleared swaps), as engaging in such business would subject them to the capital requirements for FCMs in addition to the capital requirements that would apply to them under the bank capital rules.

[1219] *See generally ISDA Margin Survey 2012.* More recent ISDA margin surveys do not include the relevant statistics.

[1220] *See 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, 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 amounts received and 27.8% of independent amounts delivered being segregated in some respects. *See also* ISDA, *Independent Amounts,* Release 2.0.

[1221] *See* SIFMA 11/19/2018 Letter.

As discussed above, the final segregation rule for stand-alone and bank SBSDs will exempt these entities from the requirements of the rule if the SBSD meets certain conditions, including that the SBSD does not clear security-based swap transactions for other persons, provides statutory notice to the counterparty regarding the right to segregate initial margin at an independent third-party custodian, and discloses in writing that any collateral received by the SBSD will not be subject to a segregation requirement and how a counterparty's claim on collateral would be treated in a bankruptcy or other formal liquidation proceeding of the SBSD. This modification from the proposed rule will lessen the costs imposed on stand-alone and bank SBSDs that do not clear security-based swaps for other persons by avoiding conflict with other regulations and minimizing the impact on hedging activity. As discussed above, the Commission expects these firms will not choose to clear security-based swaps for others because, from an economic perspective, it is more attractive to clear security-based swaps *and* swaps for others. Clearing swaps for others requires registration as an FCM and, therefore, compliance with the CFTC's capital requirements for FCMs.

However, the exemption to the final segregation rule may also impose costs on market-participants. A stand-alone or bank SBSD that is making use of this exemption would be able to comingle the collateral collected from counterparties with its own assets. In particular, the firm would be able to use a counterparty's collateral to collateralize a transaction with another counterparty (*i.e.,* collateral re-hypothecation). In the event of the stand-alone or bank SBSD's failure, counterparties may have difficulty recovering their collateral in a timely manner, or at all.

The omnibus segregation requirements are the default requirement for non-cleared security-based swaps if the counterparty does not affirmatively elect individual segregation or to waive segregation (and if the SBSD is not operating pursuant to the exemption for bank and stand-alone SBSDs). A large body of behavioral economics literature has documented the power of defaults in driving individual behavior.[1222] In addition, the final segregation rules require a foreign SBSD to disclose to a U.S. security-based swap customer the potential treatment of the assets segregated by the SBSD pursuant to Section 3E of the Exchange Act, and the rules and regulations thereunder, in insolvency proceedings under U.S. bankruptcy law and applicable foreign insolvency laws. This requirement may cause SBSDs' customers to devote more attention to the choice of segregation regime and may potentially trigger greater reluctance to transact without segregation.[1223] Thus, the rule's requirement that omnibus segregation be the default approach for non-cleared security-based swaps could have the effect of increasing the use of some form of segregation in non-cleared security-based swap transactions. However, the Commission cannot determine the extent to which having omnibus segregation be the default requirement will increase the use of segregation. In particular, the Commission lacks information on the extent to which market participants prefer various segregation options, as well as data on the extent to which defaults determine the behavior of market participants active in the security-based swap market.[1224]

The Commission cannot predict the ultimate magnitude of the use of segregation by counterparties to non-cleared security-based swap transactions under the final rules. Counterparties to non-cleared security-based swap transactions may find it privately beneficial to waive segregation. For example, a hedge fund customer of a dealer may consider the risk of dealer insolvency to be too remote to warrant requiring the segregation of its initial margin if waiving segregation results in the dealer offering better terms, or providing other non-pecuniary benefits.[1225] Alternatively, two dealers with bilateral security-based swap exposures that require similar amounts of initial margin can reduce the total collateral required to support those exposures by waiving segregation. Waiving segregation allows collateral posted by the first dealer to be used by the second dealer to satisfy its margin obligation to the first: the end result is similar to when initial margin is not required. In addition, other factors may contribute to a lower use of segregation. For example, a dealer's counterparties may not be fully aware of the implications of the lack of segregation,[1226] or have insufficient bargaining power to extract the desired segregation arrangements.[1227]

Importantly, parties that decide that it is privately optimal to waive segregation for non-cleared security-based swaps may not take into account the potential externalities of their decisions. If customers generally do not avail themselves of the option to segregate collateral for non-cleared security-based swaps, this will reduce the potential positive contribution of the final segregation rules to financial stability. For example, the emergence of doubts about a dealer can lead to sudden demands for segregation, which during times of market stress may be difficult for dealers to satisfy, precipitating distress or failure. Moreover, if a dealer fails, the likelihood that its counterparties can recover their collateral in a timely manner is decreased, raising questions about the financial condition of those counterparties. In addition, to the extent that actual insolvency contributes to the dealer's failure, counterparties' collateral may never be fully recovered. Delays in recovery of collateral, realized losses, and the potential of such losses, could potentially lead to contagion, and destabilizing runs.

Conversely, to the extent that the final segregation rules ultimately increase the use of segregation for non-cleared security-based swaps, they could impose costs on SBSDs (and their counterparties). These costs would primarily result from limitations on SBSDs' use of initial margin. As discussed above in section VI.A.5.a. of this release, margin requirements have been adopted by the CFTC, prudential regulators, and foreign regulators, but they are being phased-in over time. Further, current market practice (in the absence of regulatory requirements)

[1222] *See* William Samuelson and Richard Zeckhauser, *Status Quo Bias in Decision Making,* Journal of Risk and Uncertainty 7–59 (1988).

[1223] *See* Victor Stango and Jonathan Zinman, *Limited and varying consumer attention evidence from shocks to the salience of bank overdraft fees,* Review of Financial Studies (2014).

[1224] Broadly, the evidence for behavioral biases tends to be more limited in ''professional'' contexts. *See, e.g.,* John A. List, *Does Market Experience Eliminate Market Anomalies?* Quarterly Journal of Economics (Feb. 2003); Zur Shapira and Itzhak Venezia. *Patterns of behavior of professionally managed and independent investors,* Journal of Banking & Finance 25.8 (2001): 1573–1587.

[1225] Similar concerns were raised by a commenter who argued that by not mandating individual segregation, ''cost considerations will lead [SBSDs] to pressure counterparties not to elect segregation.'' *See PIMCO Letter.* Another commenter stated that the costs for imposing omnibus segregation on foreign SBSDs would be significant. *See* IIB 11/19/2018 Letter.

[1226] *See* Alarna Carlsson-Sweeny, *Trends in Prime Brokerage,* Practical Law: The Journal (Apr. 2010) (''Few US hedge funds fully comprehended the repercussions of allowing their assets to be transferred offshore'' to avoid the Commission's segregation requirements.).

[1227] *See id.* (''Before Lehman's collapse, the relationship between hedge funds and prime brokers was one-sided, with prime brokers holding most of the bargaining power.'').

does not generally involve posting initial margin. Therefore, the impact of any restrictions on the use of such collateral strictly relative to the baseline should be quite limited. More specifically, under the baseline scenario where the exchange of initial margin for non-cleared security-based swaps is largely voluntary, segregation requirements that impose restrictions on how SBSDs can use collateral posted by their counterparties should have minimal economic effect, as the final segregation rules would be unlikely to bind. However, the margin requirements of the CFTC, prudential regulators, and the Commission (as they come into full effect) are expected to increase the prevalence of initial margin in non-cleared security-based swap transactions, and the Commission believes it is meaningful to also analyze the interaction of the new margin and segregation requirements. In this context, the impact of the Commission's final segregation rules is likely to be more significant.[1228] If, as a result of the final margin and segregation rules, security-based swap counterparties increase demand for segregation of initial margin for non-cleared security-based swaps, dealers' costs of engaging in security-based swap transactions will increase. Having unhindered access to customers' collateral represents a significant benefit to a dealer. Such collateral can be used by the dealer in its hedging and proprietary trading activities. In its absence, the dealer will bear the cost of financing the collateral to support these activities. Depending on the level of segregation required by the dealer's counterparties, the collateral required to support current levels of security-based swap activity could be significantly greater than in a regime without segregation and no restrictions on re-hypothecation. To the extent that the provisions of the final segregation rules increase demand for segregation in non-cleared security-based swap transactions, a dealer's costs of hedging these transactions may be higher than under existing market practice. Similarly, increased use of segregation for non-cleared security-based swaps would reduce dealers' ability to otherwise benefit from the use of customers' collateral. Both of these factors could potentially lead to higher apparent transaction costs in the security-based swap market.[1229]

Additional operational and up-front costs resulting from the final rules as applied to cleared and non-cleared security-based swaps include costs of establishing qualifying bank accounts, costs of third-party custody services and associated legal fees, as well as costs of building systems to maintain custody of customer securities and to perform the required calculations.[1230] The final rules require that stand-alone broker-dealers and SBSDs compute the amount required to be maintained in the special reserve account for the exclusive benefit of security-based swap customers at least weekly. This requirement supports the benefits of segregation described above, by ensuring that the assets subject to segregation more accurately reflect the risks to the posting party in the event that the holder of collateral fails. The final rules permit more frequent computations. Such flexibility will be valuable to those broker-dealers and standalone SBSDs that have the operational capability and resources to perform daily computations. These entities may choose to perform daily computations if the benefits of doing so—for example, being able to more rapidly take advantage of investment opportunities using cash withdrawn from the reserve account—outweigh the costs associated with daily computations.

In cases of a broker-dealer SBSD, the costs of adapting existing systems to account for cleared and non-cleared security-based swap transactions may not be material in light of the similarities between the systems and procedures currently required by Rule 15c3–3 and those that will be required by final segregation rules. For bank and stand-alone SBSDs without such systems, the operational up-front costs could be higher. However, even in these cases it is likely that the entities in question will have access to similar systems and expertise from their broker-dealer affiliates.[1231]

As discussed above, the extent to which segregation will be used by market participants for non-cleared security-based swaps is unknown. In particular, the Commission lacks data on the preferences of current market participants for various segregation options, as well as the private benefits and costs described qualitatively above that may inform a market participant's choice of whether to use individual segregation or omnibus segregation, or to waive segregation. In the absence of a material increase in the use of segregation for non-cleared security-based swaps, the direct costs of the final segregation rules borne by counterparties to security-based swaps should be minimal. Moreover, for market participants electing omnibus segregation for non-cleared security-based swaps, the direct costs should be lower than counterparties that elect individual segregation where the stand-alone broker-dealer or SBSD will not hold the collateral directly and will not be able to use it for the limited purpose permitted in the final rules (*i.e.,* hedging the customer's transaction). Thus, firms running matched books that collect initial margin from end-users should not have to fund additional collateral to support hedging transactions with other SBSDs. For these reasons, the costs of omnibus segregation should be lower as compared with individual segregation.[1232]

c. Alternatives Considered

i. Mandatory Individual Segregation

A potential alternative to the final rules would be to mandate individual segregation for non-cleared security-based swaps in a manner that is consistent with the margin rules of the CFTC and the prudential regulators.[1233] This alternative would not give an SBSD's counterparty to a non-cleared security-based swap the option to elect omnibus segregation or to waive segregation altogether (if such a waiver is permitted). Thus, the alternative is considerably more restrictive. As discussed above, the magnitude of the costs and benefits of segregation depends on the extent to which it is adopted by market participants. Under this alternative, individual segregation would be mandatory and thus universally practiced. As a result, it would be more costly to market participants primarily due to significant additional collateral funding costs,

[1228] *See* section VI.B.3. of this release for estimates of the use of margin under the Commission's final margin rules.

[1229] In the absence of segregation, part of the consideration offered by the SBSD's counterparty to the SBSD in an OTC derivatives transaction is non-pecuniary: the right to make use of the counterparty's collateral. In the absence of this benefit, the SBSD can be expected to require additional (likely pecuniary) consideration from the counterparty. This would appear as higher transaction costs. It is important to note that there would be a corresponding benefit realized by security-based swap counterparties: increased collateral safety.

[1230] *See* Rule 15c3–3, as amended; Rule 18a–4, as adopted. *See* section VI.C. of this release (discussing implementation costs).

[1231] As discussed above in section VI.A. of this release, dealing activity in the security-based swap and swap market is concentrated in affiliates of large diversified bank holding companies. Such firms can be expected to have access to expertise and systems of their broker-dealer affiliates.

[1232] In addition, and as noted by one commenter, individually segregated accounts impose increased administrative burdens and related costs. *See* MFA 2/22/2013 Letter.

[1233] *See CFTC Margin Adopting Release,* 81 FR 636; *Prudential Regulator Margin and Capital Adopting Release,* 80 FR 74840.

while also providing financial stability benefits.

Mandatory individual segregation would likely reduce the risk of contagion. Third-party segregation with no re-hypothecation minimizes the risk of delays and losses in the recovery of collateral for transactions involving an entity that enters into financial distress.[1234] Under such arrangements, the counterparties of the troubled entity can be confident in their ability to recover their collateral in the event of its default. This reduces the incentives for counterparties to ''run'' on the troubled entity. In addition, it increases market participants' confidence in the financial condition of the troubled entity's counterparties in the event of its default: in such an event counterparties can be expected to recover their collateral *and* the collateral posted by the defaulting party. Access to the latter compensates the surviving counterparties for losses incurred in replacing the defaulted transaction. Together, these effects can stabilize the market in times of stress. Relatedly, this alternative would restrict the implicit leverage in non-cleared security-based swap transactions. By preventing re-hypothecation, the alternative would tie growth in the gross notional amounts of non-cleared security-based swap activity to the amount of collateral devoted to this activity. Similar to other forms of leverage limits, this can contribute to financial stability. Finally, by increasing the collateral costs of non-cleared security-based swap transactions, this alternative would create incentives for central clearing. Together, the aforementioned benefits could further reduce the likelihood of sequential counterparty failure in the security-based swap market beyond the rules the Commission is adopting.

However, these benefits of mandatory individual segregation with no re-hypothecation come with a cost. The alternative would deprive the SBSD of the use of collected collateral for re-hypothecation in related transactions, or in support of its trading operations. As discussed in the prior section, the locking up of collateral would raise the SBSD's costs of facilitating security-based swap transactions.

Aside from the additional collateral funding costs, this alternative may further increase costs by reducing the SBSD's access to defaulting counterparties' collateral in typical default scenarios. A typical defaulting counterparty is not expected to be another SBSD, but rather an end-user who does not collect collateral from the SBSD. In such scenarios, third-party segregation can complicate the SBSD's attempts to make use of the defaulting counterparty's collateral: Rather than having immediate access to collateral in its possession or control, the SBSD would need to obtain the collateral from a third party. This could create delays that harm the SBSD's ability to liquidate and reestablish the positions of the insolvent counterparty, and may cause the SBSD to incur losses.

The Commission has considered the costs and benefits of requiring segregation at a third-party custodian and prohibiting re-hypothecation. Based on its judgment and prior experience, the Commission determines that the potential benefits to financial stability do not justify the potentially considerable additional costs that would need to be borne by market participants under this alternative approach.

ii. Daily Computations To Determine Reserve Account Requirement

The proposed rule provided that the computations necessary to determine the amount required to be maintained in the SBS 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. A commenter requested that the Commission require a weekly computation rather than a daily computation.[1235] The commenter stated that calculating the reserve account formula is an onerous process that is operationally intensive and requires a significant commitment of resources. The commenter further stated that the Commission can achieve its objective of decreasing liquidity pressures on SBSDs while limiting operational burdens by requiring weekly computations and permitting daily computations. The Commission acknowledges that a daily reserve calculation will increase operational burdens as compared to a weekly computation. Therefore, in response to comments, the Commission is modifying the final rules to require a weekly SBS Customer Reserve Account computation.[1236]

iii. Including Securities Collateral Held in a Third-Party Custodial Account in the Definition of ''Excess Securities Collateral''

The proposed definition of ''excess securities collateral'' did not include securities collateral held in a third-party custodial account. As discussed above in section II.C.3.a.i. of this release, the proposed definition would have prevented a stand-alone broker-dealer or SBSD from posting a customer's securities collateral to a third-party custodian in accordance with the requirements of the prudential regulators. This consequence could have increased the cost incurred by the stand-alone broker-dealer or nonbank SBSD to enter into a non-cleared security-based swap with another SBSD to hedge a non-cleared security-based swap with a customer under the conditions in the final segregation rules. Under the proposed definition of ''excess securities collateral,'' a broker-dealer or SBSD would have had to use proprietary securities or cash to enter into a hedging transaction with a bank SBSD. To the extent that the firm incurs a cost to obtain the proprietary securities or cash, that cost would add to the cost of entering into the hedging transaction with the bank SBSD and thus raise the overall cost of hedging the transaction with the customer. Alternatively, the broker-dealer or SBSD would have had to limit its hedging transactions to nonbank SBSDs and avoid trading with bank SBSDs. This approach would have avoided the need to use proprietary securities or cash to enter into a hedging transaction, as discussed above. However, by limiting itself to a smaller set of potential counterparties (*i.e.,* other SBSDs), the firm would have reduced the competition among potential counterparties to provide hedging services to the firm. If the reduced competition resulted in higher prices for liquidity provision, for example, wider bid-ask spreads, the broker-dealer or SBSD may have incurred a higher cost to enter into a hedging transaction. To the extent that the firm passed on the increased hedging cost to the customer by charging a higher price for providing liquidity to the customer, transaction costs in the security-based swap market could have risen, which may have discouraged participation in the security-based swap market and

[1234] These risks are not entirely eliminated. Delays may still occur due to legal disputes that prevent the third-party custodian from releasing the collateral. Similarly, losses may still occur if the third-party custodian suffers from financial distress. However, under individual segregation with no re-hypothecation, the potential for such delays and losses is expected to be relatively limited.

[1235] *See* SIFMA 2/22/2013 Letter.

[1236] *See* paragraphs (p)(3)(A) and (B) of Rule 15c3–3, as amended; paragraphs (c)(3)(i) and (ii) of Rule 18a–4, as adopted.

impeded the use of this market for hedging economic exposures. In light of this concern, the Commission believes that the definition of ''excess securities collateral'' in the final rules is preferable to this alternative.

iv. Including ''Unaffiliated'' in the Definition of ''Qualified Registered Security-Based Swap Dealer Account''

The proposed definition of ''qualified registered security-based swap dealer account'' included the term ''unaffiliated,'' which meant that an affiliated SBSD would not fall within the scope of the proposed definition. As the Commission has discussed elsewhere, entities that engage in security-based swap dealing activities may lay off the risk associated with a security-based swap transaction to another affiliate via a back-to-back transaction or an assignment of the security-based swap.[1237] To the extent that a broker-dealer or SBSD enters into a non-cleared security-based swap with an affiliated SBSD to hedge a non-cleared security-based swap with a customer as part of its risk management, the proposed definition could impede the firm's risk management because it could not use the counterparty's initial to meet the margin requirement of the affiliated SBSD under the conditions of the final rules. As a consequence, the broker-dealer or SBSD could have incurred a higher cost to enter into a non-cleared security-based swap with an affiliated SBSD for hedging purposes as permitted under the conditions in the final rules. If the broker-dealer or SBSD chose to enter into a hedging transaction with an affiliated SBSD, it would had to use proprietary securities or cash to meet the affiliate SBSD's margin requirement. To the extent that the nonbank SBSD incurred a cost to obtain the proprietary securities or cash, that cost would add to the cost of entering into the hedging transaction with the affiliated SBSD and thus raise the overall cost of hedging the firm's transaction with the counterparty. Alternatively, the nonbank SBSD could enter into a hedging transaction with an unaffiliated SBSD that satisfies the proposed definition of ''qualified registered security-based swap dealer account'' so that it could use the counterparty's initial margin to meet the margin requirement of the unaffiliated SBSD. However, the nonbank SBSD may have still incurred a higher cost to enter into the hedging transaction, if the unaffiliated SBSD charges a higher price for providing liquidity than the affiliated SBSD. More generally, to the extent that cost efficiencies are realized through the use of the affiliated SBSD for risk management purposes, those efficiencies would be lost if the broker-dealer or SBSD enters into a hedging transaction with an unaffiliated SBSD, which would raise the overall cost of the hedging transaction. To the extent that the broker-dealer or SBSD passed on the increased hedging cost to the counterparty by charging a higher price for providing liquidity to the counterparty, transaction costs in the security-based swap market could have risen, which could have discouraged participation in the security-based swap market and impede the use of this market for hedging economic exposures. In light of this concern, the Commission believes that the definition of ''qualified registered security-based swap dealer account'' in the final rules is preferable to this alternative.

5. Cross-Border Application

a. Overview

As the Commission has previously indicated, security-based swap market is global, and market data presented in the economic baseline demonstrates extensive cross-border participation in the market.[1238] For example, approximately half of price-forming North American corporate single-name CDS transactions from January 2008 to December 2015 were cross-border transactions between a U.S.-domiciled counterparty and a foreign-domiciled counterparty. Counterparties in the security-based swap market are highly interconnected; dealers transact with hundreds of counterparties, and most non-dealers transact with multiple dealers. The global scale of the security-based swap market allows counterparties to access liquidity across jurisdictional boundaries, providing market participants with opportunities to share these risks with counterparties around the world. Because dealers facilitate the great majority of security-based swap transactions, with bilateral relationships that extend to potentially thousands of counterparties spanning multiple jurisdictions, the safety and soundness of non-U.S. dealers can have significant implications for U.S. financial stability.

As discussed above in section II.E.1. of this release, the Commission is treating the capital and margin requirements of the Exchange Act the final rules as entity-level requirements. The Commission also is amending Rule 3a71–6 to make a substituted compliance available with respect to the capital and margin requirements of Section 15F(e) of the Exchange Act and Rules 18a–1, 18a–2, and/or 18a–3.

The Commission is treating the segregation requirement as a transaction-level requirement. Further, substituted compliance is not available with respect to the final segregation requirements. However, the final segregation rule for stand-alone and bank SBSDs and MSBSPs has exceptions under which a foreign firm need not comply with the segregation requirements of Section 3E of the Exchange Act and Rule 18a–4 for certain transactions. The final rule also requires a foreign stand-alone or bank SBSD to make certain disclosures to a U.S. security-based swap customer relating to segregation and U.S. bankruptcy and foreign insolvency laws. There are no exceptions from the segregation rule for cross-border transactions of a broker-dealer SBSD or MSBSP.

b. Benefits and Costs

In considering the economic effects of this cross-border approach, the Commission recognizes that the economic baseline reflects markets as they exist today, in which no population of registered SBSDs and MSBSPs exists and compliance with capital, margin, and segregation requirements for security-based swaps is not required. Therefore, these final rules will apply with respect to security-based swap transactions intermediated by entities where they currently do not.

Imposing the new capital and margin requirements on non-U.S. SBSDs and MSBSPs has the potential to significantly impact the willingness of foreign entities to transact with U.S. counterparties in the security-based swap market, especially firms for which the U.S. market represents a relatively small fraction of total security-based swap business. For such firms, the additional costs resulting from having to comply with the capital and margin requirements of the Exchange Act the Commission's final rules in addition to corresponding regulations applicable in their own jurisdiction may not justify the benefits of conducting security-based swap transactions with U.S.

[1237] *See Proposed Guidance and Rule Amendments Addressing Cross-Border Application of Certain Security-Based Swap Requirements,* 84 FR 24206.

[1238] *See, e.g., Application of ''Security-Based Swap Dealer'' and ''Major Security-Based Swap Participant'' Definitions to Cross-Border Security-Based Swap Activities; Republication,* 79 FR at 47280; *Application of Certain Title VII Requirements to Security-Based Swap Transactions Connected With a Non-U.S. Person's Dealing Activity That Are Arranged, Negotiated, or Executed by Personnel Located in a U.S. Branch or Office or in a U.S. Branch or Office of an Agent,* 80 FR at 27454; *Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants,* 81 FR 29960.

entities. The exit of foreign firms from the U.S. security-based swap market could potentially harm liquidity in these markets, and more importantly, would likely reduce valuable risk-sharing opportunities for U.S. counterparties.

However, as noted earlier, the global and inter-connected nature of the security-based swap market implies that the safety and soundness of non-U.S. firms operating in this market can have a significant impact on U.S. financial stability. Moreover, failing to apply capital and margin regulations to such foreign entities would potentially create incentives for regulatory arbitrage as participants in U.S. markets would seek to locate in jurisdictions with the most favorable capital and margin treatment.

With respect to capital requirements, the Commission believes that imposing the same entity-level requirements that are applicable to U.S. firms on non-U.S. entities with the opportunity for substituted compliance in cases where the foreign jurisdiction imposes comparable requirements reflects appropriate consideration of potential compliance costs and benefits to U.S. markets. By allowing non-U.S. entities to satisfy comparable requirements in foreign jurisdictions, the rule mitigates the compliance burden on these non-U.S. entities. At the same time, by requiring compliance with capital requirements at the entity level, the rule should reduce the likelihood that entities operating in the U.S. market will impose negative financial stability externalities on the U.S. market by locating in a foreign jurisdiction. The Commission did not receive comments addressing the proposed treatment of capital as an entity-level requirement.

Similar considerations apply to the Commission's approach in treating the final margin requirements as entity-level requirements. A number of commenters suggested that the Commission should apply margin requirements on a transaction-level basis instead of on an entity-level basis, with several arguing that this was necessary for consistency with other domestic and foreign regulators.[1239] Some of these commenters also pointed to the costs and operational complications that could result from subjecting a foreign registrant to both Commission and home country margin requirements.[1240]

While there are potential consistency issues and operational complications to applying the Commission's margin requirements at the entity-level rather than at the transaction-level, these considerations have to be considered in the context of the economic function of margin requirements. The primary economic function of the Commission's final margin requirements is to enhance financial stability to help ensure the safety and soundness of nonbank SBSDs and nonbank MSBSPs. Permitting substantially different margin requirements based on the location of the counterparty would not be consistent with this objective and could undermine the stability of U.S. markets. Moreover, as above discussed in section VI.B.3. of this release, the Commission expects market participants to employ industry standard models in the calculation of initial margin amounts. It is reasonable to expect that such models will be designed in a manner to comply with the margin requirements of the key jurisdictions implementing margin regulations, thereby reducing the potential for significant discrepancies. Finally, minor differences in margin requirements across jurisdictions can be addressed through applications for substituted compliance.

While Commission's final capital and margin requirements primarily serve to ensure the safety and soundness of regulated entities and thereby enhance financial stability, a primary economic function of the Commission's final segregation requirements is to protect the assets of U.S. customers and counterparties in the event of an SBSD's insolvency and to align the final segregation requirements with U.S. insolvency laws. As such, the Commission proposed transaction-level requirements tailored to address the risks faced by U.S. customers of non-U.S. entities. The Commission did not receive comments addressing the transaction-level treatment of the segregation requirements. However, one commenter stated that it ''support[s] the Commission's overall proposal to distinguish between entity-level and transaction-level requirements'' and that it ''generally support[s] the Commission's proposed cross-border application of segregation requirements to foreign SBSDs.''[1241] The main considerations in the design of the Commission's segregation requirements with respect to non-U.S. SBSDs and MSBSPs are of a legal rather than economic nature. They are discussed in section II.D.1. of this release.

6. Rule 18a–10

a. Overview

As discussed above in section II.D. of this release, the final capital, margin, and segregation rules include an alternative compliance mechanism (codified in Rule 18a–10) pursuant to which a stand-alone SBSD that is registered as a swap dealer and predominantly engages in a swaps business may elect to comply with the capital, margin, and segregation requirements of the CEA and the CFTC's rules applicable to swap dealers instead of complying with Rules 18a–1, 18a–3, and 18a–4.[1242] In order to qualify for the alternative compliance mechanism, the firm must: (1) Be registered as an SBSD pursuant to Section 15F(b) of the Exchange Act and the rules thereunder; (2) be registered as a swap dealer pursuant to Section 4s of the Commodity Exchange Act and the rules thereunder; (3) not be registered as a broker-dealer pursuant to Section 15 of the Exchange Act or the rules thereunder; (4) meet the conditions to be exempt from Rule 18a–4 specified in paragraph (f) of that section; and (5) as of the most recently ended quarter of the fiscal year, have an aggregate gross notional amount of the security-based swap positions of the that do not exceed the lesser of the maximum fixed-dollar amount specified in paragraph (f) of the rule or 10 percent of the combined aggregate gross notional amount of the security-based swap and swap positions of the SBSD. The maximum fixed-dollar amount is set at a transitional level of $250 billion for the first 3 years after the compliance date of the rule and then drops to $50 billion thereafter unless the Commission issues an order: (1) Maintaining the $250 billion maximum fixed-dollar amount for an additional period of time or indefinitely; or (2) lowering the maximum fixed-dollar

[1239] *See* Better Markets 8/21/2013 Letter (arguing that treating margin as a transaction-level requirement ''is more consistent with the CFTC's cross-border guidance''); IIB 8/21/2013 Letter (stating that the Commission's divergence from the CFTC's rules and those envisioned by the EMIR would be ''impracticable'' and ''could also lead to significant competitive distortions''); ISDA 1/23/2013 Letter (generally requesting that the Commission recognize local margin requirements for SBSDs outside the United States, and coordinate with the CFTC and other domestic and foreign regulators to achieve consistency in the treatment of swaps and security-based swaps involving multiple jurisdictions); Japan SDA Letter (urging the Commission and the CFTC to align their rules to avoid ''hamper[ing] efficient management of derivatives transactions'').

[1240] *See* IIB 8/21/2013 Letter (stating that it would be ''cost-intensive'' to ''negotiate and execute separate credit support documentation, make separate margin calculations and have separate operational procedures across its swap and [security-based swap] transactions''); Japan SDA Letter (inconsistent rules would ''hamper efficient management of derivatives transactions'').

[1241] *See* IIB 8/21/2013 Letter.

[1242] *See* Rule 18a–10. As discussed above in section II.D. of this release, while a bank SBSD could theoretically use the alternative compliance mechanism, the Commission does not expect such an entity will do so.

amount to an amount between $250 billion and $50 billion.

The rule further requires a stand-alone SBSD operating pursuant the alternative compliance mechanism to provide a written disclosure to its counterparties before the first transaction with the counterparty after the firm begins operating pursuant to the mechanism notifying the counterparty that the firm is complying with the applicable capital, margin, segregation, recordkeeping, and reporting requirements of the CEA and the CFTC's rules in lieu of complying with Rules 18a–1, 18a–3, and 18a–4. The rule further requires, among other things, that the firm comply with the capital, margin, and segregation requirements of the CEA and the CFTC's rules applicable to swap dealers and treat security-based swaps and related collateral pursuant to those requirements to the extent the requirements do not specifically address security-based swaps and related collateral.

b. Benefits and Costs of Rule 18a–10

The final rule provides stand-alone SBSDs that are also registered as swap dealers and that engage predominantly in swap activity with flexibility to comply with a single set of requirements under the CEA and the CFTC's rules. The primary benefit of the alternative compliance mechanism is that it will avoid the costs of complying with two sets of capital, margin, and segregation requirements for a firm that is dually registered as a stand-alone SBSD and a swap dealer. This benefit is perhaps best illustrated through how it will permit a stand-alone SBSD to comply with the capital requirements of the CEA and the CFTC's rules exclusively rather than comply both with those requirements and with the capital requirements of the Commission's rules. For example, a stand-alone SBSD operating pursuant to the alternative compliance will not need to perform two capital computations and monitor its capital position and financial condition to ensure it is complying with the Commission's capital requirements (in addition to the capital requirements of the CEA and the CFTC's rules).

Moreover, as discussed above, the Commission's final capital rules impose certain requirements with respect to swap positions that are not imposed by the CFTC's proposed capital rules and that could have important economic implications for firms that engage in swap trading activity. These requirements include a requirement that a stand-alone SBSD will need to take a capital deduction if the firm posts initial margin to a counterparty in a swap transaction pursuant to the margin rules of the CFTC. The Commission is providing guidance in this release to as to how a firm could avoid this capital deduction. While some firms may be able to take advantage of this guidance, others may not. Thus, generally, the requirement may impose costs on those firms that cannot use the guidance.

In addition, stand-alone SBSDs also will be required to take a capital deduction in lieu of margin or credit risk charge for uncollateralized exposures from swap positions that are subject to an exception in the margin rules of the CFTC. For example, one such exception in the CFTC's margin rules is that swap dealers are not required to collect initial margin on swaps from counterparties that are not ''covered swap entities'' or ''financial end users,'' as those terms are defined in the rules. Because reallocating capital from other activities to support the swap trading activity or raising capital is generally costly, the requirement may impose a cost on those firms that carry uncollateralized exposures from swap transactions.

Another requirement is that stand-alone SBSDs will be required to take a capital deduction or credit risk charge for margin collateral required of a counterparty pursuant to the CFTC's margin rule that is held at a third-party custodian. The final capital rules contain an exception from having to take this capital charge. The conditions for the exception are designed to recognize existing agreements entered into pursuant the margin rules of the CFTC. However, to the extent firms cannot meet all the conditions for the exception, they may not be able to avoid taking the capital charges associated with this requirement, and therefore may incur potential costs.

The proposed capital rules of the CFTC do not include some requirements being adopted by the Commission, and therefore swap dealers that are not dually registered as SBSDs may not face the potential costs associated with these requirements. From this perspective, stand-alone SBSDs that can meet the conditions of the alternative compliance mechanism will have an incentive to take advantage of it. The larger the potential costs associated with the differences between the final capital rules of the CFTC (when adopted) and the Commission, the larger the potential impact of the overlapping regulatory regimes on the swap trading activity. The alternative compliance mechanism will reduce the potential impact of these costs on the swap trading activity of stand-alone SBSDs, which, in turn, could benefit the swap market participants to the extent that stand-alone SBSDs that use the alternative compliance mechanism pass on the associated cost savings to their counterparties in the form of lower prices for liquidity provision.

Firms that face potential costs associated with differences between the capital, margin, and segregation requirements of the Commission's rules and the CFTC's rules may be at a competitive disadvantage relative to firms that are subject to the CFTC's rules only, and, as a result, the latter category of firms may be able to offer better prices to swap market participants. Therefore, the primary benefit of the alternative compliance mechanism is that it will avoid these costs and the corresponding competitive impact of them.

However, using the alternative compliance mechanism will also impose costs on stand-alone SBSDs. In particular, the requirement to provide written disclosure to all counterparties prior to the first transaction that would be subject to the alternative compliance mechanism will impose costs. These implementation costs are discussed in more detail in section VI.C. below.

The maximum fixed-dollar amount is set at a transitional level of $250 billion for the first 3 years after the compliance date of the rule and then drops to $50 billion thereafter unless the Commission issues an order: (1) Maintaining the $250 billion maximum fixed-dollar amount for an additional period of time or indefinitely; or (2) lowering the maximum fixed-dollar amount to an amount between $250 billion and $50 billion.

Analysis by Commission staff indicates that the 10% threshold likely will be the greater of the two thresholds for stand-alone SBSDs that are also registered as swap dealers. Thus, the following discussion focuses on the maximum fixed-dollar threshold. Commission staff estimates that up to seven stand-alone SBSDs that are also registered as swap dealers have aggregate gross notional amount of single-name CDS positions that fall under the $250 billion threshold. Out these 7 stand-alone SBSDs that are also swap dealers, Commission staff estimates that between 1 and 4 [1243] may engage in levels of security-based swap activity such that the aggregate gross notional amount of their single-name CDS positions may fall under the $50 billion threshold.

[1243] The upper bound estimate of 4 accounts for data limitations and measurement errors.

To the extent that the aggregate gross notional amount of these stand-alone SBSDs' single-name CDS positions remains unchanged, the lowering of the maximum fixed-dollar amount from $250 billion to $50 billion could impose costs on certain stand-alone SBSDs that may seek to use the alternative compliance mechanism. In particular, stand-alone SBSDs with aggregate gross notional amount of less than $250 billion but above $50 billion will be able to use alternative compliance mechanism in the first 3 years and benefit from the associated cost savings discussed above. If the maximum fixed-dollar amount is lowered to $50 billion after 3 years, these stand-alone SBSDs would not be able to use alternative compliance mechanism and would begin to incur the costs described above. To the extent that these stand-alone SBSDs have to incur higher costs in order to operate their dealing businesses, they may be at a competitive disadvantage relative to dealers that are subject to CFTC requirements. In addition, to the extent that differences between Commission and CFTC capital, margin, and segregation requirements result in different implementation requirements (*e.g.,* different information technology infrastructures) these stand-alone SBSDs may have to incur costs to modify their existing systems and operations to support compliance with the Commission's capital, margin, and segregation requirements. However, the Commission believes these costs would be mitigated by the fact the final rules adopted today are harmonized with those of the CFTC to the maximum extent practicable. Moreover, if the Commission lowers the maximum fixed-dollar amount to a level that is between $250 billion and $50 billion, some of the firms with aggregate gross notional amount of single-name CDS positions may be able to continue to use the alternative compliance mechanism.

C. Implementation Costs

As discussed above, Rules 18a–1 through 18a–4, and 18a–10, as well as the amendments to Rules 15c3–1 and 15c3–3, will impose certain implementation costs on SBSDs and MSBSPs. The Commission expects that the highest economic cost impact as a result of the final rules will likely result from the additional capital that nonbank SBSDs and MSBSPs may need to hold as a result of the capital rules, and the additional margin that nonbank SBSDs and MSBSPs, and other market participants may need to post and/or collect as a result of the Commission's margin requirements.

Other costs may include start-up costs, including personnel and other costs, such as technology costs, to comply with the final rules. As discussed above in section IV.D. of this release, the Commission has estimated the burdens and related costs of these implementation requirements for SBSDs and MSBSPs.[1244] These costs are summarized below.

A stand-alone SBSD that applies to use internal models will be required under Rule 18a–1 to create and compile various documents to be included with the application, including documents related to the development of its models, and to provide additional documentation to, and respond to questions from, Commission staff throughout the application process.[1245] These firms also will 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 $1.34 million[1246] and $6.6 million,[1247] respectively. It is also estimated that these firms will incur initial technology costs of $32 million[1248] in the aggregate.

Rule 18a–1 also will 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.[1249] This requirement will impose one-time and annual costs in the aggregate of $6.1 million[1250] and $606,000,[1251] respectively. These firms also may incur aggregate initial and ongoing information technology costs of $192,000 and $246,000, respectively.[1252]

As discussed above, the Commission staff estimates that 4 broker-dealer SBSDs and 2 standalone SBSDs not authorized to use models will utilize the CDS haircut provisions under the amendments to Rules 15c3–1 and 18a–1, respectively. Consequently, these firms will use an industry sector classification system that is documented for the credit default swap reference obligors. The Commission staff estimates that nonbank SBSDs not using models will incur an aggregate annual cost of $2,226[1253] to document these industry sectors.

Under paragraph (h) of Rule 18a–1, a nonbank SBSD is required to file certain notices with the Commission relating to the withdrawal of equity capital. The Commission staff estimates that stand-alone SBSDs will incur an aggregate annual cost of $2,226[1254] to file such notices.

Under Rule 18a–1d, a nonbank SBSD is required to file a proposed subordinated loan agreement with the Commission (including nonconforming subordinated loan agreements). In connection with this provision, the Commission staff estimates that stand-alone SBSDs will incur aggregate one-time and annual costs of $50,640 and $25,320, respectively.[1255]

Rule 18a–1, as adopted, and Rule 15c3–1, as amended, will also require the execution of an account control agreement by nonbank SBSDs. This will require firms to execute each account control agreement internally, and they may engage outside counsel to review the account control agreement and potentially to draft and review an opinion that an account control agreement is (or a set of account control agreements are) legally valid, binding, and enforceable in all material respects. These requirements are estimated to impose one-time and annual costs in the aggregate of approximately $345,620[1256] and $1.86 million,[1257] respectively.

Rule 18a–2 also will 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.[1258] This requirement is estimated to impose one-time and annual costs in the aggregate of $2.77 million[1259] and $252,500[1260] for nonbank MSBSPs, respectively. These nonbank MSBSPs also may incur initial and ongoing information

[1244] *See* section IV.D. of this release (discussing the total initial and annual recordkeeping and reporting burdens of the new rules and rule amendments).

[1245] *See* section IV.A.1. of this release.

[1246] This consists of external costs of $400,000, plus internal costs of $938,000. *See* section IV.D.1. of this release.

[1247] This consists of external costs of $2.496 million, plus internal costs of $4.12 million. *See* section IV.D.1. of this release.

[1248] *See* section IV.D.1. of this release.

[1249] *See* section IV.A.1. of this release.

[1250] *See* section IV.D.1. of this release.

[1251] *See id.*

[1252] *See id.*

[1253] *See id.*

[1254] *See id.*

[1255] *See id.*

[1256] Calculated as $176,000 (outside counsel to draft and review account control agreement) + $88,000 (opinion of counsel) + $81,620 (written 'in-house' analysis) = $345,620. *See* section IV.D.1. of this release.

[1257] This is the estimated industry-wide annual burden of $1,856,800. *See* section IV.D.1. of this release.

[1258] *See* section IV.A.2. of this release.

[1259] This consists of external costs of $400,000, plus internal costs of $2.37 million. *See* section IV.D.2. of this release.

[1260] *See* section IV.D.2. of this release.

technology costs of $80,000 and $102,500, respectively.[1261]

Rule 18a–3 will require nonbank SBSDs to establish a written risk analysis methodology, which will need to be reviewed and updated.[1262] This requirement is estimated to impose one-time and annual costs in the aggregate of $1.62 million [1263] and $489,720,[1264] respectively.

Rule 18a–3, as adopted will require nonbank SBSDs to seek Commission approval to use an internal model to calculate initial margin.[1265] This requirement is estimated to impose one-time and annual costs in the aggregate of $464,200 and $1,575,750, respectively.[1266]

SBSDs and MSBSPs will incur various one-time and ongoing costs in the aggregate in order to comply with the segregation and notification requirements of Rule 18a–4 and the amendments to Rule 15c3–3.[1267] Each SBSD will incur one-time and annual costs in establishing special bank accounts required by the rule. This requirement is estimated to impose one-time and annual costs of $2.9 million [1268] and $367,290 [1269] in the aggregate on SBSDs, respectively. In addition, SBSDs will be required to perform a reserve computation required by Exhibit A to Rule 18a–4 or Exhibit B to Rule 15c3–3, which is estimated to impose on these firms annual costs in the aggregate of approximately $1.69 million.[1270]

In addition, both SBSDs and MSBSPs will be required to prepare and send to their counterparties segregation-related notices pursuant to Section 3E(f) of the Exchange Act.[1271] This requirement is estimated to impose one-time and annual costs in the aggregate to SBSDs and MSBSPs of $870,857 [1272] and $130,143,[1273] respectively.

Rule 15c3–3, as amended, and Rule 18a–4, as adopted, will require each SBSD to draft, prepare, and enter into subordination agreements with certain counterparties.[1274] This requirement is estimated to impose on these firms one-time and annual costs in the aggregate of $43.7 million [1275] and $8.4 million,[1276] respectively.

Rule 15c3–3, as amended, and Rule 18a–4, as adopted, will require registered foreign SBSDs to provide disclosures to their U.S. counterparties. This requirement is estimated to impose on these firms one-time and annual costs in the aggregate of $6,034,600 [1277] and $46,420,[1278] respectively.

The Commission estimates that 31 SBSDs (25 bank SBSDs and 6 stand-alone SBSDs) will incur costs in connection with the disclosure condition under paragraph (f)(3) of Rule 18a–4. These SBSDs are estimated to incur one-time and annual costs in the aggregate of $130,885,410,[1279] and $65,410,[1280] respectively.

Rule 18a–10 prescribes an alternative compliance mechanism pursuant to which a stand-alone that is registered as a swap dealer and predominantly engages in a swaps business may elect to comply with the capital, margin, and segregation requirements of the CEA and the CFTC's rules in lieu of complying with Rules 18a–1, 18a–3, and 18a–4 (as applicable). As discussed above, the Commission estimates that 3 stand-alone SBSDs will elect to operate under Rule 18a–10. In connection with the disclosure requirements under paragraph (b)(2) of Rule 18a–10, these stand-alone SBSDs are estimated to incur one-time and annual costs in the aggregate of $12,666,330,[1281] and $6,300,[1282] respectively. The Commission estimates that the notice requirement of paragraph (b)(3) of Rule 18a–10 will impose an aggregate annual cost of $185.50.[1283]

Rule 3a71–6 gives firms the option of applying for substituted compliance with regard to the final capital and margin rules. This requirement is estimated to impose on these firms a one-time cost in the aggregate of $341,280.[1284]

D. Effects on Efficiency, Competition, and Capital Formation

The OTC swaps and security-based swap market is characterized by complex bilateral exposure networks. Currently, such networks are opaque. Consequently, it is not possible for market participants to accurately ascertain counterparty exposures to other market participants. During times of market stress, market participants' uncertainty about the financial condition of their OTC derivative counterparties can lead markets to become illiquid. Distress at dealers or at other major participants is a particular source of concern. The lack of information about individual market participants' exposures to such troubled firms can lead to widespread ''contagion'' which may lead markets to break down. Disruptions to the OTC derivative markets can shut down critical risk-transfer mechanisms and further exacerbate concerns about the exposures of important financial intermediaries. This, in turn, can lead to disruptions in credit provision to the real economy. Moreover, the opacity of these markets can foster excessive risk taking, which can both instigate and exacerbate the breakdown of these markets.

The final capital, margin, and segregation rules work together to help improve the stability of the security-based swap market, and in so doing mitigate the inefficiencies in these markets arising from the existence of default risk of derivative counterparties. The final capital and margin rules will reduce a nonbank SBSD's

[1261] *See id.*

[1262] *See* section IV.A.3. of this release.

[1263] *See* section IV.D.3. of this release. This consists of external costs of $12,000, plus internal costs of $1.61 million.

[1264] *See id.*

[1265] *See* section IV.A.3. of this release.

[1266] *See* section IV.D.3. of this release.

[1267] *See* section IV.A.4. of this release.

[1268] *See* section IV.D.4. of this release.

[1269] *See id.*

[1270] *See id.*

[1271] *See* section IV.A.4. of this release.

[1272] *See* section IV.D.4. of this release. This consists of external costs of $220,000, plus internal costs of $650,857.

[1273] *See* section IV.D.4. of this release.

[1274] *See* section IV.A.4. of this release.

[1275] *See* section IV.D.4. of this release. Calculated as $1,603,600 (drafting and preparation of subordination agreements) + $152,000 (review by outside counsel) + $41,990,000 (entering into subordination agreements with counterparties) = $43,745,600.

[1276] *See* section IV.D.4 of this release (estimating that 19 SBSDs will incur an industry-wide annual burden of $8,398,000 in connection with establishing account relationships with new counterparties per year).

[1277] This consists of 3,300 hours of in-house attorney time in addition to 11,000 of in-house counsel hours required to create and incorporate disclosure language in trading documentation, at a rate of $422 per hour. *See* section IV.D.4. of this release.

[1278] This consists of 110 hours of in-house attorney time multiplied by $422 per hour. *See* section IV.D.4. of this release.

[1279] Calculated as cost of developing new disclosure language (155 in-house counsel hours × $422 per hour = $65,410) + cost of incorporating new disclosure language into trading documentation (310,000 in-house counsel hours × $422 per hour = $130,820,222) = $130,885,410. *See* section IV.D.4. of this release.

[1280] Calculated as 155 in-house counsel hours × $422 per hour = $65,410. *See* section IV.D.4. of this release.

[1281] Calculated as cost of developing new disclosure language (15 in-house counsel hours × $422 per hour = $6,330) + cost of incorporating new disclosure language into trading documentation (30,000 in-house counsel hours × $422 per hour = $12,660,000) = $12,666,300. *See* section IV.D.5. of this release.

[1282] Calculated as 15 in-house counsel hours × $422 per hour = $6,330. *See* section IV.D.5. of this release.

[1283] *See* section IV.D.5. of this release estimating that an internal compliance attorney of one stand-alone SBSD will take 30 minutes to file one notice annually with the Commission. Therefore, the estimated cost = 30 minutes at $371 per hour = $185.50.

[1284] This consists of 240 initial burden hours times $422 an hour for in-house attorney ($101,280), in addition to the $240,000 estimated costs for outside counsel. *See* section IV.D.6. of this release.

uncollateralized derivative exposures and require firms to hold additional capital to address uncollateralized exposures. This will reduce potential losses from these exposures in the event of a counterparty default. In cases where nonbank SBSDs are not required to collect margin or where the collected margin is not under the SBSD's control, the final capital rules require nonbank SBSDs to allocate capital to reduce the potential losses from uncollateralized counterparty exposure. In this way, the capital rules complement the margin rule to reduce a nonbank SBSD's probability of default, reduce incentives for excessive risk-taking, and reduce the probability of sequential counterparty failure. Finally, the capital requirements for nonbank MSBSPs should reduce the likelihood of a MSBSP's failure and the potential losses to nonbank SBSD counterparties in the event of MSBSP's failure. In this way, the capital and margin rules are designed to reduce the risk that the failure of one entity propagates to its counterparties.

Furthermore, the margin rule will reduce a nonbank SBSD's incentive for excessive risk taking and will restrict the amount of implicit leverage that market participants can achieve through non-cleared security-based swaps. In addition, the margin rule will also reduce the potential cost advantages of non-cleared transactions relative to cleared transactions, and thereby encourage the clearing of such transactions. While the final margin rule provides protection for the margin collector against the default of the margin poster, it simultaneously exposes the poster of initial margin to additional risk. The Commission's final segregation rules, however, are designed to complement the margin rule by ensuring that posted margin is adequately protected.

Through the aforementioned channels, the Commission's capital, margin, and segregation rules are expected to have a generally positive effect on economic efficiency, and capital formation. However, because of the complex, overlapping regulatory environment of the security-based swap market, the final rules' effects on competition are more uncertain. In this section, the Commission considers each of these effects in turn.

1. Efficiency and Capital Formation

In principle, the security-based swap market improves efficiency by facilitating risk transfer in the economy. In addition, by mitigating market imperfections in underlying securities markets (such as limited liquidity), it can help improve price discovery with attendant positive effects on firms' borrowing costs. However, the extent to which the security-based swap market improves efficiency is limited due to counterparty credit risk. Specifically, the imperfection in the security-based swap market resulting from counterparty default can facilitate excessive and opaque risk-taking and have negative effects on the stability of this market.[1285] The final capital, margin, and segregation rules help address these market imperfections.

Excessive risk-taking by dealers and other major participants in the security-based swap market can arise from misaligned incentives of the firms' manager-owners and those of other investors due to limited liability.[1286] More generally, contracting frictions can cause similar incentive misalignments between managers and shareholders, other investors, counterparties, and customers. Because the costs of monitoring large financial intermediaries are significant, the creditors and customers of such firms are generally not in a position to monitor their management. This lack of monitoring can lead financial firms to pursue inefficient risk management policies.

Even absent these incentive conflicts and monitoring limitations, firms may choose to engage in trading activity that, while privately optimal, reduces overall financial stability. Unexpected losses on derivatives positions at one firm can threaten the financial viability of its counterparties, with the potential to precipitate sequential counterparty failures. Moreover, due to the opacity of financial firms, market fears of such contagion can lead to anticipatory ''runs'' on financial institutions, further undermining financial stability. Importantly, the costs associated with the reductions in financial stability that result from a given firm's policies and strategies are not fully internalized by the firm.[1287] The final capital, margin, and segregation rules help to mitigate the inefficiencies resulting from this negative externality.

The final capital, margin, and segregation rules for participants in the security-based swap market being adopted by the Commission can improve efficiency by addressing the aforementioned market failures. By imposing a set of minimum risk management standards on affected entities, these requirements reduce the scope for incentive conflicts that may arise among these entities, their investors, counterparties, and customers, which can lead to more efficient investment policies. In addition, these new requirements can reduce the degree to which an individual firm's risk-taking imposes negative externalities on the market as a whole by: (1) Reducing uncertainty about exposures to non-cleared security-based swaps and the resulting potential for contagion; (2) reducing the ability of entities to engage in excessive risk taking; (3) promoting central clearing of sufficiently standardized products; and (4) promoting a uniform set of standards across regulatory agencies that limit opportunities for regulatory arbitrage. By improving financial stability in these ways, the final capital, margin, and segregation rules may also facilitate capital formation. In particular, because financial crises are typically associated with large reductions in the supply of aggregate capital, financial instability and financial crises resulting from such instability can have large negative economic consequences, including significant harm to capital formation. By reducing the likelihood of such crises, the Commission expects the capital, margin, and segregation rules will enhance capital formation.

The Commission acknowledges that nonbank SBSDs might pass on a portion of the costs incurred as a result of the capital, margin, and segregation rules to end users. To the extent that end users bear these costs, they might reduce investments. This potential impact on investment depends in part on the degree of competition among SBSDs. In particular, robust competition among SBSDs would limit their ability to pass on costs to end users and in turn mitigate any adverse impact on investment.

As acknowledged in section VI.C. of this release, the degree to which the aforementioned benefits improve efficiency depends on the costs imposed by these measures. These costs include the costs of funding additional collateral to meet margin requirements, the costs of additional capital, and the costs of implementation and compliance. In isolation, these additional costs would be expected to increase transaction costs of security-based swap trading, suppressing trading, and liquidity. Insofar as the benefits of the regulations do not counteract these effects, price discovery may be harmed and opportunities for risk sharing may be

[1285] *See* BCBS/IOSCO Paper.

[1286] *See* Michael C. Jensen and William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure,* Journal of Financial Economics (Oct. 1976).

[1287] One commenter noted that the dollar cost of the financial collapse will exceed $12.8 trillion, and argued that Congress's resolve to prevent another massively costly financial crisis overrides any industry-claimed cost concerns under the Dodd-Frank Act. *See* Better Markets 2/22/2013 Letter.

reduced. This, in turn, can potentially reduce the supply of credit to the real economy.

Although data limitations discussed above prevent the Commission from quantifying efficiency gains or losses from the rules being adopted, based on its judgment and experience, the Commission believes that the final rules will have a positive contribution to the overall efficiency of the market. The final rules work together to help improve the financial stability of participants in security-based swap market, and in so doing help address the market failures resulting from the possibility of counterparty defaults. By imposing margin requirements on nonbank SBSDs, the final margin rules reduce counterparty exposures and the expected costs borne by non-defaulting counterparties in the event of a counterparty default. While these new margin requirements provide protection for the margin collector against the default of the margin poster, they could simultaneously expose the poster of initial margin to additional credit risk. To address this risk, the Commission's segregation rules help ensure that posted initial margin is adequately protected. Finally, by imposing capital requirements on nonbank SBSDs and MSBSPs, the capital rules help reduce the probability of their default and moreover, increase the likelihood of recoveries in the event of default.

As mentioned earlier, several commenters urged the Commission to harmonize with other regulatory regimes when developing these rules. One commenter cited impacts on efficiency, competition, and capital formation, while another was concerned about the loss of netting and risk management efficiencies caused by fragmentation of trading activities.[1288] In developing its rules on capital, margin, and segregation for SBSDs and MSBSPs, the Commission has sought to minimize costs to the affected entities and other participants in the security-based swap market while still achieving the broader economic objective of enhancing financial stability. One key feature of the Commission's approach has been maintaining consistency with existing regulations applicable to broker-dealers. This consistency reduces compliance costs for entities with affiliates already subject to the Commission's broker-dealer financial responsibility rules. This consistent approach to regulation across firms subject to the Commission's rules can also reduce the potential for regulatory arbitrage and lead to simpler interpretation and enforcement of applicable regulatory requirements across U.S. securities markets. Moreover, the final rules reflect the Commission's consideration of rules promulgated by the CFTC and the prudential regulators. For example, Rule 18a–3, while modeled on the broker-dealer margin rule, includes significant modifications that further harmonize it with the final margin rules of the CFTC and the prudential regulators.[1289]

For entities that choose to consolidate security-based swap dealing under a broker-dealer, the Commission's approach helps to simplify and streamline risk management, allows for the more efficient use of capital, and creates operational efficiencies such as avoiding the need for multiple netting and other agreements. It also facilitates the ability to provide portfolio margining of security-based swaps with other types of securities, and in particular single-name CDS along with bonds that serve as reference obligations for the CDS. This can yield additional efficiencies for clients conducting business in securities and security-based swaps, including netting benefits,[1290] a reduction in the number of account relationships required with affiliated entities, and a reduction in the number of governing agreements.

The final rules also offer various flexibilities that aim to minimize compliance burdens without subverting the objectives of the rules, such as allowing counterparties the flexibility to post a variety of collateral types to meet margin requirements, providing a $50 million initial margin threshold, and permitting the use of third-party models in margin calculations. Similarly, the omnibus segregation requirements of Rule 15c3–3, as amended, and Rule 18a–4, as adopted, provide a less expensive segregation alternative to individual segregation.[1291]

2. Competition

The final capital, margin, and segregation rules significantly alter the regulatory environment for registered nonbank SBSDs and MSBSPs, and in the case of the segregation requirements, all SBSDs and MSBSPs participating in the U.S. security-based swap market. Thus, these new regulations are likely to have direct implications for competition among SBSDs and MSBSPs subject to the Commission's jurisdiction. As discussed in this section and elsewhere in this release, and notwithstanding uncertainties about potential effects on competition, the Commission believes that the final rules and amendments are appropriate because they achieve the purposes of the Exchange Act, including by improving financial stability. Because the Commission does not have sole rulemaking authority for all SBSDs and MSBSPs in the U.S. security-based swap market, and because the security-based swap market is global with competition across jurisdictional boundaries, consideration of the effects of the Commission's rules on competition is not limited to entities directly affected by the Commission's rules. In particular, U.S. banks operating in these markets are subject to capital and margin regulations already adopted by the prudential regulators.[1292] These entities may compete in the security-based swap market with entities regulated by the Commission. Similarly, foreign banking entities subject to foreign capital, margin, and segregation requirements may actively compete with these same entities. In the following subsection the Commission considers the impact of its rules on competition in these various contexts.

a. Nonbank SBSDs

The rules and amendments being adopted by the Commission are expected to have a significant impact on the regulatory environment of nonbank SBSDs; namely, stand-alone SBSDs and broker-dealer SBSDs. Under the baseline, stand-alone SBSDs are largely unregulated and hence not subject to capital or margin requirements on security-based swap transactions. Generally speaking, broker-dealers have historically not engaged in security-based swap transactions due to—among other factors—the relatively high capital costs of such transactions and the segregation requirements under existing broker-dealer capital and segregation rules. Thus, security-based swap dealing activity has been concentrated in stand-alone SBSDs and banks, which were not subject to the Commission's rules.[1293] The new rules and amendments create a harmonized regulatory environment

[1288] *See* MFA/AIMA 11/19/2018 Letter; Mizuho/ING Letter.

[1289] *See* section II.B. of this release.

[1290] *See, e.g.,* paragraph (c)(5) of Rule 18a–3, as adopted. *See* MFA 2/22/2013 Letter.

[1291] *See* 15 U.S.C. 78c(f)(1)(B).

[1292] *See Prudential Regulator Margin and Capital Adopting Release,* 80 FR 74840.

[1293] The references to the historical activities of "nonbank SBSDs" in this discussion is somewhat imprecise as it refers to entities that operated prior to the Commission's adoption of security-based swap entity definitions and registration requirements. Such references should be interpreted to refer to entities that would have been required to register as SBSDs had the Commission's security-based swap entity registration requirements been in effect at the time. *See Registration Process for Security-Based Swap Dealers and Major Security-Based Swap Participants,* 80 FR 48964.

for all nonbank SBSDs. By improving the financial stability of nonbank SBSDs, the final capital, margin, and segregation rules are likely to promote trade between nonbank SBSDs and a wide range of non-dealer counterparties, with potential benefits to competition. However, as discussed in more detail below, a harmonized set of rules for both stand-alone and broker-dealer SBSDs may also provide broker-dealers certain economies of scale and scope. These economies of scale and scope may provide incentives for market participants to migrate their security-based swap transaction activity away from stand-alone SBSDs. The Commission acknowledges that such migration could lead to further concentration in dealing activity.

Under the baseline, security-based swap dealing activity is dominated by a few large financial firms, reflecting in part the counterparty credit risk concerns of counterparties. The Commission's capital, margin, and segregation rules are expected to enhance the financial stability of entities subject to its rules, namely stand-alone and broker-dealer SBSDs. This may, in turn, favorably increase the views of market participants about the creditworthiness of nonbank SBSDs, increasing the amount of trade with these dealers and attracting new entrants to the industry. However, prospective new entrants will have to evaluate the costs of establishing and maintaining compliance with the Commission's new rules against the value of dealing in security-based swaps. As discussed above in sections VI.B.1. and VI.B.3. of this release, nonbank SBSDs will be subject to capital and margin requirements that vary depending on whether the nonbank SBSD obtains approval to use internal models. Although the costs of obtaining approval to use such models would likely not be large for the five ANC broker-dealers currently using models to compute net capital, for prospective dealers that are not ANC broker-dealers these costs could be large and place the nonbank SBSD at a competitive disadvantage relative to those nonbank SBSDs already are authorized to use internal models. In particular, a nonbank SBSD authorized to use internal models can make more efficient use of its capital and pass on some of the benefits to customers in the form of competitive pricing. Therefore, the success of a new entrant to attract order flow in the security-based swap business would also depend on the extent to which the entrant would be able to obtain the Commission's approval to use internal models.[1294] As several commenters observed, nonbank SBSDs lacking such approvals will generally find it difficult to compete with SBSDs that have obtained approvals.[1295] However, as discussed above, the use of models for capital purposes is standard in financial market regulation. Indeed, the prudential regulators' rules for bank SBSDs and bank swap dealers, as well as the Commission's own rules for ANC broker-dealers, permit the use of internal models for capital purposes. Furthermore, the CFTC has proposed permitting nonbank swap dealers to use models for capital purposes. While the Commission acknowledges the potential competitive advantage identified by commenters, the Commission believes it is appropriate to promote consistency with these other regulatory approaches.

As noted above, while the Commission's rules may encourage competition in the security-based swap market by increasing the safety and soundness of nonbank SBSDs (and thereby favorably increasing market participants' views about the creditworthiness of these dealers), they may also incentivize migration of dealing activities to broker-dealer SBSDs. Aggregating security-based swaps business with other securities businesses in a single entity, such as a broker-dealer SBSD, can help simplify and streamline risk management, allow more efficient use of capital, and avoid the need for multiple netting and other agreements. This increase in operating flexibility may yield efficiencies for clients conducting business in securities and security-based swaps, including netting benefits, portfolio margining, a reduction in the number of account relationships required with affiliated entities, and a reduction in the number of governing agreements. In particular, broker-dealer SBSDs could gain a competitive edge over stand-alone SBSDs by passing on some of the benefits from the added operating flexibility to their customers. Similar considerations may make it relatively costly for customers to transact through multiple dealers. To the extent that customers consolidate their positions with a single dealer, opportunities for smaller, more specialized dealers may be diminished. Moreover, customers consolidating their positions at a single and more efficient broker-dealer SBSD may find it more operationally difficult to change SBSDs in the future.

On the other hand, the less restrictive capital requirements applicable to stand-alone SBSDs could result in lower costs to these firms and, in turn, lower fees for their security-based swap customers. This could draw business away from broker-dealer SBSDs in the favor of stand-alone SBSDs.

The Commission acknowledges the various aforementioned competitive impacts, including the potential advantages held by broker-dealer and stand-alone SBSDs approved to use models over entities that must use standardized haircuts. However, overall, the Commission does not expect these competitive impacts to have a major net effect on competition among entities currently operating as nonbank SBSDs or those likely to do so in the immediate future. As noted in the baseline discussion above, security-based swap dealing activity is highly concentrated in a few entities affiliated with large national and international banking groups. This concentrated market structure reflects the importance of counterparty credit quality, scale, and financial sophistication to operating in the security-based swap market. The importance of these factors is not expected to be materially affected by the Commission's rules, nor are the rules expected to have significant disproportionate impacts on particular subsets of entities that currently operate as dealers in the security-based swap market.

b. Nonbank SBSDs and Bank SBSDs

The final margin, capital, and segregation rules have the potential to affect domestic competition in the security-based swap market significantly due to differences in the regulation of bank and nonbank SBSDs. As discussed above in sections I and II of this release, the rules adopted by the prudential regulators were considered in developing the Commission's capital, margin, and segregation requirements for SBSDs and MSBSPs. Nevertheless, the Commission's final rules differ in certain respects from the rules adopted by the prudential regulators. While some differences are based on differences in the activities of securities firms and banks, other differences reflect an alternative approach to balancing relevant policy choices and considerations.

[1294] *See, e.g., Alternative Net Capital Requirements for Broker-Dealers That Are Part of Consolidated Supervised Entities,* 69 FR at 34455 (stating that the ''major benefit for the broker-dealer'' of using an internal model ''will be lower deductions from net capital for market and credit risk''). *See also OTC Derivatives Dealer Release,* 63 FR 59362. Given the significant benefits of using models in reducing the capital required for security-based swap positions, it is likely that for new entrants to capture substantial volume in security-based swaps they will need to use models.

[1295] *See* CFA Institute Letter; Systemic Risk Council Letter; SIFMA 11/19/2018 Letter.

Large national and international banking groups that dominate dealing activity in the security-based swap market enjoy considerable flexibility in organizing their operations. Such entities can be expected to minimize the private compliance costs of participating in the security-based swap market by organizing their activities to take advantage of differences in regulators' policy choices. Prior to the passage of the Dodd-Frank Act and subsequent rulemaking, these entities have been able to conduct security-based swap dealing from either their prudentially regulated bank affiliates or affiliated nonbank entities. In either case, they were not subject to margin requirements. Following the passage of Dodd-Frank, these entities will have to reconsider the costs and benefits of these alternative organizational structures taking into consideration differences in capital, margin, and segregation requirements applicable to the different types of entities.

An SBSD's choice between these competing regulatory regimes will likely be driven by the relative costs arising from differences in the two regimes. The most significant of these differences are: (1) Initial margin requirements for inter-dealer transactions; (2) segregation requirements; (3) capital treatment of security-based swaps; and (4) availability of collateral financing.

The Commission's margin requirements on inter-dealer transactions are not consistent with the prudential regulators' rules. Under the Commission's final margin rule, nonbank SBSDs are not required to collect initial margin from financial market intermediaries, including other SBSDs. In contrast, under the prudential regulators' rules, covered entities, including SBSDs, are required to exchange initial margin on inter-dealer transactions. Furthermore, covered entities are required to segregate the initial margin at an independent third-party custodian.

The prudential regulators' approach to collateralizing inter-dealer transactions puts significant strain on dealers' capital. Under this approach, dealers ''consume'' their own capital every time they enter a transaction with other dealers. As a result, market-making activities, such as book-matching transactions with end users, become very capital intensive. While bank SBSDs may have access to alternative ways of funding collateral relative to nonbank SBSDs, the sheer amount of collateral needed to intermediate non-cleared security based swaps under the prudential regulators' margin rule will make it expensive for bank SBSDs to conduct business in this market.

The Commission's approach does not require that nonbank SBSDs collect initial margin from financial market intermediaries, but it does require them to take capital deductions in lieu of margin or credit risk charges with respect to uncollateralized potential futures exposures. They also will need to increase their net capital by a factor proportional to the initial margin that would cover this exposure when the amount of the 2% margin factor reaches or exceeds their minimum fixed-dollar net capital requirement. However, this additional capital is not likely to exceed the initial margin for the exposure, which means that for a given inter-dealer exposure, a nonbank SBSD will likely allocate less capital than a bank SBSD. Furthermore, unlike the prudential regulators' margin rules, the additional capital that nonbank SBSDs have to allocate to inter-dealer exposures is always under the firm's control. In addition, while bank SBSDs are not subject to a requirement to deduct 100% of the value of initial margin posted to a counterparty, nonbank SBSDs may avoid this deduction using the guidance in section II.A.2.b.i. of this release.

These considerations suggest that nonbank SBSDs may have a competitive advantage over bank SBSDs in the market for non-cleared security-based swaps. In particular, a bank holding company may determine to structure its dealing activities into a nonbank SBSD. However, this competitive advantage may be muted given the advantages bank SBSDs have over nonbank SBSDs in terms of access to low cost sources of funding (*i.e.,* deposits) and central bank support mechanisms.

A counterparty posting initial margin to an SBSD for a non-cleared security-based swap transaction may elect individual segregation or to waive segregation (if permitted to waive segregation) under section 3E(f) of the Exchange Act, or elect that the initial margin be held directly by the SBSD subject to the omnibus segregation requirements of the Commission's final segregation rule. Under the margin rule of the prudential regulators, initial margin must be segregated in an individual account at an independent third-party custodian.

Individual segregation of collateral is expensive because it prevents the re-hypothecation of collateral along intermediation chains. With individual segregation, the amount of initial margin required to support the transfer of risk from party A to party B depends on the length of the intermediation chain linking party A to party B (*i.e.,* the number of SBSDs with matched books standing between the initial transaction by party A and the final transaction with party B): Each SBSD in the chain may require initial margin to be ''locked up'' at the custodian. In contrast, when individual segregation is not used, the amount of collateral required to support the transfer of risk from party A to party B does not depend on the length of the intermediation chain linking party A to party B; at each non-terminal link in the chain initial margin that is collected by an SBSD can be delivered to the SBSD that is the next link in the chain (*i.e.,* the initial margin can be re-hypothecated).

Thus, operating as a nonbank SBSD could provide a potential cost advantage. Specifically, if the parties along an intermediation chain are willing to rely on the default omnibus segregation regime, or agree to waive segregation entirely (when this is permitted), then the amount of collateral necessary to support the transaction can be considerably smaller than under third-party segregation. For example, a CDS transaction involving 3 dealers where dealer A purchases protection from dealer B who in turn purchases this protection from dealer C requires approximately two units of initial margin under third-party segregation: Dealer C provides one unit collateral to the third-party custodian for the benefit of dealer B, while dealer B provides another unit of collateral to the third-party custodian for the benefit of dealer A. Conversely, under omnibus segregation or waived segregation, only one unit of collateral is required: The collateral posted by dealer C is received by dealer B, who may then use the collateral received to satisfy his posting obligation to dealer A.

As noted earlier, nonbank SBSDs will be required to allocate capital for their dealing activities in the market for non-cleared security-based swaps. Importantly, uncollateralized exposures from inter-dealer transactions require that these entities scale up their minimum net capital by a factor proportional to the initial margin of the exposure if the amount of the 2% margin factor equals or exceeds the firm's fixed-dollar minimum net capital requirement. Furthermore, dealers are required to take a capital deduction in lieu of margin or credit risk charge for the uncollateralized inter-dealer potential future exposures.

Similarly, bank SBSDs will also have to allocate capital for their exposures with other covered entities, including other dealers. The capital that supports a bank SBSD's dealing activities in the

OTC markets is determined in accordance with the prudential regulators' capital rules. These rules require that bank SBSDs calculate a risk weight amount for each of their exposures, including exposure to non-cleared security-based swaps. Furthermore, the rules require that bank SBSDs calculate an additional risk weight amount for the exposure created through the posting of initial margin to collateralize a non-cleared security-based swap. However, both of these risk weight amounts are likely to be small. The dealer's exposure to a covered-entity counterparty is collateralized by the initial margin that the counterparty has to post with a third-party custodian (for the benefit of the dealer), and the risk weight of this exposure reflects almost entirely the risk weight of the collateral—usually minimal. Similarly, by posting initial margin, the dealer creates an exposure to the third-party custodian holding the collateral. Custodian banks usually have low risk weights.

The capital that bank SBSDs have to allocate for their non-cleared security-based swaps equals the sum of the two risk weight amounts calculated above multiplied by a factor—usually 8%. Thus, the capital that a bank SBSD has to allocate to support a non-cleared security-based swap is relatively small, and likely of the same order of magnitude as the capital that a nonbank SBSD would have to allocate for a similar exposure. However, the bank SBSD must deliver initial margin to certain counterparties. The posting of collateral will ''consume'' the bank SBSD's capital, and gives nonbank SBSD a comparative advantage in terms of capital efficiency. However, this advantage will not exist if a nonbank SBSD transacts with a bank SBSD because in this scenario the bank SBSD will be required to collect initial margin from the nonbank SBSD. It also will not exist if a counterparty demands initial margin from the nonbank SBSD under the terms of an agreement between the two parties. While collateral posting makes dealing under a bank SBSD structure costly, the cost of funding such collateral is likely smaller for these dealers compared to nonbank SBSDs. Unlike nonbank SBSDs, bank SBSD may have access to low cost sources of collateral funding, including deposits or a discount window with a central bank.

Several commenters addressed the impact of the final rules on competition between bank and nonbank SBSDs. One commenter stated that the Commission's proposal would make nonbank SBSDs uncompetitive, and that consistency with the CFTC's margin and capital rules is also necessary for nonbank SBSDs to be competitive with bank SBSDs.[1296] This commenter noted that bank SBSDs will be subject to a single set of capital and margin rules for security-based swaps and swaps, but that nonbank SBSDs that are also registered with the CFTC as swap dealers would be subject to two sets of requirements with respect to these instruments. This commenter believed that the proposal's inconsistencies with other regulators' regimes would increase costs. Another commenter stated that the proposed capital requirements would result in a very different approach to capital for bank holding company subsidiaries that are swap dealers (based on the CFTC's proposal to apply the bank capital standard to these entities) and for such subsidiaries that are SBSDs, again potentially preventing the establishment of dually registered entities.[1297] Similarly, other commenters noted that the Commission's capital and margin rules would increase costs and reduce efficiency due to their potential inconsistency with the BCBS/IOSCO Paper, foreign requirements, and other domestic regulators' rules.[1298] One commenter argued that several components of the proposed margin rules differ from the recommended framework in the BCBS/IOSCO Paper and would generally make nonbank SBSDs uncompetitive with bank SBSDs and foreign SBSDs.[1299] The commenter argued that the Commission could best address these differences by permitting OTC derivatives dealers and stand-alone SBSDs to collect and maintain margin in a manner consistent with the recommendations of the BCBS/IOSCO Paper.

As discussed above in section II.A. of this release, the Commission has made two significant modifications to the final capital rules for nonbank SBSDs that should mitigate some of these concerns raised by commenters. First, as discussed above in section II.A.2.b.v. of this release, the Commission has modified Rule 18a–1 so that it no longer contains a portfolio concentration charge that is triggered when the aggregate current exposure of the stand-alone SBSD to its derivatives counterparties exceeds 50% of the firm's tentative net capital.[1300] This means that stand-alone SBSDs that have been authorized to use models will not be subject to this limit on applying the credit risk charges to uncollateralized current exposures related to derivatives transactions. This includes uncollateralized current exposures arising from electing not to collect variation margin for non-cleared security-based swap and swap transactions under exceptions in the margin rules of the Commission and the CFTC. The credit risk charges are based on the creditworthiness of the counterparty and can result in charges that are substantially lower than deducting 100% of the amount of the uncollateralized current exposure.[1301] This approach to addressing credit risk arising from uncollateralized current exposures related to derivatives transactions is generally consistent with the treatment of such exposures under the capital rules for banking institutions.[1302]

The second significant modification is an alternative compliance mechanism. As discussed above in section II.D. of this release, the alternative compliance mechanism will permit a stand-alone SBSD that is registered as a swap dealer and that predominantly engages in a swaps business to comply with the capital, margin, and segregation requirements of the CEA and the CFTC's rules in lieu of complying with the Commission's capital, margin, and segregation requirements.[1303] The CFTC's proposed capital rules for swap dealers that are FCMs would retain the existing capital framework for FCMs, which imposes a net liquid assets test similar to the existing capital requirements for broker-dealers.[1304] However, under the CFTC's proposed capital rules, swap dealers that are not FCMs would have the option of complying with: (1) A capital standard based on the capital rules for banks; (2)

[1296] *See* SIFMA 2/22/2013 Letter.

[1297] *See* Financial Services Roundtable Letter.

[1298] *See* CFA Institute Letter; ISDA 1/23/2013 Letter; KfW Bankengruppe Letter; Morgan 10/29/2014 Stanley Letter; SIFMA 2/22/2013 Letter.

[1299] *See* SIFMA 11/19/2018 Letter.

[1300] *See* paragraph (e)(2) of Rule 18a–1, as adopted. *See also Capital, Margin, and Segregation Proposing Release,* 77 FR at 70244 (proposing a portfolio concentration charge in Rule 18a–1 for stand-alone SBSDs).

[1301] *See* paragraph (e)(2) of Rule 18a–1, as adopted.

[1302] *See OTC Derivatives Dealers,* 63 FR at 59384–87 (''[T]he Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (collectively, the ''U.S. Banking Agencies'') have adopted rules implementing the Capital Accord for U.S. banks and bank holding companies. Appendix F is generally consistent with the U.S. Banking Agencies' rules, and incorporates the qualitative and quantitative conditions imposed on-banking institutions.''). The use of models to compute market risk charges in lieu of the standardized haircuts (as nonbank SBSDs will be permitted to do under Rules 15c3–1 and 18a–1) also is generally consistent with the capital rules for banking institutions. *Id.*

[1303] *See* Rule 18a–10, as adopted.

[1304] *See CFTC Capital Proposing Release,* 81 FR 91252.

a capital standard based on the Commission's capital requirements in Rule 18a–1; or (3) if the swap dealer is predominantly engaged in non-financial activities, a capital standard based on a tangible net worth requirement.

In addition, as discussed above in section II.B. of this release, the Commission has made a number of modifications to the final margin rule to more closely align the rule with the margin rules of the CFTC and the prudential regulators.

Nevertheless, to the extent that regulatory requirements differ across regimes, the Commission acknowledges the potential for registrants subject to more than one regulatory regime to face an increased compliance burden, even if capital and margin requirements are no more binding for dually-registered SBSDs than bank SBSDs. In particular, the Commission acknowledges that dual registrants may need to devote more resources towards compliance and regulatory monitoring. Because of the similarity between single-name and index CDS, the Commission expects that participants active in one market are likely to be active in the other, and dual registrants may need to devote more resources to ensure that the appropriate rules are applied to security-based swap and swap transactions than a bank SBSD.

However, as described above, the Commission expects that nonbank SBSDs will 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 lending and deposit-taking activities of commercial banks. Therefore, the Commission has modeled its capital, margin, and segregation regime on the existing rules for broker-dealers, rather than the rules of the CFTC and the prudential regulators. However, as discussed throughout this release, the Commission has modified its final rules in an effort to harmonize them, where appropriate, with the rules of the CFTC and the prudential regulators.

c. Domestic and Foreign SBSDs

The market for security-based swaps is a global market that transcends traditional jurisdiction boundaries. As discussed above in section VI.A.1. of this release, it is quite common for counterparties to a security-based swap transaction to not be based in the same jurisdiction. The specific regulatory requirements applicable in a dealer's jurisdictions can create competitive advantages and disadvantages for that dealer vis-à-vis dealers operating in other jurisdictions. There exists the possibility that differences in the capital, margin, and segregation rules eventually adopted by foreign regulators and those of the Commission may create advantages or disadvantage for U.S. registrants participating in this global market.

The potential disadvantages to U.S. registrants were pointed out by commenters. One commenter argued that because U.S. registrants must structure their activities so as to margin non-cleared security-based swaps and swaps separately from other non-centrally cleared derivatives, U.S. registrants would be at a significant competitive disadvantage to foreign competitors.[1305] The commenter argued that several components of the proposed margin rules differ from the recommended framework in the BCBS/IOSCO Paper and would generally make nonbank SBSDs uncompetitive with bank SBSDs and foreign SBSDs.[1306] The commenter argued that the Commission could best address these differences by permitting OTC derivatives dealers and stand-alone SBSDs to collect and maintain margin in a manner consistent with the recommendations of the BCBS/IOSCO Paper. Another commenter stated that requiring the use of the Appendix A methodology (rather than internal models) for initial margin calculations on non-cleared equity security-based swaps would place U.S.-based nonbank SBSDs at a competitive disadvantage in the market.[1307] For example, the technical standards published by the European regulators do not include similar provisions precluding the use of internal models in the calculation of initial margin for equity swaps. As discussed above in section VI.B.3. of this release, while the Commission acknowledges that the Appendix A methodology has certain limitations, the Commission believes that permitting the use of internal models for equity swaps could lead to inadequate margin levels in comparison to the broker-dealer margin rules. However, the Commission has modified the final rule to permit nonbank SBSDs that are not broker-dealers to apply to the Commission to use internal models to compute initial margin for equity-based security-based swaps.

Based on a review of proposals by European regulators, the Commission does not believe that its capital, margin, and segregation rules will place U.S. firms at a significant competitive disadvantage in the security-based swap market. Although certain aspects of the Commission's rules—such as the required use of Appendix A methodology for calculating initial margin for equity security-based swaps for broker-dealer SBSDs—are more restrictive than the corresponding aspects of the European rules, other aspects are less restrictive. In addition, foreign entities transacting with U.S. counterparties will, absent Commission approval for substituted compliance (with respect to capital and margin requirements) or transaction-based exceptions (with respect to segregation requirements), be subject to the Commission's rules. Thus, differences in foreign regulatory regimes are expected to have only limited impact in terms of competition for the business of domestic end users.

d. Nonbank MSBSPs

Some of the considerations outlined above for SBSDs apply to the analysis of the competitive effects on nonbank MSBSPs, although here the impact on competition is likely to be even more limited. The key characteristic distinguishing nonbank MSBSPs from nonbank SBSDs is that the former do not engage in dealing activity. Thus, the population of MSBSPs will likely consist of large financial non-dealing entities that maintain significant non-cleared security-based swap exposures. Under the final capital, margin, and segregation rules, such entities are subject to less extensive requirements than nonbank SBSDs, and consequently, the costs of compliance with these requirements is—other things being equal—expected to be less significant.

That said, the Commission acknowledges that some (non-dealing) market participants' internal systems and processes may not be designed to handle the new requirements. For example, under the new rules, nonbank MSBSPs will in most cases be required to post and collect variation margin on a daily basis. This requires back-office systems and procedures capable of handling the daily exchange of collateral. For certain participants in the non-cleared security-based swap market, such a capability may be absent or inadequate. Similarly, under the new capital provisions, nonbank MSBSPs will be required to ensure that tangible net worth is positive at all times; again, certain non-cleared security-based swap market participants may not currently possess systems or procedures for tracking tangible net worth on a real-time basis.[1308]

[1305] *See* SIFMA 3/12/2014 Letter.

[1306] *See* SIFMA 11/19/2018 Letter.

[1307] *See* ISDA 1/23/2013 Letter.

[1308] In determining net worth, all long and short positions in security-based swaps, swaps, and related positions must be marked to their market value. *See* Rule 18a–2, as adopted.

Disparities in the ease with which potential nonbank MSBSPs could comply with the Commission's new rules could rearrange the relative competitive positions of these entities. However, the Commission believes the registration thresholds for nonbank MSBSPs that the Commission has previously adopted are sufficiently high to minimize such disruptions. As discussed above in section VI.A. of this release, the Commission expects that between zero and five entities will initially register as MSBSPs, and that these entities will be operating at a scale where prudent risk management practices already include much of the infrastructure necessary to implement systems and procedures that can satisfy the Commission's new requirements.

VII. Regulatory Flexibility Act Certification

The Regulatory Flexibility Act (''RFA'') [1309] requires Federal agencies, in promulgating rules, to consider the impact of those rules on small entities. Pursuant to Section 605(b) of the RFA,[1310] the Commission certified in the proposing release and the cross-border proposing release that proposed new Rules 3a71–6 and 18a–1 through 18a–4, and the proposed amendments to Rules 15c3–1 and 15c3–3 would not have a significant economic impact on any ''small entity'' [1311] for purposes of the RFA.[1312] The Commission is also adopting Rule 18a–10 today.

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,[1313] 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 paragraph (d) of Rule 17a–5,[1314] 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.[1315] 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,[1316] firms with $175 million or less in assets; (2) for non-depository credit intermediation and certain other activities,[1317] firms with $7 million or less in annual receipts; (3) for entities in financial investments and related activities,[1318] firms with $7 million or less in annual receipts; (4) for insurance carriers and entities in related activities,[1319] firms with $7 million or less in annual receipts; and (5) for funds, trusts, and other financial vehicles,[1320] firms with $7 million or less in annual receipts.[1321]

With respect to nonbank SBSDs and MSBSPs, based on feedback from market participants and the Commission's information about the security-based swap market, the Commission continues to believe that: (1) The types of entities that would engage in more than a *de minimis* level of dealing activity involving security-based swaps—which generally would be large financial institutions—would not be ''small entities'' for purposes of the RFA; and (2) the types of entities that may have security-based swap positions above the level required to register as ''major security-based swap participants'' would not be ''small entities'' for purposes of the RFA. Thus, it is unlikely that Rules 18a–1 through 18a–4, Rule 18a–10, and the amendments to Rules 15c3–1, 15c3–3, and 3a71–6 will have a significant economic impact on any small entity.

The Commission estimates that as of December 31, 2018, there were approximately 996 broker-dealers that were ''small'' for the purposes Rule 0–10. While certain amendments to Rules 15c3–1 and 15c3–3 will apply to stand-alone broker-dealers, these amendments will not have any impact on ''small'' broker-dealers, since few, if any, of these firms engage in security-based swaps activities.[1322]

For the foregoing reasons, the Commission certifies that new Rules 18a–1 through 18a–4, new Rule 18a–10, and the amendments to Rules 3a71–6, 15c3–1, and 15c3–3 will not have a significant economic impact on a substantial number of small entities for purposes of the RFA.

VIII. Statutory Basis

Pursuant to the Exchange Act, 15 U.S.C. 78a *et seq.,* and particularly, Sections 3(b), 3E, 15, 15F, and 23(a) (15 U.S.C. 78c(b), 78c–5, 78o, 78o–10, and 78w(a)), thereof, the Commission is amending §§ 200.30–3, 240.3a71–6, 240.15c3–1, 240.15c3–1a, 240.15c3–1b, 240.15c3–1d, 240.15c3–1e, and 240.15c3–3, and adopting §§ 240.15c3–3b, 240.18a–1, 240.18a–1a, 240.18a–1b, 240.18a–1c, 240.18a–1d, 240.18a–2, 240.18a–3, 240.18a–4, 240.18a–4a, and 240.18a–10 under the Exchange Act.[1323]

List of Subjects

17 CFR Part 200

Administrative practice and procedure, Authority delegations (Government agencies), Civil rights, Classified information, Conflicts of interest, Environmental impact statements, Equal employment

[1309] *See* 5 U.S.C. 601 *et seq.*

[1310] *See* 5 U.S.C. 605(b).

[1311] 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 rulemaking, are set forth in 17 CFR 240.0–10 (''Rule 0–10''). *See Statement of Management on Internal Accounting Control,* Exchange Act Release No. 18451, (Jan. 28, 1982), 47 FR 5215 (Feb. 4, 1982).

[1312] *See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers; Proposed Rule,* 77 FR at 70328–70329; *Cross-Border Proposing Release,* 78 FR at 31204–31205.

[1313] *See* 17 CFR 240.0–10(a).

[1314] *See* 17 CFR 240.17a–5(d).

[1315] *See* 17 CFR 240.0–10(c).

[1316] 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.

[1317] 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.

[1318] 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.

[1319] 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.

[1320] 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.

[1321] *See* 13 CFR 121.201.

[1322] The amendments are discussed in detail in sections I, II, and III of this release. The Commission discusses the economic impact, including the compliance costs and burdens, of the amendments in section IV (PRA) and section VI (Economic Analysis) of this release.

[1323] If any of the provisions of these rules, or the application thereof to any person or circumstance, is held to be invalid, such invalidity shall not affect other provisions or application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application.

opportunity, Federal buildings and facilities, Freedom of information, Government securities, Organization and functions (Government agencies), Privacy, Reporting and recordkeeping requirements, Sunshine Act.

17 CFR Part 240

Brokers, Confidential business information, Fraud, Reporting and recordkeeping requirements, Securities.

Text of Rules and Rule Amendments

In accordance with the foregoing, title 17, chapter II of the Code of Federal Regulations is amended as follows:

PART 200—ORGANIZATION; CONDUCT AND ETHICS; AND INFORMATION AND REQUESTS

Subpart A—Organization and Program Management

■ 1. The authority citation for part 200, subpart A, continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77o, 77s, 77z–3, 77sss, 78d, 78d–1, 78d–2, 78*o*–4, 78w, 78ll(d), 78mm, 80a–37, 80b–11, 7202, and 7211 *et seq.,* unless otherwise noted.

* * * * *

Section 200.30–3 is also issued under 15 U.S.C. 78b, 78d, 78f, 78k–1, 78q, 78s, and 78eee.

* * * * *

■ 2. Section 200.30–3 is amended by revising paragraphs (a)(7) introductory text, (a)(7)(i) and (iv), (a)(7)(vi)(A) and (C) through (F), (a)(7)(vii) and (a)(10)(i) to read as follows:

§ 200.30–3 Delegation of authority to Director of Division of Trading and Markets.

* * * * *

(a) * * *

(7) Pursuant to Rule 15c3–1 (§ 240.15c3–1 of this chapter) and Rule 18a–1 (§ 240.18a–1 of this chapter):

(i) To approve lesser equity requirements in specialist or market maker accounts pursuant to Rule 15c3–1(a)(6)(iii)(B) (§ 240.15c3–1(a)(6)(iii)(B) of this chapter);

* * * * *

(iv) To approve a change in election of the alternative capital requirement pursuant to Rule 15c3–1(a)(1)(ii) (§ 240.15c3–1(a)(1)(ii) of this chapter);

* * * * *

(vi)(A) To review amendments to applications of brokers or dealers and security-based swap dealers filed pursuant to §§ 240.15c3–1e, 240.15c3–1g, and 240.18a–1(d) of this chapter and to approve such amendments, unconditionally or subject to specified terms and conditions;

* * * * *

(C) To impose additional conditions, pursuant to §§ 240.15c3–1e(e) and 240.18a–1(d)(9)(iii) of this chapter, on a broker or dealer that computes certain of its net capital deductions pursuant to § 240.15c3–1e of this chapter, or on an ultimate holding company of the broker or dealer that is not an ultimate holding company that has a principal regulator, as defined in § 240.15c3–1(c)(13)(ii) of this chapter, or on a security-based swap dealer that computes certain of its net capital deductions pursuant to § 240.18a–1(d) of this chapter;

(D) To require that a broker or dealer, or the ultimate holding company of the broker or dealer, or a security-based swap dealer provide information to the Commission pursuant to §§ 240.15c3–1e(a)(1)(viii)(G), 240.15c3–1e(a)(1)(ix)(C) and (a)(4), 240.18a–1(d)(2), and 240.15c3–1g(b)(1)(i)(H), and (b)(2)(i)(C) of this chapter;

(E) To determine, pursuant to §§ 240.15c3–1e(a)(10)(ii) and 240.18a–1(d)(7)(ii), that the notice that a broker or dealer and security-based swap dealer must provide to the Commission pursuant to §§ 240.15c3–1e(a)(10)(i) and 240.18a–1(d)(7)(i) of this chapter will become effective for a shorter or longer period of time; and

(F) To approve, pursuant to §§ 240.15c3–1e(a)(7)(ii) and 240.18a–1(d)(5)(ii) of this chapter, the temporary use of a provisional model, in whole or in part, unconditionally or subject to any conditions or limitations;

(vii)(A) To approve the prepayments of a subordinated loan agreement of a security-based swap dealer pursuant to § 240.18a–1d(b)(6) of this chapter;

(B) To approve a prepayment of a revolving subordinated loan agreement of a security-based swap dealer pursuant to § 240.18a–1d(c)(4) of this chapter; and

(C) To examine a proposed subordinated loan agreement filed by a security-based swap dealer and to find it acceptable pursuant to § 240.18a–1d(c)(5) of this chapter.

* * * * *

(10)(i) Pursuant to Rule 15c3–3 (§ 240.15c3–3 of this chapter) and Rule 18a–4 (§ 240.18a–4 of this chapter) to find and designate as control locations for purposes of Rule 15c3–3(c)(7) (§ 240.15c3–3(c)(7) of this chapter), Rule 15c3–3(p)(2)(ii)(E) (§ 240.15c3–3(p)(2)(ii)(E) of this chapter), and Rule 18a–4(b)(2)(v) (§ 240.18a–4(b)(2)(v) of this chapter), certain broker-dealer and security-based swap accounts which are adequate for the protection of customer securities.

* * * * *

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

■ 3. The general authority citation for part 240 is revised, the sectional authorities for §§ 240.15c3–1 and 240.15c3–3 are revised, adding 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–4, 78o–10, 78p, 78q, 78q–1, 78s, 78u–5, 78w, 78x, 78dd, 78*ll,* 78mm, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, and 7201 *et seq.,* and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; Pub. L. 111–203, 939A, 124 Stat. 1376 (2010); and Pub. L. 112–106, sec. 503 and 602, 126 Stat. 326 (2012), 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, 240.18a–3, and 240.18a–10 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).

* * * * *

■ 4. Section 240.3a71–6 is amended by adding paragraphs (d)(4) and (5) to read as follows:

§ 240.3a71–6 Substituted compliance for security-based swap dealers and major security-based swap participants.

* * * * *

(d) * * *

(4) *Capital*—(i) *Security-based swap dealers.* The capital requirements of section 15F(e) of the Act (15 U.S.C. 78o–10(e)) and § 240.18a–1; provided, however, that prior to making such substituted compliance determination, the Commission intends to consider (in addition to any conditions imposed) whether the capital requirements of the foreign financial regulatory system are designed to help ensure the safety and soundness of registrants in a manner that is comparable to the applicable provisions arising under the Act and its rules and regulations.

(ii) *Major security-based swap participants.* The capital requirements of section 15F(e) of the Act (15 U.S.C. 78o–10(e)) and § 240.18a–2; provided, however, that prior to making such substituted compliance determination, the Commission intends to consider (in addition to any conditions imposed) whether the capital requirements of the foreign financial regulatory system are comparable to the applicable provisions arising under the Act and its rules and regulations.

(5) *Margin*—(i) *Security-based swap dealers.* The margin requirements of section 15F(e) of the Act (15 U.S.C. 78o–10(e)) and § 240.18a–3; provided, however, that prior to making such substituted compliance determination, the Commission intends to consider (in addition to any conditions imposed) whether the foreign financial regulatory system requires registrants to adequately cover their current and potential future exposure to over-the-counter derivatives counterparties, and ensures registrants' safety and soundness, in a manner comparable to the applicable provisions arising under the Act and its rules and regulations.

(ii) *Major security-based swap participants.* The margin requirements of section 15F(e) of the Act (15 U.S.C. 78o–10(e)) and § 240.18a–3; provided, however, that prior to making such substituted compliance determination, the Commission intends to consider (in addition to any conditions imposed) whether the foreign financial regulatory system requires registrants to adequately cover their current exposure to over-the-counter derivatives counterparties, and ensures registrants' safety and soundness, in a manner comparable to the applicable provisions arising under the Act and its rules and regulations.

■ 5. Section 240.15c3–1 is amended by:
■ a. Redesignating paragraph (a)(5) as paragraph (a)(5)(i) and adding paragraph (a)(5)(ii);
■ b. Revising paragraph (a)(7)(i) and (ii) and the undesignated center heading above paragraph (a)(7);
■ c. Adding paragraph (a)(10) with an undesignated center heading above it;
■ d. Revising paragraph (c)(2)(iv)(E);
■ e. Adding paragraphs (c)(2)(vi)(O) and (P);
■ f. Redesignating paragraph (c)(2)(xii) as paragraph (c)(2)(xii)(A) and adding paragraph (c)(2)(xii)(B);
■ g. Adding paragraph (c)(2)(xv); and
■ h. Adding paragraph (c)(17).

The revisions and additions read as follows:

§ 240.15c3–1 Net capital requirements for brokers or dealers.

* * * * *

(a) * * *

(5) * * *

(ii) An OTC derivatives dealer that is also registered as a security-based swap dealer under section 15F of the Act (15 U.S.C. 78*o*–10) is subject to the capital requirements in §§ 240.18a–1, 240.18a–1a, 240.18a–1b, 240.18a–1c and 240.18a–1d instead of the capital requirements of this section and its appendices.

* * * * *

Alternative Net Capital Computation for Broker-Dealers Authorized to Use Models

(7) In accordance with § 240.15c3–1e, the Commission may approve, in whole or in part, an application or an amendment to an application by a broker or dealer to calculate net capital using the market risk standards of § 240.15c3–1e to compute a deduction for market risk on some or all of its positions, instead of the provisions of paragraphs (c)(2)(vi) and (vii) of this section, and § 240.15c3–1b, and using the credit risk standards of § 240.15c3–1e to compute a deduction for credit risk on certain credit exposures arising from transactions in derivatives instruments, instead of the provisions of paragraphs (c)(2)(iv) and (c)(2)(xv)(A) and (B) of this section, subject to any conditions or limitations on the broker or dealer the Commission may require as necessary or appropriate in the public interest or for the protection of investors. A broker or dealer that has been approved to calculate its net capital under § 240.15c3–1e must:

(i)(A) 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:

(*1*) Two percent of the risk margin amount; or

(*2*) Four percent or less of the risk margin amount if the Commission issues an order raising the requirement to four percent or less on or after the third anniversary of this section's compliance date; or

(*3*) Eight percent or less of the risk margin amount if the Commission issues an order raising the requirement to eight percent or less on or after the fifth anniversary of this section's compliance date and the Commission had previously issued an order raising the requirement under paragraph (a)(7)(i)(B) of this section;

(B) If, after considering the capital and leverage levels of brokers or dealers subject to paragraph (a)(7) of this section, as well as the risks of their security-based swap positions, the Commission determines that it may be appropriate to change the percentage pursuant to paragraph (a)(7)(i)(A)(*2*) or (*3*) of this section, the Commission will publish a notice of the potential change and subsequently will issue an order regarding any such change.

(ii) Provide notice that same day in accordance with § 240.17a–11(g) if the broker's or dealer's tentative net capital is less than $6 billion. The Commission may, upon written application, lower the threshold at which notification is necessary under this paragraph (a)(7)(ii), either unconditionally or on specified terms and conditions, if a broker or dealer satisfies the Commission that notification at the $6 billion threshold is unnecessary because of, among other factors, the special nature of its business, its financial position, its internal risk management system, or its compliance history; and

* * * * *

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 paragraph (a)(7) of this section, must:

(i)(A) 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:

(*1*) Two percent of the risk margin amount; or

(*2*) Four percent or less of the risk margin amount if the Commission issues an order raising the requirement to four percent or less on or after the third anniversary of this section's compliance date; or

(*3*) Eight percent or less of the risk margin amount if the Commission issues an order raising the requirement to eight percent or less on or after the fifth anniversary of this section's compliance date and the Commission had previously issued an order raising the requirement under paragraph (a)(10)(i)(B) of this section;

(B) If, after considering the capital and leverage levels of brokers or dealers subject to paragraph (a)(10) of this section, as well as the risks of their security-based swap positions, the Commission determines that it may be appropriate to change the percentage pursuant to paragraph (a)(10)(i)(A)(*2*) or (*3*) of this section, the Commission will publish a notice of the potential change and subsequently will issue an order regarding any such change; 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) and (xiv), and (d)(8) and (9) of § 240.15c3–4 shall not apply.

* * * * *

(c) * * *

(2) * * *

(iv) * * *

(E) *Other deductions.* All other unsecured receivables; all assets doubtful of collection less any reserves established therefor; the amount by which the market value of securities failed to receive outstanding longer than 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 the following need not be deducted:

(*1*) Any amounts deposited in a Customer Reserve Bank Account or PAB Reserve Bank Account pursuant to § 240.15c3–3(e) or in the ''special reserve account for the exclusive benefit of security-based swap customers'' established pursuant to § 240.15c3–3(p)(3),

(*2*) Cash and securities held in a securities account at a carrying broker or dealer (except where the account has been subordinated to the claims of creditors of the carrying broker or dealer), and

(*3*) Clearing deposits.

* * * * *

(vi) * * *

(O) *Cleared security-based swaps.* In the case of a cleared security-based swap held in a proprietary account of the broker or dealer, deducting the amount of the applicable margin requirement of the clearing agency or, if the security-based swap references an equity security, the broker or dealer may take a deduction using the method specified in § 240.15c3–1a.

(P) *Non-cleared security-based swaps*—(*1*) *Credit default swaps*—(*i*) *Short positions (selling protection).* In the case of a non-cleared 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 table 1 to § 240.15c3–1(c)(2)(vi)(P)(*1*)(*i*):

TABLE 1 TO § 240.15c3–1(c)(2)(vi)(P)(*1*)(*i*)

Length of time to maturity of credit default swap contract	Basis point spread					
	100 or less %	101–300 %	301–400 %	401–500 %	501–699 %	700 or more %
Less than 12 months	1.00	2.00	5.00	7.50	10.00	15.00
12 months but less than 24 months	1.50	3.50	7.50	10.00	12.50	17.50
24 months but less than 36 months	2.00	5.00	10.00	12.50	15.00	20.00
36 months but less than 48 months	3.00	6.00	12.50	15.00	17.50	22.50
48 months but less than 60 months	4.00	7.00	15.00	17.50	20.00	25.00
60 months but less than 72 months	5.50	8.50	17.50	20.00	22.50	27.50
72 months but less than 84 months	7.00	10.00	20.00	22.50	25.00	30.00
84 months but less than 120 months	8.50	15.00	22.50	25.00	27.50	40.00
120 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 non-cleared security-based swap that is a long credit default swap, deducting 50 percent of the deduction that would be required by paragraph (c)(2)(vi)(P)(*1*)(*i*) of this section if the non-cleared security-based swap was a short credit default swap, each such deduction not to exceed the current market value of the long position.

(*iii*) *Long and short credit default swaps.* In the case of non-cleared security-based swaps that are long and short credit default swaps referencing the same entity (in the case of non-cleared credit default swap security-based swaps referencing a corporate entity) or obligation (in the case of non-cleared credit default swap security-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)(P)(*1*)(*i*) or (*ii*) on the excess of the long or short position. In the case of non-cleared 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)(P)(*1*)(*i*) of this section, deducting 50 percent of the amount required by paragraph (c)(2)(vi)(P)(*1*)(*i*) of this section on the short position plus the deduction required by paragraph (c)(2)(vi)(P)(*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 or dealer must document the industry sector classification system used pursuant to this section.

(*iv*) *Long security and long credit default swap.* In the case of a non-cleared 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 percent of the amount specified in paragraph (c)(2)(vi) or (vii) of this section for the debt security, 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.

(*v*) *Short security and short credit default swap.* In the case of a non-cleared security-based swap that is a short credit default swap referencing a debt security or a corporate entity, and the broker or dealer is short the debt security or a debt security issued by the corporate entity, deducting the amount specified in paragraph (c)(2)(vi) or (vii) of this section for the debt security. In the case of a non-cleared 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*) *Non-cleared security-based swaps that are not credit default swaps.* In the case of a non-cleared 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)(P)(*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 and swap customer to meet the margin requirements of a clearing agency, Examining Authority, the Commission, derivatives clearing organization, or the Commodity Futures Trading Commission, as applicable, after application of calls for margin, marks to the market, or other required deposits which are outstanding within the required time frame to collect the margin, mark to the market, or other required deposits.

* * * * *

(xv) *Deduction from net worth in lieu of collecting collateral for non-cleared security-based swap and swap transactions*—(A) *Security-based swaps.* Deducting the initial margin amount calculated pursuant to § 240.18a–3(c)(1)(i)(B) for the account of a counterparty at the broker or dealer that is subject to a margin exception set forth in § 240.18a–3(c)(1)(iii), less the margin value of collateral held in the account.

(B) *Swaps.* Deducting the initial margin amount calculated pursuant to the margin rules of the Commodity Futures Trading Commission in the account of a counterparty at the broker or dealer that is subject to a margin exception in those rules, less the margin value of collateral held in the account.

(C) *Treatment of collateral held at a third-party custodian.* For the purposes of the deductions required pursuant to paragraphs (c)(2)(xv)(A) and (B) of this section, collateral held by an independent third-party custodian as initial margin may be treated as collateral held in the account of the counterparty at the broker or dealer if:

(*1*) The independent third-party custodian is a bank as defined in section 3(a)(6) of the Act or a registered U.S. clearing organization or depository that is not affiliated with the counterparty or, if the collateral consists of foreign securities or currencies, a supervised foreign bank, clearing organization, or depository that is not affiliated with the counterparty and that customarily maintains custody of such foreign securities or currencies;

(*2*) The broker or dealer, the independent third-party custodian, and the counterparty that delivered the collateral to the custodian have executed an account control agreement governing the terms under which the custodian holds and releases collateral pledged by the counterparty as initial margin that is a legal, valid, binding, and enforceable agreement under the laws of all relevant jurisdictions, including in the event of bankruptcy, insolvency, or a similar proceeding of any of the parties to the agreement, and that provides the broker or dealer with the right to access the collateral to satisfy the counterparty's obligations to the broker or dealer arising from transactions in the account of the counterparty; and

(*3*) The broker or dealer maintains written documentation of its analysis that in the event of a legal challenge the relevant court or administrative authorities would find the account control agreement to be legal, valid, binding, and enforceable under the applicable law, including in the event of the receivership, conservatorship, insolvency, liquidation, or a similar proceeding of any of the parties to the agreement.

* * * * *

(17) The term *risk margin amount* means the sum of:

(i) The total initial margin required to be maintained by the broker or dealer at each clearing agency with respect to security-based swap transactions cleared for security-based swap customers; and

(ii) The total initial 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).

* * * * *

■ 6. Section 240.15c3–1a is amended by revising paragraphs (a)(3) and (4) and (b)(1)(v)(C)(*3*) and (*4*) and adding paragraph (b)(1)(v)(C)(*5*) to read as follows:

§ 240.15c3–1a Options (Appendix A to 17 CFR 240.15c3–1)

(a) * * *

(3) The term *related instrument* within an option class or product group refers to futures contracts, options on futures contracts, security-based swaps on a narrow-based security index, and swaps 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 other than a security-based swap on a narrow-based security index, 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 section, the broker or 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, security-based swaps on a narrow-based security index, qualified stock baskets, unlisted instruments, or swaps.

* * * * *

(b) * * *

(1) * * *

(v) * * *

(C) * * *

(*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 percent of the market value of the qualified stock basket for high-capitalization diversified and narrow-based indexes;

(*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 7 ½ percent of the market value of the qualified stock basket for non-high-capitalization diversified indexes; and

(*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 percent times the multiplier for each security future and equity option.

* * * * *

■ 7. Section 240.15c3–1b is amended:

■ a. In paragraph (a)(3)(iii)(C) by adding the phrase ''cleared swap transactions or,'' before the phrase ''commodity futures or options transactions''; and

■ b. By adding paragraph (b).

The addition reads 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) *Cleared swaps.* In the case of a cleared swap held in a proprietary account of the broker or dealer, deducting the amount of the applicable margin requirement of the derivatives clearing organization or, if the swap references an equity security index, the broker or dealer may take a deduction using the method specified in § 240.15c3–1a.

(2) *Non-cleared swaps*—(i) *Credit default swaps referencing broad-based security indices.* In the case of a non-cleared credit default swap for which the deductions in § 240.15c3–1e do not apply:

(A) *Short positions (selling protection).* In the case of a non-cleared swap that is a short credit default swap referencing a broad-based security 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 table 1 to § 240.15c3–1a(b)(2)(i)(A):

TABLE 1 TO § 240.15c3–1a(b)(2)(i)(A)

Length of time to maturity of credit default swap contract	Basis point spread					
	100 or less (%)	101–300 (%)	301–400 (%)	401–500 (%)	501–699 (%)	700 or more (%)
Less than 12 months	0.67	1.33	3.33	5.00	6.67	10.00
12 months but less than 24 months	1.00	2.33	5.00	6.67	8.33	11.67
24 months but less than 36 months	1.33	3.33	6.67	8.33	10.00	13.33
36 months but less than 48 months	2.00	4.00	8.33	10.00	11.67	15.00
48 months but less than 60 months	2.67	4.67	10.00	11.67	13.33	16.67
60 months but less than 72 months	3.67	5.67	11.67	13.33	15.00	18.33
72 months but less than 84 months	4.67	6.67	13.33	15.00	16.67	20.00
84 months but less than 120 months	5.67	10.00	15.00	16.67	18.33	26.67
120 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 non-cleared swap that is a long credit default swap referencing a broad-based security index, deducting 50 percent of the deduction that would be required by paragraph (b)(2)(i)(A) of this section if the non-cleared swap was a short credit default swap, each such deduction not to exceed the current market value of the long position.

(C) *Long and short credit default swaps.* In the case of non-cleared 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)(2)(i)(A) or (B) of this section on the excess of the long or short position.

(D) *Long basket of obligors and long credit default swap.* In the case of a non-cleared swap that is a long credit default swap referencing a broad-based security index and the broker or dealer is long a basket of debt securities comprising all of the components of the security index, deducting 50 percent 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.

(E) *Short basket of obligors and short credit default swap.* In the case of a non-cleared swap that is a short credit default swap referencing a broad-based security index and the broker or dealer is short a basket of debt securities comprising all of the components of the security index, deducting the amount specified in § 240.15c3–1(c)(2)(vi) for the component securities.

(ii) *All other swaps.* (A) In the case of a non-cleared swap that is not a credit default swap for which the deductions in § 240.15c3–1e do not apply, deducting the amount calculated by multiplying the notional value of the swap by the percentage specified in:

(*1*) Section 240.15c3–1 applicable to the reference asset if § 240.15c3–1 specifies a percentage deduction for the type of asset;

(*2*) 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

(*3*) In the case of non-cleared 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 one eighth of 1 percent of the amount of a long position that is netted against a short position in the case of a non-cleared swap with a maturity of three months or more.

(B) A broker or dealer may reduce the deduction under paragraph (b)(2)(ii)(A) 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.

* * * * *

■ 8. Section 240.15c3–1d is amended by revising paragraphs (b)(7) and (8), (b)(10)(ii)(B), (c)(2), and (c)(5)(i)(B) to read as follows:

§ 240.15c3–1d Satisfactory subordination agreements (Appendix D to 17 CFR 240.15c3–1).

* * * * *

(b) * * *

(7) A broker or dealer at its option but not at the option of the lender may, if the subordination agreement so provides, make a Payment of all or any portion of the Payment Obligation thereunder prior to the scheduled maturity date of such Payment Obligation (hereinafter referred to as a ‘‘Prepayment’’), but in no event may any Prepayment be made before the expiration of one year from the date such subordination agreement became effective. This restriction shall not apply to temporary subordination agreements that comply with the provisions of paragraph (c)(5) of this section. No Prepayment shall be made, if, after

giving effect thereto (and to all Payments of Payment Obligations under any other subordinated agreements then outstanding the maturity or accelerated maturities of which are scheduled to fall due within six months after the date such Prepayment is to occur pursuant to this provision or on or prior to the date on which the Payment Obligation in respect of such Prepayment is scheduled to mature disregarding this provision, whichever date is earlier) without reference to any projected profit or loss of the broker or dealer, either aggregate indebtedness of the broker or dealer would exceed 1000 percent of its net capital or its net capital would be less than 120 percent of the minimum dollar amount required by § 240.15c3–1 or, in the case of a broker or dealer operating pursuant to § 240.15c3–1(a)(1)(ii), its net capital would be less than 5 percent of its aggregate debit items computed in accordance with § 240.15c3–3a, or if registered as a futures commission merchant, 7 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), if greater, or its net capital would be less than 120 percent of the minimum dollar amount required by § 240.15c3–1(a)(1)(ii), or if, in the case of a broker or dealer operating pursuant to § 240.15c3–1(a)(10), its net capital would be less than 120 percent of its minimum requirement.

(8)(i) The Payment Obligation of the broker or dealer in respect of any subordination agreement shall be suspended and shall not mature if, after giving effect to Payment of such Payment Obligation (and to all Payments of Payment Obligations of such broker or dealer under any other subordination agreement(s) then outstanding that are scheduled to mature on or before such Payment Obligation) either:

(A) The aggregate indebtedness of the broker or dealer would exceed 1200 percent of its net capital, or in the case of a broker or dealer operating pursuant to § 240.15c3–1(a)(1)(ii), its net capital would be less than 5 percent of aggregate debit items computed in accordance with § 240.15c3–3a or, if registered as a futures commission merchant, 6 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers on or subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), if greater, or, in the case of a broker or dealer operating pursuant to § 240.15c3–1(a)(10), its net capital would be less than 120 percent of its minimum requirement; or

(B) Its net capital would be less than 120 percent of the minimum dollar amount required by § 240.15c3–1 including paragraph (a)(1)(ii), if applicable. The subordination agreement may provide that if the Payment Obligation of the broker or dealer thereunder does not mature and is suspended as a result of the requirement of this paragraph (b)(8) for a period of not less than six months, the broker or dealer shall thereupon commence the rapid and orderly liquidation of its business, but the right of the lender to receive Payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of §§ 240.15c3–1 and 240.15c3–1d.

(ii) [Reserved]

* * * * *

(10) * * *

(ii) * * *

(B) The aggregate indebtedness of the broker or dealer exceeding 1500 percent of its net capital or, in the case of a broker or dealer that has elected to operate under § 240.15c3–1(a)(1)(ii), its net capital computed in accordance therewith is less than two percent of its aggregate debit items computed in accordance with § 240.15c3–3a or, if registered as a futures commission merchant, four percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers on or subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), if greater, or, in the case of a broker or dealer operating pursuant to § 240.15c3–1(a)(10), its net capital is less than its minimum requirement, throughout a period of 15 consecutive business days, commencing on the day the broker or dealer first determines and notifies the Examining Authority for the broker or dealer, or the Examining Authority or the Commission first determines and notifies the broker or dealer of such fact;

* * * * *

(c) * * *

(2) Every broker or dealer shall immediately notify the Examining Authority for such broker or dealer if, after giving effect to all Payments of Payment Obligations under subordination agreements then outstanding that are then due or mature within the following six months without reference to any projected profit or loss of the broker or dealer either the aggregate indebtedness of the broker or dealer would exceed 1200 percent of its net capital or its net capital would be less than 120 percent of the minimum dollar amount required by § 240.15c3–1, or, in the case of a broker or dealer operating pursuant to § 240.15c3–1(a)(1)(ii), its net capital would be less than 5 percent of aggregate debit items computed in accordance with § 240.15c3–3a, or, if registered as a futures commission merchant, 6 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers on or subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), if greater, or less than 120 percent of the minimum dollar amount required by § 240.15c3–1(a)(1)(ii), or, in the case of a broker or dealer operating pursuant to § 240.15c3–1(a)(10), its net capital would be less than 120 percent of its minimum requirement.

* * * * *

(5)(i) * * *

(B) In the case of a broker or dealer operating pursuant to § 240.15c3–1(a)(1)(ii), its net capital is less than 5 percent of aggregate debits computed in accordance with § 240.15c3–1, or, if registered as a futures commission merchant, less than 7 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers on or subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), if greater, or less than 120 percent of the minimum dollar amount required by paragraph (a)(1)(ii) of this section, or, in the case of a broker or dealer operating pursuant to § 240.15c3–1(a)(10), its net capital would be less than 120 percent of its minimum requirement, or

* * * * *

■ 9. Section 240.15c3–1e is amended by:

■ a. Redesignating the Preliminary Note as introductory text and revising it;

■ b. Revising paragraph (a) introductory text;

■ c. Redesignating paragraph (a)(7) as paragraph (a)(7)(i) and adding paragraph (a)(7)(ii);

■ d. Revising paragraph (c)(3);
■ e. Adding paragraphs (c)(4)(v)(B)(*1*) and (*2*);
■ f. Removing paragraph (c)(4)(v)(D) and redesignating paragraphs (c)(4)(v)(E) through (H) as paragraphs (c)(4)(v)(D) through (G);
■ g. In paragraph (e) introductory text by removing the phrase ''§ 240.15c3–1(c)(2)(vi), (c)(2)(vii), and (c)(2)(iv), as appropriate'' and adding in its place ''§ 240.15c3–1(c)(2)(iv), (vi), and (vii), (c)(2)(xv)(A) and (B), as appropriate, and § 240.15c–1b, as appropriate''; and
■ h. Revising paragraph (e)(1).

The revisions read as follows:

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

Sections 240.15c3–1e and 240.15c3–1g set forth a program that allows a broker or dealer to use an alternative approach to computing net capital deductions, subject to the conditions described in §§ 240.15c3–1e and 240.15c3–1g, including supervision of the broker's or dealer's ultimate holding company under the program. The program is designed to reduce the likelihood that financial and operational weakness in the holding company will destabilize the broker or dealer, or the broader financial system. The focus of this supervision of the ultimate holding company is its financial and operational condition and its risk management controls and methodologies.

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

* * * * *

(7) * * *

(ii) The Commission may approve the temporary use of a provisional model in whole or in part, subject to any conditions or limitations the Commission may require, if:

(A) The broker or dealer has a complete application pending under this section;

(B) The use of the provisional model has been approved by:

(*1*) A prudential regulator;

(*2*) The Commodity Futures Trading Commission or a futures association registered with the Commodity Futures Trading Commission under section 17 of the Commodity Exchange Act;

(*3*) A foreign financial regulatory authority that administers a foreign financial regulatory system with capital requirements that the Commission has found are eligible for substituted compliance under § 240.3a71–6 if the provisional model is used for the purposes of calculating net capital;

(*4*) A foreign financial regulatory authority that administers a foreign financial regulatory system with margin requirements that the Commission has found are eligible for substituted compliance under § 240.3a71–6 if the provisional model is used for the purposes of calculating initial margin pursuant to § 240.18a–3; or

(*5*) Any other foreign supervisory authority that the Commission finds has approved and monitored the use of the provisional model through a process comparable to the process set forth in this section.

* * * * *

(c) * * *

(3) A portfolio concentration charge of 100 percent of the amount of the broker's or dealer's aggregate current exposure for all counterparties in excess of 10 percent of the tentative net capital of the broker or dealer;

(4) * * *

(v) * * *

(B) * * *

(*1*) The collateral is subject to the broker's or dealer's physical possession or control and may be liquidated promptly by the firm without intervention by any other party; or

(*2*) The collateral is held by an independent third-party custodian that is a bank as defined in section 3(a)(6) of the Act or a registered U.S. clearing organization or depository that is not affiliated with the counterparty or, if the collateral consists of foreign securities or currencies, a supervised foreign bank, clearing organization, or depository that is not affiliated with the counterparty and that customarily maintains custody of such foreign securities or currencies;

* * * * *

(e) * * *

(1) The broker or dealer is required by § 240.15c3–1(a)(7)(ii) to provide notice to the Commission that the broker's or dealer's tentative net capital is less than $6 billion;

* * * * *

■ 10. Section 240.15c3–3 is amended by adding introductory text and paragraph (p) to read as follows:

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

Except where otherwise noted, § 240.15c3–3 applies to a broker or dealer registered under section 15(b) of the Act (15 U.S.C. 78o(b)), including a broker or dealer also registered as a security-based swap dealer or major security-based swap participant under section 15F(b) of the Act (15 U.S.C. 78o–10(b)). A security-based swap dealer or major security-based swap participant registered under section 15F(b) of the Act that is not also registered as a broker or dealer under section 15(b) of the Act is subject to the requirements under § 240.18a–4.

* * * * *

(p) *Segregation requirements for security-based swaps.* The following requirements apply to the security-based swap activities of a broker or dealer.

(1) *Definitions.* For the purposes of this paragraph:

(i) The term *cleared security-based swap* means 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 Act (15 U.S.C. 78q–1);

(ii) 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 broker or dealer (after reducing the current exposure by the amount of cash in the account) to the security-based swap customer, excluding:

(A) 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 security-based swap customer; and

(B) Securities and money market instruments held in a qualified registered security-based swap dealer account or in a third-party custodial account but only to the extent the securities and money market instruments are being used to meet a regulatory margin requirement of a security-based swap dealer resulting from the broker or dealer entering into a non-cleared security-based swap transaction with the security-based swap dealer to offset the risk of a non-cleared security-based swap transaction between the broker or dealer and the security-based swap customer;

(iii) The term *qualified clearing agency account* means an account of a broker or dealer at a clearing agency registered with the Commission pursuant to section 17A of the Act (15

U.S.C. 78q–1) that holds funds and other property in order to margin, guarantee, or secure cleared security-based swap transactions for the security-based swap customers of the broker or dealer that meets the following conditions:

(A) The account is designated ''Special Clearing Account for the Exclusive Benefit of the Cleared Security-Based Swap Customers of [name of broker or dealer]'';

(B) The clearing agency has acknowledged in a written notice provided to and retained by the broker or 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 broker or dealer in accordance with the regulations of the Commission and are being kept separate from any other accounts maintained by the broker or dealer with the clearing agency; and

(C) The account is subject to a written contract between the broker or 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.

(iv) The term *qualified registered security-based swap dealer account* means an account at a security-based swap dealer that is registered with the Commission pursuant to section 15F of the Act that meets the following conditions:

(A) The account is designated ''Special Reserve Account for the Exclusive Benefit of the Security-Based Swap Customers of [name of broker or dealer]'';

(B) The security-based swap dealer has acknowledged in a written notice provided to and retained by the broker or dealer that the funds and other property held in the account are being held by the security-based swap dealer for the exclusive benefit of the security-based swap customers of the broker or dealer in accordance with the regulations of the Commission and are being kept separate from any other accounts maintained by the broker or dealer with the security-based swap dealer;

(C) The account is subject to a written contract between the broker or dealer and the 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 security-based swap dealer or any person claiming through the 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

(D) The account and the assets in the account are not subject to any type of subordination agreement between the broker or dealer and the security-based swap dealer.

(v) The term *qualified security* means:

(A) Obligations of the United States;

(B) Obligations fully guaranteed as to principal and interest by the United States; and

(C) General obligations of any State or a political subdivision of a State that:

(*1*) Are not traded flat and are not in default;

(*2*) Were part of an initial offering of $500 million or greater; and

(*3*) Were issued by an issuer that has published audited financial statements within 120 days of its most recent fiscal year end.

(vi) The term *security-based swap customer* means any person from whom or on whose behalf the broker or 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 broker or dealer or, in the case of an affiliate of the broker or dealer, is subordinated to all claims of customers (including PAB customers) and security-based swap customers of the broker or dealer.

(vii) The term *special reserve account for the exclusive benefit of security-based swap customers* means an account at a bank that meets the following conditions:

(A) The account is designated ''Special Reserve Account for the Exclusive Benefit of the Security-Based Swap Customers of [name of broker or dealer]'';

(B) The account is subject to a written acknowledgement by the bank provided to and retained by the broker or 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 broker or dealer in accordance with the regulations of the Commission and are being kept separate from any other accounts maintained by the broker or dealer with the bank; and

(C) The account is subject to a written contract between the broker or 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 broker or 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.

(viii) The term *third-party custodial account* means an account carried by an independent third-party custodian that meets the following conditions:

(A) The account is established for the purposes of meeting regulatory margin requirements of another security-based swap dealer;

(B) The account is carried by a bank as defined in section 3(a)(6) of the Act or a registered U.S. clearing organization or depository or, if the collateral to be held in the account consists of foreign securities or currencies, a supervised foreign bank, clearing organization, or depository that customarily maintains custody of such foreign securities or currencies;

(C) The account is designated for and on behalf of the broker or dealer for the benefit of its security-based swap customers and the account is subject to a written acknowledgement by the bank, clearing organization, or depository provided to and retained by the broker or dealer that the funds and other property held in the account are being held by the bank, clearing organization, or depository for the exclusive benefit of the security-based swap customers of the broker or dealer and are being kept separate from any other accounts maintained by the broker or dealer with the bank, clearing organization, or depository; and

(D) The account is subject to a written contract between the broker or dealer and the bank, clearing organization, or depository 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, clearing organization, or depository and, shall be subject to no right, charge, security interest, lien, or claim of any kind in favor of the bank, clearing organization, or depository or any person claiming through the bank, clearing organization, or depository.

(2) *Physical possession or control of excess securities collateral.* (i) A broker or dealer must promptly obtain and thereafter maintain physical possession or control of all excess securities collateral carried for the security-based

swap accounts of security-based swap customers.

(ii) A broker or dealer has *control* of excess securities collateral only if the securities and money market instruments:

(A) 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 broker or dealer does not require the payment of money or value, and if the books or records of the broker or 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;

(B) 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 broker or dealer to the issuer or its transfer agent, new certificates conforming to the instructions of the broker or dealer have not been received by the broker or dealer, the broker or 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 broker or dealer has not obtained a revalidation of a window ticket from a transfer agent with respect to the certificate delivered for transfer;

(C) 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 broker or 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;

(D)(*1*) Are held in or are in transit between offices of the broker or dealer; or

(*2*) Are held by a corporate subsidiary if the broker or 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 broker or 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

(E) Are held in such other locations as the Commission shall upon application from a broker or dealer find and designate to be adequate for the protection of security-based swap customer securities.

(iii) Each business day the broker or dealer must determine from its books and records the quantity of excess securities collateral in its possession or control as of the close of the previous business day and the quantity of excess securities collateral not in its possession or control as of the previous business day. If the broker or 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:

(A) Securities or money market instruments subject to a lien securing an obligation of the broker or dealer, then the broker or 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;

(B) Securities or money market instruments held in a qualified clearing agency account, then the broker or 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;

(C) Securities or money market instruments held in a qualified registered security-based swap dealer account maintained by another security-based swap dealer or in a third-party custodial account, then the broker or 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 security-based swap dealer or the third-party custodian and must obtain physical possession or control of the securities or money market instruments within two business days following the date of the instructions;

(D) Securities or money market instruments loaned by the broker or dealer, then the broker or 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;

(E) Securities or money market instruments failed to receive more than 30 calendar days, then the broker or 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;

(F) Securities or money market instruments receivable by the broker or dealer as a security dividend, stock split or similar distribution for more than 45 calendar days, then the broker or 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

(G) Securities or money market instruments included on the broker's or dealer's books or records that allocate to a short position of the broker or dealer or a short position for another person, for more than 30 calendar days, then the broker or 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.

(3) *Deposit requirement for special reserve account for the exclusive benefit of security-based swap customers.* (i) A broker or dealer must maintain a special reserve account for the exclusive benefit of security-based swap customers that is separate from any other bank account of the broker or dealer. The broker or dealer must at all times maintain in the special reserve 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 § 240.15c3–3b. In determining the amount maintained in a special reserve account for the exclusive benefit of security-based swap customers, the broker or dealer must deduct:

(A) The percentage of the value of a general obligation of a State or a political subdivision of a State specified in § 240.15c3–1(c)(2)(vi);

(B) The aggregate value of general obligations of a State or a political subdivision of a State to the extent the amount of the obligations of a single issuer (after applying the deduction in paragraph (p)(3)(i)(A) of this section) exceeds two percent of the amount required to be maintained in the special reserve account for the exclusive benefit of security-based swap customers;

(C) The aggregate value of all general obligations of States or political subdivisions of States to the extent the amount of the obligations (after applying the deduction in paragraph (p)(3)(i)(A) of this section) exceeds 10 percent of the amount required to be maintained in the special reserve account for the exclusive benefit of security-based swap customers;

(D) The amount of cash deposited with a single non-affiliated bank to the extent the amount exceeds 15 percent of the equity capital of the bank as reported by the bank in its most recent Call Report or any successor form the bank is required to file by its appropriate federal banking agency (as defined by section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)); and

(E) The total amount of cash deposited with an affiliated bank.

(ii) A broker or dealer must not accept or use credits identified in the items of the formula set forth in § 240.15c3–3b except for the specified purposes indicated under items comprising Total Debits under the formula, and, to the extent Total Credits exceed Total Debits, at least the net amount thereof must be maintained in the Special Reserve Account pursuant to paragraph (p)(3)(i) of this section.

(iii)(A) The computations necessary to determine the amount required to be maintained in the special reserve account for the exclusive benefit of security-based swap customers must be made weekly as of the close of the last business day of the week and any deposit required to be made into the account must be made no later than one hour after the opening of banking business on the second following business day. The broker or dealer may make a withdrawal from the special reserve 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 (p)(3) of this section.

(ii) (B) Computations in addition to the computations required pursuant to paragraph (p)(3)(iii)(A) of this section may be made as of the close of any business day, and deposits so computed must be made no later than one hour after the open of banking business on the second following business day.

(iv) A broker or dealer must promptly deposit into a special reserve account for the exclusive benefit of security-based swap customers cash and/or qualified securities of the broker or dealer if the amount of cash and/or qualified securities in one or more special reserve accounts for the exclusive benefit of security-based swap customers falls below the amount required to be maintained pursuant to this section.

(4) *Requirements for non-cleared security-based swaps*—(i) *Notice.* A broker or dealer registered under section 15F(b) of the Act (15 U.S.C. 78o–10(b)) as a security-based swap dealer or 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)) in writing to a duly authorized individual prior to the execution of the first non-cleared security-based swap transaction with the counterparty occurring after the compliance date of this section.

(ii) *Subordination*—(A) *Counterparty that elects to have individual segregation at an independent third-party custodian.* A broker or dealer must obtain an agreement from a counterparty whose funds or other property to meet a margin requirement of the broker or dealer are held at a third-party custodian in which the counterparty agrees to subordinate its claims against the broker or dealer for the funds or other property held at the third-party custodian to the claims of customers (including PAB customers) and security-based swap customers of the broker or 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 or *customer* property as defined in 15 U.S.C. 78*lll*(4) in a liquidation of the broker or dealer.

(B) *Counterparty that elects to have no segregation.* A broker or dealer registered under section 15F(b) of the Act as a security-based swap dealer must obtain an agreement from a counterparty that is an affiliate of the broker or dealer that affirmatively chooses not 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 broker or dealer to the claims of customers (including PAB customers) and security-based swap customers of the broker or dealer.

■ 11. Section 240.15c3–3b is added to read as follows:

§ 240.15c3–3b Exhibit B—Formula for determination of security-based swap customer reserve requirements of brokers and dealers under § 240.15c3–3.

	Credits	Debits
1. Free credit balances and other credit balances in the accounts carried for security-based swap customers (See Note A)	$______	....
2. Monies borrowed collateralized by securities in accounts carried for security-based swap customers (See Note B)	$______	....
3. Monies payable against security-based swap customers' securities loaned (See Note C)	$______	....
4. Security-based swap customers' securities failed to receive (See Note D)	$______	....
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 (See Note E)	....	$______
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	....	$______

	Credits	Debits
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 (See Note F)	....	$_____
14. Margin related to security futures 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) (See Note G)	....	$_____
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 a security-based swap dealer or at a third-party custodial account	....	$_____
Total Credits	$_____	....
Total Debits	....	$_____
Excess of Credits over Debits	$_____	....

Note A. Item 1 must include all outstanding drafts payable to security-based swap customers which have been applied against free credit balances or other credit balances and must also include checks drawn in excess of bank balances per the records of the broker or dealer.

Note B. Item 2 must 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 must include in addition to monies payable against security-based swap customers' 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 must 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 carried for security-based swap customers must 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 must 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 a security-based swap dealer, must be reduced by any deficits in such accounts (or if a credit, such credit must 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 must 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 broker or dealer and debit balances in accounts of affiliated persons of a broker or dealer must be excluded from the reserve formula, unless the broker or 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) must be reduced by the amount by which any single security-based swap customer's debit balance exceeds 25 percent (to the extent such amount is greater than $50,000) of the broker's or dealer's tentative net capital (*i.e.,* net capital prior to securities haircuts) unless the broker or dealer can demonstrate that the debit balance is directly related to credit items in the Reserve Formula. Related accounts (*e.g.,* the separate accounts of an individual, accounts under common control or subject to cross guarantees) will be deemed to be a single security-based swap customer's account for purposes of this provision.

If the registered national securities exchange or the registered national securities association having responsibility for examining the broker or dealer (''designated examining authority'') 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 such designated examining authority 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 that include both assets of a person who would be excluded from the definition of security-based swap customer (''non-security-based swap customer'') and assets of a person or persons includible in the definition of security-based swap customer must 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 must be excluded from the formula unless the broker or 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 must be excluded from the formula unless the broker or dealer can demonstrate that the debit balance is directly related to credit items in the formula.

Note F. Item 13 must 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 must 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 will apply only if the broker or 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 broker or dealer, that the broker or 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 will 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 will provide that such funds and/or securities will 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 will 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, will 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 or 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 will apply only if a broker or dealer determines, at least annually, that the registered clearing agency or derivatives clearing organization with which the broker or dealer has on deposit margin related to security futures products meets the conditions of this Note G.

■ 12. An undesignated center heading and § 240.18a–1 are added to read as follows:

Capital, Margin and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants

§ 240.18a–1 Net capital requirements for security-based swap dealers for which there is not a prudential regulator.

Sections 240.18a–1, 240.18a–1a, 240.18a–1b, 240.18a–1c, and 240.18a–1d apply to a security-based swap dealer registered under section 15F of the Act (15 U.S.C. 78*o*–10), including a security-based swap dealer that is an *OTC derivatives dealer* as that term is defined in § 240.3b–12. A security-based swap dealer registered under section 15F of the Act (15 U.S.C. 78*o*–10) that is also a broker or dealer registered under section 15 of the Act (15 U.S.C. 78o), other than an OTC derivatives dealer, is subject to the net capital requirements in § 240.15c3–1 and its appendices. A security-based swap dealer registered under section 15F of the Act that has a prudential regulator is not subject to § 240.18a–1, 240.18a–1a, 240.18a–1b, 240.18a–1c, and 240.18a–1d.

(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 paragraph (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)(i) A security-based swap dealer must at all times maintain net capital of not less than the greater of $20 million or:

(A) Two percent of the risk margin amount; or

(B) Four percent or less of the risk margin amount if the Commission issues an order raising the requirement to four percent or less on or after the third anniversary of this section's compliance date; or

(C) Eight percent or less of the risk margin amount if the Commission issues an order raising the requirement to eight percent or less on or after the fifth anniversary of this section's compliance date and the Commission had previously issued an order raising the requirement under paragraph (a)(1)(ii) of this section;

(ii) If, after considering the capital and leverage levels of security-based swap dealers subject to this paragraph (a)(1), as well as the risks of their security-based swap positions, the Commission determines that it may be appropriate to change the percentage pursuant to paragraph (a)(1)(i)(B) or (C) of this section, the Commission will publish a notice of the potential change and subsequently will issue an order regarding any such change.

(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 § 240.18a–1b, and using the credit risk standards of paragraph (d) to compute a deduction for credit risk on certain credit exposures arising from transactions in derivatives instruments, instead of the provisions of paragraphs (c)(1)(iii) and (c)(1)(ix)(A) and (B) 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:

(i)(A) Two percent of the risk margin amount;

(B) Four percent or less of the risk margin amount if the Commission issues an order raising the requirement to four percent or less on or after the third anniversary of this section's compliance date; or

(C) Eight percent or less of the risk margin amount if the Commission issues an order raising the requirement to eight percent or less on or after the fifth anniversary of this section's compliance date and the Commission had previously issued an order raising the requirement under paragraph (a)(2)(ii) of this section;

(ii) If, after considering the capital and leverage levels of security-based swap dealers subject to this paragraph (a)(2), as well as the risks of their security-based swap positions, the Commission determines that it may be appropriate to change the percentage pursuant to paragraph (a)(2)(i)(B) or (C) of this section, the Commission will publish a notice of the potential change and subsequently will issue an order regarding any such change; 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) *Net capital.* 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*) through (*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)(vi) and (vii) 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 § 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 the required time frame to collect the margin, marks to the market, or other required deposits; 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 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 longer than 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 reserve account for the exclusive benefit of the security-based swap customers'' established pursuant to § 240.18a–4 and clearing deposits shall not be so deducted.

(E) *Repurchase agreements.* (*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 this paragraph (c)(1)(iii)(E)(*1*), 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: Any margin or other deposits held by the security-based swap dealer on account of the reverse repurchase agreement; 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; 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 calls for margin, marks to the market, or other required deposits that are outstanding one business day or less.

(*3*) In the case of repurchase agreements, the deduction shall be:

(*i*) 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

(*ii*) 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)(vi) and (vii) of this section (less any deduction taken with respect to repurchase agreements with that party under paragraph (c)(1)(iii)(E)(*3*)(*i*) of this section) or, if greater; 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)(vi) and (vii) of this section.

(*iii*) In determining the required deduction under paragraphs (c)(1)(iii)(E)(*3*)(*i*) and (*ii*) of this section, the security-based swap dealer may reduce a repurchase agreement by 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; 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 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) *Affiliate receivables and collateral.* 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)(A) *Cleared security-based swaps.* In the case of a cleared security-based swap held in a proprietary account of the security-based swap dealer, deducting the amount of the applicable margin requirement of the clearing agency or, if the security-based swap references an equity security, the security-based swap dealer may take a deduction using the method specified in § 240.18a–1a.

(B) *Non-cleared security-based swaps*—(*1*) *Credit default swaps*—(*i*) *Short positions (selling protection).* In the case of a non-cleared 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 table 1 to § 240.18a–1(c)(1)(vi)(B)(*1*)(*i*):

TABLE 1 TO § 240.18A–1(C)(1)(VI)(B)(*1*)(*i*)

Length of time to maturity of credit default swap contract	Basis point spread					
	100 or less (%)	101–300 (%)	301–400 (%)	401–500 (%)	501–699 (%)	700 or more (%)
Less than 12 months	1.00	2.00	5.00	7.50	10.00	15.00
12 months but less than 24 months	1.50	3.50	7.50	10.00	12.50	17.50
24 months but less than 36 months	2.00	5.00	10.00	12.50	15.00	20.00
36 months but less than 48 months	3.00	6.00	12.50	15.00	17.50	22.50
48 months but less than 60 months	4.00	7.00	15.00	17.50	20.00	25.00
60 months but less than 72 months	5.50	8.50	17.50	20.00	22.50	27.50

TABLE 1 TO § 240.18A–1(C)(1)(VI)(B)(*1*)(*i*)—Continued

Length of time to maturity of credit default swap contract	Basis point spread					
	100 or less (%)	101–300 (%)	301–400 (%)	401–500 (%)	501–699 (%)	700 or more (%)
72 months but less than 84 months	7.00	10.00	20.00	22.50	25.00	30.00
84 months but less than 120 months	8.50	15.00	22.50	25.00	27.50	40.00
120 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 non-cleared security-based swap that is a long credit default swap, deducting 50 percent of the deduction that would be required by paragraph (c)(1)(vi)(B)(*1*)(*i*) of this section if the non-cleared security-based swap was a short credit default swap, each such deduction not to exceed the current market value of the long position.

(*iii*) *Long and short credit default swaps.* In the case of non-cleared security-based swaps that are long and short credit default swaps referencing the same entity (in the case of non-cleared credit default swap security-based swaps referencing a corporate entity) or obligation (in the case of non-cleared credit default swap security-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)(1)(vi)(B)(*1*)(*i*) or (*ii*) on the excess of the long or short position. In the case of non-cleared 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)(1)(vi)(B)(*1*)(*i*) of this section, deducting 50 percent of the amount required by paragraph (c)(1)(vi)(B)(*1*)(*i*) of this section on the short position plus the deduction required by paragraph (c)(1)(vi)(B)(*1*)(*ii*) 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 the security-based swap dealer must document the industry sector classification system used pursuant to this section.

(*iv*) *Long security and long credit default swap.* In the case of a non-cleared 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 percent of the amount specified in § 240.15c3–1(c)(2)(vi) or (vii) for the debt security, provided that the security-based swap dealer can deliver the debt security to satisfy the obligation of the security-based swap dealer on the credit default swap.

(*v*) *Short security and short credit default swap.* In the case of a non-cleared security-based swap that is a short credit default swap referencing a debt security or a corporate entity, and the security-based swap dealer is short the debt security or a debt security issued by the corporate entity, deducting the amount specified in § 240.15c3–1(c)(2)(vi) or (vii) for the debt security. In the case of a non-cleared 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.

(*2*) *All other security-based swaps.* In the case of a non-cleared 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)(*2*) 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 for certain undermargined accounts.* Deducting the amount of cash required in the account of each security-based swap and swap customer to meet the margin requirements of a clearing agency, the Commission, derivatives clearing organization, or the Commodity Futures Trading Commission, as applicable, after application of calls for margin, marks to the market, or other required deposits which are outstanding within the required time frame to collect the margin, mark to the market, or other required deposits.

(ix) *Deduction from net worth in lieu of collecting collateral for non-cleared security-based swap and swap transactions*—(A) *Security-based swaps.* Deducting the initial margin amount calculated pursuant to § 240.18a–3(c)(1)(i)(B) for the account of a counterparty at the security-based swap dealer that is subject to a margin exception set forth in § 240.18a–3(c)(1)(iii), less the margin value of collateral held in the account.

(B) *Swaps.* Deducting the initial margin amount calculated pursuant to the margin rules of the Commodity Futures Trading Commission in the account of a counterparty at the security-based swap dealer that is subject to a margin exception in those rules, less the margin value of collateral held in the account.

(C) *Treatment of collateral held at a third-party custodian.* For the purposes of the deductions required pursuant to paragraphs (c)(1)(ix)(A) and (B) of this section, collateral held by an independent third-party custodian as initial margin may be treated as collateral held in the account of the counterparty at the security-based swap dealer if:

(*1*) The independent third-party custodian is a bank as defined in section 3(a)(6) of the Act or a registered U.S. clearing organization or depository that is not affiliated with the counterparty or, if the collateral consists of foreign securities or currencies, a supervised foreign bank, clearing organization, or depository that is not affiliated with the counterparty and that customarily maintains custody of such foreign securities or currencies;

(*2*) The security-based swap dealer, the independent third-party custodian, and the counterparty that delivered the collateral to the custodian have executed an account control agreement governing the terms under which the custodian holds and releases collateral pledged by the counterparty as initial margin that is a legal, valid, binding, and enforceable agreement under the laws of all relevant jurisdictions, including in the event of bankruptcy, insolvency, or a similar proceeding of any of the parties to the agreement, and that provides the security-based swap dealer with the right to access the collateral to satisfy the counterparty's obligations to the security-based swap dealer arising from transactions in the account of the counterparty; and

(*3*) The security-based swap dealer maintains written documentation of its analysis that in the event of a legal challenge the relevant court or administrative authorities would find the account control agreement to be legal, valid, binding, and enforceable under the applicable law, including in the event of the receivership, conservatorship, insolvency, liquidation, or a similar proceeding of any of the parties to the agreement.

(x)(A) Deducting the market value of all short securities differences (which shall include securities positions reflected on the securities record which are not susceptible to either count or confirmation) unresolved after discovery in accordance with the schedule in table 2 to § 240.18a–1(c)(1)(x)(A):

TABLE 2 TO § 240.18A–1(c)(1)(x)(A)

Differences [1]	Number of business days after discovery
25 percent	7
50 percent	14
75 percent	21
100 percent	28

[1] Percentage of market value of short securities differences.

(B) Deducting the market value of any long securities differences, where such securities have been sold by the security-based swap dealer before they are adequately resolved, less any reserves established therefor;

(C) The Commission may extend the periods in paragraph (c)(1)(x)(A) of this section for up to 10 business days if it finds that exceptional circumstances warrant an extension.

(2) The term *exempted securities* shall mean those securities deemed exempted securities by section 3(a)(12) of the Act (15 U.S.C. 78c(a)(12)) 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 exist 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 deducting the haircuts computed pursuant to paragraphs (c)(1)(vi) and (vii) of this section and the charges on inventory computed pursuant to § 240.18a–1b. However, for purposes of paragraph (a)(2) of this section, 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 paragraph (d) of this section or paragraphs (c)(1)(vi) and (vii) of this section, if applicable, and increased by the balance sheet value (including counterparty net exposure) resulting from transactions in derivative instruments which would otherwise be deducted pursuant to paragraph (c)(1)(iii) of this section. 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 total initial margin required to be maintained by the security-based swap dealer at each clearing agency with respect to security-based swap transactions cleared for security-based swap customers; and

(ii) The total initial 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 § 240.18a–1b, 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 paragraphs (c)(1)(iii) and (c)(1)(ix)(A) and (B) 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)(i) 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;

(ii) The Commission may approve the temporary use of a provisional model in whole or in part, subject to any conditions or limitations the Commission may require, if:

(A) The security-based swap dealer has a complete application pending under this section;

(B) The use of the provisional model has been approved by:

(*1*) A prudential regulator;

(*2*) The Commodity Futures Trading Commission or a futures association registered with the Commodity Futures Trading Commission under section 17 of the Commodity Exchange Act;

(*3*) A foreign financial regulatory authority that administers a foreign financial regulatory system with capital requirements that the Commission has found are eligible for substituted compliance under § 240.3a71–6 if the provisional model is used for the purposes of calculating net capital;

(*4*) A foreign financial regulatory authority that administers a foreign financial regulatory system with margin requirements that the Commission has found are eligible for substituted compliance under § 240.3a71–6 if the provisional model is used for the purposes of calculating initial margin pursuant to § 240.18a–3; or

(*5*) Any other foreign supervisory authority that the Commission finds has approved and monitored the use of the provisional model through a process comparable to the process set forth in this section.

(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) 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, 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 3 to § 240.18a–1(d)(9)(i)(C)(*3*) in determining its market risk until it obtains the next quarter's backtesting results;

TABLE 3 TO § 240.18a–1(d)(9)(i)(C)(*3*)—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.* 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), (vi), (vii), and (c)(1)(ix)(A) and (B), as appropriate, and § 240.18a–1b, 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:

(A)–(B)_[Reserved];

(C) 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;

(D) The security-based swap dealer fails to comply with this paragraph (d); or

(E) 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 may compute a deduction for credit risk on transactions in derivatives instruments (if this paragraph (e) is used to calculate a deduction for market risk on those positions) in an amount equal to the sum of the following:

(i) *Counterparty exposure charge.* 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)(iii)(A) of this section, multiplied by the credit risk weight of the counterparty, as determined in accordance with paragraph (e)(2)(iii)(F) of this section, multiplied by eight percent; and

(ii) *Counterparty concentration charge.* 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 percent or less, 5 percent of the amount of the current exposure to the counterparty in excess of 5 percent of the tentative net capital of the security-based swap dealer;

(B) For each counterparty with a credit risk weight of greater than 20 percent but less than 50 percent, 20 percent of the amount of the current exposure to the counterparty in excess of 5 percent 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 percent, 50 percent of the amount of the current exposure to the counterparty in excess of 5 percent of the tentative net capital of the security-based swap dealer;

(iii) *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)(iii)(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)(iii)(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)(iii)(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)(iii)(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)(iii)(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)(iii)(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*)(*i*) The collateral is subject to the security-based swap dealer's physical possession or control and may be liquidated promptly by the firm without intervention by any other party; or

(*ii*) The collateral is held by an independent third-party custodian that is a bank as defined in section 3(a)(6) of the Act or a registered U.S. clearing organization or depository that is not affiliated with the counterparty or, if the collateral consists of foreign securities or currencies, a supervised foreign bank, clearing organization, or depository that is not affiliated with the counterparty and that customarily maintains custody of such foreign securities or currencies;

(*3*) The collateral is liquid and transferable;

(*4*) The collateral agreement is legally enforceable by the security-based swap dealer against the counterparty and any other parties to the agreement;

(*5*) 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;

(*6*) 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

(*7*) 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 this paragraph (e)(2) shall apply a credit risk weight for transactions with a counterparty of either 20 percent, 50 percent, or 150 percent 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 percent, 50 percent, or 150 percent 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) *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 § 240.15c3–4(c)(5)(xiii) and (xiv) and (d)(8) and (9) shall not apply.

(g) *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 (g) 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 (h) 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 (g) if:

(1) It does not have any of the provisions for accelerated maturity provided for by paragraph (b)(8)(i) or (b)(9)(i) or (ii) of § 240.18a–1d and is maintained as capital subject to the provisions restricting the withdrawal thereof required by paragraph (h) of this section; or

(2) The partnership agreement provides that capital contributed pursuant to a satisfactory subordination agreement as defined in § 240.18a–1d shall in all respects be partnership capital subject to the provisions restricting the withdrawal thereof required by paragraph (h) of this section.

(h) *Provisions relating to the withdrawal of equity capital*—(1) *Notice provisions relating to limitations on the withdrawal of equity capital.* No equity capital of the security-based swap dealer or a subsidiary or affiliate consolidated pursuant to § 240.18a–1c 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 (h)(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 (h)(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 (h)(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 § 240.18a–1c 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 § 240.18a–1d) 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; or

(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 § 240.18a–1c (other than such agreements which qualify as equity under paragraph (g) of this section) would exceed 70 percent of the debt-equity total as defined in paragraph (g) 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 (h)(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)(vi) and (vii) and § 240.18a–1a reported in its most recently required filed Part II of Form X–17A–5 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 Part II of Form X–17A–5 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 (h)(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 (h)(1) and (2) of this section.

(iv) For the purpose of this paragraph (h), 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.

■ 13. Section 240.18a–1a is added to read as follows:

§ 240.18a–1a Options.

(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, options on futures contracts, security-based swaps on a narrow-based security index, and swaps 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 other than a security-based swap on a narrow-based security index, 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 broker or 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, security-based swaps on a narrow-based security index, qualified stock baskets, unlisted instruments, or 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.

(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 percent 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 percent of the capitalization for such narrow-based index.

(ii) With respect to positions involving listed options 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 percent for equity securities with a ready market, narrow-based indexes, and non-high-capitalization diversified indexes;

(B) +(−) 6 percent for major market foreign currencies;

(C) +(−) 20 percent for all other currencies; and

(D) +(−)10 percent 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 percent 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 percent, 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 percent 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 percent 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 percent 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 percent 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 percent 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 percent of the market value of the qualified stock basket for high-capitalization diversified and narrow-based indexes;

(*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 percent of the market value of the qualified stock basket for non-high-capitalization diversified indexes; and

(*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 percent times the multiplier for each security-future and equity option.

■ 14. Section 240.18a–1b is added to read as follows:

§ 240.18a–1b Adjustments to net worth for certain commodities transactions.

(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 (c) of § 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 section. Where a commodity related asset or liability, including 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 § 240.18a–1 or this section, 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 § 240.18a–1(c)(1), the net worth of a security-based swap dealer shall be adjusted as follows with respect to commodity-related transactions:

(i)(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 cleared swap transactions or, commodity futures or option transactions, except those specifically excluded under paragraph (a)(2)(ii) of this section.

(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 percent of the market value.

(C) Inventory which is not covered—20 percent 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 percent 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 percent 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 section, 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 the value attributable to such asset pursuant to the margin rules of the applicable board of trade, or the market value of such asset after application of the percentage deductions specified in paragraph (a)(2)(ix) of this section or, where appropriate, specified in § 240.18a–1(c)(1)(iv), (vi), or (vii) of this part;

(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 section 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 the account, the value attributable to such asset for purposes of this paragraph shall be the lesser of the value attributable to such asset pursuant to the margin rules of the applicable board of trade, or the market value of such asset after application of the percentage deductions specified in paragraph (a)(2)(ix) of this section or, where appropriate, specified in § 240.18a–1(c)(1)(iv), (vi), or (vii) of this part;

(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 percent 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 percent 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 percent 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) of this section, 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 section 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 section; 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 section shall mean cover as defined in 17 CFR 1.17(j).

(xvii) The term *customer* for purposes of this section shall mean customer as defined in 17 CFR 1.17(b)(2). The term *non-customer* for purposes of this section 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) *Cleared swaps.* In the case of a cleared swap held in a proprietary account of the security-based swap dealer, deducting the amount of the applicable margin requirement of the derivatives clearing organization or, if the swap references an equity security index, the security-based swap dealer may take a deduction using the method specified in § 240.18a–1a.

(2) *Non-cleared swaps*—(i) *Credit default swaps referencing broad-based security indices.* In the case of a non-cleared credit default swap for which the deductions in § 240.18a–1(e) do not apply:

(A) *Short positions (selling protection).* In the case of a non-cleared swap that is a short credit default swap referencing a broad-based security 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 table 1 to § 240.18a–1b(b)(2)(i)(A):

TABLE 1 TO § 240.18a–1b(b)(2)(i)(A)

Length of time to maturity of credit default swap contract	Basis point spread					
	100 or less (%)	101–300 (%)	301–400 (%)	401–500 (%)	501–699 (%)	700 or more (%)
Less than 12 months	0.67	1.33	3.33	5.00	6.67	10.00
12 months but less than 24 months	1.00	2.33	5.00	6.67	8.33	11.67
24 months but less than 36 months	1.33	3.33	6.67	8.33	10.00	13.33
36 months but less than 48 months	2.00	4.00	8.33	10.00	11.67	15.00
48 months but less than 60 months	2.67	4.67	10.00	11.67	13.33	16.67
60 months but less than 72 months	3.67	5.67	11.67	13.33	15.00	18.33
72 months but less than 84 months	4.67	6.67	13.33	15.00	16.67	20.00
84 months but less than 120 months	5.67	10.00	15.00	16.67	18.33	26.67
120 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 non-cleared swap that is a long credit default swap referencing a broad-based security index, deducting 50 percent of the deduction that would be required by paragraph (b)(2)(i)(A) of this section if the non-cleared swap was a short credit default swap, each such deduction not to exceed the current market value of the long position.

(C) *Long and short credit default swaps.* In the case of non-cleared 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)(2)(i)(A) or (B) of this section on the excess of the long or short position.

(D) *Long basket of obligors and long credit default swap.* In the case of a non-cleared swap that is a long credit default swap referencing a broad-based security index and the security-based swap dealer is long a basket of debt securities comprising all of the components of the security index, deducting 50 percent of the amount specified in § 240.15c3–1(c)(2)(vi) for the component securities, provided the security-based swap dealer can deliver the component securities to satisfy the obligation of the security-based swap dealer on the credit default swap.

(E) *Short basket of obligors and short credit default swap.* In the case of a non-cleared swap that is a short credit default swap referencing a broad-based security index and the security-based swap dealer is short a basket of debt securities comprising all of the components of the security index, deducting the amount specified in § 240.15c3–1(c)(2)(vi) for the component securities.

(ii) *All other swaps.* (A) In the case of any non-cleared swap that is not a credit default swap for which the deductions in § 240.18a–1(e) do not apply, deducting the amount calculated by multiplying the notional value of the swap by the percentage specified in:

(*1*) Section 240.15c3–1 applicable to the reference asset if § 240.15c3–1 specifies a percentage deduction for the type of asset;

(*2*) 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

(*3*) In the case of a non-cleared 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 one eighth of 1 percent of the amount of a long position that is netted against a short position in the case of a non-cleared swap with a maturity of three months or more.

(B) A security-based swap dealer may reduce the deduction under paragraph (b)(2)(ii) of this section 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.

■ 15. 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.

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.

■ 16. Section 240.18a–1d is added to read as follows:

§ 240.18a–1d Satisfactory Subordinated Loan Agreements.

(a) *Introduction*—(1) *Minimum requirements.* This section 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 section.

(2) *Certain definitions.* For purposes of § 240.18a–1 and this section:

(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) *Subordinated loan agreement.* 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 section.

(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 120 percent of its minimum requirement 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 percent of the minimum requirement. 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 120 percent of its minimum requirement 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 percent of the minimum requirement. 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 section, 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 section, 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 section and liquidation of the security-based swap dealer has not commenced on or prior to such accelerated maturity date, then notwithstanding paragraph (b)(7) 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 section. 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 section, 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 section. 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 its minimum requirement 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 the minimum requirement, 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) *Notification.* 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 120 percent of its minimum requirement 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 percent of the minimum requirement.

(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 120 percent of its minimum requirement 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 percent of the minimum requirement; or

(ii) Pre-tax losses during the latest three-month period equaled more than 15 percent 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 section. Any such subordinated loan agreement shall not be considered equity for purposes of § 240.18a–1(g), 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.

■ 17. 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 and is not registered as a broker or dealer pursuant to section 15(b) of the Act (15 U.S.C. 78o(b)) 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 § 240.15c3–4(c)(5)(xiii) and (xiv) and (d)(8) and (9) shall not apply.

■ 18. 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 that holds one or more non-cleared security-based swaps for a counterparty.

(2) The term *commercial end user* means a counterparty that qualifies for an exception from clearing under section 3C(g)(1) of the Act (15 U.S.C. 78o–3(g)(1)) and implementing regulations or satisfies the criteria in section 3C(g)(4) of the Act (15 U.S.C. 78o–3(g)(4)) and implementing regulations.

(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 *initial margin amount* means the amount calculated pursuant to paragraph (d) of this section.

(5) The term *non-cleared security-based swap* means a security-based swap that is not, directly or indirectly, submitted to and cleared by a clearing agency registered pursuant to section 17A of the Act (15 U.S.C. 78q–1) or by a clearing agency that the Commission has exempted from registration by rule or order pursuant to section 17A of the Act (15 U.S.C. 78q–1).

(6) The term *security-based swap legacy account* means an account that holds no security-based swaps entered into after the compliance date of this section and that only is used to hold one or more security-based swaps entered into prior to the compliance 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 the current exposure in the account of the counterparty; and

(B) The initial margin amount for the account of the counterparty.

(ii) *Account equity requirements.* Except as provided in paragraph (c)(1)(iii) of this section, a security-based swap dealer must take an action required in paragraph (c)(1)(ii)(A) or (B) of this section by no later than the close of business of the first business day following the day of the calculation required under paragraph (c)(1)(i) of this section or, if the counterparty is located in another country and more than four time zones away, the second business day following the day of the calculation required under paragraph (c)(1)(i) of this section:

(A)(*1*) Collect from the counterparty collateral in an amount equal to the current exposure that the security-based swap dealer has to the counterparty; or

(*2*) Deliver to the counterparty collateral in an amount equal to the current exposure that the counterparty has to the security-based swap dealer, provided that such amount does not include the initial margin amount collected from the counterparty under paragraph (c)(1)(ii)(B) of this section; and

(B) Collect from the counterparty collateral in an amount equal to the initial margin amount.

(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.

(B) *Counterparties that are financial market intermediaries.* 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, swap dealer, broker or dealer, futures commission merchant, bank, foreign bank, or foreign broker or dealer.

(C) *Counterparties that use third-party custodians.* The requirements of paragraph (c)(1)(ii)(B) of this section do not apply to an account of a counterparty that delivers the collateral to meet the initial margin amount to an independent third-party custodian.

(D) *Security-based swap legacy accounts.* The requirements of paragraph (c)(1)(ii) of this section do not apply to a security-based swap legacy account.

(E) *Bank for International Settlements, European Stability Mechanism, and Multilateral development banks.* The requirements of paragraph (c)(1)(ii) of this section do not apply to an account of a counterparty that is the Bank for International Settlements or the European Stability Mechanism, or is the International Bank for Reconstruction and Development, the Multilateral Investment Guarantee Agency, the International Finance Corporation, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the European Investment Fund, the Nordic Investment Bank, the Caribbean Development Bank, the Islamic Development Bank, the Council of Europe Development Bank, or any other multilateral development bank that provides financing for national or regional development in which the U.S. government is a shareholder or contributing member.

(F) *Sovereign entities.* The requirements of paragraph (c)(1)(ii)(B) of this section do not apply to an account of a counterparty that is a central government (including the U.S. government) or an agency, department, ministry, or central bank of a central government if the security-based swap dealer has determined that the counterparty has only a minimal amount of credit risk pursuant to policies and procedures or credit risk models established pursuant to § 240.15c3–1 or § 240.18a–1 (as applicable).

(G) *Affiliates.* The requirements of paragraph (c)(1)(ii)(B) of this section do not apply to an account of a counterparty that is an affiliate of the security-based swap dealer.

(H) *Threshold amount.* (*1*) A security-based swap dealer may elect not to collect the initial margin amount required under paragraph (c)(1)(ii)(B) of this section to the extent that the sum of that amount plus all other credit exposures resulting from non-cleared swaps and non-cleared security-based swaps of the security-based swap dealer and its affiliates with the counterparty and its affiliates does not exceed $50 million. For purposes of this calculation, a security-based swap dealer need not include any exposures arising from non-cleared security based swap transactions with a counterparty that is a commercial end user, and non-cleared swap transactions with a counterparty that qualifies for an exception from margin requirements pursuant to section 4s(e)(4) of the Commodity Exchange Act (7 U.S.C. 6s(e)(4)).

(*2*) *One-time deferral.* Notwithstanding paragraph (c)(1)(iii)(H)(*1*) of this section, a security-based swap dealer may defer collecting the initial margin amount required under paragraph (c)(1)(ii)(B) of this section for up to two months following the month in which a counterparty no longer qualifies for this threshold exception for the first time.

(I) *Minimum transfer amount.* Notwithstanding any other provision of this rule, a security-based swap dealer is not required to collect or deliver collateral pursuant to this section with respect to a particular counterparty unless and until the total amount of collateral that is required to be collected or delivered, and has not yet been collected or delivered, with respect to the counterparty is greater than $500,000.

(2) *Major security-based swap participants*—(i) *Calculation required.* A major security-based swap participant must with respect to each account of a counterparty calculate as of the close of each business day the amount of the current exposure in the account of the counterparty.

(ii) *Account equity requirements.* Except as provided in paragraph (c)(2)(iii) of this section, a major security-based swap participant must take an action required in paragraph (c)(2)(ii)(A) or (B) of this section by no later than the close of business of the first business day following the day of the calculation required under paragraph (c)(2)(i) or, if the counterparty is located in another country and more than four time zones away, the second business day following the day of the calculation required under paragraph (c)(2)(i) of this section:

(A) Collect from the counterparty collateral in an amount equal to the current exposure that the major security-based swap participant has to the counterparty; or

(B) Deliver to the counterparty collateral in an amount equal to the current exposure that the counterparty has to the major security-based swap participant.

(iii) *Exceptions*—(A) *Commercial end users.* The requirements of paragraph (c)(2)(ii)(A) of this section do not apply to an account of a counterparty that is a commercial end user.

(B) *Security-based swap legacy accounts.* The requirements of paragraph (c)(2)(ii) of this section do not apply to a security-based swap legacy account.

(C) *Bank for International Settlements, European Stability Mechanism, and Multilateral development banks.* The requirements of paragraph (c)(2)(ii)(A) of this section do not apply to an account of a counterparty that is the Bank for International Settlements or the European Stability Mechanism, or is the International Bank for Reconstruction and Development, the Multilateral Investment Guarantee Agency, the International Finance Corporation, the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the European Investment Fund, the Nordic Investment Bank, the Caribbean Development Bank, the Islamic Development Bank, the Council of Europe Development Bank, or any other multilateral development bank that provides financing for national or regional development in which the U.S. government is a shareholder or contributing member.

(D) *Minimum transfer amount.* Notwithstanding any other provision of this rule, a major security-based swap participant is not required to collect or deliver collateral pursuant to this section with respect to a particular counterparty unless and until the total amount of collateral that is required to be collected or delivered, and has not yet been collected or delivered, with respect to the counterparty is greater than $500,000.

(3) *Deductions for collateral.* (i) The fair market value of collateral delivered by a counterparty or the security-based swap dealer must be reduced by the amount of the standardized deductions the security-based swap dealer would apply to the collateral pursuant to

§ 240.15c3–1 or § 240.18a–1, as applicable, for the purpose of paragraph (c)(1)(ii) of this section.

(ii) Notwithstanding paragraph (c)(3)(i) of this section, the fair market value of assets delivered as collateral by a counterparty or the security-based swap dealer may be reduced by the amount of the standardized deductions prescribed in 17 CFR 23.156 if the security-based swap dealer applies these standardized deductions consistently with respect to the particular counterparty.

(4) *Collateral requirements.* A security-based swap dealer or a major security-based swap participant when calculating the amounts under paragraphs (c)(1) and (2) of this section may take into account the fair market value of collateral delivered by a counterparty provided:

(i) The collateral:

(A) Has a ready market;

(B) Is readily transferable;

(C) Consists of cash, securities, money market instruments, a major foreign currency, the settlement currency of the non-cleared security-based swap, or gold;

(D) Does not consist of securities and/or money market instruments issued by the counterparty or a party related to the security-based swap dealer, the major security-based swap participant, or the counterparty; and

(E) Is subject to an agreement between the security-based swap dealer or the major security-based swap participant and the counterparty that 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; and

(ii) The collateral is either:

(A) Subject to the physical possession or control of the security-based swap dealer or the major security-based swap participant and may be liquidated promptly by the security-based swap dealer or the major security-based swap participant without intervention by any other party; or

(B) The collateral is carried by an independent third-party custodian that is a bank as defined in section 3(a)(6) of the Act or a registered U.S. clearing organization or depository that is not affiliated with the counterparty or, if the collateral consists of foreign securities or currencies, a supervised foreign bank, clearing organization, or depository that is not affiliated with the counterparty and that customarily maintains custody of such foreign securities or currencies.

(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) 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*) 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.

(7) *Liquidation.* A security-based swap dealer or major security-based swap participant must take prompt steps to liquidate positions in an account that does not meet the margin requirements of this section to the extent necessary to eliminate the margin deficiency.

(d) *Calculating initial margin amount.* A security-based swap dealer must calculate the initial 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)(B)(*1*) 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)(P)(*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)(*2*) 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)(P)(*2*).

(2) *Model approach.* (i) For security-based swaps other than equity security-based swaps, a security-based swap dealer may apply to the Commission for authorization to use and be responsible for a model to calculate the initial margin amount required by paragraph (c)(1)(i)(B) of this section subject to the application process in § 240.15c3–1e or § 240.18a–1(d), as applicable. The model must use a 99 percent, one-tailed confidence level with price changes equivalent to a ten business-day movement in rates and prices, and must use risk factors sufficient to cover all the material price risks inherent in the positions for which the initial margin amount is being calculated, including foreign exchange or interest rate risk, credit risk, equity risk, and commodity risk, as appropriate. Empirical correlations may be recognized by the model within each broad risk category, but not across broad risk categories.

(ii) Notwithstanding paragraph (d)(2)(i) of this section, a security-based swap dealer that is not registered as a broker or dealer pursuant to Section 15(b) of the Act (15 U.S.C. 78o(b)), other than as an OTC derivatives dealer, may apply to the Commission for authorization to use a model to calculate the initial margin amount required by paragraph (c)(1)(i)(B) of this section for equity security-based swaps, subject to the application process and model requirements of paragraph (d)(2)(i) of this section; provided, however, the account of the counterparty subject to the requirements of this paragraph may not hold equity security positions other than equity security-based swaps and equity swaps.

(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.

■ 19. 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.

Section 240.18a–4 applies to a security-based swap dealer or major security-based swap participant registered under section 15F(b) of the Act (15 U.S.C. 78o–10(b)), including a security-based swap dealer that is an *OTC derivatives dealer* as that term is defined in § 240.3b–12. A security-based swap dealer registered under section 15F of the Act (15 U.S.C. 78*o*–10) that is also a broker or dealer registered under section 15 of the Act (15 U.S.C. 78o), other than an *OTC derivatives dealer,* is subject to the customer protection requirements under § 240.15c3–3, including paragraph (p) of that rule with respect to its security-based swap activity.

(a) *Definitions.* For the purposes of this section:

(1) The term *cleared security-based swap* means 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 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 (after reducing the current exposure by the amount of cash in the account) to the security-based swap 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 security-based swap customer; and

(ii) Securities and money market instruments held in a qualified registered security-based swap dealer account or in a third-party custodial account but only to the extent the securities and money market instruments are being used to meet a regulatory margin requirement of another 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 security-based swap customer.

(3) The term *foreign major security-based swap participant* has the meaning set forth in § 240.3a67–10(a)(6).

(4) The term *foreign security-based swap dealer* has the meaning set forth in § 240.3a71–3(a)(7).

(5) The term *qualified clearing agency account* means an account of a security-based swap dealer at a clearing agency registered with the Commission pursuant to section 17A of the Act (15 U.S.C. 78q–1) that holds funds and other property in order to margin, guarantee, or secure 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.

(6) 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 meets the following conditions:

(i) The account is designated ''Special Reserve Account for the Exclusive Benefit of the Security-Based Swap Customers of [name of security-based swap dealer]'';

(ii) The other security-based swap dealer has acknowledged in a written notice 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.

(7) 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 a political 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.

(8) 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.

(9) The term *special reserve account for the exclusive benefit of security-based swap customers* means an account at a bank that meets the following conditions:

(i) The account is designated ''Special Reserve 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.

(10) The term *third-party custodial account* means an account carried by an independent third-party custodian that meets the following conditions:

(i) The account is established for the purposes of meeting regulatory margin requirements of another security-based swap dealer;

(ii) The account is carried by a bank as defined in section 3(a)(6) of the Act or a registered U.S. clearing organization or depository or, if the collateral to be held in the account consists of foreign securities or currencies, a supervised foreign bank, clearing organization, or depository that customarily maintains custody of such foreign securities or currencies;

(iii) The account is designated for and on behalf of the security-based swap dealer for the benefit of its security-based swap customers and the account is subject to a written acknowledgement by the bank, clearing organization, or depository 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, clearing organization, or depository for the exclusive benefit of the security-based swap customers of the security-based swap dealer and are being kept separate from any other accounts maintained by the security-based swap dealer with the bank, clearing organization, or depository; and

(iv) The account is subject to a written contract between the security-based swap dealer and the bank, clearing organization, or depository 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, clearing organization, or depository and, shall be subject to no right, charge, security interest, lien, or claim of any kind in favor of the bank, clearing organization, or depository or any person claiming through the bank, clearing organization, or depository.

(11) The term *U.S. person* has the meaning set forth in § 240.3a71–3(a)(4).

(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 security-based swap 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 security-based swap 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 or control as of the close of the previous business day and the quantity of excess securities collateral not in its possession or 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 or in a third-party custodial 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 other security-based swap dealer or by the third-party custodian 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 for 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 security-based swap dealer's books or records that allocate to a short position of the security-based swap dealer or a short position for another person, for more than 30 calendar days, 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 reserve account for the exclusive benefit of security-based swap customers.* (1) A security-based swap dealer must maintain a special reserve 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 reserve 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.

(i) In determining the amount maintained in a special reserve account for the exclusive benefit of security-based swap customers, the security-based swap dealer must deduct:

(A) The percentage of the value of a general obligation of a State or a political subdivision of a State specified in § 240.15c3–1(c)(2)(vi);

(B) The aggregate value of general obligations of a State or a political subdivision of a State to the extent the amount of the obligations of a single issuer (after applying the deduction in paragraph (c)(1)(i)(A) of this section) exceeds two percent of the amount required to be maintained in the special reserve account for the exclusive benefit of security-based swap customers;

(C) The aggregate value of all general obligations of States or political subdivisions of States to the extent the amount of the obligations (after applying the deduction in paragraph (c)(1)(i)(A) of this section) exceeds 10 percent of the amount required to be maintained in the special reserve account for the exclusive benefit of security-based swap customers;

(D) The amount of cash deposited with a single non-affiliated bank to the extent the amount exceeds 15 percent of the equity capital of the bank as reported by the bank in its most recent Call Report or any successor form the bank is required to file by its appropriate federal banking agency (as defined by section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813)); and

(E) The total amount of cash deposited with an affiliated bank.

(ii) *Exception.* A security-based swap dealer for which there is a prudential regulator need not take the deduction specified in paragraph (c)(1)(i)(D) of this section if it maintains the special reserve account for the exclusive benefit of security-based swap customers itself rather than at an affiliated or non-affiliated bank.

(2) A security-based swap dealer must not accept or use credits identified in the items of the formula set forth in § 240.18a–4a except for the specified purposes indicated under items comprising Total Debits under the formula, and, to the extent Total Credits exceed Total Debits, at least the net amount thereof must be maintained in the Special Reserve Account pursuant to paragraph (c)(1) of this section.

(3)(i) The computations necessary to determine the amount required to be maintained in the special reserve account for the exclusive benefit of security-based swap customers must be made weekly as of the close of the last business day of the week and any deposit required to be made into the account must be made no later than one hour after the opening of banking business on the second following business day. The security-based swap dealer may make a withdrawal from the special reserve 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.

(ii) Computations in addition to the computations required pursuant to paragraph (c)(3)(i) of this section may be made as of the close of any business day, and deposits so computed must be made no later than one hour after the open of banking business on the second following business day.

(4) A security-based swap dealer must promptly deposit into a special reserve account for the exclusive benefit of security-based swap customers cash and/or qualified securities of the security-based swap dealer if the amount of cash and/or qualified securities in one or more special reserve 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 swap 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)) in writing to a duly authorized individual prior to the execution of the first non-cleared security-based swap transaction with the counterparty occurring after the compliance 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 whose funds or other property to meet a margin requirement of the security-based swap dealer are held at a third-party custodian in which the counterparty agrees to subordinate its claims against the security-based swap dealer for the funds or other property held at the third-party custodian 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 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 affirmatively chooses not 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.

(e) *Segregation and disclosure requirements for foreign security-based swap dealers and foreign major security-based swap participants*—(1) *Segregation requirements for foreign security-based swap dealers*—(i) *Foreign bank.* Section 3E of the Act (15 U.S.C. 78c–5) and this section thereunder apply to a foreign security-based swap dealer registered under section 15F of the Act (15 U.S.C. 78o–10) that is a foreign bank, foreign savings bank, foreign cooperative bank, foreign savings and loan association, foreign building and loan association, or foreign credit union:

(A) With respect to a security-based swap customer that is a U.S. person, and

(B) With respect to a security-based swap customer that is not a U.S. person if the foreign security-based swap dealer holds funds or other property arising out of a transaction had by such person with a branch or agency (as defined in section 1(b) of the International Banking Act of 1978) in the United States of such foreign security-based swap dealer.

(ii) *Not a foreign bank.* Section 3E of the Act (15 U.S.C. 78c–5) and this section thereunder apply to a foreign security-based swap dealer registered under section 15F of the Act (15 U.S.C. 78o–10) that is not a foreign bank, foreign savings bank, foreign cooperative bank, foreign savings and loan association, foreign building and loan association, or foreign credit union:

(A) *Cleared security-based swaps.* With respect to all cleared security-based swap transactions, if such foreign security-based swap dealer has received or acquired or holds funds or other property for at least one security-based swap customer that is a U.S. person with respect to a cleared security-based swap transaction with such U.S. person, and

(B) *Non-cleared security-based swaps.* With respect to funds or other property such foreign security-based swap dealer has received or acquired or holds for a security-based swap customer that is a U.S. person with respect to a non-cleared security-based swap transaction with such U.S. person.

(2) *Segregation requirements for foreign major security-based swap participants.* Section 3E of the Act (15 U.S.C. 78c–5) and this section thereunder apply to a foreign major security-based swap participant registered under section 15F of the Act (15 U.S.C. 78o–10), with respect to a counterparty that is a U.S. person.

(3) *Disclosure requirements for foreign security-based swap dealers.* A foreign security-based swap dealer registered under section 15F of the Act (15 U.S.C. 78o–10) must disclose in writing to a security-based swap customer that is a U.S. person, prior to receiving, acquiring, or holding funds or other property for such security-based swap customer with respect to a security-based swap transaction, the potential treatment of the funds or other property segregated by such foreign security-based swap dealer pursuant to section 3E of the Act (15 U.S.C. 78c–5), and the rules and regulations thereunder, in insolvency proceedings under U.S. bankruptcy law and any applicable foreign insolvency laws. Such disclosure must include whether the foreign security-based swap dealer is subject to the segregation requirement set forth in section 3E of the Act (15 U.S.C. 78c–5), and the rules and regulations thereunder, with respect to the funds or other property received, acquired, or held for the security-based swap customer that will receive the disclosure, whether the foreign security-based swap dealer could be subject to the stockbroker liquidation provisions in the U.S. Bankruptcy Code, whether the segregated funds or other property could be afforded customer property treatment under U.S. bankruptcy law, and any other relevant considerations that may affect the treatment of the funds or other property segregated under section 3E of the Act (15 U.S.C. 78c–5), and the rules and regulations thereunder, in insolvency proceedings of the foreign security-based swap dealer.

(f) *Exemption.* The requirements of this section do not apply if the following conditions are met:

(1) The security-based swap dealer does not:

(i) Effect transactions in cleared security-based swaps for or on behalf of another person;

(ii) Have any open transactions in cleared security-based swaps executed for or on behalf of another person; and

(iii) Hold or control any money, securities, or other property to margin, guarantee, or secure a cleared security-based swap transaction executed for or on behalf of another person (including money, securities, or other property accruing to another person as a result of a cleared security-based swap transaction);

(2) The security-based swap dealer provides the notice required pursuant to section 3E(f)(1)(A) of the Act (15 U.S.C. 78c–5(f)(1)(A)) in writing to a duly authorized individual prior to the execution of the first non-cleared security-based swap transaction with the counterparty occurring after the compliance date of this section; and

(3) The security-based swap dealer discloses in writing to a counterparty before engaging in the first non-cleared security-based swap transaction with the counterparty that any margin collateral received and held by the security-based swap dealer will not be subject to a segregation requirement and how a claim of a counterparty for the collateral would be treated in a bankruptcy or other formal liquidation proceeding of the security-based swap dealer.

■ 20. Section 240.18a–4a is added to read as follows:

§ 240.18a–4a Exhibit A—Formula for determination of security-based swap customer reserve requirements under § 240.18a–4.

	Credits	Debits
1. Free credit balances and other credit balances in the accounts carried for security-based swap customers (See Note A)	$_____	....
2. Monies borrowed collateralized by securities in accounts carried for security-based swap customers (See Note B)	$_____	....
3. Security-based swap customers' securities failed to receive (See Note C)	$_____	....
4. Credit balances in firm accounts which are attributable to principal sales to security-based swap customers	$_____	....
5. Market value of stock dividends, stock splits and similar distributions receivable outstanding over 30 calendar days	$_____	....
6. Market value of short security count differences over 30 calendar days old	$_____	....
7. Market value of short securities and credits (not to be offset by longs or by debits) in all suspense accounts over 30 calendar days	$_____	....
8. 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	....	$_____
9. 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	....	$_____
10. Failed to deliver of security-based swap customers' securities not older than 30 calendar days	....	$_____
11. 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 (See Note D)	....	$_____
12. Margin related to security futures 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) (See Note E)	....	$_____
13. 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)	....	$_____
14. 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 or at a third-party custodial account	....	$_____
Total Credits	$_____	....
Total Debits	....	$_____
Excess of Credits over Debits	$_____	....

Note A. Item 1 must include all outstanding drafts payable to security-based swap customers which have been applied against free credit balances or other credit balances and must 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 must 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 D. Item 11 must 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 E. (a) Item 12 must 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 12 will 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 E 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 E, 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 will 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 will provide that such funds and/or securities will 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 will 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, will 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 security-based swap 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 E. (b)(1) through (3).

(c) Item 12 will 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 E.

■ 21. Section 240.18a–10 is added to read as follows:

§ 240.18a–10 Alternative compliance mechanism for security-based swap dealers that are registered as swap dealers and have limited security-based swap activities.

(a) A security-based swap dealer may comply with capital, margin, and segregation requirements of the Commodity Exchange Act and chapter I of title 17 of the Code of Federal Regulations applicable to swap dealers in lieu of complying with §§ 240.18a–1, 240.18a–3, and 240.18a–4 if:

(1) The security-based swap dealer is registered as such pursuant to section 15F(b) of the Act and the rules thereunder;

(2) The security-based swap dealer is registered as a swap dealer pursuant to section 4s of the Commodity Exchange Act and the rules thereunder;

(3) The security-based swap dealer is not registered as a broker or dealer pursuant to section 15 of the Act or the rules thereunder;

(4) The security-based swap dealer meets the conditions to be exempt from § 240.18a–4 specified in paragraph (f) of that section; and

(5) As of the most recently ended quarter of the fiscal year of the security-based swap dealer, the aggregate gross notional amount of the outstanding security-based swap positions of the security-based swap dealer did not exceed the lesser of the maximum fixed-dollar amount specified in paragraph (f) of this section or 10 percent of the combined aggregate gross notional amount of the security-based swap and swap positions of the security-based swap dealer.

(b) A security-based swap dealer operating under this section must:

(1) Comply with the capital, margin, and segregation requirements of the Commodity Exchange Act and chapter I of title 17 of the Code of Federal Regulations applicable to swap dealers and treat security-based swaps and related collateral pursuant to those requirements to the extent the requirements do not specifically address security-based swaps and related collateral;

(2) Disclose in writing to each counterparty to a security-based swap before entering into the first transaction with the counterparty after the date the security-based swap dealer begins operating under this section that the security-based swap dealer is operating under this section and is therefore complying with the applicable capital, margin, and segregation requirements of the Commodity Exchange Act and the rules promulgated by the Commodity Futures Trading Commission thereunder in lieu of complying with the capital, margin, and segregation requirements promulgated by the Commission in §§ 240.18a–1, 240.18a–3, and 240.18a–4; and

(3) Immediately notify the Commission and the Commodity Futures Trading Commission in writing if the security-based swap dealer fails to meet a condition specified in paragraph (a) of this section.

(c) A security-based swap dealer that fails to meet one or more of the conditions specified in paragraph (a) of this section must begin complying with §§ 240.18a–1, 240.18a–3, and 240.18a–4 no later than:

(1) Two months after the end of the month in which the security-based swap dealer fails to meet a condition in paragraph (a) of this section; or

(2) A longer period of time as granted by the Commission by order subject to any conditions imposed by the Commission.

(d)(1) A person applying to register as a security-based swap dealer that intends to operate under this section beginning on the date of its registration must provide prior written notice to the Commission and the Commodity Futures Trading Commission of its intent to operate under the conditions of this section.

(2) A security-based swap dealer that elects to operate under this section beginning on a date after the date of its registration as a security-based swap dealer must:

(i) Provide prior written notice to the Commission and the Commodity Futures Trading Commission of its intent to operate under the conditions of this section; and

(ii) Continue to comply with §§ 240.18a–1, 240.18a–3, and 240.18a–4 for at least:

(A) Two months after the end of the month in which the security-based swap dealer provides the notice; or

(B) A shorter period of time as granted by the Commission by order subject to any conditions imposed by the Commission.

(e) The notices required by this section must be sent by facsimile transmission to the principal office of the Commission and the regional office of the Commission for the region in which the security-based swap dealer has its principal place of business or to an email address to be specified separately, and to the principal office of the Commodity Futures Trading Commission in a manner consistent with the notification requirements of the Commodity Futures Trading

Commission. The notice must include a brief summary of the reason for the notice and the contact information of an individual who can provide further information about the matter that is the subject of the notice.

(f)(1) The maximum fixed-dollar amount is $250 billion until the three-year anniversary of the compliance date of this section at which time the maximum fixed-dollar amount is $50 billion unless the Commission issues an order to:

(i) Maintain the maximum fixed-dollar amount at $250 billion for an additional period of time or indefinitely; or

(ii) Lower the maximum fixed-dollar amount to an amount that is less than $250 billion but greater than $50 billion.

(2) If, after considering the levels of security-based swap activity of security-based swap dealers operating under this section, the Commission determines that it may be appropriate to change the maximum fixed-dollar amount pursuant paragraph (f)(1)(i) or (ii) of this section, the Commission will publish a notice of the potential change and subsequently will issue an order regarding any such change.

By the Commission.

Dated: June 21, 2019.

Jill M. Peterson,

Assistant Secretary.

[FR Doc. 2019–13609 Filed 8–21–19; 8:45 am]

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Part III

Environmental Protection Agency

40 CFR Part 121
Updating Regulations on Water Quality Certification; Proposed Rule

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 121

[EPA–HQ–OW–2019–0405; FRL–9997–82–OW]

RIN 2040–AF86

Updating Regulations on Water Quality Certification

AGENCY: Environmental Protection Agency (EPA).

ACTION: Proposed rule.

SUMMARY: The Environmental Protection Agency (EPA) is publishing for public comment a proposed rule providing updates and clarifications to the substantive and procedural requirements for water quality certification under Clean Water Act (CWA or the Act) section 401. CWA section 401 is a direct grant of authority to states (and tribes that have been approved for ''treatment as a state'' status) to review for compliance with appropriate federal, state, and tribal water quality requirements any proposed activity that requires a federal license or permit and may result in a discharge to waters of the United States. This proposal is intended to increase the predictability and timeliness of section 401 certification by clarifying timeframes for certification, the scope of certification review and conditions, and related certification requirements and procedures.

DATES: Comments must be received on or before October 21, 2019.

ADDRESSES: Submit your comments, identified by Docket ID No. EPA–HQ–OW–2019–0405, at *https://www.regulations.gov.* Follow the online instructions for submitting comments. Once submitted, comments cannot be edited or removed from *Regulations.gov.* The EPA may publish any comment received to its public docket. Do not submit electronically any information you consider to be Confidential Business Information (CBI) or other information whose disclosure is restricted by statute. Multimedia submissions (audio, video, etc.) must be accompanied by a written comment. The written comment is considered the official comment and should include discussion of all points you wish to make. The EPA will generally not consider comments or comment contents located outside of the primary submission (*i.e.,* on the web, cloud, or other file sharing system). For additional submission methods, the full EPA public comment policy, information about CBI or multimedia submissions, and general guidance on making effective comments, please visit *https://www.epa.gov/dockets/commenting-epa-dockets.*

FOR FURTHER INFORMATION CONTACT: Lauren Kasparek, Oceans, Wetlands, and Communities Division, Office of Water (4504–T), Environmental Protection Agency, 1200 Pennsylvania Avenue NW, Washington, DC 20460; telephone number: (202) 564–3351; email address: *cwa401@epa.gov.*

SUPPLEMENTARY INFORMATION:

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I. General Information

A. How can I get copies of this document and related information?

1. *Docket.* An official public docket for this action has been established under Docket ID No. EPA–HQ–OW–2019–0405. The official public docket consists of the documents specifically referenced in this action, and other information related to this action. The official public docket is the collection of materials that is available for public viewing at the OW Docket, EPA West, Room 3334, 1301 Constitution Ave. NW, Washington, DC 20004. This Docket Facility is open from 8:30 a.m. to 4:30 p.m., Monday through Friday, excluding legal holidays. The OW Docket telephone number is 202–566–2426. A reasonable fee will be charged for copies.

2. *Electronic Access.* You may access this **Federal Register** document electronically under the ''**Federal Register**'' listings at *https://www.regulations.gov.* An electronic version of the public docket is available through EPA's electronic public docket and comment system, EPA Dockets. You may access EPA Dockets at *https://www.regulations.gov* to view public comments as they are submitted and posted, access the index listing of the contents of the official public docket, and access those documents in the public docket that are available electronically. For additional information about EPA's public docket, visit the EPA Docket Center homepage at *http://www.epa.gov/epahome/dockets.htm.* Although not all docket materials may be available electronically, you may still access any of the publicly available docket materials through the Docket Facility.

B. Under what legal authority is this proposed rule issued?

The authority for this action is the Federal Water Pollution Control Act, 33 U.S.C. 1251 *et seq.,* including section 401 and 501(a).

C. How should I submit comments?

Throughout this document, the EPA solicits comment on a number of issues related to the proposed rulemaking. Comments on this proposed rulemaking should be submitted to Docket ID No. EPA–HQ–OW–2019–0405 at *https://www.regulations.gov* per the online instructions for submitting comments and the information provided in **ADDRESSES**, above.

As discussed in section II.C in this preamble, this proposed rule is the outgrowth of extensive outreach efforts, including requests for recommendations, and the EPA has taken recommendations received into account in developing this proposal. In developing a final rule, the EPA will be considering comments submitted on this proposal. Persons who wish to provide views or recommendations on this proposal and have them considered as part of this rulemaking process must provide comments to the EPA as part of this comment process. To facilitate the processing of comments, commenters are encouraged to organize their comments in a manner that corresponds to the outline of this proposal.

II. Background

A. Executive Summary

Congress enacted section 401 of the CWA to provide states and authorized tribes with an important tool to help protect water quality of federally regulated waters within their borders in collaboration with federal agencies. Under section 401, a Federal agency may not issue a license or permit to conduct any activity that may result in any discharge into waters of the United States,[1] unless the state or authorized tribe where the discharge would originate either issues a section 401 water quality certification finding compliance with existing water quality requirements or waives the certification requirement. As described in greater detail below, section 401 envisions a robust state and tribal role in the federal licensing or permitting process where local authority may otherwise be preempted by federal law, but places limitations on how that role may be implemented to maintain an efficient process, consistent with the overall cooperative federalism construct established by the CWA as explained below in section II.F.1 in this preamble.

The plain language of section 401 provides that a state or authorized tribe must act on a section 401 certification request within a reasonable period of time, which shall not exceed one year.[2] Section 401 does not guarantee a state or tribe a full year to act on a certification request. The statute only grants as much time as is reasonable, and federal licensing or permitting agencies, in their discretion, may establish a period of time shorter than one year if the federal licensing and permitting agencies determine that a shorter period is ''reasonable.'' 33 U.S.C. 1341(a)(1). The CWA provides that the timeline for action on a section 401 certification begins ''upon receipt'' of a certification request. *Id.* If a state or tribe does not grant, grant with conditions, deny, or expressly waive the section 401 certification within a reasonable time period as determined by the federal licensing and permitting agencies, section 401 authorizes the federal licensing and permitting agencies to find that the state or tribe waived the section 401 certification requirement and issue the federal license or permit. *Id.* at 1341; 40 CFR 121.16(b). If the certification requirement has been waived and the federal license or permit is issued, any subsequent action by a state or tribe to grant, grant with condition, or deny section 401 certification has no legal force or effect.

Section 401 authorizes states and tribes to certify that a discharge to waters of the United States that may result from a proposed activity will comply with certain enumerated sections of the CWA, including the effluent limitations and standards of performance for new and existing discharge sources (sections 301, 302 and 306 of the CWA), water quality standards and implementation plans (section 303), and toxic pretreatment effluent standards (section 307). When granting a section 401 certification, states and tribes are directed by CWA section 401(d) to include conditions, including ''effluent limitations[3] and other limitations, and monitoring requirements'' that are necessary to assure that the applicant for a federal license or permit will comply with applicable provisions of CWA sections 301, 302, 306 and 307, and with ''any other appropriate requirement of State law.''

As the agency charged with administering the CWA,[4] the EPA is responsible for developing a common framework for certifying authorities to follow when completing section 401 certifications. *See* 33 U.S.C. 1251(d), 1361(a). In 1971, the EPA promulgated at 40 CFR part 121 a common framework for implementing the certification provisions pursuant to section 21(b) of the Federal Water Pollution Control Act of 1948 (FWCPA), but the EPA never updated that framework to reflect the 1972 amendments to the FWCPA (commonly known as the Clean Water Act or CWA), which created section 401. Over the last several years, litigation over the section 401 certifications for several high-profile infrastructure projects have highlighted the need for the EPA to update its regulations to provide a common framework for consistency with CWA section 401 and to give project proponents, certifying authorities, and federal licensing and permitting agencies additional clarity and regulatory certainty.

In April 2019, the President issued Executive Order 13868 titled *Promoting Energy Infrastructure and Economic Growth,* which directed the EPA to engage with states, tribes, and federal agencies and update the Agency's outdated guidance and regulations, including the existing certification framework. Consistent with Executive Order 13868 and the modern CWA, this proposal provides an updated common framework that is consistent with the modern CWA and which seeks to increase predictability and timeliness.

B. Executive Order 13868: Promoting Energy Infrastructure and Economic Growth

On April 10, 2019, the President issued Executive Order 13868 titled *Promoting Energy Infrastructure and Economic Growth.* Its purpose is to encourage greater investment in energy

[1] The CWA, including section 401, uses ''navigable waters'', defined as ''waters of the United States, including territorial seas.'' 33 U.S.C. 1362(7). This proposal uses ''waters of the United States'' throughout. The EPA is currently in the process of revising the definition of waters of the United States via rulemaking and expects the final definition of the term to control in all CWA contexts.

[2] ''If the State, interstate agency, or Administrator, as the case may be, fails or refuses to act on a request for certification, within a reasonable period of time (which shall not exceed one year) after receipt of such request, the certification requirements of this subsection shall be waived with respect to such Federal application.'' 33 U.S.C. 1341(a)(1); *see also Hoopa Valley Tribe* v. *FERC,* 913 F.3d 1099 (D.C. Cir. 2019).

[3] This proposal does not interpret ''effluent limitations'' to be synonymous with ''effluent limitation guidelines'', the pollution control technology-based limits developed under section 304, 306, and 307 of the CWA, but also does interpret the term to include, for example, water quality based effluent limits required under sections 301 and 303.

[4] The EPA co-administers section 404 with the Corps.

infrastructure in the United States by promoting efficient federal permitting processes and reducing regulatory uncertainty. The Executive Order identifies the EPA's outdated federal guidance and regulations as one source of confusion and uncertainty hindering the development of energy infrastructure. As noted above, the EPA's current certification regulations (codified at 40 CFR part 121) have not been updated since they were promulgated in 1971, pursuant to section 21(b) of the FWPCA. Additionally, at the time the Executive Order was issued, the EPA's only guidance to the public on section 401 implementation was an interim handbook titled *Clean Water Act Section 401 Water Quality Certification: A Water Quality Protection Tool for States and Tribes,* which had not been updated since it was released in 2010 and therefore no longer reflected the current case law interpreting CWA section 401.

The Executive Order directed the EPA to review CWA section 401 and the EPA's existing certification regulations and interim guidance, issue new guidance to states, tribes, and federal agencies within 60 days of the Order, and propose new section 401 regulations within 120 days of the Order. The Executive Order also directed the EPA to consult with states, tribes, and relevant federal agencies while reviewing its existing guidance and regulations to identify areas that would benefit from greater clarity.

As part of its review, the Executive Order directed the EPA to take into account the federalism considerations underlying section 401 and to focus its attention on the appropriate scope of water quality reviews and conditions, the scope of information needed to act on a certification request in reasonable period of time, and expectations for certification review times. Section 3.a. of Executive Order 13868 *Promoting Energy Infrastructure and Economic Growth.* Following the release of the EPA's new guidance document, the Executive Order directed the EPA to lead an interagency review of all existing federal regulations and guidance pertaining to section 401 to ensure consistency with the EPA's new guidance and rulemaking efforts. The Executive Order directs all federal agencies to update their existing section 401 guidance within 90 days after publication of the EPA's new guidance documents. Additionally, the Executive Order directs other federal agencies to initiate rulemaking, if necessary, within 90 days of the completion of the EPA's rulemaking, to ensure their own CWA section 401 regulations are consistent with the EPA's new rules and with the Executive Order's policy goals. Although the Executive Order focuses on section 401's impact on the energy sector, section 401 applies broadly to any proposed federally licensed or permitted activity that may result in any discharge into a water of the United States. Therefore, updates to the EPA's existing certification regulations and guidance are relevant to all water quality certifications.

Additional information on the EPA's state and tribal engagement is discussed in section II.C in this preamble, and additional information on the EPA's updated guidance document is discussed in section II.D in this preamble.

C. Pre-Proposal Stakeholder Engagement

Prior to the release of Executive Order 13868 *Promoting Energy Infrastructure and Economic Growth,* the Agency's 2018 Spring Unified Agenda of Regulatory and Deregulatory Actions announced that the Agency was considering, as a long-term action, the issuance of a notice soliciting public comment on whether the section 401 certification process would benefit from a rulemaking to promote nationwide consistency and regulatory certainty for states, authorized tribes, and stakeholders. While the Agency has decided to issue this proposal instead of the notice, that entry was the first indication to the public of the Agency's interest in revising its section 401 certification process.

On August 6, 2018, the Agency sent a letter to the Environmental Council of the States, the Association of Clean Water Administrators, the Association of State Wetlands Managers, the National Tribal Water Council, and the National Tribal Caucus indicating the Agency's interest in engaging on potential clarifications to the section 401 process. The Agency discussed section 401 at several association meetings and calls in Fall 2018 and Spring 2019 and received correspondence from several stakeholders between Fall 2018 and Spring 2019. Early stakeholder feedback received prior to the issuance of the Executive Order, as well as presentations given between Fall 2018 and Spring 2019, may be found in the pre-proposal recommendations docket (Docket ID No. EPA–HQ–OW–2018–0855).

Following the release of the Executive Order, the EPA continued its effort to engage with states and tribes on how to increase clarity in the section 401 certification process, including creating a new website to provide information on section 401 and notifying state environmental commissioners and tribal environmental directors of a two-part webinar series for states and tribes. *See www.epa.gov/cwa-401.* The first webinar was held on April 17, 2019, and discussed the Executive Order, the EPA's next steps, and solicited feedback from states and tribes consistent with the Executive Order. Shortly thereafter, the EPA initiated formal consultation efforts with states and tribes regarding provisions that require clarification within section 401 of the CWA and related federal regulations and guidance. Consultation occurred from April 24, 2019 through May 24, 2019, and the EPA opened a docket for pre-proposal recommendations during this time period (Docket ID No. EPA–HQ–OW–2018–0855). On May 7, 2019 and May 15, 2019, the EPA held tribal informational webinars, and on May 8, 2019, the EPA held an informational webinar for both states and tribes. See section V in this preamble for further details on the Agency's federalism and tribal consultations. Questions and recommendations from the webinar attendees are available in the pre-proposal docket (Docket ID No. EPA–HQ–OW–2018–0855).

During the consultation period, the EPA participated in phone calls and in-person meetings with inter-governmental and tribal associations including the National Governor's Association and National Tribal Water Council. The EPA also attended the EPA Region 9 Regional Tribal Operations Committee meeting on May 22, 2019, to solicit recommendations for the proposed rule. The EPA engaged with federal agencies that issue permits or licenses subject to section 401, including the United States Department of Agriculture, Federal Energy Regulatory Commission, Army Corps of Engineers, Alcohol and Tobacco Tax and Trade Bureau, and Nuclear Regulatory Commission through several meetings and phone calls to gain additional feedback from federal partners.

At the webinars and meetings, the EPA provided a presentation and sought input on areas of section 401 that may require updating or benefit from clarification, including timeframe, scope of certification review, and coordination among certifying authorities, federal licensing or permitting agencies, and project proponents. The EPA requested input on issues and process improvements that the EPA might consider for a future rule. Participant recommendations from webinars, meetings, and the docket represent a diverse range of interests, positions and suggestions. Several themes emerged throughout this process, including support for ongoing state and tribal engagement, support for retention of state and tribal authority, and suggestions for process improvements for CWA section 401 water quality certifications.

Tribes provided several specific recommendations regarding the proposed rulemaking. First, some tribes requested the EPA better clarify its responsibilities under CWA section 401(a)(2). These tribes expressed the importance of considering impacts to neighboring jurisdictions during the section 401 certification process. Tribes also emphasized that section 401 certification decision-making should not be prolonged such that section 401 certifications delay implementation of updated water quality standards. Tribes also requested that any changes to the section 401 certification process should maintain tribal authority and sovereignty. Finally, tribes emphasized the importance of meaningful consultation and engagement throughout the rulemaking process.

The EPA received several specific recommendations regarding process improvements for section 401 certifications. First, states, cross-cutting state organizations, and industry groups expressed support for pre-application meetings and information-sharing among project proponents, certifying authorities, and federal licensing and permitting agencies. Additionally, state officials, tribal officials, and cross-cutting state organizations cited deficient certification applications as a primary cause for delays in the certification decision-making process. Permit applicants suggested the lack of clear state processes and prolonged information requests contributed significantly to the delay in the 401 certification process. The Agency was also made aware of relatively low staffing availability in many state and tribal 401 certification programs. Stakeholders suggested that pre-application meetings as well as explicit state processes and checklists could increase the quality of certification applications.

Additionally, state and tribal officials as well as cross-cutting state organizations cautioned the Agency against mandating a specific reasonable period of time (*e.g.,* 60 days) that would apply to all types of projects. These recommendations encouraged the EPA to maintain the authority of federal licensing and permitting agencies to determine the appropriate reasonable period of time.

Finally, the EPA received pre-proposal recommendations covering a wide variety of viewpoints on the certifying authority's scope of certification review. The EPA considered all of this information and stakeholder input, including all 72 recommendations submitted to the docket during development of this proposed rule, and feedback received prior to the initiation of and during the formal consultation period.

D. Guidance Document

Pursuant to Executive Order 13868, the Agency released updated section 401 guidance on June 7, 2019, available at *https://www.epa.gov/cwa-401/clean-water-act-section-401-guidance-federal-agencies-states-and-authorized-tribes.* Coincident with the release of the new guidance, EPA rescinded the 2010 document titled *Clean Water Act Section 401 Water Quality Certification: A Water Quality Protection Tool for States and Tribes* (''Interim Handbook''). The 2010 Interim Handbook had not been updated or revised since its release in 2010, and therefore no longer reflected the current case law interpreting CWA section 401, nor had it been finalized.

The updated guidance provides information and recommendations for implementing the substantive and procedural requirements of section 401, consistent with the areas of focus in the Executive Order. More specifically, the guidance focuses on aspects of the certification process, including the timeline for review and decision-making and the appropriate scope of review and conditions. Additionally, the guidance provides recommendations for how federal licensing and permitting agencies, states, and tribes can better coordinate to improve the section 401 certification process. The emphasis on early coordination and collaboration to increase process efficiency aligns with other agency directives under Executive Order 13807, *Establishing Discipline and Accountability in the Environmental Review and Permitting Process for Infrastructure Projects,* or simply, the ''One Federal Decision'' policy. For major infrastructure projects, the One Federal Decision policy directs federal agencies to use a single, coordinated process for compliance with the National Environmental Policy Act (NEPA), 42 U.S.C. 4321 *et seq.,* and emphasizes advance coordination to streamline federal permitting actions.

The new guidance is not a regulation, nor does it change or substitute for any applicable regulations. Therefore, it does not impose legally binding requirements on the EPA, states, tribes, other federal agencies, or the regulated community. The EPA expects its final regulation, once promulgated, will provide the clarity and regulatory certainty expected by the Executive Order and additional guidance will not be necessary to implement section 401. The Agency therefore requests comment on whether it should rescind its June 7, 2019 guidance upon completion of this rulemaking or whether separate guidance would be helpful on implementation of the provisions that are finalized in this proposal.

E. Effect on Existing Federal, State, and Tribal Regulations

Section 3.d. of Executive Order 13868 provides that, within 90 days after the EPA issues its final section 401 regulations, ''if necessary, the heads of each 401 implementing Agency shall initiate a rulemaking to ensure that their respective agencies' regulations are consistent with'' EPA's final section 401 regulations and ''the policies set forth in section 2 of [the Executive Order].'' According to the Executive Order, these subsequent federal agency rulemaking efforts will follow an EPA-led interagency review and examination of existing federal guidance and regulations ''for consistency with EPA guidance and regulations.'' As the EPA understands the Executive Order, the other federal agencies that issue permits or licenses subject to the certification requirements of section 401 are expected to ensure that regulations governing their own processing, disposition, and enforcement of section 401 certifications are consistent with the EPA's final regulations and the policies articulated in section 2 of the Executive Order. The EPA plans to review its own National Pollutant Discharge Elimination System (NPDES) regulations to ensure its program certification regulations are also consistent with the Agency's final regulations under this proposal. The EPA will be working with its fellow section 401 implementing agencies to accomplish this goal.

The EPA recommends that states and authorized tribes update, as necessary, their own CWA section 401 regulations to provide procedural and substantive requirements that are consistent with those the EPA eventually promulgates. Regulatory consistency across both federal and state governments with respect to issues like timing, waiver, and scope of section 401 reviews and conditions will substantially contribute towards ensuring that section 401 is implemented in an efficient, effective, transparent, and nationally consistent manner and will reduce the likelihood of protracted litigation over these issues.

The EPA solicits comments from state and tribal governments, and the public at large regarding the need for, and potential benefits of, a consistent, national and state regulatory approach to section 401 and how the EPA may best promote such consistency.

F. Legal Background

This proposal initiates the EPA's first comprehensive effort to promulgate federal rules governing the implementation of CWA section 401. The Agency's existing certification regulations at 40 CFR part 121 pre-date the 1972 CWA amendments. This proposal therefore provides the EPA's first holistic analysis of the statutory text, legislative history, and relevant case law informing the implementation of the CWA section 401 program by the Agency and our federal, state, and tribal partners. The proposal, while focused on the relevant statutory provisions and case law interpreting those provisions, is informed by policy considerations where necessary to address certain ambiguities in the statutory text. The following sections describe the basic operational construct and history of the modern CWA, how section 401 fits within that construct, and certain core administrative legal principles that guide agency decision-making in this context. This legal background is intended to inform the public's review of the proposed regulation by summarizing the legal framework for the proposal.

1. The Clean Water Act

Congress amended the CWA [5] in 1972 to address longstanding concerns regarding the quality of the nation's waters and the federal government's ability to address those concerns under existing law. Prior to 1972, the ability to control and redress water pollution in the nation's waters largely fell to the U.S. Army Corps of Engineers (Corps) under the Rivers and Harbors Act of 1899 (RHA). While much of that statute focused on restricting obstructions to navigation on the nation's major waterways, section 13 of the RHA made it unlawful to discharge refuse ''into any navigable water of the United States,[6] or into any tributary of any navigable water from which the same shall float or be washed into such navigable water.'' 33 U.S.C. 407. Congress had also enacted the Water Pollution Control Act of 1948, Pub. L. 80–845, 62 Stat. 1155 (June 30, 1948), to address interstate water pollution, and subsequently amended that statute in 1956 (giving the statute is current formal name), 1961, and 1965. The early versions of the CWA promoted the development of pollution abatement programs, required states to develop water quality standards, and authorized the federal government to bring enforcement actions to abate water pollution.

These earlier statutory frameworks, however, proved challenging for regulators, who often worked backwards from an overly-polluted waterway to determine which dischargers and which sources of pollution may be responsible. *See EPA* v. *State Water Resources Control Bd.,* 426 U.S. 200, 204 (1976). In fact, Congress determined that they ultimately proved inadequate to address the decline in the quality of the nation's waters, *see City of Milwaukee* v. *Illinois,* 451 U.S. 304, 310 (1981), so Congress performed a ''total restructuring'' and ''complete rewriting'' of the existing statutory framework of the Act in 1972. *Id.* at 317 (quoting legislative history of 1972 amendments). That restructuring resulted in the enactment of a comprehensive scheme designed to prevent, reduce, and eliminate pollution in the nation's waters generally, and to regulate the discharge of pollutants into waters of the United States specifically. *See, e.g., S.D. Warren Co.* v. *Maine Bd. of Envtl. Prot.,* 547 U.S. 370, 385 (2006) (''[T]he Act does not stop at controlling the 'addition of pollutants,' but deals with 'pollution' generally[.]'').

The objective of the new statutory scheme was ''to restore and maintain the chemical, physical, and biological integrity of the Nation's waters.'' 33 U.S.C. 1251(a). In order to meet that objective, Congress declared two national goals: (1) ''that the discharge of pollutants into the navigable waters be eliminated by 1985;'' and (2) ''that wherever attainable, an interim goal of water quality which provides for the protection and propagation of fish, shellfish, and wildlife and provides for recreation in and on the water be achieved by July 1, 1983 . . . .'' *Id.* at 1251(a)(1)–(2).

Congress established several key policies that direct the work of the Agency to effectuate those goals. For example, Congress declared as a national policy ''that the discharge of toxic pollutants in toxic amounts be prohibited; . . . that Federal financial assistance be provided to construct publicly owned waste treatment works; . . . that areawide waste treatment management planning processes be developed and implemented to assure adequate control of sources of pollutants in each State; . . . [and] that programs for the control of nonpoint sources of pollution be developed and implemented in an expeditious manner so as to enable the goals of this Act to be met through the control of both point and nonpoint sources of pollution.'' *Id.* at 1251(a)(3)–(7).

Congress provided a major role for the states in implementing the CWA, balancing the traditional power of states to regulate land and water resources within their borders with the need for a national water quality regulation. For example, the statute highlighted ''the policy of the Congress to recognize, preserve, and protect the primary responsibilities and rights of States to prevent, reduce, and eliminate pollution'' and ''to plan the development and use . . . of land and water resources . . . .'' *Id.* at 1251(b). Congress also declared as a national policy that States manage the major construction grant program and implement the core permitting programs authorized by the statute, among other responsibilities. *Id.* Congress added that ''[e]xcept as expressly provided in this Act, nothing in this Act shall . . . be construed as impairing or in any manner affecting any right or jurisdiction of the States with respect to the waters (including boundary waters) of such States.'' *Id.* at 1370.[7] Congress also pledged to provide technical support and financial aid to the States ''in connection with the prevention, reduction, and elimination of pollution.'' *Id.* at 1251(b).

To carry out these policies, Congress broadly defined ''pollution'' to mean ''the man-made or man-induced alteration of the chemical, physical, biological, and radiological integrity of water,'' *id.* at 1362(19), to parallel the broad objective of the Act ''to restore and maintain the chemical, physical, and biological integrity of the Nation's waters.'' *Id.* at 1251(a). Congress then crafted a non-regulatory statutory

[5] The FWPCA is commonly referred to as the CWA following the 1977 amendments to the FWPCA. Public Law 95–217, 91 Stat. 1566 (1977). For ease of reference, the Agency will generally refer to the FWPCA in this notice as the CWA or the Act.

[6] The term ''navigable water of the United States'' is a term of art used to refer to waters subject to federal jurisdiction under the RHA. *See, e.g.,* 33 CFR 329.1. The term is not synonymous with the phrase ''waters of the United States'' under the CWA, *see id.,* and the general term ''navigable waters'' has different meanings depending on the context of the statute in which it is used. *See, e.g., PPL Montana, LLC* v. *Montana,* 132 S. Ct. 1215, 1228 (2012).

[7] 33 U.S.C. 1370 also prohibits authorized states from adopting any limitations, prohibitions, or standards that are less stringent than required by the CWA.

framework to provide technical and financial assistance to the states to prevent, reduce, and eliminate pollution in the nation's waters generally. *See, e.g., id.* at 1256(a) (authorizing the EPA to issue ''grants to States and to interstate agencies to assist them in administering programs for the prevention, reduction, and elimination of pollution''); *see also* 84 FR 4154, 4157 (Feb. 14, 2019) (discussing non-regulatory program provisions); 83 FR 32227, 32232 (July 12, 2018) (same).

In addition to the Act's non-regulatory measures to control pollution of the nation's waters, Congress created a federal regulatory program designed to address the discharge of pollutants into a subset of those waters identified as ''the waters of the United States.'' *See* 33 U.S.C. 1362(7). Section 301 contains the key regulatory mechanism: ''Except as in compliance with this section and sections 302, 306, 307, 318, 402, and 404 of this Act, the discharge of any pollutant by any person shall be unlawful.'' *Id.* at 1311(a). A ''discharge of a pollutant'' is defined to include ''any addition of any pollutant to navigable waters from any point source,'' such as a pipe, ditch or other ''discernible, confined and discrete conveyance.'' *Id.* at 1362(12), (14). The term ''pollutant'' means ''dredged spoil, solid waste, incinerator residue, sewage, garbage, sewage sludge, munitions, chemical wastes, biological materials, radioactive materials, heat, wrecked or discarded equipment, rock, sand, cellar dirt and industrial, municipal, and agricultural waste discharged into water.'' *Id.* at 1362(6). Thus, it is unlawful to discharge pollutants into waters of the United States from a point source unless the discharge is in compliance with certain enumerated sections of the CWA, including obtaining authorizations pursuant to the section 402 NPDES permit program or the section 404 dredged or fill material permit program. *See id.* at 1342, 1344. Congress therefore hoped to achieve the Act's objective ''to restore and maintain the chemical, physical, and biological integrity of the Nation's waters'' by addressing pollution of all waters via non-regulatory means and federally regulating the discharge of pollutants to the subset of waters identified as ''navigable waters.'' [8]

Within the regulatory programs established by the Act, two principal components focus on ''achieving maximum 'effluent limitations' on 'point sources,' as well as achieving acceptable water quality standards,'' and the development of the NPDES permitting program that imposes specific discharge limitations for regulated entities. *EPA* v. *State Water Resources Control Bd.,* 426 U.S. at 204. Together these components provide a framework for the Agency to focus on reducing or eliminating discharges while creating accountability for each entity that discharges into a waterbody, facilitating greater enforcement and overall achievement of the CWA water quality goals. *Id.; see Oregon Natural Desert Association* v. *Dombeck,* 172 F.3d 1092, 1096 (9th Cir. 1998) (observing that 1972 amendments ''largely supplanted'' earlier version of CWA ''by replacing water quality standards with point source effluent limitations'').

Under this statutory scheme, the states [9] are authorized to assume program authority for issuing section 402 and 404 permits within their borders, subject to certain limitations. 33 U.S.C. 1342(b), 1344(g). States are also responsible for developing water quality standards for ''waters of the United States'' within their borders and reporting on the condition of those waters to the EPA every two years. *Id.* at 1313, 1315. States must develop total maximum daily loads (TMDLs) for waters that are not meeting established water quality standards and must submit those TMDLs to the EPA for approval. *Id.* at 1313(d). And, central to this proposed rule, states under CWA section 401 have authority to grant, grant with conditions, deny, or waive water quality certifications for every federal license or permit issued within their borders that may result in a discharge to waters of the United States. *Id.* at 1341. These same regulatory authorities can be assumed by Indian tribes under section 518 of the CWA, which authorizes the EPA to treat eligible tribes with reservations in a similar manner to states (referred to as ''treatment as states'' or TAS) for a variety of purposes, including administering the principal CWA regulatory programs. *Id.* at 1377(e). In addition, states and tribes retain authority to protect and manage the use of those waters that are not waters of the United States under the CWA. *See, e.g., id.* at 1251(b), 1251(g), 1370, 1377(a).

In enacting section 401, Congress recognized that where states and tribes do not have direct permitting authority (either under a section 402 or 404 program authorization or where Congress has preempted a regulatory field, *e.g.,* under the Federal Power Act), they may still play a valuable role in protecting water quality of federally regulated waters within their borders in collaboration with federal agencies. Under section 401, a federal agency may not issue a license or permit for an activity that may result in a discharge to waters of the United States, unless the appropriate certification authority provides a section 401 certification or waives its ability to do so. The authority to certify a federal license or permit lies with the agency (the certifying authority) that has jurisdiction over the discharge location to the receiving waters of the United States. *Id.* at 1341(a)(1). Examples of federal licenses or permits potentially subject to section 401 certification include, but are not limited to, CWA section 402 NPDES permits in states where the EPA administers the permitting program, CWA section 404 permits issued by the Corps, hydropower and pipeline licenses issued by Federal Energy Regulatory Commission (FERC), and RHA sections 9 and 10 permits issued by the Corps.

Under section 401, a certifying authority may grant, grant with conditions, deny, or waive certification in response to a request from a project proponent. The certifying authority determines whether the proposed activity will comply with the applicable provisions of sections 301, 302, 303, 306, and 307 of the CWA and any other appropriate requirement of state law. *Id.* Certifying authorities may also add to a certification ''any effluent limitations and other limitations, and monitoring requirements'' necessary to assure compliance. *Id* at 1341(d). These

[8] Fundamental principles of statutory interpretation support the Agency's recognition of a distinction between ''nation's waters'' and ''navigable waters.'' As the Supreme Court has observed, ''[w]e assume that Congress used two terms because it intended each term to have a particular, nonsuperfluous meaning.'' *Bailey* v. *United States,* 516 U.S. 137, 146 (1995) (recognizing the canon of statutory construction against superfluity). Further, ''the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.'' *FDA* v. *Brown & Williamson Tobacco Corp.,* 529 U.S. 120, 133 (2000) (internal quotation marks and citation omitted); *see also United Savings Ass'n* v. *Timbers of Inwood Forest Associates,* 484 U.S. 365, 371 (''Statutory construction . . . is a holistic endeavor. A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme—because the same terminology is used elsewhere in a context that makes its meaning clear[.]'') (citation omitted). The non-regulatory sections of the CWA reveal Congress' intent to restore and maintain the integrity of the nation's waters using federal assistance to support State and local partnerships to control pollution in the nation's waters in addition to a federal regulatory prohibition on the discharge of pollutants into the navigable waters. For further discussion, see 83 FR at 32232 and 84 FR at 4157.

[9] The CWA defines ''state'' as ''a State, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, and the Trust Territory of the Pacific Islands.'' 33 U.S.C. 1362(3).

additional provisions must become ''a condition'' of the federal license or permit should it be issued. *Id.* A certifying authority may deny certification if it is unable to determine that the discharge from the proposed activity will comply with the applicable sections of the CWA and appropriate requirements of state law. If a certifying authority denies certification, the federal license or permit may not issue. *Id.* at 1341(a)(1). A certifying authority may waive certification by ''fail[ing] or refus[ing] to act on a request for certification, within a reasonable period of time . . . after receipt of such request.'' *Id.*

Perhaps with the exception of section 401,[10] the EPA has developed comprehensive, modern regulatory programs designed to ensure that the CWA is fully implemented as Congress intended. This includes pursuing the overall ''objective'' of the CWA to ''restore and maintain the chemical, physical, and biological integrity of the Nation's waters,'' *id.* at 1251(a), while implementing the specific ''policy'' directives from Congress to, among other things, ''recognize, preserve, and protect the primary responsibilities and rights of States to prevent, reduce, and eliminate pollution'' and ''to plan the development and use . . . of land and water resources.'' *Id.* at 1251(b); *see also Webster's II, New Riverside University Dictionary* (1994) (defining ''policy'' as a ''plan or course of action, as of a government[,] designed to influence and determine decisions and actions;'' an ''objective'' is ''something worked toward or aspired to: Goal''). The Agency therefore recognizes a distinction between the specific word choices of Congress, including the need to develop regulatory programs that aim to accomplish the goals of the Act while implementing the specific policy directives of Congress. For further discussion of these principles, see 83 FR at 32237 and 84 FR at 4168–69.

Congress' authority to regulate navigable waters, including those subject to CWA section 401 water quality certification, derives from its power to regulate the ''channels of interstate commerce'' under the Commerce Clause. *Gibbons* v. *Ogden,* 22 U.S. (9 Wheat.) 1 (1824); *see also United States* v. *Lopez,* 514 U.S. 549, 558–59 (1995) (describing the ''channels of interstate commerce'' as one of three areas of congressional authority under the Commerce Clause). The Supreme Court explained in *Solid Waste Agency of Northern Cook County* v. *U.S. Army Corps of Engineers (SWANCC)* that the term ''navigable'' indicates ''what Congress had in mind as its authority for enacting the Clean Water Act: Its traditional jurisdiction over waters that were or had been navigable in fact or which could reasonably be so made.'' 531 U.S. 159, 172 (2001). The Court further explained that nothing in the legislative history of the Act provides any indication that ''Congress intended to exert anything more than its commerce power over navigation.'' *Id.* at 168 n.3. The Supreme Court, however, has recognized that Congress intended ''to exercise its powers under the Commerce Clause to regulate at least some waters that would not be deemed 'navigable' under the classical understanding of that term.'' *United States* v. *Riverside Bayview Homes,* 474 U.S. 121, 133 (1985); *see also SWANCC,* 531 U.S. at 167.

The classical understanding of the term navigable was first articulated by the Supreme Court in *The Daniel Ball:*

> Those rivers must be regarded as public navigable rivers in law which are navigable in fact. And they are navigable in fact when they are used, or are susceptible of being used, in their ordinary condition, as highways of commerce, over which trade and travel are or may be conducted in the customary modes of trade and travel on water. And they constitute navigable waters of the United States within the meaning of the Acts of Congress, in contradistinction from the navigable waters of the States, when they form in their ordinary condition by themselves, or by uniting with other waters, a continued highway over which commerce is or may be carried on with other States or foreign countries in the customary modes in which such commerce is conducted by water.

77 U.S. (10 Wall.) 557, 563 (1871). Over the years, this traditional test has been expanded to include waters that had been used in the past for interstate commerce, *see Economy Light & Power Co.* v. *United States,* 256 U.S. 113, 123 (1921), and waters that are susceptible for use with reasonable improvement. *See United States* v. *Appalachian Elec. Power Co.,* 311 U.S. 377, 407–10 (1940).

By the time the 1972 CWA amendments were enacted, the Supreme Court had held that Congress' authority over the channels of interstate commerce was not limited to regulation of the channels themselves but could extend to activities necessary to protect the channels. *See Oklahoma ex rel. Phillips* v. *Guy F. Atkinson Co.,* 313 U.S. 508, 523 (1941) (''Congress may exercise its control over the non-navigable stretches of a river in order to preserve or promote commerce on the navigable portions.''). The Supreme Court also had clarified that Congress could regulate waterways that formed a part of a channel of interstate commerce, even if they are not themselves navigable or do not cross state boundaries. *See Utah* v. *United States,* 403 U.S. 9, 11 (1971). Congress therefore intended to assert federal regulatory authority over more than just waters traditionally understood as navigable and rooted that authority in ''its commerce power over navigation.'' *SWANCC,* 531 U.S. at 168 n.3.

The EPA recognizes and respects the primary responsibilities and rights of states to regulate their land and water resources, as envisioned by the CWA. *See* 33 U.S.C. 1251(b), 1370. The oft-quoted objective of the CWA to ''restore and maintain the chemical, physical, and biological integrity of the Nation's waters,'' *id.* at 1251(a), must be implemented in a manner consistent with Congress' policy directives. The Supreme Court long ago recognized the distinction between waters subject to federal authority, traditionally understood as navigable, and those waters ''subject to the control of the States.'' *The Daniel Ball,* 77 U.S. (10 Wall.) 557, 564–65 (1870). Over a century later, the Supreme Court in *SWANCC* reaffirmed the state's ''traditional and primary power over land and water use.'' 531 U.S. at 174. Ensuring that states retain authority over their land and water resources helps carry out the overall objective of the CWA and ensures that the agency is giving full effect and consideration to the entire structure and function of the Act. *See, e.g., Hibbs* v. *Winn,* 542 U.S. 88, 101 (2004) (''A statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant.'') (citation omitted); *see also Rapanos* v. *United States,* 547 U.S. 715, 755–56 (2006) (Scalia, J., plurality opinion) (''[C]lean water is not the *only* purpose of the statute. So is the preservation of primary state responsibility for ordinary land-use decisions. 33 U.S.C. 1251(b).'') (original emphasis).

In summary, Congress relied on its authority under the Commerce Clause when it enacted the CWA and intended to assert federal authority over more than just waters traditionally understood as navigable, but it limited the exercise of that authority to ''its commerce power over navigation.'' *SWANCC,* 531 U.S. at 168 n.3. In doing so, Congress specifically sought to avoid ''federal encroachment upon a traditional state power.'' *Id.* at 173. The Court in *SWANCC* found that ''[r]ather than expressing a desire to readjust the

[10] As noted in section II.F in this preamble, the EPA's existing certification regulations were promulgated prior to the 1972 CWA Amendments and have not been updated to reflect the current statutory text.

federal-state balance in this manner, Congress chose [in the CWA] to 'recognize, preserve, and protect the primary responsibilities and rights of States . . . to plan the development and use . . . of land and water resources . . .'' *Id.* at 174 (quoting 33 U.S.C. 1251(b)). The Court found no clear statement from Congress that it had intended to permit federal encroachment on traditional state power and construed the CWA to avoid the significant constitutional questions related to the scope of federal authority authorized therein. *Id.* That is because the Supreme Court has instructed that ''[w]here an administrative interpretation of a statute invokes the outer limits of Congress' power, we expect a clear indication that Congress intended that result.'' *Id.* at 172. The Court has further stated that this is particularly true ''where the administrative interpretation alters the federal-state framework by permitting federal encroachment upon a traditional state power.'' *Id.* at 173; *see also Will* v. *Michigan Dept. of State Police,* 491 U.S. 58, 65 (1989) (''[I]f Congress intends to alter the 'usual constitutional balance between the States and the Federal Government,' it must make its intention to do so 'unmistakably clear in the language of the statute.' '') (quoting *Atascadero State Hospital* v. *Scanlon,* 473 U.S. 234, 242 (1985)); *Gregory* v. *Ashcroft,* 501 U.S. 452, 461 (1991) (''this plain statement rule . . . acknowledg[es] that the States retain substantial sovereign powers under our constitutional scheme, powers with which Congress does not readily interfere''). This means that that the executive branch's authority under the CWA, while broad, is not unlimited, and the waters to which CWA regulatory programs apply must necessarily respect those limits. For further discussion of these principles, see 84 FR at 4165 and 83 FR at 32234.

In some cases, CWA section 401 denials have been challenged on grounds that the denial improperly interfered with interstate commerce. *See, e.g., Lighthouse Resources, Inc.* v. *Inslee,* No. 3:18–cv–5005, Complaint at ¶¶ 206–210; ¶¶ 224–248 (W.D. Wash. Filed Jan. 8, 2018) (alleging State's denial of section 401 certification violated the dormant commerce clause and dormant foreign commerce clause). In *Lake Carriers Association* v. *EPA,* 652 F.3d 1 (D.C. Cir. 2011), a court of appeals found that the section 401 statutory scheme of delegation to states itself does not create an impermissible burden on interstate commerce; however actions taken by states pursuant to section 401 are not insulated from dormant commerce clause challenges. 652 F.3d at 10 (''If [petitioners] believe that the certification conditions imposed by any particular state pose an inordinate burden on their operations, they may challenge those conditions in that state's courts. If [petitioners] believe that a particular state's law imposes an unconstitutional burden on interstate commerce, they may challenge that law in federal (or state) court.''). Accordingly, EPA seeks comment on whether its proposed regulations appropriately balance the scope of state authority under section 401 with Congress' goal of facilitating commerce on interstate navigable waters, and whether they define the scope in a manner that would limit the potential for states to withhold or condition certifications such that it would place undue burdens on interstate commerce.

2. The EPA's Role in Implementing Section 401

The EPA, as the federal agency charged with administering the CWA, is responsible for developing regulations and guidance to ensure effective implementation of all CWA programs, including section 401.[11] In addition to administering the statute and promulgating implementing regulations, the Agency has several other roles under section 401.

The EPA acts as the section 401 certification authority under two circumstances. First, the EPA will certify on behalf of a state or tribe where the jurisdiction in which the discharge will originate does not itself have certification authority. 33 U.S.C. 1341(a)(1). In practice, this results in the EPA certifying on behalf of the many tribes that do not have TAS authority for section 401. Second, the EPA will act as the certifying authority where the discharge would originate on lands of exclusive federal jurisdiction.[12]

The EPA also coordinates the opportunity for neighboring jurisdictions to raise concerns and recommendations where their water quality may be affected by a discharge subject to section 401 certification. *Id.* at 1341(a)(2). Although section 401 certification authority lies with the jurisdiction where the discharge originates, a neighboring jurisdiction whose water quality is potentially affected by the discharge may have an opportunity to raise concerns. Where the EPA Administrator determines that a discharge subject to section 401 ''may affect'' the water quality of a neighboring jurisdiction, the EPA is required to notify that other jurisdiction. *Id.* If the neighboring jurisdiction determines that the discharge ''will affect'' the quality of its waters in violation of any water quality requirement of that jurisdiction, it may notify the EPA and the federal licensing or permitting agency of its objection to the license or permit. *Id.* It may also request a hearing on its objection with the federal licensing or permitting agency. At the hearing, the EPA will submit its evaluation and recommendations. The federal agency will consider the jurisdiction's and the EPA's recommendations, and any additional evidence presented at the hearing. The federal agency ''shall condition such license or permit in such manner as may be necessary to insure compliance with the applicable water quality requirements'' of the neighboring jurisdiction. *Id.* If the conditions cannot ensure compliance, the federal agency may not issue the license or permit.

The EPA also must provide technical assistance for section 401 certifications upon the request of any federal or state agency, or project proponent. *Id.* at 1341(b). Technical assistance might include provision of any relevant information on applicable effluent limitations, standards, regulations, requirements, or water quality criteria.

Finally, the EPA is responsible for developing regulations and guidance to ensure effective implementation of all CWA programs, including section 401. The EPA's current water quality certification regulations were promulgated in 1971,[13] prior to the 1972

[11] *See* 33 U.S.C. 1251(d), 1361(a); *Mayo Found. for Medical Educ. and Res.* v. *United States,* 562 U.S. 44, 45 (2011); *Hoopa Valley Tribe* v. *FERC,* 913 F.3d 1099, 1104 (D.C. Cir. 2019); *Alabama Rivers Alliance* v. *FERC,* 325 F.3d 290, 296–97 (D.C. Cir. 2003); *California Trout* v. *FERC,* 313 F.3d 1131, 1133 (9th Cir. 2002); *American Rivers, Inc.* v. *FERC,* 129 F. 3d 99, 107 (2d. Cir. 1997).

[12] The federal government may obtain exclusive federal jurisdiction over lands in multiple ways, including where the federal government purchases lands with state consent consistent with article 1, section 8, clause 17 of the U.S. Constitution, where a state chooses to cede jurisdiction to the federal government, and where the federal government reserved jurisdiction upon granting statehood. *See Collins* v. *Yosemite Park Co.,* 304 U.S. 518, 529–30 (1938); *James* v. *Dravo Contracting Co.,* 302 U.S. 134, 141–42 (1937); *Surplus Trading Company* v. *Cook,* 281 U.S. 647, 650–52 (1930); *Fort Leavenworth Railroad Company* v. *Lowe,* 114 U.S. 525, 527 (1895). Examples of lands of exclusive federal jurisdiction include Denali National Park.

[13] The EPA's existing water quality certification regulations are found at 40 CFR part 121, 36 FR 22487 (November 25, 1971). The EPA has also promulgated regulations addressing how 401 certification applies to the CWA section 402 NPDES program, found at 40 CFR 124.53, 124.54, 124.55; 48 FR 14264 (April 1, 1983). This proposed rule

Continued

amendments that enacted CWA section 401.

The EPA's 1971 regulations were designed to implement an earlier version of the certification requirement that was included in the pre-1972 version of the FWPCA. The legislative history reveals Congress added the certification requirement to ''recognize[] the responsibility of Federal agencies to protect water quality whenever their activities affect public waterways.'' S. Rep. No. 91–351, at 3 (1969). ''In the past, these [Federal] licenses and permits have been granted without any assurance that the [water quality] standards will be met or even considered.'' *Id.* As an example, the legislative history discusses the Atomic Energy Commission's failure to consider the impact of thermal pollution on receiving waters when evaluating ''site selection, construction, and design or operation of nuclear powerplants.'' *Id.*

Prior to 1972, the certification provision required states to certify that ''such *activity* will be conducted in a manner which will not violate applicable *water quality standards.*'' Public Law 91–224, § 21(b)(1), 84 Stat. 91 (1970) (emphasis added). As described above, the 1972 amendments restructured the CWA and created a framework for compliance with effluent limitations that would be established in discharge permits issued pursuant to the new federal permitting program.

The 1972 amendments retained the pre-existing water quality certification requirements but modified the requirements to be consistent with the overall restructuring of the CWA so that a water quality certification would assure that the ''*discharge will comply*'' with effluent limitations and other enumerated regulatory provisions of the Act, and with ''any other appropriate requirement'' of state or tribal law. 33 U.S.C. 1341(a), (d) (emphasis added). Because the EPA's existing certification regulations were promulgated prior to the 1972 CWA amendments, they contain language from the pre-1972 FWCPA that Congress changed in those amendments. In contrast to the language in CWA section 401, the EPA's existing certification regulations direct authorities to certify that there is ''*reasonable assurance* that *the activity* will be conducted in a manner which will not violate applicable water quality standards.'' 40 CFR 121.2(a)(2)–(3) (emphasis added). These outdated provisions have caused confusion for states, tribes, stakeholders, and courts reviewing section 401 certifications, and a primary goal for this proposal is to update and clarify the Agency's regulations to ensure that they are consistent with the CWA.

3. The EPA's Existing Certification Regulations

The EPA's existing certification regulations require certifying authorities to act on a certification request within a ''reasonable period of time.'' 40 CFR 121.16(b). The regulations provide that the federal licensing or permitting agency determines what constitutes a ''reasonable period,'' and that the period shall generally be six months but in any event shall not exceed one year. *Id.*

The existing certification regulations also provide that certifying authorities may waive the certification requirement under two circumstances: First, when the certifying authority sends written notification expressly waiving its authority to act on a request for certification; and second, when the federal licensing or permitting agency sends written notification to the EPA Regional Administrator that the certifying authority failed to act on a certification request within a reasonable period of time after receipt of such a request. *Id.* at 121.16(a)–(b). Once waiver occurs, certification is not required, and the federal license or permit may be issued. 33 U.S.C. 1341(a).

When the EPA is the certifying authority, the existing certification regulations at 40 CFR part 121 establish different requirements, including specific information to be included in a certification request and additional procedures. When the EPA is providing certification, the project proponent must submit to the EPA Regional Administrator the name and address of the project proponent, a description of the facility or activity and of any related discharge into waters of the United States, a description of the function and operation of wastewater treatment equipment, dates on which the activity and associated discharge will begin and end, and a description of the methods to be used to monitor the quality and characteristics of the discharge. 40 CFR 121.22. Once the request is submitted to the EPA, the Regional Administrator must provide public notice of the request and an opportunity to comment, specifically stating that ''all interested and affected parties will be given reasonable opportunity to present evidence and testimony at a public hearing on the question whether to grant or deny certification if the Regional Administrator determines that such a hearing is necessary or appropriate.'' *Id.* at 121.23. If, after consideration of relevant information, the Regional Administrator determines that there is ''reasonable assurance that the proposed activity will not result in a violation of applicable water quality standards,'' the Regional Administrator shall issue the certification.[14] *Id.* at 121.24.

The existing certification regulations identify a number of requirements that all certifying authorities must include in a section 401 certification. *Id.* at 121.2. For example, a section 401 certification shall include the name and address of the project proponent. *Id.* at 121.2(a)(2). The certification shall also include a statement that the certifying authority examined the application made by the project proponent to the federal licensing or permitting agency and bases its certification upon an evaluation of the application materials which are relevant to water quality considerations or that it examined other information sufficient to permit the certifying authority to make a statement that there is a ''reasonable assurance that the activity will be conducted in a manner which will not violate applicable water quality standards.'' *Id.* at 121.2(a)(2)–(3). The certification shall state ''any conditions which the certifying agency deems necessary or desirable with respect to the discharge of the activity,'' and other information the certifying authority deems appropriate.[15] *Id.* at 121.2(a)(4)–(5).

The existing certification regulations at 40 CFR part 121 also establish a process for the EPA to provide neighboring jurisdictions with an opportunity to comment on a certification that is similar to that provided in the modern CWA section 401(a)(2). Under the existing certification regulations, the Regional Administrator is required to review the federal license or permit application, the certification, and any supplemental information provided to the EPA by the federal licensing or permitting agency, and if the Regional Administrator determines there is ''reason to believe that a discharge may affect the quality of the waters of any State or States other than the State in which the discharge originates,'' the Regional Administrator is required to notify each affected state within thirty days of receipt of the application materials and certification. *Id.* at 121.13. If the documents provided are insufficient to make the

does not address the NPDES regulations, and the Agency will make any necessary conforming regulatory changes in a subsequent rulemaking.

[14] Use of the terms ''reasonable assurance'' and ''activity'' in this operative provision of the EPA's existing certification regulation is an artifact of the pre-1972 statutory language and those terms are not used in the operative provision of CWA section 401. *See* Public Law 91–224, 21(b)(1), 84 Stat. 91 (1970).

[15] The term ''desirable'' is also not used in CWA section 401.

determination, the Regional Administrator may request any supplemental information ''as may be required to make the determination.'' *Id.* at 121.12. In cases where the federal licensing or permitting agency holds a public hearing on the objection raised by a neighboring jurisdiction, notice of such objection shall be forwarded to the Regional Administrator by the licensing or permitting agency no later than 30 days prior to the hearing. *Id.* at 121.15. At the hearing the Regional Administrator shall submit an evaluation and ''recommendations as to whether and under what conditions the license or permit should be issued.'' *Id.* at 121.15.

The existing certification regulations establish that the Regional Administrator ''may, and upon request shall'' provide federal licensing and permitting agencies, certifying authorities, and project proponents with information regarding water quality standards, status of compliance by dischargers with the conditions and requirements of applicable water quality standards. *Id.* at 121.30.

Finally, the existing certification regulations establish an oversight role for the EPA when a certifying authority modifies a prior certification. The regulation provides for a certifying authority to modify its certification ''in such manner as may be agreed upon by the certifying agency, the licensing or permitting agency, and *the Regional Administrator.*'' *Id.* at 121.2(b) (emphasis added).

As noted throughout this preamble, the EPA's existing certification regulations were promulgated prior to the 1972 CWA amendments and they do not reflect the current statutory language in section 401. In addition, the EPA's existing certification regulations at 40 CFR part 121 do not address some important procedural and substantive components of section 401 certification review and action. This proposal is intended to modernize the EPA's regulations, align them with the current text and structure of the CWA, and provide additional regulatory procedures that the Agency believes will help promote consistent implementation of section 401 and streamline federal license and permit processes, consistent with the objectives of the Executive Order.

4. Judicial Interpretations of Section 401

During the 47 years since its passage, the federal courts on numerous occasions have interpreted key provisions of section 401. The United States Supreme Court has twice addressed questions related to the scope and triggering mechanism of section 401, and lower courts have also addressed certain elements of section 401 certifications. This section summarizes the U.S. Supreme Court decisions and major lower court decisions.

a. U.S. Supreme Court Decisions

i. P.U.D. No. 1 of Jefferson County

In 1994, the Supreme Court reviewed a water quality certification issued by the State of Washington for a new hydroelectric project on the Dosewallips River. *See PUD No. 1 of Jefferson County and City of Tacoma* v. *Washington Department of Ecology,* 511 U.S. 700 (1994) (*PUD No. 1*). This particular decision, though narrow in its holding, has been read by other courts as well as the EPA and some states and tribes to significantly broaden the scope of section 401 beyond its plain language meaning.

The principal dispute adjudicated in *PUD No. 1* was whether a state or tribe may require a minimum stream flow as a condition in a certification issued under section 401. In this case, the project proponent identified two potential discharges from its proposed hydroelectric facility: ''the release of dredged and fill material during construction of the project, and the discharge of water at the end of the tailrace after the water has been used to generate electricity.'' *Id* at 711. The project proponent argued that the minimum stream flow condition was unrelated to these discharges and therefore beyond the scope of the state's authority under section 401. *Id.*

The Court analyzed sections 401(a) and 401(d); specifically it analyzed the use of different terms in those sections of the statute to inform the scope of a section 401 certification. Section 401(a) requires the certifying authority to certify that the *discharge* from a proposed federally licensed or permitted project will comply with enumerated CWA provisions, and section 401(d) allows the certifying authority to include conditions to assure that the *applicant* will comply with enumerated CWA provisions and ''other appropriate state law requirements.'' The Court concluded that, consistent with the EPA's implementing regulations, section 401(d) ''is most reasonably read as authorizing additional conditions and limitations on the activity as a whole once the threshold condition, the existence of a discharge, is satisfied.'' [16] *Id.* at 712. The Court cited the EPA's certification regulations at 40 CFR 121.2(a)(3) with approval and quoted the EPA's guidance titled Wetlands and 401 Certification, and stated that ''EPA's conclusion that *activities*—not merely discharges—must comply with state water quality standards is a reasonable interpretation of § 401 and is entitled to deference.'' *Id.* (citing EPA, *Wetlands and 401 Certification* 23 (April 1989)).

The Court was careful to note that a state's authority to condition a certification ''is not unbounded'' and that states ''can only ensure that the project complies with 'any applicable effluent limitations and other limitations, under [33 U.S.C. 1311, 1312]' or certain other provisions of the Act, 'and with any other appropriate requirement of State Law.' '' *Id.* The Court concluded that ''state water quality standards adopted pursuant to § 303 are among the 'other limitations' with which a State may ensure compliance through the § 401 certification process'' and noted that its view ''is consistent with EPA's view of the statute,'' again citing the EPA's regulations and guidance. *Id.* at 713.

Although this decision has been interpreted by some to broadly expand state authority under section 401—beyond assessing water quality impacts from the discharge and allowing conditions beyond the enumerated CWA provisions—the Court did not stray from the bedrock principles that a section 401 certification must address water quality and that appropriate conditions include those necessary to assure compliance with the state's water quality standards. Indeed, referring to the section 401 language allowing certification conditions based on ''any other appropriate requirements of state law,'' the Court explicitly declined to speculate ''on what additional state laws, *if any,* might be incorporated by this language. But at a minimum, limitations imposed pursuant to state water quality standards adopted pursuant to § 303 are appropriate requirements of state law.'' *Id.* (emphasis added).

On the scope of section 401, the dissenting opinion would have declined to adopt the interpretation suggested by the EPA's regulations and guidance and instead analyzed the statutory section as a whole, attempting to harmonize sections 401(a) and (d). The dissent first noted that, if the Court's conclusion that states can impose conditions unrelated

[16] The Court apparently failed to identify or understand that the EPA's regulations were promulgated prior to the 1972 CWA amendments and that the exact provision the Court was analyzing contained outdated terminology, including the term ''activity'' from the pre-1972 versions of the Act.

to discharges is correct, ''Congress' careful focus on discharges in § 401(a)(1)—the provision that describes the scope and function of the certification process—was wasted effort,'' and that the Court's conclusion ''effectively eliminates the constraints of § 401(a)(1).'' *Id.* at 726. The dissent then ''easily reconciled'' the two provisions by concluding that, ''it is reasonable to infer that the conditions a State is permitted to impose on certification must relate to the very purpose the certification process is designed to serve. Thus, while section 401(d) permits a State to place conditions on a certification to ensure compliance of 'the applicant,' those conditions must still be related to discharges.'' *Id.* at 726–27. The dissent further noted that each of the CWA provisions enumerated in section 401 ''describes discharge-related limitations'' and therefore the plain language of section 401(d) supports the conclusion that certification conditions must address water quality concerns from the discharge, not the proposed activity as a whole. *Id.* at 727. Finally, the dissent applied the principle *ejusdem generis* in its analysis and concluded that because ''other appropriate requirements of state law'' is included in a list of more specific discharge-related CWA provisions, that the ''appropriate'' requirements are ''most reasonably construed to extend only to provisions that, like the other provisions in the list, impose discharge-related restrictions.'' *Id.* at 728.

The dissent also took issue with the Court's reliance, at least in part, on the EPA's regulations and its application of *Chevron* deference in this case without first identifying ambiguity in the statute and, where the government apparently did not seek deference on an interpretation of section 401(d). *Id.* The dissent noted that there was no EPA interpretation directly addressing the language in sections 401(a) and (d), and that the only existing EPA regulation that addresses conditions ''speaks exclusively in terms of limiting discharges.'' [17] *Id.* (citing 40 CFR 121.2(a)(4)).

The *PUD No. 1* decision addressed two other scope-related elements of section 401: Whether certification conditions may be designed to address impacts to designated uses, and whether conditions related to minimum stream flows are appropriate under section 401. First, the Court conducted a plain language analysis of the CWA and concluded that, ''under the literal terms of the statute, a project that does not comply with a designated use of the water does not comply with the applicable water quality standards.'' *Id.* at 715. This means a section 401 certification may appropriately include conditions to require compliance with designated uses, which pursuant to the CWA, are a component of a water quality standard. *Id.* Second, the Court acknowledged that the Federal Power Act (FPA) empowers FERC ''to issue licenses for projects 'necessary or convenient . . . for the development, transmission, and utilization of power across, along, from, or in any of the streams . . . over which Congress has jurisdiction,''' and that the FPA ''requires FERC to consider a project's effect on fish and wildlife.'' *Id.* at 722. Although the Court had previously rejected a state's minimum stream flow requirement that conflicted with a stream flow requirement in a FERC license, the Court found no similar conflict in this case because FERC had not yet issued the hydropower license. *Id.* Given the breadth of federal permits that CWA section 401 applies to, the Court declined to assert a broad limitation on stream flow conditions in certifications but concluded they may be appropriate if necessary to enforce a state's water quality standard, including designated uses. *Id.* at 723.

ii. S.D. Warren

In 2006, the Court revisited section 401 in connection with the State of Maine's water quality certification of FERC license renewals for five hydroelectric dams on the Presumpscot River. *S.D. Warren Co.* v. *Maine Board of Environmental Protection et al.,* 547 U.S. 370 (2006) (*S.D. Warren*). The issue presented in *S.D. Warren* was whether operation of a dam may result in a ''discharge'' into the waters of the United States, triggering the need for a section 401 certification, even if the discharge did not add any pollutants. The Court analyzed the use of different terms—''discharge'' and ''discharge of pollutants''—within the CWA, how those terms are defined and how they are used in CWA sections 401 and 402. The Court noted that section 402 expressly uses the term ''discharge of pollutants'' and requires permits for such discharges; and that section 401, by contrast, provides a tool for states to maintain water quality within their jurisdiction and uses the term ''discharge'' which is not independently defined in the Act.[18] Finding no specific definition of the term ''discharge'' in the statute, the Court turned to its common dictionary meaning: A ''flowing or issuing out'' and concluded that the term is ''presumably broader'' than ''discharge of a pollutant.'' *Id.* at 375–76.

The Court held that operating a dam ''does raise the potential for a discharge'' and, therefore, section 401 is triggered. *Id.* at 373. In so holding, the Court observed that, ''[t]he alteration of water quality as thus defined is a risk inherent in limiting river flow and releasing water through turbines,'' and such changes in a river ''fall within a State's legitimate legislative business, and the Clean Water Act provides for a system that respects the State's concerns.'' *Id.* at 385–86. The Court concluded by observing that ''[s]tate certifications under [section] 401 are essential in the scheme to preserve state authority to address the broad range of pollution.'' *Id.* at 386. This sentence when read in isolation could be interpreted as broadening the scope of section 401 to allow certifying authorities to consider potential environmental impacts from a proposed federally licensed or permitted project beyond water quality. However, the Court followed that sentence with a quote from Senator Muskie's floor statement during the enactment of section 401:

> No polluter will be able to hide behind a Federal license or permit as an excuse for a violation of *water quality standard[s].* No polluter will be able to make major investments in facilities under a Federal license or permit without providing assurance that the facility will comply with *water quality standards.* No State water pollution control agency will be confronted with a fait accompli by an industry that has built a plant without consideration of *water quality requirements.*

Id. (emphasis added). The Court then stated, ''These are the *very reasons* that Congress provided the States with

[17] The EPA's amicus brief filed in this case did not grapple with the language in 401(a) and (d) at all, but primarily argued that the proposed project had two distinct discharges (which were undisputed) and that ''both discharges could reasonably be said to cause a violation of the State's water quality standards,'' including the designated uses and antidegradation components. Brief for the United States as Amicus Curiae Supporting Affirmance, at 12 n. 2 (Dec. 1993) (''It is therefore unnecessary to determine in this case whether Congress intended by the use of the term ''applicant,'' rather than ''discharge'' in section 401(d) to grant States a broader power to condition certifications under Section 401(d) than to deny them under Section 401(a) and, if so, whether there are limitations on the States' authority to impose such conditions.'' The EPA's amicus brief also did not inform the Court that the Agency's implementing regulations included language from the prior version of the Act.

[18] The Court noted that the Act provides, that ''the term 'discharge' when used without qualification incudes a discharge of a pollutant, and a discharge of pollutants.'' 547 U.S. at 375 (quoting 33 U.S.C. 1362(16)).

power to enforce 'any other appropriate requirement of State law,' by imposing conditions on federal licenses for activities that may result in a discharge.'' *Id.* (emphasis added). Read in context, the Court's statement about a state's authority to address a ''broad range of pollution'' under section 401 does not suggest that an ''appropriate requirement of State law'' means anything other than water quality requirements or that a state's or tribe's action on a certification request can be focused on anything other than compliance with appropriate water quality requirements.

b. Circuit Court Decisions

Over the years, federal appellate courts have also addressed important aspects of section 401, including the timing for certifying authorities to act on a request and the scope of authority of federal agencies other than the EPA to make determinations on section 401 certifications. This section highlights a few of the most significant issues concerning section 401 and the most often cited decisions but does not cover the universe of lower federal court or state court case law. The Agency intends for this proposed rule, if finalized, to provide consistency and certainty where there may currently be conflicting or unclear but locally binding legal precedent.

Recent case law has provided insight concerning the timing and waiver provisions of section 401. In 2018, the Second Circuit addressed the question of when the statutory review clock begins. *N.Y. State Dep't of Envtl. Conservation* v. *FERC,* 884 F.3d 450, 455–56 (2d Cir. 2018). Considering Millennium Pipeline Company's certification request, the court disagreed with the State of New York and held that the statutory time limit is *not* triggered when a state determines that a request for certification is ''complete,'' but that the ''plain language of Section 401 outlines a bright-line rule regarding the beginning of review,'' and that the clock begins upon ''receipt of such request'' by the certifying authority. *Id.* Otherwise, the court noted that states could ''blur this bright-line into a subjective standard, dictating that applications are complete only when state agencies decide that they have all the information they need. The state agencies could thus theoretically request supplemental information indefinitely.'' *Id.* at 456.

The D.C. Circuit has also recently analyzed the statutory timeline for review of a certification and held that, consistent with the plain language of CWA section 401(a)(1), ''while a full year is the absolute maximum, [the statute] does not preclude a finding of waiver prior to the passage of a full year.'' *Hoopa Valley Tribe* v. *FERC,* 913 F.3d 1099, 1104 (D.C. Cir. 2019). The court also noted that the EPA—''the agency charged with administering the CWA''—has regulations that allow it to find that a state has waived certification of an NPDES permit application after only six months. *Id.*

In *Hoopa Valley Tribe,* the D.C. Circuit also held that ''the withdrawal-and-resubmission of water quality certification requests does not trigger new statutory periods of review.'' *Id.* at 1101. The court found that the project proponent and the certifying authorities (California and Oregon) had improperly entered into an agreement whereby the ''very same'' request for state certification of its relicensing application was automatically withdrawn-and resubmitted every year by operation of ''the same one-page letter,'' submitted to the states before the statute's one-year waiver deadline. *Id.* at 1104. The court observed that ''[d]etermining the effectiveness of such a withdrawal-and-resubmission scheme is an undemanding inquiry'' because the statute's text ''is clear'' that failure or refusal to act on a request for certification within a reasonable period of time, not to exceed one year, waives the state's ability to certify.[19] *Id.* at 1103. The court found that, pursuant to the unlawful withdrawal-and resubmission ''scheme,'' the states had not yet rendered a certification decision ''more than a decade'' after the initial request was submitted to the states. *Id.* at 1104. The court declined to ''resolve the legitimacy'' of an alternative arrangement whereby an applicant may actually submit a new request in place of the old one. *Id.* Nor did it determine ''how different a request must be to constitute a 'new request' such that it restarts the one-year clock.'' *Id.* On the facts before it, the court found that ''California's and Oregon's deliberate and contractual idleness'' defied the statute's one-year limitation and ''usurp[ed] FERC's control over whether and when a federal license will issue.'' *Id.*

Another important area of case law deals with the scope of authority and deference provided to federal agencies other than the EPA in addressing issues arising under section 401. Many other federal agencies, including FERC and the Corps, routinely issue licenses and permits that require section 401 certifications and are responsible for enforcing state certification conditions that are incorporated into federal licenses and permits. However, because the EPA has been charged by Congress with administering the CWA, some courts have concluded that those other federal agencies are not entitled to deference on their interpretations of section 401. *See Alabama Rivers Alliance* v. *FERC,* 325 F.3d 290, 296–97 (D.C. Cir. 2002); *California Trout, Inc.* v. *FERC,* 313 F.3d 1131, 1133–34 (9th Cir. 2002); *American Rivers, Inc.* v. *FERC,* 129 F.3d 99, 107 (2d. Cir. 1997). Other courts have concluded that FERC has an affirmative obligation to determine whether a certifying authority has complied with requirements related to a section 401 certification. *See City of Tacoma* v. *FERC,* 460 F.3d 53, 67–68 (D.C. Cir. 2006) (FERC had an obligation to ''obtain some minimal confirmation of such compliance.''); *see also Keating* v. *FERC,* 927 F.2d 616, 622–623, 625 (D.C. Cir. 1991) (while federal agency may not question propriety of state certification before license has issued, ''FERC must at least decide whether the state's assertion of revocation satisfies section 401(a)(3)'s predicate requirements.'').

In an important determination of procedural authorities, the Second Circuit affirmed that FERC—as the licensing agency—''may determine whether the proper state has issued the certification or whether a state has issued a certification within the prescribed period.'' *Am. Rivers, Inc.,* 129 F.3d at 110–111. This holding is consistent with and supported by the implied statutory authority of a federal agency to establish the ''reasonable period of time (which shall not exceed one year)'' in the first place. 33 U.S.C. 1341(a)(1).

Case law also highlights the potential enforcement challenges that federal agencies face with section 401 certification conditions included in federal licenses and permits. Federal agencies have been admonished not to ''second guess'' a state's water quality certification or its conditions, *see, e.g., City of Tacoma,* 460 F.3d at 67; *Am. Rivers Inc.,* 129 F.3d at 107; *U.S. Dept. of Interior* v. *FERC,* 952 F.2d 538, 548 (D.C. Cir. 1992) (''FERC may not alter or reject conditions imposed by the states through section 401 certificates.''), even where the federal agency has attempted to impose conditions that are more

[19] Two decisions from the Second Circuit Court of Appeals recently acknowledged that project proponents have withdrawn and resubmitted certification requests to extend the reasonable time period for a state to review. *See N.Y. State Dep't of Envtl. Conservation* v. *FERC,* 884 F.3d at 456; *Constitution Pipeline* v. *N.Y. State Dep't of Envtl. Conservation,* 868 F.3d 87, 94 (2d Cir. 2018). However, in neither case did the court consider the merits or opine on the legality of such an arrangement.

stringent than the state's condition. *See Sierra Club* v. *U.S. Army Corps of Engineers,* 909 F.3d 635, 648 (4th Cir. 2018) (''the plain language of the Clean Water Act does not authorize the Corps to replace a state condition with a meaningfully different alternative condition, even if the Corps reasonably determines that the alternative condition is more protective of water quality''); *see also Lake Carriers' Association* v. *EPA,* 652 F.3d 1, 6, 12 (D.C. Cir. 2011) (concluding that petitioners' request for additional notice and comment procedure on state certification conditions would have been futile because ''the petitioners have failed to establish that EPA can alter or reject state certification conditions. . . .'' But the court also observed, ''[n]otably, the petitioners never argued that the certifications failed to 'compl[y] with the terms of section 401,' . . . by overstepping traditional bounds of state authority to regulate interstate commerce'' (citing *City of Tacoma,* 460 F.3d at 67) and the court ''therefore need not consider whether EPA has authority to reject state conditions under such circumstances.'')). But in *Snoqualmie Indian Tribe* v. *FERC,* the Ninth Circuit upheld FERC's inclusion of minimum flow requirements greater than those specified in the State of Washington's certification as long as they ''do not conflict with or weaken the protections provided by the [State] certification.'' 545 F.3d 1207, 1219 (9th Cir. 2008). In that case, FERC had added license conditions increasing the minimum flows specified in the state's certification in order to ''produce a great amount of mist'' which it determined would ''augment the Tribe's religious experience,'' one of the water's designated uses. *Id.; see also* cases discussed at section III.F in this preamble affirming a role for federal agencies to confirm whether certifications comply with the requirements of section 401.

This proposal is intended to provide clarity to certifying authorities, federal agencies, and project proponents, as it addresses comprehensively and for the first time some competing case law and attempts to clarify the scope of conditions that may be included in a certification and the federal agencies' role in the certification process.

5. Administrative Law Principles

To understand the full context and legal basis for this proposal, it is useful to understand some key governing principles of administrative law. In general, administrative agencies can only exercise authority provided by Congress, and courts must enforce unambiguous terms that clearly express congressional intent. However, when Congress delegates authority to administrative agencies, it sometimes enacts ambiguous statutory provisions. To carry out their congressionally authorized missions, agencies, including the EPA, must often interpret ambiguous statutory terms. However, they must do so consistent with congressional intent. In *Chevron, U.S.A., Inc.* v. *Natural Resources Defense Council,* Inc., 467 U.S. 837 (1984) (*Chevron*), the Supreme Court concluded that courts have a limited role when reviewing agency interpretations of ambiguous statutory terms. In such cases, reviewing courts defer to an agency's interpretation of ambiguous terms if the agency's interpretation is reasonable. Under *Chevron,* federal agencies—not federal courts—are charged in the first instance with resolving statutory ambiguities to implement delegated authority from Congress.

The Supreme Court has described the *Chevron* analysis as a ''two-step'' process. *Encino Motorcars, LLC* v. *Navarro,* 136 S. Ct. 2117, 2124 (2016). At step one, the reviewing court determines whether Congress has ''directly spoken to the precise question at issue.'' *Chevron,* 467 U.S. at 842. If so, ''that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.'' *Id.* at 842–43. If the statute is silent or ambiguous, the reviewing court proceeds to the second step, where the court must defer to the agency's ''reasonable'' interpretation. *Id.* at 844.

Chevron deference relies on the straightforward principle that, ''when Congress grants an agency the authority to administer a statute by issuing regulations with the force of law, it presumes the agency will use that authority to resolve ambiguities in the statutory scheme.'' *Encino Motorcars,* 136 S. Ct. at 2125 (citing *Chevron,* 467 U.S. at 843–44). Indeed, courts have applied *Chevron* deference to an agency's statutory interpretation ''when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority.'' *Mayo Found. for Medical Educ. and Res.* v. *United States,* 562 U.S. 44, 45 (2011) (quoting *United States* v. *Mead Corp.,* 533 U.S. 218, 226–27 (2001)).

In *Chevron,* the Supreme Court reviewed the EPA's interpretation of statutory language from the Clean Air Act Amendments of 1977. Congress amended the Clean Air Act to impose requirements on states that had not achieved the national air quality standards promulgated by the EPA. States that had not attained the established air standards had to implement a permit program that would regulate ''new or modified major stationary sources'' of air pollution. Clean Air Act Amendments of 1977, Public Law 95–95, 91 Stat. 685 (1977). The EPA promulgated regulations defining a ''stationary source'' as the entire plant where pollutant-producing structures may be located. The EPA, therefore, treated numerous pollution-producing structures collectively as a single ''stationary source,'' even if those structures were part of the same larger facility or complex. *See* 40 CFR 51.18(j)(1)(i)–(ii) (1983). Under the EPA's regulation, a facility could modify or construct new pollution-emitting structures as long as the stationary source—the facility as a whole—did not increase its pollution emissions.

The Natural Resources Defense Council (NRDC) opposed the EPA's definition of ''stationary source'' and filed a challenge to the Agency's regulations. The D.C. Circuit agreed with the NRDC and set aside the EPA's regulations. The D.C. Circuit acknowledged that the Clean Air Act ''does not explicitly define what Congress envisioned as a 'stationary source,' to which the permit program . . . should apply'' and also concluded that Congress had not clearly addressed the issue in the legislative history. *NRDC* v. *Gorsuch,* 685 F.2d 718, 723 (D.C. Cir. 1982). Without clear text or intent from Congress, the D.C. Circuit looked to the purposes of the program to guide the court's interpretation. *Id.* at 726. According to the court, Congress sought to improve air quality when it amended the Clean Air Act, and the EPA's definition of ''stationary source'' merely promoted the maintenance of current air quality standards.

In a unanimous decision, the Supreme Court reversed, finding that the D.C. Circuit committed a ''basic legal error'' by adopting ''a static judicial definition of the term 'stationary source' when it had decided that Congress itself had not commanded that decision.'' *Chevron,* 467 U.S. at 842. The Court explained that it is not the judiciary's place to establish a controlling interpretation of a statute delegating authority to an agency, but, rather, it is the agency's job to ''fill any gap left, implicitly or explicitly, by Congress.'' *Id.* at 843. When Congress expressly delegates to an administrative agency the authority to interpret a statute through regulation, courts cannot substitute their own interpretation of the statute when the agency has provided a reasonable construction of the statute. *See id.* at 843–44.

During the rulemaking process, the EPA had explained that Congress had not fully addressed the definition of ''source'' in the amendments to the Clean Air Act or in the legislative history. *Id.* at 858. The Supreme Court agreed, concluding that ''the language of [the statute] simply does not compel any given interpretation of the term 'source.' '' *Id.* at 860. And the legislative history associated with the amendments was ''silent on the precise issue.'' *Id.* at 862.

In its proposed and final rulemaking, the EPA noted that adopting an individualized equipment definition of ''source'' could disincentivize the modernization of plants, if industry had to go through the permitting process to create changes. *Id.* at 858. The EPA believed that adopting a plant-wide definition of ''source'' could result in reduced pollution emissions. *Id.* Considering the Clean Air Act's competing objectives of permitting economic growth and reducing pollution emissions, the Supreme Court stated that ''the plantwide definition is fully consistent with one of those concerns—the allowance of reasonable economic growth—and, whether or not we believe it most effectively implements the other, we must recognize that the EPA has advanced a reasonable explanation for its conclusion that the regulations serve the environmental objectives as well.'' *Id.* at 863. The Court upheld the EPA's definition of the term ''stationary source,'' explaining that ''the Administrator's interpretation represents a reasonable accommodation of manifestly competing interests and is entitled to deference: The regulatory scheme is technical and complex, the agency considered the matter in a detailed and reasoned fashion, and the decision involves reconciling conflicting policies.'' *Id.* at 865.[20]

Even if a court has ruled on the interpretation of a statute, the ''court's prior judicial construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference *only if* the prior court decision holds that its construction follows from the unambiguous terms of the statute and thus leaves no room for agency discretion.'' *Nat'l Cable & Telecomm. Ass'n* v. *Brand X Internet Serv.,* 545 U.S. 967, 982 (2005) (emphasis added). Put another way, *Brand X* held that ''a court's choice of one reasonable reading of an ambiguous statute does not preclude an implementing agency from later adopting a different reasonable interpretation.'' *United States* v. *Eurodif S.A.,* 555 U.S. 305, 315 (2009). This principle stems from *Chevron* itself, which ''established a 'presumption that Congress, when it left ambiguity in a statute meant for implementation by an agency, understood that the ambiguity would be resolved, first and foremost, by the agency, and desired the agency (rather than the courts) to possess whatever degree of discretion the ambiguity allows.' '' *Brand X,* 545 U.S. at 982 (quoting *Smiley* v. *Citibank,* 517 U.S. 735, 740–41 (1996)). Indeed, even the ''initial agency interpretation is not instantly carved in stone.'' *Chevron,* 467 U.S. at 863.

In *Brand X,* the Federal Communications Commission (FCC or Commission) interpreted the scope of the Communications Act of 1934, which subjects providers of ''telecommunications service'' to mandatory common-carrier regulations. *Brand X,* 545 U.S. at 977–78. Brand X internet Services challenged the FCC's interpretation, and the Ninth Circuit concluded that the Commission could not permissibly construe the Communications Act the way that it did based on the Court's earlier precedent. *Id.* at 979–80. The Supreme Court granted certiorari and reversed. The Supreme Court upheld the FCC's interpretation of the Communications Act by applying *Chevron's* two-step analysis. The Court found that the relevant statutory provisions failed to unambiguously foreclose the Commission's interpretation, while other provisions were silent. The FCC had ''discretion to fill the consequent statutory gap,'' and its construction was reasonable. *Id.* at 997.

The entire ''point of *Chevron* is to leave the discretion provided by the ambiguities of a statute with the implementing agencies.'' *Id.* at 981 (quoting *Smiley,* 517 U.S. at 742). The Supreme Court emphasized that courts cannot override an agency's interpretation of an ambiguous statute based on judicial precedent. *Id.* at 982. Instead, as a ''better rule,'' a reviewing court only can rely on precedent that interprets a statute at ''*Chevron* step one.'' *Id.* ''Only a judicial precedent holding that the statute unambiguously forecloses the agency's interpretation, and therefore contains no gap for the agency to fill, displaces a conflicting agency construction.'' *Id.* at 982–83. A contrary rule produces anomalous results because the controlling interpretation would then turn on whether a court or the agency interprets the statutory provision first. *See id.* at 983. Congress delegated authority to agencies to interpret statutes and that authority ''does not depend on the order in which the judicial and administrative constructions occur.'' *Id.* Agencies have the authority to revise ''unwise judicial constructions of ambiguous statutes.'' *Id.*

6. Legal Construct for the Proposed Rule

As the preceding summary of the statutory, regulatory and judicial history demonstrates, the most challenging aspects of section 401 concern the scope of review and action on a certification request, and the amount of time available for a certifying authority to act. The Agency is proposing a regulation that would clarify these aspects and provide additional regulatory certainty for states, tribes, federal agencies, and project proponents. This subsection summarizes some of the core legal principles that inform this proposal, and the following section (section III) describes how the Agency is applying those legal principles to support the proposed regulation.

a. Scope of Certification

The EPA has for the first time conducted a holistic analysis of the text, structure, and history of CWA section 401. As a result of that analysis, the EPA proposes to interpret the scope of section 401 as protecting the quality of waters of the United States from point source discharges associated with federally licensed or permitted activities by requiring compliance with the CWA and EPA-approved state and tribal CWA regulatory program provisions.

Since at least 1973, the EPA has issued memoranda and guidance documents and filed briefs in various court cases addressing section 401. Only a handful of these documents address the scope of section 401, and they were not the product of a holistic examination of the statute or its legislative history and, as a result, included little explanation for the Agency's interpretations. For example, in 1989, the EPA issued a guidance document asserting that a section 401 certification could broadly address ''all of the potential effects of a proposed

[20] For other instructive applications of *Chevron's* interpretative principles, see *Entergy Corp.* v. *Riverkeeper, Inc.* 556 U.S. 208, 222–223 (2009) (statutory silence interpreted as ''nothing more than a refusal to tie the agency's hands''); *Zuni Pub. School Dist.* v. *Dep't of Edu.* 550 U.S. 81, 89–94 (2007) (court considered whether agency's interpretation was reasonable in light of the ''plain language of the statute'' as well as the statute's ''background and basic purposes''); *Healthkeepers, Inc.* v. *Richmond Ambulance Auth.,* 642 F.3d 466, 471 (4th Cir. 2011) (''statutory construction . . . is a holistic endeavor'').

activity on water quality—direct and indirect, short and long term, upstream and downstream, construction and operation. . . .'' EPA, *Wetlands and 401 Certification* 23 (April 1989). The EPA's only explanation for this assertion is a reference to section 401(a)(3), which provides that a certification for a construction permit may also be used for an operating permit that requires certification. The guidance does not provide any analysis to support its assertion that a certification could address all potential impacts from the ''proposed activity'' as opposed to the discharge. Several years later, the United States filed an amicus brief on behalf of the EPA in the *PUD No. 1* case. The EPA's brief asserted that petitioners were ''mistaken'' in their contention that the minimum flow condition is outside the scope of section 401 because it does not address a discharge, but the brief provided no analysis to support this position. The EPA's brief also did not offer an affirmative interpretation to harmonize the different language in sections 401(a) and 401(d). More than a decade later, the EPA's amicus brief in the *S.D. Warren* case simply adopted the Supreme Court's analysis in *PUD No. 1* that once section 401 is triggered by a discharge, a certification can broadly cover impacts from the entire activity. Finally, in 2010 the EPA issued its now-rescinded Interim Handbook which included a number of recommendations on scope, timing, and other issues, none of which were supported with robust analysis or interpretation of the Act.

This proposed rulemaking marks the first time that the EPA has undertaken a holistic review of the text of section 401 in the larger context of the structure and legislative history of the 1972 Act and earlier federal water protection statutes and the first time the Agency has subjected its analysis to public notice and comment. The proposed regulation is informed by this holistic review and presents a framework that EPA considers to be most consistent with congressional intent. The Agency solicits comments on whether the proposed approach appropriately captures the scope of authority for granting, conditioning, denying, and waiving a section 401 certification.

i. Water Quality

The EPA proposes to conclude that the scope of a section 401 review or action must be limited to considerations of water quality. The Congressional purpose of the CWA is to protect and maintain water quality, and there is no suggestion in either the plain language or structure of the statute that Congress envisioned section 401 to authorize action beyond that which is necessary to address water quality directly. Indeed, as described in greater detail above, the 1972 amendments to the CWA resulted in the enactment of a comprehensive scheme designed to prevent, reduce, and eliminate pollution in the nation's waters generally, and to regulate the discharge of pollutants into waters of the United States specifically.

The EPA is aware that certifying authorities may have previously interpreted the scope of section 401 in a way that resulted in the incorporation of non-water quality related considerations into their certification review process. For example, certifying authorities have included conditions not related directly to water quality in section 401 certifications, including requiring construction of biking and hiking trails, requiring one-time and recurring payments to state agencies for improvements or enhancements that are unrelated to the proposed federally licensed or permitted project, and creating public access for fishing along waters of the United States. Certifying authorities have also attempted to address all potential impacts from the operation or subsequent use of products generated by a proposed federally licensed or permitted project that may be identified in an environmental impact statement or environmental assessment, prepared pursuant to the NEPA or a state law equivalent. This includes, for example, consideration of impacts associated with air emissions and transportation effects.

The Agency proposes to conclude that expanding the scope of section 401 to include consideration of effects and the imposition of conditions unrelated to water quality would, at a minimum, invoke the outer limits of power Congress delegated under the CWA. There is nothing in the text of the statute or its legislative history that signals that Congress intended to impose federal regulations on anything more than water quality-related impacts to waters of the United States. Indeed, Congress knows how to craft statutes to require consideration of multi-media effects, *see* 42 U.S.C. 4321 *et seq.* (NEPA), and has enacted specific statutes addressing impacts to air (Clean Air Act), land (Resource Conservation and Recovery Act), wildlife (Endangered Species Act), and cultural resources (National Historic Preservation Act), by way of example.[21] Subsequent congressional action directly addressing a particular subject is relevant to determining whether a previously adopted statute reaches that subject matter. *See FDA* v. *Brown & Williamson Tobacco Corp.,* 529 U.S. 120, 155 (2000) (determining that ''actions by Congress over the past 35 years'' that addressed tobacco directly, when ''taken together,'' ''preclude[d] an interpretation'' that a previously adopted statute, the Food, Drug, and Cosmetic Act, ''grant[ed] the FDA jurisdiction to regulate tobacco products.'').

If Congress intended section 401 of the CWA to authorize consideration or the imposition of certification conditions based on air quality concerns, public access to waters, energy policy, or other multi-media or non-water quality impacts, it would have provided a clear statement to that effect. Neither the CWA nor section 401 contain any such clear statement. In fact, Congress specifically contemplated a broader policy direction in the 1972 amendments that would have authorized the EPA to address impacts to land, air and water through implementation of the CWA, but it was rejected.[22] Agencies must avoid interpretations of the statutes they implement to avoid pressing the envelope of constitutional validity absent a clear statement from Congress to do so. *See SWANCC,* 531 U.S. at 172–73; Rapanos, 547 U.S. at 738 (Scalia, J., plurality). That includes interpretations of the statute that would provide states, tribes and the EPA the ability to regulate interstate commerce beyond the four corners of the CWA. *See* discussion *supra* at section II.F.1 in this preamble. The Agency proposes to conclude that inclusion of the phrase ''other appropriate requirements of state law'' in section 401(d) lacks that clear direction from Congress.[23]

Pursuant to the plain language of section 401, when a state or authorized tribe (and in some cases, the EPA) issues

[21] *See, e.g.,* 42 U.S.C. 7401 *et seq.* (Clean Air Act); 42 U.S.C. 6901 *et seq.* (Resource Conservation and Recovery Act); 16 U.S.C. 1531 *et seq.* (Endangered Species Act); and 16 U.S.C. 470 *et seq.* (National Historic Preservation Act).

[22] As Congress drafted the 1972 CWA amendments, the House bill (H.R. 11896) included section 101(g) within its ''Declaration of Goals and Policy'' providing, ''(g) In the implementation of this Act, agencies responsible therefor shall consider all potential impacts relating to the water, *land, and air* to insure that other significant environmental degradation and damage to the health and welfare of man does not result.'' H.R. 11896, 92nd Cong. (1971). Section 101(g) of the House bill was ''eliminated'' at conference, and the Act was ultimately passed with no federal policy, goal or directive to address non-water quality impacts through the CWA. S. Rep. 92–1236, at 100 (1972) (Conf. Rep.).

[23] The Agency also proposes to conclude that the use of the term ''applicant'' in 401(d) creates ambiguity in the statute. See section II.F.6.a.ii in this preamble for discussion on the use of the term ''applicant'' in section 401(d).

a certification, it has determined that the discharge to waters of the United States from a proposed federally licensed or permitted activity will comply with applicable effluent limitations for new and existing sources (CWA sections 301, 302 and 306), water quality standards and implementation plans (section 303), toxic pretreatment effluent standards (section 307), and other ''appropriate requirements'' of state or tribal law. 33 U.S.C. 1341(a)(1), (d). The enumerated CWA provisions identify requirements to ensure that discharges of pollutants do not degrade water quality,[24] and specifically referenced throughout section 401 is the requirement to ensure compliance with ''applicable effluent limitations'' and ''water quality requirements,'' underscoring the focused intent of this provision on the protection of water quality from discharges.[25] *See* 33 U.S.C. 1341(a), (b), (d). The legislative history for the Act provides further support for the EPA's interpretation, as it frequently notes the focus of the section is on assuring compliance with water quality requirements and water quality standards and the elimination of any discharges of pollutants. *See e.g.,* S. Rep. No. 92–414, at 69 (1971).

The CWA does not define what is an ''appropriate requirement'' of state law that should be considered as part of a section 401 review, and the Agency acknowledges the need to respect the clear policy direction from Congress to recognize and preserve state authority over land and water resources within their borders. *See* 33 U.S.C. 1251(b). Indeed, the Agency must avoid interpretations of the CWA that infringe on traditional state land use planning authority. *See SWANCC,* 531 U.S. at 172–73; *Will,* 491 U.S. at 65. One potential interpretation of this clause in section 401(d) could be to authorize the imposition of conditions or veto authority over a federal license or permit based on non-water quality related impacts if those requirements are based on existing state law. But such an interpretation could authorize the EPA as a certifying authority to push the constitutional envelope of its delegated authority into regulatory arenas more appropriately reserved to the states, ''powers with which Congress does not readily interfere.'' *Gregory,* 501 U.S. at 461 (describing the ''plain statement rule'').

More importantly, the Agency does not believe that Congress intended the phrase ''any other appropriate requirements of State law'' to be read so broadly. Instead, the principle *ejusdem generis* helps to inform the appropriate interpretation of the text. Under this principle, where general words follow an enumeration of two or more things, they apply only to things of the same general kind or class specifically mentioned. *See Washington State Dept. of Social and Health Services* v. *Keffeler,* 537 U.S. 371, 383–85 (2003). Here, the general term ''appropriate requirement'' follows an enumeration of four specific sections of the CWA that are all focused on the protection of water quality from point source discharges to waters of the United States. Given the text, structure, purpose, and legislative history of the CWA and section 401, the EPA proposes to interpret ''appropriate requirements'' for section 401 certification review to include those provisions of state or tribal law that are EPA-approved CWA regulatory programs that control discharges, including provisions that are more stringent than federal law. *See* S. Rep. No. 92–414, at 69 (1971) (''In addition, this provision makes clear that any water quality requirements established under State law, more stringent than those requirements established under the Act, shall through certification become conditions on any Federal license or permit.''). In this respect, the EPA agrees with the logic of Justice Thomas's dissent in *PUD No. 1,* wherein he concludes that ''the general reference to 'appropriate' requirements of state law is most reasonably construed to extend only to provisions that, like other provisions in the list, impose discharge-related restrictions.'' *PUD No. 1,* 511 U.S. at 728 (Thomas, J., dissenting). The CWA provisions that regulate point source discharges to waters of the United States, and those discharge-related restrictions referenced in Justice Thomas's dissent, are the ''regulatory provisions of the CWA.'' When states or tribes enact CWA regulatory provisions as part of a state or tribal program, including those designed to implement the section 402 and 404 permit programs and those that are more stringent than federal requirements, those provisions require EPA approval before they become effective for CWA purposes. Because the EPA interprets ''appropriate requirements'' to mean the regulatory provisions of the CWA, it follows that those would necessarily be EPA-approved provisions. The EPA requests comment on whether this interpretation is a reasonable and appropriate reading of the statute and related legal authorities.

ii. Activity Versus Discharge

Based on the text, structure, and legislative history of the CWA, the EPA proposes to conclude that a certifying authority's review and action under section 401 must be limited to water quality impacts from the potential discharge associated with a proposed federally licensed or permitted project. Section 401(a) explicitly provides that the certifying authority, described as ''the State in which the *discharge* originates or will originate,'' must certify that ''any such *discharge* will comply with the applicable provisions of sections 301, 302, 303, 306 and 307 of this Act'' (emphasis added). The plain language of section 401(a) therefore directs authorities to certify that the discharge resulting from the proposed federally licensed or permitted project will comply with the CWA. Section 401(d) uses different language and allows the certifying authority to include conditions ''to assure that *any applicant*[26] for a Federal license or permit will comply'' (emphasis added) with applicable provisions of the CWA and other appropriate requirements of state or tribal law. The use of this different term in section 401(d) creates ambiguity and has been interpreted as broadening the scope of section 401(a) beyond consideration of water quality impacts from the ''discharge'' which triggers the certification requirement, to allow certification conditions that address water quality impacts from any aspect of the construction or operation of the activity as a whole. *See PUD No. 1,* 511 U.S. at 712.

[24] For example, section 306 defines the standard of performance for new sources of discharges as ''a standard for the control of the discharge of pollutants which reflects the greatest degree of effluent reduction which the Administrator determines to be achievable through application of best available demonstrated control technology, processes, operating methods, or other alternatives, including, where practicable, a standard permitting no discharge of pollutants.'' 33 U.S.C. 1316(a)(1). Section 303 notes that new or revised state water quality standards ''[s]hall be such as to protect the public health or welfare, enhance the quality of water and serve the purposes of this chapter.'' *Id.* at 1313(c)(2)(A).

[25] The term ''effluent limit'' is defined as, ''any restriction established by a State or the Administrator on quantities, rates, and concentrations of chemical, physical, biological, and other constituents which are discharged from point sources into navigable waters, the waters of the contiguous zone, or the ocean, including schedules of compliance[,]'' 33 U.S.C. 1362(11); and the CWA requires that ''water quality standards'' developed by states and tribes ''consist of the designated uses of the navigable waters involved and the water quality criteria for such waters based upon such uses.'' *Id.* at 1313(c)(2)(A).

[26] As a matter of practice, the Corps seeks state certification for ''its own discharges of dredged or fill material'', ''[a]lthough the Corps does not process and issue permits for its own activities.'' 33 CFR 336.1(a)(1).

The ordinary meaning of the word ''applicant'' is ''[o]ne who applies, as for a job or admission.'' *See Webster's II, New Riverside University Dictionary* (1994). In section 401(d), this term is used to describe the person or entity that applied for the federal license or permit that requires a certification. The use of this term in section 401(d) is consistent with the text of the CWA, which uses the term ''applicant'' throughout to describe an individual or entity that has applied for a grant, a permit, or some other authorization.[27] Importantly, the term is also used in section 401(a) to identify the person responsible for obtaining the certification: ''Any applicant for a Federal license or permit to conduct any activity including, but not limited to, the construction or operation of facilities, which may result in any discharge into the navigable waters, shall provide the licensing or permitting agency a certification from the State . . . .'' Broadly interpreting the use of ''applicant'' in section 401(d) to authorize certification conditions that are unrelated to the discharge would expand section 401 beyond the scope of federal regulatory authority integrated throughout the core regulatory provisions of the modern CWA—the ability to regulate discharges to waters of the United States. The Agency is not aware of any other instance that the term ''applicant'' (or permittee or owner or operator) as used in the CWA has been interpreted to significantly expand the jurisdictional scope or meaning of the statute and believes a better interpretation would be to align its meaning with its plain language roots.

The Agency therefore proposes to interpret the use of the term ''applicant'' in section 401(d), consistent with its use in section 401(a) and other areas of the CWA, as identifying the person or entity responsible for obtaining and complying with the certification and any associated conditions. Throughout the CWA, the term ''applicant'' is used to identify the person or entity responsible for compliance with the federal regulatory provisions of the CWA, all of which remain focused on controlling discharges of pollutants to waters of the United States.[28] The legislative history of section 401, discussed below, provides additional support for this interpretation.

Section 401 was updated as part of the 1972 CWA amendments to reflect the restructuring of the Act, as described in section II.F.1 in this preamble. Two important phrases were modified between the 1970 and the 1972 versions of section 401 that help inform what Congress intended with the 1972 amendments. First, the 1970 version provided that an authority must certify ''that such *activity* . . . will not violate water quality standards.'' Public Law 91–224 § 21(b)(1) (emphasis added). The 1972 version was modified to require an authority to certify ''that any such *discharge* shall comply with the applicable provisions of [the CWA].'' 33 U.S.C. 1341(a) (emphasis added). On its face, this modification makes the 1972 version of section 401 consistent with the overall framework of the amended statutory regime, which focuses on eliminating discharges and attaining water quality standards.

Second, the 1972 version included section 401(d) for the first time, which authorizes conditions to be imposed on a certification ''to assure that any applicant for a Federal license or permit will comply with any applicable effluent limitations and other limitations, under section 301 or 302 of this Act, standard of performance under section 306 of this Act, or prohibition, effluent standard, or pretreatment standard under section 307 of this Act, and with any other appropriate requirement of State law set forth in such certification . . . .''*Id.* at 1341(d). This new section also requires such conditions to be included in the federal license or permit.

Together, these provisions: Focus section 401 on discharges that may affect water quality; enumerate newly-created federal regulatory programs with which section 401 mandates compliance; and require that water-quality related certification conditions be included in federal licenses and permits and thereby become federally enforceable. The legislative history describing these changes supports a conclusion that they were made intentionally and with the purpose of making the new section 401 consistent with the new framework of the Act. Indeed, the 1971 Senate Report provides that section 401 was ''amended to assure consistency with the bill's changed emphasis from water quality standards to effluent limitations based on the elimination of any discharge of pollutants.'' S. Rep. No. 92–414, at 69 (1971).

The EPA previously analyzed the modifications made to section 401 between the 1970 and 1972 Acts. *See* Memorandum from Catherine A. Winer, Attorney, EPA Office of General Counsel, to David K. Sabock, North Carolina Department of Natural Resources (November 12, 1985).[29] In its analysis, the EPA characterized the legislative history quoted above as ''not very explicit,'' and characterized the new section 401 language as ''not altogether clear.'' *Id.* Based on this analysis, the EPA found at that time that ''the overall purpose of section 401 is clearly 'to assure that Federal licensing or permitting agencies cannot override water quality requirements' '' and that ''section 401 may reasonably be read as retaining its original scope, that is, allowing state certifications to address any water quality standard violation resulting from an activity for which a certification is required, whether or not the violation is directly caused by a 'discharge' in the narrow sense.'' *Id.* (citing S. Rep. No. 92–414, at 69 (1971)).

The EPA has now performed a holistic analysis of the text and structure of the CWA, the language of section 401, and the amendments made between 1970 and 1972. Based on this review, the EPA now proposes to adopt the reasonable interpretation that the 1972 version of section 401 made specific changes to ensure that *discharges* were controlled and in compliance with the modern CWA regulatory programs, and appropriate requirements of state law implementing the same. For the reasons noted above in section II.F.1 in this preamble, identifying and regulating discharges, as opposed to managing ambient water quality, promotes accountability and enforcement of the Act in a way that the 1970 and earlier versions did not. The EPA also observes that, had Congress intended the 1972 amendments to retain the original scope concerning the ''activity,'' it could have easily crafted section 401(d) to authorize certification conditions to assure that ''the activity'' would comply with the specified CWA provisions, but it did not. Instead Congress used the term ''applicant'' which, based upon its plain ordinary meaning, identifies the person seeking the certification and the related federal

[27] *See e.g.,* 33 U.S.C. 1311 (''An application for an alternative requirement under this subsection shall not stay the applicant's obligation to comply with the effluent limitation guideline or categorical pretreatment standard which is the subject of the application.''); *id.* at 1344 (''Not later than the fifteenth day after the date an applicant submits all the information required to complete an application for a permit under this subsection, the Secretary shall publish the notice required by this subsection.'')

[28] For example, section 404 provides that after an applicant requests a permit, the Corps ''may issue [a] permit[ ], after notice and opportunity for public hearings for the discharge of dredged or fill material into the navigable waters at specified disposal sites.'' 33 U.S.C. 1344(a).

[29] Available at *https://www.epa.gov/sites/production/files/2015-01/documents/standards-marinas-memo.pdf.*

license or permit. When Congress enacted the 1972 CWA amendments, it used the term ''discharge'' to frame the scope of the certification requirement under the Act. As a result, the Agency now considers a more natural interpretation of the 1972 amendments to be that Congress rejected the idea that the scope of a certifying authority's review or its conditions should be defined by the term ''activity.'' Congress specifically did not carry forward the term ''activity'' in the operative phrase in section 401(a) and did not incorporate it into the new provision authorizing certification conditions in section 401(d). Under basic canons of statutory construction, the EPA begins with the presumption that Congress chose its words intentionally. *See, e.g., Stone* v. *INS,* 514 U.S. 386, 397 (1995) (''When Congress acts to amend a statute, we presume it intends its amendment to have real and substantial effect.''). This is also consistent with the dissent in *PUD No. 1,* wherein Justice Thomas concluded that ''[i]t is reasonable to infer that the conditions a State is permitted to impose on certification must relate to the very purpose the certification process is designed to serve. Thus, while § 401(d) permits a State to place conditions on a certification to ensure compliance of the 'applicant'[,] those conditions must still be related to discharges.'' *PUD No. 1,* 511 U.S. at 726–27 (Thomas, J., dissenting). The EPA proposes to conclude that this interpretation is a reasonable and appropriate reading of the statute and related legal authorities and seeks public comment on this proposed interpretation.

As described in detail in section II.F.4.a.i in this preamble, the Supreme Court in *PUD No. 1* considered the scope of a state's authority to condition a section 401 certification and concluded that, once the 401(a) ''discharge to navigable water'' triggers the requirement for certification, section 401(d) authorizes a certifying authority to impose conditions on ''the applicant,'' meaning the activity as a whole and not just the discharge. In its discussion of the CWA, the Supreme Court relied on its own interpretation of the scope of section 401 and did not analyze section 401 at ''*Chevron* step one'' or rely on ''the unambiguous terms'' of the CWA to support its reading of section 401. *Brand X,* 545 U.S. at 982. Instead, the Court ''*reasonably read*'' section 401(d) ''as authorizing additional conditions and limitations on the activity as a whole once the threshold condition, the existence of a discharge, is satisfied.'' *PUD No. 1,* 511 U.S. at 712 (emphasis added).

To support what it considered to be a reasonable reading of section 401(d), the Court looked at the EPA's certification regulations at 40 CFR 121.2(a)(3) and related guidance at that time, but did not have before it the EPA's interpretation of how section 401(a) and 401(d) could be harmonized. *Id.* In fact, the Court either was not aware of or did not mention that the EPA regulations in place at that time predated the 1972 CWA amendments and therefore contained outdated terminology implementing what was functionally a different statute. As described above, the EPA's existing certification regulations are consistent with the text of the pre-1972 CWA, and they require a state to certify that the ''activity'' will comply with the Act. The 1972 CWA amendments changed this language to require a state to certify that the ''discharge'' will comply with the Act.

Based in part on what the EPA now recognizes was infirm footing, the Court found that ''EPA's conclusion that activities—not merely discharges—must comply with state water quality standards is a *reasonable interpretation* of § 401 and is entitled to deference.'' *Id.* (emphasis added). As amicus curiae, the federal government did not seek *Chevron* ''deference for the EPA's regulation in [the *PUD No. 1* case]'' or for EPA's interpretation of section 401. *Id.* at 729 (Thomas, J., dissenting). In fact, the EPA's amicus brief did not analyze or interpret the different language in sections 401(a) and 401(d) and instead asserted that it was unnecessary to harmonize the provisions to resolve the dispute. *See* Brief for the United States as Amicus Curiae Supporting Affirmance, at 12 n. 2. The EPA's amicus brief asked the Court to analyze the two undisputed discharges from the proposed federally licensed project and determine whether they would cause violations of the state's water quality standards.

Given the circumstances of the *PUD No. 1* litigation, and the fact that the Supreme Court did not analyze section 401 under *Chevron* Step 1 or rely on unambiguous terms in the CWA to support its own reasonable reading of the statute, *PUD No. 1* does not foreclose the Agency's proposed interpretation of section 401 in this document. *See Brand X,* 545 U.S. at 982–83. The Supreme Court's ''choice of one reasonable reading'' of section 401 does not prevent the EPA ''from later adopting a different reasonable interpretation.'' [30] *Eurodif S.A.,* 555 U.S. at 315. An agency may engage in ''a formal adjudication or notice-and-comment rulemaking'' to articulate its interpretation of an ambiguous statute. *Christensen* v. *Harris County,* 529 U.S. 576, 587 (2000). When it does, courts apply ''*Chevron*-style'' deference to the agency's interpretation. *Id.* That is exactly what the EPA is doing in this proposal. EPA has for the first time, holistically interpreted the text of section 401(a) and (d) to support this proposed update to the EPA's existing certification regulations while ensuring consistency with the plain language of the 1972 CWA. The Agency solicits comment on its proposed interpretation of the CWA and the prevailing case law as discussed above in section II.F.1 and II.F.4 in this preamble.

The Agency also solicits comment on an alternate interpretation of the text of section 401(d) suggested by language in the *PUD No. 1* majority opinion. At page 712, the Court observes that, ''[a]lthough 401(d) authorizes the State to place restrictions on the activity as a whole, that authority is not unbounded.'' (emphasis added). The Court does not define the precise limits of State authority under section 401(d). However, the Court goes on to say that ''[t]he State can only ensure that the project complies with 'any applicable effluent limitations and other limitations, under [33 U.S.C. 1311, 1312]' or certain other provisions of the Act, 'and with any other appropriate requirement of State law.' 33 U.S.C. 1341(d).'' In the previous discussion, we explained why the most reasonable interpretation of the ''bounds'' set by the statutory text is that it limits the imposition of effluent limitations, limitations, and other certification conditions to ''the discharge,'' and not ''the activity as a whole.'' However, EPA is also seeking comment on an alternate interpretation of the text that would allow imposition of effluent limitations and other similar conditions that address the water quality-related effects of ''the activity as a whole,'' and not just ''the discharge,'' provided such effluent limitations and other conditions are based on ''water quality requirements'' as defined in this proposal.

[30] The EPA is not proposing to modify or alter the Agency's longstanding interpretation of the Act that was confirmed by the Court in *PUD No. 1* that ''a water quality standard must 'consist of the designated uses of the navigable waters involved *and* the water quality criteria for such waters based upon such uses' '' and that ''a project that does not comply with the designated use of the water does not comply with the applicable water quality standards.'' 511 U.S. at 714–15 (emphasis in original).

iii. Discharges From Point Sources to Waters of the United States

Based on the text, structure and purpose of the Act, the history of the 1972 CWA amendments, and supporting case law, the EPA proposes to conclude that a certifying authority's review and action under section 401 is limited to water quality impacts to waters of the United States resulting from a potential *point source* discharge associated with a proposed federally licensed or permitted project. The text of section 401(a) clearly specifies that certification is required to ''conduct any activity . . . which may result in any discharge into the *navigable* waters'' (emphasis added). Prior interpretations extending section 401 applicability beyond such waters conflict with and would render meaningless the plain language of the statute. And although the statute does not define with specificity the meaning of the unqualified term *discharge,* interpreting section 401 to cover all discharges without qualification would undercut the bedrock structure of the CWA regulatory programs which are focused on addressing *point source* discharges to waters of the United States. CWA section 502(14) defines point source as ''any discernible, confined and discrete conveyance, including but not limited to any pipe, ditch, channel, tunnel, conduit, well, discrete fissure, container, rolling stock, concentrated animal feeding operation, or vessel or other floating craft, from which pollutants are or may be discharged.'' [31]

As described in section II.F.1 in this preamble, the CWA is structured such that the federal government provides assistance, technical support, and grant money to assist states in managing *all* of the nation's waters. By contrast, the federal regulatory provisions, including CWA sections 402 and 404, apply only to *point source* discharges to waters of the United States. 33 U.S.C. 1362(7). Section 401 is the first section of Title IV of the CWA, titled Permits and Licenses, and it requires water quality-related certification conditions to be legally binding and federally enforceable conditions of federal licenses and permits. *Id.* at 1341(d). Similar to the section 402 and 404 permit programs, section 401 is a core regulatory provision of the CWA. Accordingly, the scope of its application is most appropriately interpreted, consistent with the other federal regulatory programs, as addressing point source discharges to waters of the United States.

The EPA is not aware of any court decisions that have directly addressed the scope of waters covered by section 401; however, in *Oregon Natural Desert Association* v. *Dombeck,* the Ninth Circuit relied on the text and structure of section 401 to interpret the meaning of ''discharge.'' In that case, a citizen's organization challenged a decision by the U.S. Forest Service to issue a permit to graze cattle on federal lands without first obtaining a section 401 certification from the state of Oregon. 172 F.3d 1092. The government argued that a certification was not needed because the ''unqualified'' term ''discharge''—as used in CWA section 401—is ''limited to point sources but includes both polluting and nonpolluting releases.'' *Id.* at 1096. Finding that the 1972 amendments to the CWA ''overhauled the regulation of water quality,'' the court said that ''[d]irect federal regulation [under the CWA] now focuses on reducing the level of effluent that flows from point sources.'' *Id.* The court stated that the word ''discharge'' as used consistently in the CWA refers to the release of effluent from a point source. *Id.* at 1098. The court found that cattle—even if they wade in a stream—are not point sources. *Id.* at 1098–99. Accordingly, the court held that certification under section 401 was not required. *Id.* at 1099.

The EPA previously suggested that the scope of section 401 may extend to non-point discharges to non-waters of the United States once the requirement for the section 401 certification is triggered. Specifically, in the EPA's now-withdrawn 2010 Interim Handbook the Agency included the following paragraphs,

> The scope of waters of the U.S. protected under the CWA includes traditionally navigable waters and also extends to include territorial seas, tributaries to navigable waters, adjacent wetlands, and other waters. Since § 401 certification only applies where there may be a discharge into waters of the U.S., how states or tribes designate their own waters does not determine whether § 401 certification is required. Note, however, that once § 401 has been triggered due to a potential discharge into a water of the U.S., additional waters may become a consideration in the certification decision if it is an aquatic resource addressed by ''other appropriate provisions of state [or tribal] law.''
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> Section 401 applies to any federal permit or license for an activity that may discharge into a water of the U.S. The Ninth Circuit Court of Appeals ruled that the discharge must be from a point source, and agencies in other jurisdictions have generally adopted the requirement. Once these thresholds are met, the scope of analysis and potential conditions can be quite broad. As the U.S. Supreme Court has held, once § 401 is triggered, the certifying state or tribe may consider and impose conditions on the project activity in general, and not merely on the discharge, if necessary to assure compliance with the CWA and with any other appropriate requirement of state or tribal law.

EPA, *Clean Water Act Section 401 Water Quality Certification: A Water Quality Protection Tool for States and Tribes,* 5, 26 (2010) (citations omitted). To support the first referenced paragraph on the scope of waters, the Interim Handbook cited to section 401(d), presumably referring to the use of the term ''applicant'' rather than ''discharge'' used in section 401(a).[32] To support the second paragraph on the scope of discharges, the Interim Handbook cited to the *PUD No. 1* and *S.D. Warren Co.* Supreme Court decisions. It appears that both paragraphs from the Agency's 2010 Interim Handbook relied on the *PUD No. 1* Court's interpretation of the ambiguity created by the different language in sections 401(a) and 401(d).[33]

For many of the same reasons that the Agency proposes to avoid interpreting the word ''applicant'' in section 401(d) as broadening the scope of certification beyond the discharge itself, the Agency also proposes to decline to interpret section 401(d) as broadening the scope of waters and the types of discharges to which the CWA federal regulatory programs apply. Were the Agency to interpret the use in section 401(d) of the term ''applicant'' instead of the term ''discharge'' as authorizing the federal government to implement and enforce CWA conditions on non-waters of the United States, that single word (''applicant'') would effectively broaden the scope of the federal regulatory programs enacted by the 1972 CWA

[31] In the section 404 context, point source includes bulldozers, mechanized land clearing equipment, dredging equipment, and the like. *See, e.g., Avoyelles Sportsman's League, Inc.* v. *March,* 715 F.2d 897, 922 (5th Cir. 1983).

[32] Interim Handbook, at 5 n. 23. Tellingly, footnote 23 of the Interim Handbook also states, ''Note that the Corps may consider a 401 certification as administratively denied where the certification contains conditions that require the Corps to take an action outside its statutory authority or are otherwise unacceptable. *See, e.g.,* RGL 92–04, 'Section 401 Water Quality Certification and Coastal Zone Management Act Conditions for Nationwide Permits.'' In other words, in this footnote the EPA was advising states that, while section 401(d) could perhaps be interpreted to expand the scope of federal regulatory and enforcement authority beyond navigable waters (but without citation to any case law to support that proposition), the Army Corps of Engineers may reject a certification in its entirety that is outside the statutory authority provided by the CWA.

[33] The *S.D. Warren* decision did not analyze or adopt the *PUD No. 1* Court's analysis of section 401(a) and 401(d).

amendments beyond the limits that Congress intended. Such an interpretation could permit the application of the CWA's regulatory programs, including section 401 certification conditions that are enforced by federal agencies, to land and water resources more appropriately subject to traditional state land use planning authority. *See, e.g., SWANCC,* 531 U.S. at 172–73.

As described in section II.F.4.a.i in this preamble and pursuant to its authority to reasonably interpret ambiguous statutes to fill gaps left by Congress, the EPA is proposing to interpret section 401 differently than the Supreme Court did in *PUD No. 1.* The Court's prior interpretation of sections 401(a) and 401(d) was not based on the plain unambiguous text of the statute, but rather was based on the Court's own reasonable interpretation (see section II.F.4.a.i in this preamble). The EPA's proposed interpretation is also based on a reasonable interpretation of the text, structure and legislative history of section 401 and the Agency's current proposal is not foreclosed by the Court's prior interpretation. *See Brand X,* 545 U.S. at 982.

For the reasons above, the EPA proposes to conclude that section 401 is a regulatory provision that creates federally enforceable requirements and its application must therefore be limited to point source discharges to waters of the United States. This proposed interpretation is consistent with the text and structure of the CWA as well as the principal purpose of this rulemaking, *i.e.,* to ensure that the EPA's regulations (including those defining a section 401 certification's scope) are consistent with the current CWA. The Agency solicits comment on this revised interpretation of the CWA and associated case law discussed in this section.

b. Timeline for Section 401 Certification Analysis

Based on the language of the CWA and relevant case law, the EPA proposes to conclude that a certifying authority must act on a section 401 certification within a reasonable period of time, which shall not exceed one year and that there is no tolling provision to stop the clock at any time. The Agency requests comment on this plain language interpretation of the statute.

The text of section 401 expressly states that a certifying authority must act on a section 401 certification request within a reasonable period of time, which shall not exceed one year. 33 U.S.C. 1341(a)(1). Importantly, the CWA does not guarantee that a certifying authority may take a full year to act on a section 401 certification request. The certifying authority may be subject to a shorter period of time, provided it is reasonable. *See Hoopa Valley Tribe* v. *FERC,* 913 F.3d 1099, 1104 (D.C. Cir. 2019) (''Thus, while a full year is the absolute maximum, it does not preclude a finding of waiver prior to the passage of a full year. Indeed, the [EPA]—the agency charged with administering the CWA—generally finds a state's waiver after only six months. *See* 40 CFR 121.16.''). The CWA's legislative history indicates that inclusion of a maximum period of time was to ''insure that sheer inactivity by the [certifying agency] will not frustrate the Federal application.'' H.R. Rep. No. 92–911, at 122 (1972).

The timeline for action on a section 401 certification begins upon receipt of a certification request. *Id.* The CWA does not specify any legal requirements for what constitutes a request or otherwise define the term. The EPA has long recommended that a project proponent requiring federal licenses or permits subject to section 401 certification hold early discussions with both the certifying authority and the federal agency, to better understand the certification process and potential data needs.

The CWA does not contain provisions for pausing or delaying the timeline for any reason, including to request or receive additional information from a project proponent. If the certifying authority has not acted on a request for certification within the reasonable time period, the certification requirement will be waived by the federal licensing and permitting agencies. For further discussion, see section III.F in this preamble. The proposed revisions to the EPA's regulations in this proposal are intended to provide greater clarity and certainty and address some of the delays and confusion associated with the timing elements of the section 401 certification process.

III. Proposed Rule

This proposed rule is intended to make the Agency's regulations consistent with the current text of CWA section 401, increase efficiencies, and clarify aspects of CWA section 401 that have been unclear or subject to differing legal interpretations in the past. The Agency proposes these revisions to replace the entirety of the existing certification regulations at 40 CFR part 121. The following sections explain the Agency's rationale for the proposed rule and provides detailed explanation and analysis for the substantive changes that the Agency is proposing.

The EPA's existing certification regulations were issued almost 50 years ago in 1971, when the Agency was newly formed and the CWA had not yet been amended to include the material revisions to section 401.[34] In modernizing 40 CFR part 121, this proposal recognizes and responds to the changes to the CWA that occurred after the current regulations were finalized, especially the 1972 and 1977 amendments to the CWA.

Updating the existing certification regulations to clarify expectations, timelines, and deliverables also increases efficiencies. Some aspects of the existing regulations have been implemented differently by different authorities, likely because the scope and timing of review are not clearly addressed by the EPA's existing certification regulations. While the EPA recognizes that states and tribes have broad authority to implement state and tribal law to protect their water quality, *see* 33 U.S.C. 1251(b), section 401 is a federal regulatory program that contains explicit limitations on when and how states and tribes may exercise this particular authority. Modernizing and clarifying the EPA's regulations will help states, tribes, federal agencies, and project proponents know what is required and what to expect during a section 401 certification process, thereby reducing regulatory uncertainty. The Agency requests comment on all aspects of this effort to modernize and clarify its section 401 regulations, including any specific suggestions on how any of the proposed definitions or other requirements might be modified to implement Congress' intent in enacting section 401.

The EPA's existing certification regulations at 40 CFR part 121 do not fully address the public notice requirements called for under CWA 1341(a)(1). The EPA solicits comment on whether the Agency should include additional procedures in its final regulations to ensure that the public is appropriately informed of proposed federally licensed or permitted projects, potential discharges, and related water quality effects. At a minimum, such procedures could include public notice and hearing opportunities, but they could also include mechanisms to ensure that the certifying authority is in a position to appropriately inform the public, as required by section 401(a)(1). Such mechanisms could focus on how and when the certifying authority is notified of potential certification requests and what information may be

[34] *See* 36 FR 22487, Nov. 25, 1971, redesignated at 37 FR 21441, Oct. 11, 1972, further redesignated at 44 FR 32899, June 7, 1979; Reorganization Plan No. 3 of 1970 (creating the EPA), 84 Stat. 2086, effective Dec. 2, 1970.

necessary for the certifying authority to act on a request. If the EPA were to include such additional procedures in its final regulations, they could be the same as or similar to the procedures currently proposed to apply when EPA is the certifying authority (see proposed sections 121.12 and 121.13). The Agency also solicits comment on whether it would be appropriate or necessary to require certifying authorities to submit their section 401 procedures and regulations to the EPA for informational purposes.

A. When Section 401 Certification is Required

The EPA proposes that the requirement for a section 401 certification is triggered based on the potential for any federally licensed or permitted activity to result in a discharge from a point source into waters of the United States.[35] This proposal is consistent with the Agency's longstanding interpretation and is not intended to alter the scope of applicability established in the CWA. Consistent with section 401(a)(1), the EPA is proposing that:

> Any applicant for a license or permit to conduct any activity which may result in a discharge shall provide the Federal agency a certification from the certifying authority in accordance with this part.

Based on the text of the statute, the EPA proposes that section 401 is triggered by the potential for a discharge to occur, rather than an actual discharge. This is different from other parts of the Act[36] and is intended to provide certifying authorities with a broad opportunity to review proposed federally licensed or permitted projects that may result in a discharge to waters of the United States within their borders. This proposal does not identify a process for certifying authorities or project proponents to determine whether a federally licensed or permitted project has a potential or actual discharge. However, the EPA observes that if a certifying authority or project proponent determines after the certification process is triggered that there is no actual discharge from the proposed federally licensed or permitted project and no potential for a discharge, there is no longer a need to request certification. The EPA requests certifying authorities and project proponents to submit comment on prior experiences with undertaking the certification process and later determining that the proposed federally licensed or permitted project would not result in an actual discharge. The EPA also requests comment on whether there are specific procedures that could be helpful in determining whether a proposed federally licensed or permitted project will result in an actual discharge. Finally, the EPA requests comment on how project proponents may establish for regulatory purposes that there is no potential discharge and therefore no requirement to pursue a section 401 certification. This request is intended to solicit mechanisms for project proponents to generate a record for themselves that no 401 certification was required; this is not intended to propose a process for project proponents to seek or require concurrence from the certifying authority.

The EPA also proposes that section 401 is triggered by a potential discharge into a water of the United States. 33 U.S.C. 1341(a)(1), 1362(7). Potential discharges into state or tribal waters that are not waters of the United States do not trigger the requirement to obtain section 401 certification. *Id.* at 1342(a)(1). This interpretation flows from the plain text of the statute, is supported by the legislative history, and is consistent with other CWA regulatory program requirements that are triggered by discharges into waters of the United States, not state or tribal waters. *Id.; see also* H.R. Rep. No. 92–911, at 124 (1972) (''It should be clearly noted that the certifications required by section 401 are for activities which may result in any discharge into *navigable waters.*'') (emphasis added); *see also* section II.F.6.a.iii for discussion on discharges to waters of the United States.

Unlike other CWA regulatory programs, however, the EPA proposes that section 401 be triggered by any unqualified discharge, rather than by a discharge of pollutants. This interpretation is consistent with the text of the statute and with U.S. Supreme Court precedent. In *S.D. Warren,* the Court considered whether discharges from a dam were sufficient to trigger section 401, even if those discharges did not add pollutants to waters of the United States. Because section 401 uses the term *discharge* but the Act does not specifically define the term,[37] the Court applied its ordinary dictionary meaning, ''flowing or issuing out.'' *S.D. Warren Co.* v. *Maine Bd. of Envtl. Prot. et al.,* 547 U.S. 370, 376 (2006). The Court concluded that Congress intended this term to be broader than the term *discharge of pollutants* that is used in other provisions of the Act, like section 402. *See e.g.,* 33 U.S.C. 1342, 1344; *S.D. Warren Co.,* 547 U.S. at 380–81. For further discussion on *S.D. Warren* see section II.F.4.a.ii and for further discussion on discharges see section II.F.6.a.ii–iii in this preamble. The Court held that discharges from the dam trigger section 401 because ''reading § 401 to give 'discharge' its common and ordinary meaning preserves the state authority apparently intended.'' *S.D. Warren Co.,* 547 U.S. at 387. The EPA's interpretation in support of this proposal is therefore consistent with the Court's conclusion.

Finally, the EPA proposes that to trigger section 401, a discharge must be from a point source. This is consistent with case law from the Ninth Circuit, which concluded that the word ''discharge'' as used consistently throughout the CWA refers to the release of effluent from a point source, and that use is also appropriate for section 401. *Oregon Natural Desert Association* v. *Dombeck, 172 F.3d 1092, 1099.* Because this proposed interpretation is consistent with the structure of the Act and with the other CWA regulatory programs (see section II.F above), the EPA adopted the Ninth Circuit's interpretation and has consistently implemented that interpretation of section 401.[38]

The CWA does not list specific federal licenses and permits that are subject to section 401 certification requirements, instead providing that section 401 applies when *any activity that requires a federal license or permit* may result in a discharge into waters of the United States. The most common examples of licenses or permits that may be subject to section 401 certification are CWA section 402 NPDES permits in states where the EPA administers the permitting program, CWA section 404

[35] State or tribal implementation of a license or permit program in lieu of the federal program, such as a CWA section 402 permit issued by an authorized state, does not federalize the resulting permits or licenses and therefore does not trigger section 401 certification. This is supported by the legislative history of CWA section 401 which noted that ''since permits granted by States under section 402 are not Federal permits—but State permits—the certification procedures are not applicable.'' H.R. Rep. No. 92–911, at 127 (1972). The legislative history of the CWA amendments of 1977, discussing state assumption of section 404, also noted that ''[t]he conferees wish to emphasize that such a State program is one which is established under State law and which functions in lieu of the Federal program. It is not a delegation of Federal authority.'' H.R. Rep. No. 95–830, at 104 (1977).

[36] *See e.g., National Pork Producers Council* v. *EPA,* 635 F.3d 738, 751 (5th Cir. 2011); *Waterkeeper Alliance, Inc.* v. *EPA,* 399 F.3d 486, 505 (2d Cir. 2005) (Interpreting section 402 in the context of CAFOs, courts said the CWA gives EPA jurisdiction to require permits for only actual discharges).

[37] The Act provides, ''The term 'discharge' when used without qualification includes a discharge of a pollutant, and a discharge of pollutants.'' 33 U.S.C. 1362(16)

[38] *See, e.g., Briefs of the United States in ONDA* v. *Dombeck,* Nos. 97–3506, 97–35112, 97–35115 (9th Cir. 1997) and *ONDA* v. *USFS,* No. 08–35205 (9th Cir. 2008).

permits for the discharge of dredged or fill material, RHA sections 9 and 10 permits issued by the Corps, and hydropower and interstate natural gas pipeline licenses issued by FERC. The Agency is not proposing to further define this list but requests comment identifying other federal licenses or permits that may trigger the section 401 certification requirement.

B. Certification Request/Receipt

Under this proposal, to initiate an action under section 401, a project proponent must submit a certification request to a certifying authority. The statute limits the time for a certifying authority to act on a request as follows:

> If the State, interstate agency, or Administrator, as the case may be, fails or refuses to act on a *request for certification,* within a reasonable period of time (which shall not exceed one year) after *receipt* of such request, the certification requirements of this subsection shall be waived with respect to such Federal application.

33 U.S.C. 1341(a)(1) (emphasis added). Although the plain language of the Act requires the reasonable period of time to begin upon receipt of a certification request, the statute does not define those terms. Because they are not defined and their precise meaning is ambiguous, these terms are susceptible to different interpretations, which have resulted in inefficiencies in the certification process, individual certification decisions that have extended beyond the statutory reasonable period of time, and regulatory uncertainty and litigation. See section II.F in this preamble. Given the number of certification requests submitted each year [39] and the statutory requirement that those requests be acted on within a reasonable period of time not to exceed one year, it is important that the certifying authorities, project proponents, and federal agencies have a clear understanding of what the terms ''request'' and ''receipt'' mean.

The CWA does not address (and therefore is ambiguous regarding) whether a certification request must be in writing, must be signed and dated, or if it must contain specific kinds of information. The EPA's prior section 401 guidance (the now-withdrawn 2010 Interim Handbook) indicated that the timeline for action begins upon receipt of a ''complete application,'' as determined by the certifying authority, even though section 401 does not use the term ''complete application'' or prescribe what an ''application'' would require. The reference by the EPA to a ''complete application'' without explaining what an ''application'' must include has led to subjective determinations about the sufficiency of certification request submittals. This in turn has caused uncertainty about when the statutory reasonable period of time begins to run. Certification request requirements vary from state to state (*e.g.,* location maps and topographical maps versus latitude/longitude or GPS locations). For example, some states have open-ended and broad submittal requirements (*e.g.,* ''all information concerning water resource impacts'') which create the potential for certifying authorities to conclude (sometimes repeatedly) that a submittal is incomplete. Additionally, if a certifying authority requires additional information to be submitted before it will review and act on a certification request, it may be unclear whether the certifying authority considers the request to be ''complete'' and whether the statutory clock has started to run. Further, differences in the contents of a request or required supporting materials can create special challenges for project proponents and federal agencies working on large interstate projects that require certification from multiple states.

The CWA also does not define the term ''receipt,'' which has led to different states, tribes, and project proponents, as well as different courts, using different definitions. ''Receipt of the request'' has been used alternately to mean receipt by the certifying authority of the request in whatever form it was submitted by the project proponent, or receipt of a ''complete application'' as determined by the certifying authority (see section II.F in this preamble). The statute also does not specify how requests are to be ''received'' by the certifying authority—whether by mail, by electronic submission, or some other means.

As the Agency charged with administering the CWA, the EPA is authorized to interpret through rulemaking undefined terms, including those associated with CWA section 401 certifications. *See Chevron, U.S.A., Inc.* v. *Natural Resources Defense Council,* Inc., 467 U.S. 837, 844 (1984). To address the particular challenges identified above, the EPA is proposing to define ''certification request'' and ''receipt,'' which Congress left undefined and ambiguous. By establishing uniform definitions for ''certification request'' and ''receipt,'' EPA hopes to eliminate confusion about when the statutory reasonable period of time begins and ends. *See id.* at 843.

Consistent with the text of the CWA, the EPA is proposing that the statutory timeline for certification review starts upon receipt by the certifying authority of a ''certification request,'' rather than the receipt of a ''complete application'' or ''complete request'' as determined by the certifying authority. To increase consistency, the EPA's proposed definition of ''certification request'' includes an enumerated list of documents and information that must be included in a certification request:

> *Certification request* means a written, signed, and dated communication from a project proponent to the appropriate certifying authority that:
> 1. Identifies the project proponent(s) and a point of contact;
> 2. identifies the proposed project;
> 3. identifies the applicable federal license or permit;
> 4. identifies the location and type of any discharge that may result from the proposed project and the location of receiving waters;
> 5. includes a description of any methods and means proposed to monitor the discharge and the equipment or measures planned to treat or control the discharge;
> 6. includes a list of all other federal, interstate, tribal, state, territorial, or local agency authorizations required for the proposed project, including all approvals or denials already received; and
> 7. contains the following statement: '*The project proponent hereby requests that the certifying authority review and take action on this CWA section 401 certification request within the applicable reasonable timeframe.*'

The EPA anticipates that a certification request that contains each of these components will provide the certifying authority with sufficient notice and information to allow it to begin to evaluate and act on the request in a timely manner. The EPA solicits comment on whether this list of documents and information is appropriately inclusive, whether it is specific enough to inform project proponents of the submittal requirements, and whether it is clear enough to avoid subjective determinations by a certifying authority of whether submittal requirements have been satisfied. The EPA acknowledges that not all proposed projects may be subject to monitoring or treatment for a discharge (*e.g.,* section 404 dredge or fill permits rarely allow for a treatment option). The EPA solicits comment on whether the fourth and fifth items proposed to be required in a certification request are sufficiently broad to capture all potential federal licenses or permits. The EPA also acknowledges that some certifying authorities may charge a fee to process certification requests. The Agency solicits comment on whether it should

[39] *See* Economic Analysis for the Proposed Clean Water Act Section 401 Rulemaking at XX.

include ''any applicable fees'' in the definition of certification request. Pre-proposal recommendations to the EPA also requested that the Agency require project proponents to include existing documentation or reports showing prior contamination at the proposed federally licensed or permitted project site. The EPA solicits comment on whether this would be an appropriate requirement for all certification requests, or whether this information is best requested on a case-by-case basis by the certifying authority. Additionally, the EPA solicits comment on whether such documentation or reports would be appropriate if the permit or license is being reissued or amended, or only for initial license or permit processes.

The EPA intends that the term ''*certification request*'' means only written requests for certification. In addition, EPA intends that any written request for certification include the specific information identified in the definition. Providing this new definition is intended to ensure that the certifying authority and the project proponent understand what is required to start the statutory reasonable time period. The proposed requirement that a request include the following statement—''*The project proponent hereby requests that the certifying authority review and take action on this CWA section 401 certification request within the applicable reasonable timeframe.*''—is intended to remove any potential ambiguity on the part of the certifying authority about whether the written request before it is, in fact, a ''request for certification'' that triggers the statutory timeline. The EPA also solicits comment on whether the Agency should generate a standard form that all project proponents can use to submit certification requests. A standard form could help project proponents provide all necessary information and help certifying authorities quickly identify all components of the certification request. If the EPA promulgated a standard form, it could include all seven items included in the proposed definition of certification request.

This proposal requires a project proponent to identify the location of a discharge in the certification request. To meet this requirement, the EPA recommends that the project proponent provide locational information about the extent of the project footprint and discharge locations, as shown on design drawings and plans. Project proponents should consider, but are not limited to, using the following formats:

(1) ArcGIS File Geodatabase with accompanying Feature Classes
(2) ArcGIS Shapefile
(3) DXF or DWG (CAD files) projected to WGS 84 Decimal Degrees
(4) KMZ/KML (Google Earth)

Alternatively, the project proponent might consider identifying discharge locations on readable maps. The EPA solicits comment on whether the location of all potential discharges from proposed federally licensed or permitted projects can be identified with such specificity or if other methods may be more appropriate for different types of activities.

Many states and tribes have established their own requirements for section 401 certification request submittals, which may be different from or more extensive than the proposed ''certification request'' requirements listed above. The EPA recommends that, following establishment of final EPA regulations defining ''certification request'' and ''receipt,'' certifying authorities update their existing section 401 certification regulations to ensure consistency with the EPA's regulations. Additionally, the EPA encourages certifying authorities to work with neighboring jurisdictions to develop regulations that are consistent from state to state. This may be particularly useful for interstate projects, like pipelines and transmission lines, requiring certification in more than one state.

In some cases, federal agencies may be project proponents for purposes of section 401, for both individual projects and activities and for general federal licenses or permits (*e.g.,* Corps general permits). The Agency requests comment on whether federal agencies should be subject to the same ''certification request'' submittal requirements as proposed, or if they require different considerations and procedures than section 401 certification requests by other non-federal agency project proponents. Specifically, the Agency requests comments on an alternative approach for federal agencies that issue general federal license or permits whereby ''certification request for a general permit or license'' would mean a written, signed, and dated communication from a Federal agency to the appropriate certifying authority that:

(1) Identifies the Federal agency and a point of contact;

(2) identifies the proposed categories of activities to be authorized by general permit for which general certification is requested;

(3) includes the proposed general permit;

(4) estimates the number of discharges expected to be authorized by the proposed general permit or license each year;

(5) includes a general description of the methods and means used or proposed to monitor the discharge and the equipment or measures employed or planned for the treatment or control of the discharge;

(6) identifies the reasonable period of time for the certification request; and

(7) contains the following statement: *'The federal agency hereby requests that the certifying authority review and take action on this CWA 401 certification request within the applicable reasonable period of time.'*

The statutory reasonable period of time for a certifying authority to act on a certification request begins upon ''receipt of such request.'' The EPA is proposing to define the term ''receipt'' as follows:

> *Receipt* means the date that a certification request is documented as received by a certifying authority in accordance with applicable submission procedures.

The EPA understands that some certifying authorities have established general procedures for project proponents to follow when seeking state or tribal licenses or permits and encourages the use of consistent procedures for all submittals, including section 401 certification requests. The proposed requirement that certification requests be documented as received ''in accordance with applicable submission procedures'' is intended to recognize that some certifying authorities may require hard copy paper submittals and some may require or allow electronic submittals. If the certifying authority accepts hard copy paper submittals, EPA recommends that the project proponents submitting a hard copy request send the request via certified mail (or similar means) to confirm receipt of the section 401 certification request. If the certifying authority allows for electronic submittals, EPA recommends that the project proponent set up an electronic process to confirm receipt of the request. The EPA recommends that project proponents retain a copy of any written or electronic confirmation of submission or receipt for their records. The Agency solicits comment on whether these new definitions will provide sufficient clarity and regulatory certainty or if additional procedures or requirements may be necessary, and if so, what those procedures or requirements might be.

C. Certification Actions

Consistent with the text of the CWA, the EPA proposes that a certifying authority may take four potential actions pursuant to its section 401 authority: It may grant certification, grant with conditions, deny, or waive its opportunity to provide a certification. These actions are reflected in § 121.5 of the proposed regulatory text.

Granting a section 401 certification demonstrates that the authority has concluded that the discharge to waters of the United States from the proposed activity will be consistent with the listed CWA provisions and appropriate state or tribal water quality requirements (as defined at § 121.1(p) of this proposal). Granting certification allows the federal agency to proceed with processing the application for the license or permit.

If the certifying authority determines that the discharge from a proposed activity would be consistent with applicable water quality requirements only if certain conditions are met, the authority may include such conditions in its certification. Any conditions must be necessary to assure compliance with water quality requirements. The EPA proposes that water quality related conditions that meet the requirements in this proposed rule and that are placed on a section 401 certification must become conditions of the resulting federal license or permit if it is issued. 33 U.S.C. 1341(d).

A certifying authority may choose to deny certification if it is unable to certify that the proposed activity would be consistent with applicable water quality requirements. If a certification is denied, the federal agency may not issue a license or permit for the proposed activity. *Id.* at 1341(a).

Finally, a certifying authority may waive the requirement for a certification in two different ways. First, the certifying authority may waive expressly by issuing a statement that it is waiving the requirement. Second, the certifying authority may implicitly waive by failing or refusing to act in accordance with section 401. *Id.* As discussed throughout this preamble, a certifying authority has a reasonable period of time, not to exceed one year, to complete its section 401 certification analysis. If the authority fails or refuses to act within that reasonable period, the certification requirement will be deemed waived by the federal licensing or permitting agency. *Id.* Where section 401 certification has been waived—expressly or implicitly—the federal agency may issue the license or permit. *Id.* This proposal is consistent with the Agency's longstanding interpretation of what actions may be taken in response to a certification request. The EPA solicits comment on this interpretation and continued approach in this proposed rule.

D. Appropriate Scope for Section 401 Certification Review

Section 401 of the CWA provides states and tribes with additional authority to protect water quality within their jurisdictions that complements the other regulatory programs and the nonregulatory grant and planning programs established by the CWA. CWA section 401(a) does so by authorizing states and tribes to certify that a potential discharge to waters of the United States that may result from a proposed activity will comply with applicable provisions of certain enumerated sections of the CWA, including effluent limitations and standards of performance for new and existing sources (sections 301, 302, and 306 of the CWA), water quality standards and implementation plans (section 303), and toxic pretreatment effluent standards (section 307). 33 U.S.C. 1341(a)(1). When granting a section 401 certification, states and tribes are authorized by CWA section 401(d) to include conditions, including effluent limitations, other limitations and monitoring requirements that are necessary to assure that the applicant for a federal license or permit will comply with appropriate provisions of CWA sections 301, 302, 306, and 307, and with any other appropriate requirement of state law. *Id.* at 1341(d). In addition to the specific enumerated sections of the CWA referenced throughout section 401, the focus of section 401(a) on the compliance of ''any such discharge,'' and the substance of the enumerated CWA sections in section 401(d), *e.g.,* to ensure compliance with ''effluent limitations'' under sections 301 and 302 and any ''effluent standard'' under section 307, underscore that Congress intended this provision to focus on the protection of water quality.

Although the text, structure, and legislative history of the CWA (including the name of the statute itself—the Clean Water Act) clearly demonstrate that section 401 of the CWA is intended to focus on addressing *water quality* impacts from discharges from federally licensed or permitted projects, there continues to be some confusion and uncertainty over the precise scope of a certifying authority's review under section 401 and the scope of appropriate conditions that may be included in a certification (see section II.F in this preamble). This proposal is intended to provide clarity on these issues.

Section 401 contains several important undefined terms that, individually and collectively, can be interpreted in varying ways to place boundaries on the scope of a certifying authority's review and authority. Discerning the meaning, both individually and in context, of terms like ''discharge,'' ''activity,'' ''applicant,'' ''other limitations,'' and ''any other appropriate requirements of State law'' with respect to a state or tribe's certification authority without clear regulatory guidance, presents a challenge to project proponents, certifying authorities, federal agencies, and the courts. The challenge is exacerbated by the fact that nowhere in section 401 did Congress provide a single, clear, and unambiguous definition of the section's scope, a gap the Agency is proposing to remedy in this proposal. *See Chevron,* 467 U.S. at 843–44.

The phrase ''any other appropriate requirement of State law'' in section 401(d) is illustrative of this ambiguity. Congress did not intend that the scope of a certifying entity's authority to impose conditions to be unbounded. *PUD No. 1 of Jefferson County and City of Tacoma* v. *Washington Department of Ecology,* 511 U.S. 700, 712 (1994). Presumably, that is why Congress added the modifier ''appropriate'' in the phrase ''any other appropriate requirements of State law.'' In this context, the exact meaning of ''appropriate'' and how it modifies the preceding term ''any other'' or the following phrase ''requirements of State law'' are important, but undefined by Congress. The Agency, as the federal entity charged with administering the CWA, has authority under *Chevron* and its progeny to address these ambiguities through notice and comment rulemaking.

To provide needed clarity regarding the scope of a certifying entity's authority to grant and condition a certification, the EPA is proposing a clear and concise statement of the scope of certification, as well as clear regulatory definitions for the terms ''certification,'' ''condition,'' ''discharge,'' and ''water quality requirement.''

As explained in section II.F.6.a.iii in this preamble, based on the text and structure of the Act, as well as the history of modifications between the 1970 version and the 1972 amendments, the EPA has concluded that section 401 is best interpreted as protecting water quality from federally licensed or permitted activities with point source discharges to waters of the United States by requiring compliance with the CWA as well as EPA-approved state and tribal

CWA regulatory programs. This proposal includes for the first time a well-defined scope for section 401 certification that reflects the EPA's holistic interpretation of the statutory language, which is based on the text and structure of the Act. As the Agency charged with administering the CWA, the EPA is authorized to interpret by rulemaking the appropriate scope for a CWA section 401 certification. 33 U.S.C. 1361(a). The EPA proposes to establish the ''scope of certification'' as follows:

The *scope of a Clean Water Act section 401 certification* is limited to assuring that a discharge from a Federally licensed or permitted activity will comply with water quality requirements.

The proposed scope of certification is consistent with the plain language of section 401 and is intended to provide clarity to certifying authorities, federal agencies, and project proponents about the extent of environmental review that is expected, the type of information that may reasonably be needed to review a certification request, and the scope of conditions that are appropriate for inclusion in a water quality certification.

The proposed scope of certification differs from the EPA's existing regulations, which require a certification to include a statement that, ''there is a reasonable assurance that the activity will be conducted in a manner which will not violate applicable water quality standards.'' *See* 40 CFR 121.2(a)(3). The ''reasonable assurance'' language in the EPA's existing regulations is an artifact from the pre-1972 version of the statute which provided that the certifying authority would certify ''that there is reasonable assurance . . . that such activity will be conducted in a manner which will not violate applicable water quality standards.'' Public Law 91–224, 21(b)(1), 84 Stat. 91 (1970). The proposed scope could be considered more stringent than the EPA's existing certification regulations because, consistent with the 1972 CWA amendments, it requires certifying authorities to conclude that a discharge ''will comply'' with water quality requirements (as defined at § 121.1(p) of this proposal), rather than providing ''reasonable assurance.''

Section 401 is triggered by a proposed federally licensed or permitted project that may result in any *discharge* into waters of the United States. The term ''discharge'' is not defined in section 401, and the only definition in the CWA provides that ''the term 'discharge' when used without qualification includes a discharge of a pollutant, and a discharge of pollutants.'' 33 U.S.C. 1362(16). Consistent with the analysis above concerning the scope of section 401 and the need to provide greater clarity, the Agency is proposing to define the term ''discharge'' as follows:

Discharge for purposes of this part means a discharge from a point source into navigable waters.

The Agency solicits comment on whether this definition is necessary, whether it provides appropriate clarification, or whether the EPA's proposed regulations would be sufficiently clear without including this new definition. The Agency also solicits comment on whether an alternate definition of ''discharge'' may provide greater clarity and regulatory certainty.

Section 401(d) requires a certification to ''set forth any effluent limitations and other limitations, and monitoring requirements necessary to assure that any applicant for a Federal license or permit will comply with [enumerated provisions of the CWA], and with any other appropriate requirement of State law'' and that these requirements ''shall become a *condition* on any Federal license or permit subject to the provisions of this section'' (emphasis added). As described in section II.F.6.a.i in this preamble, the EPA interprets ''appropriate requirement of state law'' to mean applicable provisions of those EPA-approved state and tribal CWA regulatory programs (*e.g.,* state water quality standards, NPDES program provisions). To provide greater clarity, the EPA proposes to define the term ''water quality requirements'' as follows:

Water quality requirements means applicable provisions of 301, 302, 303, 306, and 307 of the Clean Water Act and EPA-approved state or tribal Clean Water Act regulatory program provisions.

The term ''water quality requirements'' appears throughout section 401, but it is not defined in the statute. The EPA's interpretation of this term and the proposed definition are intended to align section 401 program implementation with the text of the statute, which specifically identifies those provisions of the Act enumerated in the proposed definition. The term ''EPA-approved state or tribal CWA regulatory programs'' in the proposed definition is intended to include those state or tribal provisions of law that are more stringent than federal law, as authorized in 33 U.S.C. 1370. The legislative history supports the interpretation in this proposal. *See* S. Rep. No. 92–414, at 69 (1971) (''In addition, the provision makes clear that any water quality requirements established under State law, more stringent than those requirements established under this Act, also shall through certification become conditions on any Federal license or permit.''). The CWA provisions that regulate point source discharges to waters of the United States are the ''regulatory provisions of the CWA.'' When states or tribes enact CWA regulatory provisions as part of a state or tribal program, including those designed to implement the section 402 and 404 permit programs and those that are more stringent than federal requirements, those provisions require EPA approval before they become effective for CWA purposes. Because the EPA interprets ''appropriate requirements'' to mean the ''regulatory provisions of the CWA,'' it follows that those would necessarily be EPA-approved provisions.

The EPA solicits comment on whether this proposed definition is clear and specific enough to provide regulatory certainty for certifying authorities and project proponents. The EPA also solicits comment on whether additional specificity should be added to the proposed definition, for example that the term *does not* include non-water quality related state or local laws. In an alternate approach, the EPA may consider defining the term ''appropriate requirement of State law'' to provide additional clarity concerning the scope of section 401. Under this alternate approach, the EPA solicits comment on whether that term should be defined similar to or more broadly or narrowly than ''EPA-approved state or tribal Clean Water Act regulatory program provisions'' as proposed in this rulemaking.

The scope of certification established in this proposal also informs the scope of conditions that may be included in a certification. The statute does not define ''condition,'' but several appellate courts have analyzed the plain language of the CWA and concluded that the Act ''leaves no room for interpretation'' and that ''state conditions *must* be'' included in the federal license or permit. *Sierra Club* v. *U.S. Army Corps of Engineers,* 909 F.3d 635, 645 (4th Cir. 2018) (emphasis in original); *see also U.S. Dep't of Interior* v. *FERC, 952 F.2d 538, 548 (D.C. Cir. 1992); Am. Rivers, Inc.* v. *FERC, 129 F.3d 99, 107 (2d Cir. 1997)* (recognizing the ''unequivocal'' and ''mandatory'' language of section 1341(d)); *Snoqualmie Indian Tribe* v. *FERC, 545 F.3d 1207, 1218 (9th Cir. 2008)* (collecting cases); *FERC, 952 F.2d at 548* (''FERC may not alter or reject conditions imposed by the states through section 401 certificates.''). The EPA is not proposing to modify this plain language interpretation of the

CWA concerning the inclusion of certification conditions in federal licenses and permits. However, the EPA is proposing to define the term ''condition'' to address ambiguity in the statute and provide clarity and regulatory certainty. *See Chevron,* 467 U.S. at 843–44.

Although the structure and content of section 401(d) provide helpful context for what should be included as conditions in a federal license or permit, the CWA does not define that operative term. Because this term is not defined in the statute, its meaning has been susceptible to different interpretations. For example, the EPA understands some certifying authorities have included conditions in a certification that have nothing to do with effluent limitations, monitoring requirements, water quality, or even the CWA. Such requirements were perhaps based on other non-water quality related federal statutory or regulatory programs, concerns about environmental media other than water, or they might have been related to state laws, policies, or guidance that make decisions or recommendations unrelated to the regulation of point source discharges to waters of the United States. As the Agency charged with administering the CWA, the EPA is authorized to interpret by rulemaking what the term ''condition'' means in the context of a CWA section 401 certification. Under the *Chevron* doctrine, courts presume ''that when an agency-administered statute is ambiguous with respect to what it prescribes, Congress has empowered the agency to resolve the ambiguity.'' *Utility Air Regulatory Group* v. *EPA,* 573 U.S. 302, 315 (2014). Congressional silence is read ''as a delegation of authority to EPA to select from among reasonable options.'' *EPA* v. *EME Homer City Generation,* 572 U.S. 489, 515 (2014).

The EPA recognizes that the majority of certification actions reflect an appropriately limited interpretation of the purpose and scope of section 401. However, the Agency is also aware that some certifications have included conditions that may be unrelated to water quality, including requirements for biking and hiking trails to be constructed, one-time and recurring payments to state agencies for improvements or enhancements that are unrelated to the proposed federally licensed or permitted project, and public access for fishing and other activities along waters of the United States. The EPA is also aware of certification conditions that purport to require project proponents to address pollutants that are not discharged from the construction or operation of a federally licensed or permitted project. Using the certification process to yield facility improvements or payments from project proponents that are unrelated to water quality impacts from the proposed federally licensed or permitted project is inconsistent with the authority provided by Congress. During pre-proposal stakeholder engagement, the EPA also heard from federal agencies that, because several court decisions have concluded that they do not have authority to ''review and reject the substance of a state certification or the conditions contained therein,'' *Am. Rivers, Inc.,* 129 F.3d at 106, non-water quality conditions are often included in federal licenses and permits. Once included in the federal license or permit, federal agencies have found it challenging to implement and enforce these non-water quality related conditions. The Agency solicits comment on other examples of certification conditions that may have been unrelated to water quality.

This proposal includes three elements designed to address the issues described above. First, the proposal defines the term ''condition'' as follows:

> *Condition* means a specific requirement included in a certification that is within the scope of certification.

As described above, the lack of a statutory definition for the term ''condition,'' despite its central use in section 401(d), creates ambiguity and uncertainty over the types of conditions that may be included in a certification. *See Chevron,* 467 U.S. at 843–44. For example, does section 401(d) authorize certifying authorities to include any kind of limitation or requirement in a certification? Or it is more limited, and if so, how limited?

As used in section 401(d), the term is most logically read to refer to those ''effluent limitations and other limitations, and monitoring requirements necessary to assure'' compliance with certain enumerated provisions of the CWA and with ''any other appropriate requirements of State law.'' The statute mandates that these kinds of limitations and monitoring requirements ''shall become a condition'' on a federal license or permit subject to section 401. Thus, based on the plain language of the statute for these limitations or requirements to become a license or permit ''condition'' through operation of section 401(d), they must be of a certain character. That is, they must be necessary to assure compliance with water quality requirements (as defined at § 121.1(p) of this proposal). That is why EPA's proposed definition of ''condition'' would require that it be a limitation or requirement within the statute's ''scope of certification.'' If it purports to require something beyond the appropriate scope of section 401, the limitation or requirement offered by the certifying authority would not be a ''condition'' as that term is used in section 401(d).

Providing a clear definition of ''condition'' addresses the ambiguity in section 401 and provides regulatory certainty to certifying authorities, project proponents, and federal agencies. Although this would be a new provision in the EPA's regulations, the Agency presumes that the majority of certification conditions included by states and tribes are consistent with the authority granted by Congress. The EPA expects this proposed definition, however, to provide much needed clarity to federal agencies and regulatory certainty to project proponents that have been subjected to delays and project denials as a result of the lack of regulatory certainty in this area.

Second, to assure that such ''conditions'' are appropriately tailored to the scope and authorized by law, this proposal would require the following information be provided for each condition included in a certification:

1. A statement explaining why the condition is necessary to assure that the discharge from the proposed project will comply with water quality requirements;
2. A citation to federal, state, or tribal law that authorizes the condition; and
3. A statement of whether and to what extent a less stringent condition could satisfy applicable water quality requirements.

The EPA intends this provision to require citation to specific state or tribal law or CWA provision that authorizes the condition, and that citations to CWA section 401 or other general authorization or policy provisions in federal, state or tribal law would be insufficient to satisfy the proposed requirement. These proposed requirements are intended to ensure that any limitation or requirement added to a certification is within the ''scope of certification'' and is, thus, a true section 401(d) ''condition.''

These proposed requirements might create new obligations for some certifying authorities, but the EPA anticipates that the value of including this information in every certification, in terms of transparency and regulatory certainty, will far outweigh the minimal additional administrative burden of including this information in a certification. Stakeholders in pre-proposal engagement expressed concern that federal agencies do not enforce the certification conditions incorporated in their federal licenses or permits. Providing a citation to the legal authority underpinning a federally enforceable permit condition is one way to address these concerns. In fact, federal agencies during pre-proposal engagement acknowledged that this information will help them understand how best to implement and enforce certification conditions. In addition, including this information in each certification will provide transparency for the overall certification process and allow the project proponent to understand the legal authority that the certifying authority is relying on to require the condition. This information will help the project proponent assess whether the condition is within the statute's lawful scope and what recourse it might have to challenge or appeal it. Overall, the EPA believes that the benefits of providing this information will significantly outweigh any additional administrative burden that certifying authorities may incur because of these new requirements. The Agency solicits comment on the proposed information needed to support each condition, particularly on the utility of such information for the certification process. In an alternate approach, the Agency may define the third requirement as ''a statement of whether and to what extent a more or less stringent condition could satisfy applicable water quality requirements,'' or remove the third requirement altogether. The Agency also requests comment on these alternate approaches.

Third, this proposal would specifically provide federal agencies the ability to determine whether certification conditions meet the new regulatory definition for condition, and whether the state or tribe has provided the information required for each condition. If a condition satisfies these requirements, under this proposal it would have to be included in the federal license or permit; if a condition does not satisfy these requirements, it may not be included in the federal license or permit. See section III.J in this preamble for more discussion on the federal licensing or permitting agency's enforcement responsibility and discretion. The EPA expects that the proposed requirements are clear and specific enough that a federal agency would not need to have water quality expertise to determine if a certification condition meets the proposed requirements.[40] The Agency solicits comment on whether the proposed requirements for conditions need to be further refined to allow federal agencies other than the EPA to appropriately determine compliance. Although this review function may be new to some federal agencies, it is consistent with the EPA's own longstanding practice under its NPDES regulations implementing section 401 that allow the EPA to make such determinations under certain circumstances. *See* 40 CFR 124.53(e).

This proposal would require other federal agencies to review and determine whether certification conditions are within the ''scope'' articulated in the proposed implementing regulations. This is consistent with the principle that federal agencies have the authority to reject certifications or conditions that are inconsistent with the requirements and limitations of section 401 itself. In *City of Tacoma, Washington* v. *FERC,* the Court of Appeals for the D.C. Circuit noted that ''[i]f the question regarding the state's section 401 certification is not the application of state water quality standards, but compliance with the terms of section 401, then [the federal agency] must address it. This conclusion is evident from the plain language of section 401: 'No license or permit shall be granted until the certification required by this section has been obtained or has been waived.' '' 460 F.3d 53, 67–68 (D.C. Cir. 2006) (citing 33 U.S.C. 1341(a)(1)). The court went on to explain that even though the federal licensing or permitting agency did not need to ''inquire into every nuance of the state law proceeding . . . it [did] require [the federal agency] to at least confirm that the state has facially satisfied the express requirements of section 401.'' *Id.* at 68. This proposal provides that, if a federal agency determines that a certifying authority included a condition in a certification that is beyond the scope of certification, as defined in the proposed regulation, or that the state has not provided the specific information necessary to support each condition, that condition may not be included in the federal license or permit and it does not become federally enforceable.

As noted above, the EPA is not proposing to modify prior case law interpreting the plain language of the CWA to require certification conditions to be included in federal licenses and permits. *See, e.g., City of Tacoma,* 460 F.3d at 67; *Am. Rivers Inc.,* 129 F.3d at 107; *FERC,* 952 F.2d at 548; *Sierra Club,* 909 F.3d at 645. The EPA is proposing to maintain that requirement for conditions that are consistent with section 401 and necessary to assure compliance with the Act and with other appropriate requirements of state law. The statute does not define the term ''condition'' and the EPA proposes to fill the gap left by Congress and define the term to address ambiguity in the statute and provide clarity and regulatory certainty. *See Chevron,* 467 U.S. at 843–44.

This proposal would also provide federal agencies an opportunity to allow a certifying authority to remedy a condition that the federal agency determines exceeds or conflicts with the scope of section 401 authority under certain circumstances. If a federal agency determines that a condition does not satisfy the proposed requirements for a condition and the reasonable period of time has not yet expired, this proposal would allow the federal agency to notify the certifying authority and provide an opportunity to remedy the defective condition, either by modifying the condition to conform to the scope of certification, or by providing the information required in the proposed regulation. A federal agency would not be required to provide this opportunity to the certifying authority, but if it does, this proposal nonetheless would require the certifying authority to provide the corrected condition or required information within the original reasonable period of time, which shall not exceed one year from receipt. Under this proposal, any federal agency determination on whether to allow a certifying authority to remedy a deficient condition would have to occur within the original reasonable period of time. Under this proposal, if the certifying authority fails to remedy the deficiencies within the reasonable period of time, the condition would not be included in the federal license or permit. Deficient conditions do not invalidate the entire certification, nor do they invalidate the remaining conditions in the certification. The EPA solicits comment on whether the regulatory text should clarify that deficient conditions do not invalidate the entire certification or the remaining conditions. The EPA also solicits comment on whether the proposed opportunity to remedy deficient conditions would be helpful and an appropriate use of federal agency resources, whether it should be mandatory for federal agencies to provide this opportunity, and whether it is within the scope of EPA authority to establish through regulation. The EPA also solicits comment on an alternative

[40] Additionally, section 401 provides that federal agencies may request EPA advice on ''any relevant information on applicable effluent limitations, or other limitations, standards, regulations, or requirements, or water quality criteria'' and compliance methods. 33 U.S.C. 1341(b).

approach where certifying authorities would not have the opportunity to remedy deficient conditions, even if the reasonable period of time has not expired.

The proposed regulations clarify the EPA's interpretation that the appropriate scope of review under section 401(a) is limited to the potential water quality impacts caused by the point source discharge from a proposed federally licensed or permitted project to the waters of the United States. This is consistent with the statutory language in sections 401(a) and 401(d) and is supported by the legislative history. *See* S. Rep. No. 92–414, at 69 (1971) (providing that authorities must certify that ''any such discharge will comply with [CWA] Sections 301 and 302'' and that section 401 was ''amended to assure consistency with the bill's changed emphasis from water quality standards to effluent limitations based on the elimination of any discharge of pollutants''), 41 (describing CWA section 301 as prohibiting the discharge of any pollutant except as permitted under CWA sections 301, 302, 306, 307 or 402, and identifying point sources of pollution as the regulatory target), 46 (describing CWA section 302 to authorize water quality based effluent limits ''for the affected point sources at a level which can reasonably be expected to contribute to the attainment or maintenance of such a standard of water quality''). The scope of certification also extends to the scope of conditions that are appropriate for inclusion in a certification—specifically, that these conditions must be necessary to assure that the discharge from a proposed federally licensed or permitted project will comply with water quality requirements, as defined at § 121.1(p) of this proposal.

The EPA solicits comments on whether the proposed approach appropriately captures the scope of authority for granting, conditioning, denying, and waiving a section 401 certification. The EPA solicits comment on the extent to which project proponents have received non-water quality related conditions in certifications. The EPA also solicits comment on whether this proposal regarding the scope of certification and conditions is an appropriate and useful way to ensure that federal licenses will not contain non-water quality related certification decisions and conditions, or if there are other more useful and appropriate tools or mechanisms the EPA should consider to address these concerns. In particular, the EPA solicits comment on what it means for a certification or its conditions to be ''related to water quality'' and how direct that relationship to water quality must be to properly define a certification or condition as within the appropriate scope of section 401.

In addition, the EPA solicits comment on its interpretation of the phrase ''any other appropriate requirements of State law'' as limited to requirements in EPA-approved state and tribal CWA regulatory programs. In particular, EPA solicits comment on whether EPA should interpret that phrase more broadly to include *any* requirement of State law, any *water quality-related requirement* of State law (regardless of whether it is part of an EPA-approved program), or any different universe of state or tribal requirements (reflecting, or not, CWA sections or programs) that might be broader or narrower in scope than this proposal. The EPA also solicits comment on its interpretation of sections 401(a) and 401(d) as limiting the scope of state and tribal section 401 review and conditions to impacts from potential ''discharges,'' or whether the state or tribe may also consider a different and broader universe of impacts, such as impacts from the licensed project or activity as a whole, or some other universe of potential impacts to water quality. The EPA also solicits comment on whether this proposal will facilitate enforcement of certification conditions by federal agencies, or whether there are other approaches the Agency should consider beyond requiring a citation to state, tribal, or federal law or explaining the reason for a condition.

Pre-proposal recommendations identified concerns with certain types of conditions that have created regulatory uncertainty for project proponents, including conditions that extend the effective date of a certification out beyond the reasonable period of time and conditions that authorize certifications to be re-opened. To better understand these concerns, the Agency solicits comment on whether, given the explicit limitations on conditions in this proposal, it may still be necessary or appropriate to expressly preclude these or other types of conditions that may create regulatory uncertainty.

The EPA is also soliciting comment on an alternate approach that it is considering taking whereby the Agency would interpret CWA sections 401(a) and 401(d) as providing two different scopes for action on a certification request. Specifically, section 401(a) could be read to authorize review of a section 401 certification only on the basis of determining whether the discharge would comply with the enumerated sections of the CWA; and section 401(d) could be read to authorize consideration of ''any other appropriate requirement of State law'' only for purposes of establishing conditions once the certifying authority has determined to grant certification. Under this alternate approach, a certification request could be denied only if the certifying authority cannot certify that the discharge will comply with applicable provisions of CWA sections 301, 302, 303, 306 and 307. This proposal would also define the term ''any other appropriate requirement of State law'' to mean EPA-approved state or tribal CWA regulatory program provisions (*e.g.,* state water quality standards, NPDES program provisions). The EPA solicits comment on this alternate interpretation. The EPA also solicits comment on whether establishing two different scopes for action under section 401 would clarify the certification process or if it could cause further confusion or potential delays in processing certification requests.

E. Timeframe for Certification Analysis and Decision

The EPA proposes to reaffirm that CWA section 401 requires certifying authorities to act on a request for certification within a reasonable period of time, which shall not exceed one year. By establishing an absolute outer bound of one year following receipt of a certification request, Congress signaled that certifying authorities have the expertise and ability to evaluate potential water quality impacts from even the most complex proposals within a reasonable period of time after receipt of a request, and in all cases within one year. The CWA also provides that if a certifying authority fails or refuses to act within that reasonable period of time, the certification requirement is waived; however, the CWA does not define the term ''*fails or refuses to act.*'' This proposal provides additional clarity on what is a ''reasonable period,'' how the period of time is established, and for the first time defines the term ''*fails or refuses to act*'' to provide additional clarity and regulatory certainty.

Section 401 does not include a tolling provision. Therefore, the period of time to act on a certification request does not pause or stop for any reason once the certification request has been received. One recent court decision held that withdrawing and resubmitting the same section 401 request for the purpose of circumventing the one-year statutory deadline does not restart the reasonable period of time. *Hoopa Valley Tribe* v. *FERC,* 913 F.3d 1099 (D.C. Cir. 2019) (*Hoopa Valley*). The EPA agrees with the *Hoopa Valley* court that ''Section 401's text is clear'' that one year is the absolute maximum time permitted for a certification, and that the statute ''does not preclude a finding of waiver prior to the passage of a full year.'' *Id.* at 1103–04. The court noted that, ''[b]y shelving water quality certifications, the states usurp FERC's control over whether and when a federal license will issue. Thus, if allowed, the withdrawal-and-resubmittal scheme could be used to indefinitely delay federal licensing proceedings and undermine FERC's jurisdiction to regulate such matters.'' *Id.* at 1104. The court further observed that the legislative history supports its interpretation of the statute's plain language because, ''Congress intended Section 401 to curb a *state's* 'dalliance or unreasonable delay.' '' *Id.* at 1104–05 (emphasis in original).

The *Hoopa Valley* case raised another important issue: Perpetual delay of relicensing efforts (in that case for more than a decade) delays the implementation and enforcement of water quality requirements that have been updated and made more stringent in the years or decades since the last relicensing process.[41] *See id.* at 1101. This concern was also raised in stakeholder recommendations received during the pre-proposal outreach period. One stakeholder specifically cited the delays in the *Hoopa Valley* case as a ''concrete example of how the § 401 certification process was being manipulated by a state certification agency to delay implementation of effective water quality controls and enhancement measures'' and that ''allowing the § 401 certification process to be used to achieve further delays in the re-licensing process is in turn an abuse of the certification process.'' Letter from National Tribal Water Council to David P. Ross, Assistant Administrator of the Office of Water, EPA (Mar. 1, 2019).

Given the *Hoopa Valley* court's plain language analysis of the statute and the potential water quality impacts from allowing certification decisions to be delayed, and the Agency's agreement with that analysis, EPA is proposing to amend the Agency's regulations in a manner consistent with the *Hoopa Valley* holding as follows:

> The certifying authority is not authorized to request the project proponent to withdraw a certification request or to take any other action for the purpose of modifying or restarting the established reasonable period of time.

The Agency proposes this clear statement to reflect the plain language of section 401, which as described above, is supported by legislative history. The Agency expects this clarification will reduce delays and help ensure that section 401 certification requests are processed within the reasonable period of time established by the federal agency, and at most, within one year from receipt of the request. The Agency understands that in cases where the certifying authority and project proponent are working collaboratively and in good faith, it may be desirable to allow the certification process to extend beyond the reasonable period of time and beyond the one-year statutory deadline. The Agency solicits comment on whether there is any legal basis to allow a federal agency to extend the reasonable period of time beyond one year from receipt.

During the pre-proposal recommendation period, stakeholders also expressed concern about the effect of potentially limited certification review timeframes on state and tribal resources. The Agency has similar concerns regarding its own resources. This proposal therefore would establish a pre-filing meeting process *when the EPA is the certifying authority* to ensure that the Agency receives early notification of anticipated projects and can discuss its information needs with the project proponent (see section III.G in this preamble). This pre-filing meeting process is intended to occur before the statutory timeframe begins. The Agency solicits comment on whether the pre-filing meeting process would be helpful for other certifying authorities, whether it is an appropriate mechanism to promote and encourage early coordination between project proponents and certifying authorities, and if there are other options that may also be appropriate from a regulatory perspective. The EPA also solicits comment on whether the Agency has the authority to propose similar requirements on state and tribal certifying authorities through this rulemaking. The Agency also heard concerns from certifying authorities on staffing challenges, agency priorities, and the need for additional federal funding to support timely action on certification requests. To better understand these concerns, the Agency solicits comment from certifying authorities on the extent to which section 401 programs are funded by states and tribes and the number of full or part time employees that are assigned to evaluate and take action on certification requests.

The EPA recognizes that federal agencies are uniquely positioned to promote pre-application coordination among federal agencies, certifying authorities, and project proponents to harmonize project planning activities and promote timely action on certification requests. For instance, early coordination between the certifying authority and the federal agency could decrease duplication of materials that need to be prepared and submitted by the project proponent. The EPA encourages federal agencies to notify certifying authorities as early as possible about potential projects that may require a section 401 certification. Additionally, the EPA encourages federal agencies to respond timely to requests from certifying authorities for information concerning the proposed federal license or permit, and to provide technical and procedural assistance to certifying authorities and project proponents upon request and to the extent consistent with agency regulations and procedures. The Agency solicits comment on the responsibilities of federal agencies, ways to facilitate technical and procedural information sharing among federal agencies, project proponents, and certifying authorities, and ways to provide technical and procedural assistance to project proponents and certifying authorities.

The EPA also proposes to reaffirm that the federal agencies determine the reasonable period of time for a certifying authority to act on a certification request. Some existing federal agency regulations specify a reasonable period of time that applies across all permit types. For instance, FERC's regulations at 18 CFR 5.23(b)(2) provide that ''[a] certifying agency is deemed to have waived the certification requirements of section 401(a)(1) of the Clean Water Act if the certifying agency has not denied or granted certification by one year after the date the certifying agency received a written request for certification.'' Similarly, the Corps regulations at 33 CFR 325.2(b)(1)(ii) state that ''[a] waiver may be explicit, or will be deemed to occur if the certifying agency fails or refuses to act on a request for certification within sixty days after receipt of such a request unless the district engineer determines a shorter or longer period is reasonable for the state to act.'' Executive Order 13868 directed

[41] This is a concern shared by the EPA. The Agency has recently taken steps to promote its own compliance with CWA deadlines, including acting on state and tribal water quality standard submittals, because prior delays have created a significant backlog of state submittals awaiting EPA action. Memorandum from David P. Ross to Regional Administrators (June 3, 2019). These delays and backlogs prevent states and tribes from timely implementing and enforcing updated programs and standards that could otherwise be improving water quality.

these agencies to update their existing regulations to promote consistency across the federal government upon completion of the EPA's current rulemaking to modernize its certification regulations.

In setting the reasonable period of time for a certification—either on a project-by-project basis or categorically through a rulemaking—the EPA proposes to require federal agencies to consider:

1. The complexity of the proposed project;
2. The potential for any discharge; and
3. The potential need for additional study or evaluation of water quality effects from the discharge.

The EPA solicits comment on whether these factors are appropriate and whether there are other factors that a federal agency should consider when establishing the reasonable period of time (*e.g.,* permit type within a federal agency, certifying authority resources and capacity to review). The EPA also solicits comment on whether the Agency should establish reasonable periods of time for different federal permit types on a categorical basis in its final rule. For example, the EPA could establish that section 401 certifications for CWA section 404 permits that disturb a certain acreage threshold must be completed in a prescribed period of time. As another example, the EPA could establish that for interstate pipelines that will cross a certain number of states or transport a certain volume of material, certification must be completed within a specific period of time. The EPA understands that the federal agencies that implement their own permitting programs are experts in those areas, however, the Agency also understands that establishing a clear national framework for section 401 certifications may help create efficiencies in the process and therefore provide greater regulatory certainty.

The Agency is also soliciting comment on an alternate approach that it is considering taking whereby the EPA would retain the language in its existing certification regulations that specifies a reasonable period of time ''shall generally be considered to be 6 months, but in any event shall not exceed 1 year.'' 40 CFR 121.16(b). In the event the EPA pursues this alternate approach, the Agency requests comment on whether six months is an appropriate general rule, if a longer or shorter period of time would be more appropriate as a general rule, and whether having such a general rule is appropriate. Such alternate approach would retain the federal agencies ability to determine the reasonable period of time but would allow for a default reasonable period of time in the event that a federal agency fails to establish a reasonable period of time or prefers to rely on the default.

This proposal also intends to clarify the process by which federal agencies and certifying authorities communicate regarding the reasonable period of time. A clear understanding of the reasonable period of time will prevent certifying authorities from inadvertently waiving their opportunity to certify a request and will provide regulatory certainty to the project proponent. Under this proposal, upon submittal of the request for certification, the project proponent would contact the federal agency to provide notice of the certification request. Within 15 days of receiving a notice of the certification request from the project proponent, the federal agency would provide, in writing, the following information to the certifying authority: The applicable reasonable period of time to act on the request, the date of receipt, and the date upon which waiver will occur if the certifying authority fails to act. The EPA understands that this process may create additional administrative burdens on federal agencies, given the number of section 401 certification requests that are submitted each year. However, the Agency expects that the benefit of clarity and transparency that this additional process will provide for all parties involved in a section 401 certification process will outweigh any potential additional burden. The EPA also expects the federal agencies will quickly routinize this process, using forms, electronic notifications or other tools to minimize the potential administrative burden associated with providing written notice of the reasonable period of time. The EPA solicits comment on whether the proposed process is the most efficient way to provide clarity and transparency, or if there are other procedural or administrative mechanisms that may be more effective. In an alternate approach the EPA could require federal agencies to post the reasonable period of time notification on a public website, instead of requiring it be sent to the certifying authority. The EPA solicits comment on whether this alternate approach would provide greater efficiency and transparency in the certification process, or if there are concerns with this approach.

The EPA also solicits comment on whether, if a federal agency promulgates reasonable periods of time categorically based on project type, the notification process in this proposal would still be necessary. For example, FERC has promulgated regulations for hydropower projects that require the license or permit applicant to file with FERC either a copy of the certification, a copy of the request for certification, including proof of the date that the certifying authority received the request, or evidence of waiver. 18 CFR 4.34(b)(5)(i). In its permitting processes, FERC allows certifying authorities to take the full year provided in section 401, and its regulations clearly state, ''A certifying agency is deemed to have waived the certification requirements . . . if the certifying agency has not denied or granted certification by one year after the date the certifying agency received a written request for certification.'' 18 CFR 4.34(b)(5)(iii). The EPA solicits comment on whether FERC's hydropower regulations, or other existing federal regulations, provide clear enough procedure and transparency that the additional notice to the certifying authority proposed in this rule would be redundant, unnecessary, or a waste of resources.

The EPA also proposes to clarify that section 401 does not prohibit a federal agency from modifying an established reasonable period of time, provided the modified time period is reasonable and does not exceed one year from receipt. The EPA does not expect periods of time to be modified frequently, but this proposal is intended to provide federal agencies with additional flexibility for unique circumstances that may reasonably require a longer period of time than was originally established. In such cases, the modified time period would be communicated in writing to the certifying authority and the project proponent to ensure all parties are aware of the change. In all cases, the reasonable period of time would not exceed one year from the original receipt of the certification request.

To ensure that the section 401 certification process does not unreasonably delay the federal licensing and permitting processes, the plain language of section 401(a)(1) provides that the requirement to obtain a certification is waived when a certifying authority ''fails or refuses to act'' on a request for certification, within a reasonable period of time (which shall not exceed one year).'' 33 U.S.C. 1341(a)(1). The Act does not define the term ''fails or refuses to act.'' This term is ambiguous and the lack of a statutory definition has resulted in different interpretations of when the period of time for review expires and inefficiencies in the certification process. It has also resulted in significant regulatory uncertainty and litigation. See section II.F in this preamble. As the Agency charged with administering the CWA, the EPA is authorized to interpret by rulemaking what these terms mean in the context of a request for a CWA section 401 certification. *See Chevron,* 467 U.S. at 843–44.

The phrase ''fails or refuses to act'' lends itself to at least two interpretations. One interpretation of the ''fails or refuses to act'' language in section 401 is that a certifying authority took no action, or refused to take any action, on a section 401 certification request within the reasonable period of time. Such lack of action would be understood as triggering a waiver. Alternatively, when read in the larger context of the section, ''fails or refuses to act'' could also mean that—while the certifying authority took some action in response to the request—the action it took was outside the statute's permissible scope and thus the certifying authority failed or refused to act in a way Congress intended, and that such failure amounts to a failure or refusal to act, triggering a waiver. To resolve this ambiguity, under this proposed definition, if a certifying authority either takes no action at all within the reasonable period of time, or acts outside the scope of certification, as defined in this proposal, the federal agency may determine that waiver has occurred and issue the federal license or permit. Accordingly, this proposal includes the following definition:

Fail or refuse to act means the certifying authority actually or constructively fails or refuses to grant or deny certification, or waive the certification requirement, within the scope of certification and within the reasonable period of time.

A certifying authority actually fails or refuses to grant or deny certification when it states its intention unambiguously in writing or takes no action within the reasonable period of time. A certifying agency constructively fails or refuses to grant or deny certification when it acts outside the scope of certification as defined in the proposed rule.

The EPA expects that for the majority of circumstances where states and tribes issue section 401 certifications, this new definition will have little practical implication because they will have acted on certification requests within the scope of CWA section 401. However, the EPA is aware of circumstances where some states have denied certifications on grounds that are unrelated to water quality requirements and that are beyond the scope of CWA section 401.[42] The EPA's existing certification regulations at 40 CFR part 121 are silent on this point and thus when a certifying authority acts beyond the scope of authority granted by Congress in section 401, the project proponent has two options: (1) Walk away from the proposed federally licensed or permitted project because certification has been denied, or (2) challenge the certification denial in court. Under this proposal, the Agency intends to clarify that a denial based on factors outside the scope of authority under section 401 amounts to a ''fail[ure] or refus[al] to act.'' The burden is thus placed on the certifying authority to act within the proper scope of authority granted by Congress, or otherwise risk having the certification denial being set aside by the federal agency. If that were to happen, under this proposal, a certifying authority that disagrees that its action was outside the scope of section 401 could consider its options for legal or administrative review against the federal agency for issuing the license or permit without considering its certification denial. The EPA intends that this proposed definition of ''fails or refuses to act'' will encourage certifying authorities to act within the scope of certification and promote timely and CWA-consistent action on certification requests. As discussed in section III.D in this preamble, an entire certification is not considered waived if a certifying authority grants certification with deficient conditions. In those circumstances, the deficient conditions are addressed by the federal agency but the remainder of the certification remains in place.

Alternatively, the Agency seeks comment on an approach that would not define ''*fails or refuses to act*'' as a separate term. In the event the Agency pursues that alternate approach, the Agency solicits comment on other tools or mechanisms to encourage certifying authorities to act timely and within the scope of certification, consistent with the text of the CWA as defined in this proposal.

This proposal also includes a process by which, if a certifying authority denies certification on grounds outside the scope of certification, and the reasonable period of time has not yet expired, the federal agency may provide an opportunity for the certifying authority to remedy the deficient denial, so long as the remedy occurs within the original reasonable period of time. This process is intended to promote actions by certifying authorities that are within the scope of certification and provide an ability to remedy deficient denials so long as it is does not extend the reasonable period of time, and therefore does not delay the federal licensing or permitting process. The Agency solicits comment on whether the opportunity to remedy deficient certifications or conditions would be helpful and appropriate, or if it could create additional delays in the federal licensing or permitting process. The EPA also solicits comment on an alternative approach where certifying authorities would not have the opportunity to remedy deficient denials, even if the reasonable period of time has not expired. The Agency also solicits comment on whether there are other mechanisms that may also promote timely and appropriate action on certification requests.

F. Contents and Effect of a Certification

The CWA does not define the term ''certification'' or offer a definitive list of its contents or elements. Accordingly, the EPA under section 501(a) may reasonably interpret the statute to add content to that term. *See* 33 U.S.C. 1251(d); 33 U.S.C. 1361(a); *Chevron,* 467 U.S. at 843–44. While the EPA's existing regulations at 40 CFR 121.2(a) identify certification requirements that might have made sense in 1971, in this proposal the EPA seeks to update those requirements and also address more fully the effects of certification decisions. Among other things, the EPA is proposing that any action on a certification request be in writing and clearly state whether the certifying authority has chosen to grant, grant with conditions, or deny certification. The EPA is also proposing that any express waiver of the certification requirement by the certifying authority also be in writing.

In circumstances where certification is granted, with or without conditions, the EPA is proposing that the written certification include a statement that the discharge from the proposed federally licensed or permitted project will comply with applicable water quality requirements, as defined at § 121.1(p) of this proposal. Where the certifying authority has granted without conditions, the federal agency could continue processing the license or permit in accordance with its implementing regulations. Where the certifying authority is granting certification with conditions, the federal

[42] *See* Letter from Thomas Berkman, Deputy Commissioner and General Counsel, New York State Department of Environmental Conservation, to Georgia Carter, Vice President and General Counsel, Millennium Pipeline Company, and John Zimmer, Pipeline/LNG Market Director, TRC Environmental Corp. (Aug. 30, 2017) (denying 401 certification because ''FERC failed to consider or quantify the effects of downstream [greenhouse gas emissions] in its environmental review of the Project'').

agency could continue processing the license or permit and would include those conditions as terms in the federal license or permit. Under the proposal, the certification would include specific supporting information for each condition that will be included in the certification, including at a minimum: A statement explaining why the condition is necessary to assure that the discharge resulting from the proposed federally licensed or permitted project will comply with applicable water quality requirements; a citation to federal, state, or tribal law that authorizes the condition; and a statement of whether and to what extent a less stringent condition could satisfy applicable water quality requirements. See section III.D in this preamble for information about the scope of appropriate conditions and for information about how conditions could be written to ensure enforceability by federal agencies.

CWA section 401(a)(1) provides that ''[n]o license or permit shall be granted if certification has been denied by the State, interstate agency, or the Administrator, as the case may be.'' 33 U.S.C. 1341(a)(1). In circumstances where certification is denied, the EPA is proposing that the written notification include the reasons for denial, including the specific water quality requirements with which the proposed federally licensed or permitted project will not comply, a statement explaining why the proposed project will not comply with the identified water quality requirements, and the specific data, information, or project modifications, if any, that would be needed for the certifying authority to determine that the discharge will comply with water quality requirements. In circumstances where a certifying authority is unable to certify that a discharge will comply with the Act, EPA is proposing that the certifying authority may deny certification or waive the requirement for certification. The EPA notes that there may be multiple reasons why a certifying authority may be unable to certify, including a lack of resources for reviewing the certification request, other more pressing priority work that the agency must attend to, or because the information provided to the agency demonstrates that the discharge will not comply with the Act. Under the former circumstances, waiver may be appropriate and under the latter circumstance, denial would be appropriate. The statute does not prevent a project proponent from reapplying for a section 401 certification if the original request is denied, and this proposal reaffirms the ability of a project proponent to submit a new certification request. In the event that a denial is issued, the EPA recommends that the project proponent discuss with the certifying authority whether project plans could be altered to meet applicable water quality requirements upon submittal of a new request for certification.

Where a federal agency determines that a certifying authority's denial satisfied the requirements of section 401, the EPA proposes that the federal agency provide written notification to the certifying authority and the project proponent that the denial was consistent with section 401 and that the license or permit will not be granted. A project proponent may explore its options to challenge a denial in court, or alternatively, it may submit a new request for certification that addresses the water quality issues identified in the denial in addition to the other requirements for a request for certification, as discussed in section III.B in this preamble.

Where a federal agency determines that a certifying authority's denial failed to meet the requirements of section 401, the EPA proposes that the federal agency provide written notification to the certifying authority and the project proponent and indicate which provision(s) of section 401 the certifying authority failed to meet. If the federal agency receives the certifying authority's certification decision prior to the end of the reasonable period of time, the federal agency may provide the certifying authority an opportunity to remedy the deficiencies within the remaining period of time. In such circumstances, if the certifying authority does not provide an updated certification decision by the end of the reasonable period of time, under the proposal the federal agency would treat the certification in a similar manner as waiver. The EPA solicits comment on whether this opportunity to remedy a deficient denial would be helpful and an appropriate use of federal agency resources, whether it should be mandatory for federal agencies to provide this opportunity, and whether it is within the scope of Agency authority to establish through regulation.

EPA's proposed regulations at sections 121.6 (Effect of denial of certification), 121.7 (Waiver), and 121.8 (Incorporation of conditions in the license or permit) contemplate that the licensing or permitting agency would review and make appropriate determinations about the adequacy of certain aspects of a 401 certification. Establishing such a role for federal licensing or permitting agencies is a reasonable interpretation of the CWA. In *City of Tacoma, Washington* v. *FERC,* the Court of Appeals for the D.C. Circuit noted that ''[i]f the question regarding the state's section 401 certification is not the application of state water quality standards but compliance with the terms of section 401, then [the federal agency] must address it. This conclusion is evident from the plain language of section 401: 'No license or permit shall be granted until the certification *required by this section* has been obtained or has been waived.' '' 460 F.3d at 67–68 (citing 33 U.S.C. 1341(a)(1)) (emphasis in original). The court went on to explain that even though the federal agency did not need to ''inquire into every nuance of the state law proceeding . . . it [did] require [the federal agency] to at least to confirm that the state has facially satisfied the express requirements of section 401.'' *Id.* at 68; *see also Hoopa Valley Tribe* v. *FERC,* 913 F.3d 1099, 1105 (D.C. Cir. 2019) (''had FERC properly interpreted Section 401 and found waiver when it first manifested more than a decade ago, decommissioning of the Project might very well be underway''); *Airport Communities Coalition* v. *Graves,* 280 F. Supp.2d 1207, 1217 (W.D. Wash. 2003) (holding that the Army Corps had discretion not to incorporate untimely certification conditions).[43]

In circumstances where certification is waived, under this proposal, the federal agency may continue processing the license or permit in accordance with its implementing regulations. As discussed in section III.E and section III.F in this preamble, under this

[43] Cases like *Sierra Club,* 909 F.3d at 645; *Snoqualmie Indian Tribe,* 545 F.3d at 1218; and *FERC,* 952 F.2d at 548 are not to the contrary. These cases do not stand for the proposition that licensing agencies have no role to play in reviewing and implementing state or tribal certifications. Although the courts' language is at times strong (*e.g.,* ''FERC may not alter or reject conditions''), a closer reading shows that these holdings are more nuanced. In *Sierra Club,* the court faulted FERC for replacing a state certification condition with a different, alternative condition *FERC thought was more protective.* In *Snoqualmie,* the court allowed FERC to require additional license conditions *that did not conflict with or weaken* the protections provided by the state's certificate. In *FERC,* the court upheld FERC's hydroelectric facility license, observing that ''we have no reason to doubt that any *valid* conditions imposed by West Virginia in its section 401 certificates must and will be respected by the Commission.'' (Emphasis added). Even *American Rivers,* 129 F.3d at 110–111, recognized that FERC ''may determine whether the proper state has issued the certification or whether a state has issued a certification within the prescribed period.'' To the extent any of these cases arguably stand for the proposition that licensing agencies lack the authority or discretion to make appropriate determinations regarding the adequacy of certain aspects of a state's or authorized tribe's certification, EPA disagrees.

proposal a certifying authority may waive its opportunity to certify, either expressly by issuing a statement that it is waiving its opportunity to certify or by failing or refusing to act within the reasonable period of time and in accordance with section 401.

The EPA's existing certification regulations recognize the role of the federal agency to determine whether a waiver has occurred. 40 CFR 121.16(b); *see also Millennium Pipeline Company, L.L.C.* v. *Seggos,* 860 F.3d at 700–701 (acknowledging that a project proponent can ask the federal agency to determine whether a waiver has occurred). As discussed in section III.E in this preamble, the federal agency also determines the reasonable period of time for a certifying authority to act on a request for certification. The EPA proposes to reaffirm that it is the federal agency that also determines whether a waiver has occurred.

The EPA is also proposing to clarify the procedures for a federal agency to notify a certifying authority that a waiver has occurred. If the certifying authority fails or refuses to act before the date specified by the federal agency, as explained in section III.E in this preamble, the federal agency would be required to communicate to the certifying authority and project proponent in writing that waiver has occurred. The communication would also include the original notification from the federal agency to the certifying authority of the reasonable period of time.

As discussed in section III.E in this preamble, the practice of withdrawing and resubmitting the same request for certification does not pause or reset the clock for purposes of determining whether a waiver has occurred. In *Hoopa Valley Tribe,* the Court of Appeals for the D.C. Circuit held that waiver occurred where the applicant and certifying authority coordinated to repeatedly resubmit the same certification request for over a decade. 913 F.3d 1099.

This proposal reaffirms the ability of a state to expressly or affirmatively waive the requirement to obtain a section 401 certification. Although the statute does not explicitly provide for express or affirmative waiver, such waivers are consistent with the certification authority's ability to waive through failure or refusal to act. An express or affirmative decision to waive certification does not provide the certifying authority's determination of whether or not the section 401 certification request will comply with the Act. Instead, an express or affirmative waiver indicates that the certifying authority has chosen not to act on a certification request. *See EDF* v. *Alexander,* 501 F. Supp. 742, 771 (N.D. Miss. 1980) (''We do not interpret [the Act] to mean that affirmative waivers are not allowed. Such a construction would be illogical and inconsistent with the purpose of this legislation.''). Additionally, express or affirmative waiver enables the federal agency to proceed with processing an application where the certifying authority has stated it does not intend to act, thereby avoiding the need to wait for the reasonable period of time to lapse.

The Agency solicits comments on whether the proposed approach appropriately captures the scope of authority for granting, conditioning, waiving, and denying a section 401 certification, and whether the proposed approach also effectively addresses those circumstances where certification is sought for general permits issued by the federal agencies (*e.g.,* 33 U.S.C. 1344(e)).

G. Certification by the Administrator

Section 401(a)(1) of the CWA provides that ''[i]n any case where a State or interstate agency has no authority to give such a certification, such certification shall be from the Administrator.'' 33 U.S.C. 1341(a)(1). Currently, all states have authority to implement section 401 certification programs. However, there are two scenarios where the EPA acts as the certifying authority: (1) On behalf of federally recognized Indian tribes that have not received TAS for section 401, and (2) on lands of exclusive federal jurisdiction, such as Denali National Park. As discussed in section II.F.1 in this preamble, tribes may obtain TAS authorization for purposes of issuing CWA section 401 certifications. If a tribe does not obtain TAS for section 401 certifications, the EPA is responsible to act as the certifying authority for projects proposed on tribal land. The Agency solicits comment on whether additional information on the TAS process for section 401 certifications would be helpful and how the Agency could best communicate that information to the public.

The federal government may obtain exclusive federal jurisdiction in multiple ways, including where the federal government purchases land with state consent consistent with article 1, section 8, clause 17 of the U.S. Constitution; where a state chooses to cede jurisdiction to the federal government; and where the federal government reserved jurisdiction upon granting statehood. *See Collins* v. *Yosemite Park Co.,* 304 U.S. 518, 529–30 (1938); *James* v. *Dravo Contracting Co.,* 302 U.S. 134, 141–42 (1937); *Surplus Trading Company* v. *Cook,* 281 U.S. 647, 650–52 (1930); *Fort Leavenworth Railroad Company* v. *Lowe,* 114 U.S. 525, 527 (1895). For example, the federal government retained exclusive jurisdiction over Denali National Park in Alaska's Statehood Act. Alaska Statehood Act, Public Law 85–508, 72 Stat. 339 (1958). Considering the potential for jurisdictional overlap between certifying authorities at certain project sites (*e.g.,* boundary between tribal land and a state), the Agency encourages project proponents to engage in pre-application communications with certifying authorities and federal agencies to ensure project proponents submit a request for certification to the appropriate certifying authority.

The EPA's existing certification regulations discuss circumstances where the Administrator certifies instead of a state, tribe, or interstate authority. The Agency proposes to modernize and clarify these regulations, and withdraw the text in 40 CFR 121.21 in its entirety and replace it with the following text:

> Certification by the Administrator that the discharge from a proposed project will comply with water quality requirements will be required where no state, tribe, or interstate agency has authority to give such a certification.

In circumstances where the EPA is the certifying authority and the water body impacted by the proposed discharge does not have any applicable water quality standards, the EPA's existing regulation provides the EPA with an advisory role. 40 CFR 121.24. The statute does not explicitly provide for this advisory role, and therefore this proposal does not include a similar provision. However, the Agency believes that this advisory role may not be inconsistent with the Agency's technical advisory role provided at 33 U.S.C. 1341(b). In an alternate approach, the Agency may reaffirm the Agency's advisory role when it certifies for water bodies without water quality requirements. The Agency solicits comment on its interpretation of the EPA's advisory role under Section 401 and the utility of maintaining such a role for the EPA.

This proposal includes three procedural requirements that would apply when the Administrator is the certifying authority: Clarified public notice procedures, a pre-filing meeting process, and specific timelines and requirements for the EPA to request additional information to support a certification request. Each of these is discussed below and would be contained in proposed sections 121.11 through 121.13.

1. Public Notice Procedure

Section 401 requires a certifying authority to provide procedures for public notice, and a public hearing where necessary, on a certification request. The courts have held that this includes a requirement for public notice itself. *City of Tacoma,* 460 F.3d at 68. As discussed above in section III.B in this preamble, the timeframe for making a certification decision begins upon receipt of request, and not when the public notice is issued. The existing regulations at 40 CFR part 121.23 describe the EPA's procedures for public notice after receiving a request for certification.

The EPA proposes to update these regulations to provide greater clarity to project proponents, federal agencies, and other interested parties on the EPA's procedures for public notice when it is acting as the certifying authority. Under the proposal, the Agency would provide appropriate public notice within 20 days of receipt of a certification request to parties known to be interested, such as tribal, state, county, and municipal authorities, heads of state agencies responsible for water quality, adjacent property owners, and conservation organizations. If the EPA in its discretion determines that a public hearing is appropriate or necessary, the Agency would, to the extent practicable, give all interested and affected parties the opportunity to present evidence or testimony at a public hearing.

When acting as a certifying authority, the EPA is subject to the same timeframes and section 401 certification requirements as other certifying authorities. The Agency requests comment on whether providing public notice within 20 days of receipt is appropriate or whether more or less time would be appropriate.

2. Pre-Filing Meeting Procedure

This proposal also includes for the first time a requirement that the project proponent request a pre-filing meeting with the EPA when the Agency is the certifying authority. The Agency solicits comment regarding whether the term ''request'' as used in the statute is broad enough to include an implied requirement that, as part of the submission of a request for certification, a project proponent also provide the certifying authority with advance notice that a request is imminent. The fact that the statute requires the certifying authority to act on a request within a relatively short time (no longer than one year and possibly much less) or else waive, provides some justification in this context to interpret the term ''request for certification'' to also include a pre-filing meeting process.

In order to facilitate early engagement and coordination, and using its discretion to interpret the term ''request'' as applied to its own certification procedures, the EPA is proposing a regulatory requirement for a 30-day pre-filing meeting process. Under this proposal, a project proponent would be required to request in writing a pre-filing meeting with EPA as the certifying authority at least 30 days before submitting a certification request. As proposed, the EPA would be required to promptly accommodate the meeting request or respond in writing that such a meeting is not necessary. This proposed pre-filing meeting process would give the EPA the option to meet with project proponents before a certification request is received to learn more about a proposed federally licensed or permitted project. Alternatively, the EPA would have the option to decline the meeting request. The EPA expects to take advantage of this proposed pre-filing meeting process for larger or more complex projects and may choose to decline the request for more routine and less complex projects.

The EPA is proposing to require this pre-filing meeting process to trigger early communication with the EPA about important aspects of section 401 certification requests *before* the project proponent submits its certification request. The period prior to submitting a certification request provides an opportunity for the project proponent to verify whether a section 401 certification is required and for the EPA to identify potential information, in addition to the request requirements proposed in this rule, that may be necessary to evaluate the certification request. This will be particularly important if the EPA anticipates requesting additional information from the project proponent.

Pre-filing meetings could be particularly helpful for complex projects. In all cases, the EPA recommends that preliminary discussions between the project proponent and the EPA begin well before submittal of a certification request. Early engagement and coordination, including participation in a pre-filing meeting or other pre-filing procedures, may also help increase the quality of application materials and reduce the need for the EPA to request additional information during the CWA section 401 review period. For further discussion, see section III.E in this preamble.

Many states and tribes have indicated how valuable pre-filing communication between the project proponent and the certifying authority can be. The Association of Clean Water Administrators also reports that many states either require or encourage pre-filing meetings with project proponents and observes that many states work with project proponents through early engagement to ensure project proponents are aware of the state's information needs. During pre-proposal outreach for this rulemaking, stakeholders identified and recommended specific opportunities for early coordination among the project proponent, certifying authority, and relevant federal agencies. For instance, some stakeholders encouraged pre-filing meetings, and others encouraged early information sharing between federal agencies and certifying authorities.

The EPA's existing section 401 certification regulations do not address pre-filing consultation with the EPA or any other certifying authority. However, other federal agencies provide for pre-filing discussions in their regulations. For example, FERC regulations provide that ''[b]efore it files any application for an original, new, or subsequent license under this part, a potential applicant must consult with the relevant Federal, state, and interstate resource agencies. . . .'' 18 CFR 5.1(d)(1). Additionally, the Corps regulations state ''[t]he district engineer will establish local procedures and policies including appropriate publicity programs which will allow potential applicants to contact the district engineer or the regulatory staff element to request pre-application consultation.'' 33 CFR 325.1(b).

The Agency encourages states and tribes to engage in early communications with project proponents and federal agencies, including participation in pre-filing meetings that federal agencies may require for their licensing or permitting processes, as these meetings may provide significant advance notice and additional information about proposed federally licensed or permitted projects and upcoming or future certification requests. However, this proposal would only require a pre-filing meeting process when the EPA is the certifying authority. The EPA received recommendations from many states and tribes during the pre-proposal process that additional pre-filing procedures would be valuable for them as well, and the EPA would like to be responsive to these comments. The EPA seeks comment on the proposed pre-filing meeting process. The EPA is particularly interested in comments related to existing state, tribal or federal agency pre-filing notice or meeting requirements and whether such requirements have favorably affected the review and disposition of certification requests, particularly with respect to timely receipt of information relevant for reaching informed section 401 certification decisions. The EPA also solicits comment on whether states, tribes and project proponents would like this pre-filing meeting process to be required for all certification requests, including those where the EPA is not the certifying authority, and what legal authority the EPA would have to impose such requirements on states and tribes through this rulemaking. The EPA also solicits comment on whether such pre-filing meeting process, if adopted nationwide, should be mandatory or discretionary. If such pre-filing meeting process were mandatory, the EPA also solicits comment on the regulatory effect of a project proponent or certifying authority failing to participate in this process.

3. Requests for Additional Information

The definition of a certification request in this proposal identifies the information that project proponents would be required to provide to certifying authorities when they submit a request for certification. However, in some cases, the EPA and other certifying authorities may conclude that additional information is necessary to determine that the proposed activity will comply with water quality requirements (as defined at § 121.1(p) of this proposal). Section 401 does not expressly address the issue of whether and under what conditions a certifying authority may request additional information to review and act on a certification request. Given the importance of this issue, it is reasonable and consistent with the CWA's statutory framework that EPA when acting as a certifying authority be afforded the opportunity to seek additional information necessary to do its job. However, consistent with the statute's firm timeline, it is also reasonable to assume that Congress intended there to be some appropriate limits placed on the timing and nature of such requests. This proposal fills the statutory gap and provides a structure for the EPA as the certifying authority to request additional information and for project proponents to timely respond. The structure in this proposal includes procedural processes and timeframes for action and is intended to provide transparency and regulatory certainty for the EPA and project proponents.

Certifying authorities like the EPA need relevant information as early as possible to review and act on section 401 certification requests within the reasonable period of time. As discussed earlier, the proposed pre-filing meeting process is intended to ensure that the EPA has an opportunity to engage with the project proponent early, learn about the proposed federally licensed or permitted project, and consider what information might be needed from the project proponent to act on a certification request. The EPA is also proposing that the Agency would have 30 days after the receipt of a certification request to seek additional information from the project proponent. Additional information may include more detail about the contents of the potential discharge from the proposed federally licensed or permitted project or specific information about treatment or waste management plans or, where the certification will also cover a federal operation permit, additional details about discharges associated with the operation of the facility.

The EPA is also proposing that the Agency would only request additional information that can be collected or generated within the established reasonable period of time. Under this proposal, in any request for additional information, the EPA would include a deadline for the project proponent to respond. The deadline must be required to allow sufficient time for the Agency to review the additional information and act on the certification request within the established reasonable period of time. The EPA is proposing that project proponents would be required to submit requested information by the EPA's deadline. If the project proponent fails to submit the requested information, the EPA may conclude that it does not have sufficient information to certify that the discharge will comply with applicable water quality requirements. The EPA may also use its expertise to evaluate the potential risk associated with the remaining information or data gap and consider issuing timely certification with conditions to address those potential risks. The EPA expects these proposed procedures to provide clarity and regulatory certainty to the EPA and project proponents.

This proposal is intended to address concerns that the EPA heard from stakeholders during the pre-proposal period concerning the desire for pre-filing procedure and additional information requests. The EPA recognizes the advantages of working cooperatively with project proponents to secure the information needed to conduct an informed review of a certification request. This proposal provides additional procedures to assure the EPA will have an opportunity to request additional information to make informed and timely decisions on certification requests.

This proposal is also intended to address other issues that have caused delays in certifications and project development and that have resulted in protracted litigation. For example, the Agency is aware that some certifying authorities have requested "additional information" in the form of multi-year environmental investigations and studies, including completion of a NEPA review, before the authority would begin review of the certification request.[44] [45] Consistent with the plain language of section 401, under this proposal such requests from the EPA would not be authorized because they would extend the statutory reasonable period of time, which is not to exceed one year. This proposal provides clarity that, while additional information requests may be a necessary part of the certification process, such requests may not result in extending the period of time beyond which the CWA requires the EPA to act.

[44] *See e.g., Exelon Generation Co.* v. *Grumbles,* 2019 WL 1429530 (D.D.C. 2019) (describing how the State of Maryland's request for a multi-year sediment study resulted in Exelon withdrawing and resubmitting its certification request multiple times to prevent waiver while the company completed the study).

[45] Some stakeholders have suggested that it may be challenging for a state to act on a certification request without the benefit of review under NEPA or a similar state authority. *See e.g.,* Cal. Pub. Res. Code Section 21000 *et seq.;* Wash. Rev. Code Section 43.21C.150. Consistent with the EPA's June 7, 2019 guidance, the EPA recommends that certifying authorities not delay action on a certification request until a NEPA review is complete. The environmental review required by NEPA has a broader scope than that required by section 401. For example, the NEPA review evaluates potential impacts to all environmental media, as well as potential impacts from alternative proposals that may not be the subject of a federal license or permit application. By comparison, a section 401 certification review is far more narrow and is focused on assessing potential water quality impacts from the proposed federally licensed or permitted project. Additionally, the NEPA process has historically taken more than one year to complete and waiting for a NEPA process to conclude may result in waiver of the certification requirement for failure to act within a reasonable period of time. To the extent that state or tribal implementing regulations require a NEPA review to be completed as part of a section 401 certification review, the EPA encourages certifying authorities to update those regulations to incorporate deadlines consistent with the reasonable period of time established under the CWA, or decouple the NEPA review from the section 401 process to ensure timely action on section 401 certification requests.

The EPA is aware that some states have regulations addressing timeframes within which states must request additional information after the receipt of a request for certification. For instance, the California Code of Regulations states that, ''Upon receipt of an application, it shall be reviewed by the certifying agency to determine if it is complete. If the application is incomplete, the applicant shall be notified in writing no later than 30 days after receipt of the application, of any additional information or action needed.'' Cal. Code Regs. tit. 23, 3835(a). The EPA also notes that some state regulations may require the completion of certain processes, studies or other regulatory milestones before it will consider a certification request. Although the CWA does provide flexibility for certifying authorities to follow their own administrative processes, particularly for public notice and comment, *see* 33 U.S.C. 1341(a), these processes cannot be implemented in such a manner to violate the plain language of the CWA. The Act requires the timeline for review to begin upon receipt of a certification request and requires certifications to be processed within a reasonable period of time, not to exceed one year.

A number of stakeholders submitted recommendations to the pre-proposal docket that the EPA propose procedural requirements for certifying authorities' requests for additional information. Some stakeholders recommended certifying authorities be required to request additional information within 90 days of receipt, and that project proponents must be required to respond within 60 days. The EPA appreciates these recommendations but notes that those timelines would not be workable if the federal agency establishes the reasonable period of time as, for example, 60 days from receipt.[46] The EPA understands that providing only 30 days from receipt for the EPA to request additional information may seem short but the proposed pre-filing meeting process is a way for the Agency to understand more about the proposed federally licensed or permitted project before the certification request is submitted. The EPA solicits comment on whether 30 days would be too long in cases with a 60-day reasonable period of time for a certifying authority to act on a request. The EPA also solicits comment on other appropriate timelines for requesting additional information that would be consistent with the reasonable period of time established by the federal agency.

[46] The Army Corps' existing federal regulations require certifications to be completed within 60 days unless circumstances require more or less time. 33 CFR 325.2(b)(1)(ii).

The EPA solicits comment on whether nationally consistent procedures for requesting and receiving additional information to support a certification request would provide additional clarity and regulatory certainty for certifying authorities and project proponents. The EPA solicits comment on whether the procedures in this proposal should be encouraged or required for all certifying authorities, not just the EPA, and under what authority the Agency could require states and tribes to comply with these procedures.

H. Determination of Effect on Neighboring Jurisdictions

Section 401(a)(2) provides a mechanism for the EPA to coordinate input from states and authorized tribes where the EPA has determined the discharge from a proposed federally licensed or permitted project subject to section 401 may affect the quality of their waters. The EPA's existing pre-1972 certification regulations establish procedural requirements for this process but require updating to align with the modern CWA section 401 and establish additional clarity. Additionally, pre-proposal stakeholder input identified section 401(a)(2) as an area of the regulations in need of procedural clarification.

This proposal affirms the EPA's interpretation that section 401(a)(2) establishes a discretionary authority for the Agency to determine if a water quality certification and related federal license or permit may impact the water quality in a neighboring jurisdiction. Where the Agency in its discretion has determined that the certified license or permit ''may affect'' the quality of water in any other state or authorized tribal jurisdiction, the Act requires the EPA to coordinate input from the affected jurisdictions and make recommendations to the federal agency.

This proposal modifies the EPA's existing certification regulations to mirror the CWA in describing EPA's procedural duties regarding neighboring jurisdictions. The statute provides that, following notice of a section 401 certification, the Administrator shall within 30 days notify a potentially affected downstream state or authorized tribe ''[w]henever such a discharge *may affect, as determined by the Administrator,* the quality of the waters of any other State.'' 33 U.S.C. 1341(a)(2) (emphasis added). Because the EPA's duty to notify is only triggered when the EPA has made a determination that a discharge ''may affect'' a downstream state or tribe, the section 401(a)(2) notification requirement is contingent. It is not a duty that applies to EPA with respect to all certifications and licenses, rather it applies where—at its discretion—EPA has determined that the discharge in question ''may affect'' a neighboring jurisdiction's waters. This proposal provides updated language to increase clarity regarding EPA's discretionary determination.

The EPA also proposes to clarify the section 401(a)(2) notification process in this proposal, as such procedures are not described in sufficient detail in the existing regulations. If the EPA in its discretion determines that a neighboring jurisdiction may be affected by a discharge from a federally licensed or permitted project, the EPA must notify the affected jurisdiction, certifying authority, and federal agency within 30 days of receiving the notice of the certification request from the federal agency. If the EPA in its discretion does not determine that the discharge may affect neighboring waters, the EPA would not provide section 401(a)(2) notice.

The EPA is proposing that its notification to neighboring jurisdictions be in writing, dated, and state that the affected jurisdiction has 60 days to notify the EPA and the federal agency, in writing, whether or not the discharge will violate any of its water quality requirements (as defined at § 121.1(p) of this proposal) and whether the jurisdiction will object to the issuance of the federal license or permit and request a public hearing from the federal agency. The EPA is also proposing that, if an affected jurisdiction requests a hearing, the federal agency forward the hearing notice to the EPA at least 30 days before the hearing takes place. The EPA would then provide its recommendations on the federal license or permit at the hearing. After considering the EPA and affected jurisdiction's input, the federal agency would under this proposal be required to condition the license or permit as necessary to assure that the discharge from the certified project will comply with applicable water quality requirements. Under this proposal, if additional conditions cannot assure that the discharge from the certified project will comply with water quality requirements, the federal agency would not issue the license or permit. The proposed regulation further clarifies that the federal agency may not issue the license or permit pending the conclusion of the determination of effects on a neighboring jurisdiction. The EPA solicits comments on this approach and whether additional process or clarification is needed to explain the EPA's role in determining the effects on neighboring jurisdictions.

I. EPA's Role in Review and Advice

This proposal reaffirms the EPA's important role in providing advice and assistance. Section 40 CFR 121.30 of the existing regulations specifically highlight the EPA's role in assisting federal agencies as they assess project compliance with conditions of a license or permit. Although this proposal aims to provide greater clarity on section 401 implementation, the Agency recognizes its role in providing advice and assistance as needed. For example, the EPA proposes to change the term ''water quality standards''—as currently appearing in 40 CFR 121.30—to ''water quality requirements'' in 121.15(a) to align its regulations with the scope of review and the scope of conditions specified in section III.D in this preamble. This change is not intended to preclude federal agencies from seeking support in interpreting applicable water quality standards or requirements and evaluating the appropriate scope of review and conditions for particular projects and certification.

The EPA also proposes to clarify that federal agencies, certifying authorities, and project proponents may seek the EPA's technical expertise at any point during the section 401 water quality certification process. Additionally, the EPA proposes that a certifying authority, federal agency, or project proponent may request assistance from the Administrator to evaluate whether a certification condition is intended to address potential water quality impacts caused by the discharge from a proposed federally licensed or permitted project into waters of the United States. See section III.D in this preamble for further discussion on the appropriate scope of certification conditions. The Agency solicits comment on whether this proposal is tailored for the EPA to provide appropriate technical assistance to certifying authorities, federal agencies and project proponents, or if the EPA should offer or provide assistance in other specific or additional circumstances.

J. Enforcement

The CWA expressly notes that all certification conditions ''shall become a condition on any Federal license or permit'' subject to section 401. 33 U.S.C. 1341(d); *see also Am. Rivers,* 129 F.3d at 111 (''The CWA . . . expressly requir[es] [federal agencies] to incorporate into its licenses state-imposed-water-quality-conditions.''). However, the EPA's existing certification regulations do not discuss the federal agency's responsibility to enforce such conditions after they are incorporated into the permit. Under this proposal and consistent with the Act, a federal agency would be responsible for enforcing conditions included in a certification that are incorporated into a federal license or permit. The EPA requests comment on these provisions, and whether additional enforcement procedures may be appropriate to further define the federal agency's enforcement obligations. In limited circumstances, the EPA's existing certification regulations require the Agency to provide notice of a violation and allow six months for a project proponent to return to compliance before pursuing further enforcement. *See* 40 CFR 121.25. The Agency solicits comment on whether specific procedures such as these would be reasonable to include in section 401 regulations, or whether the general enforcement provisions of the CWA provide sufficient notice and procedure.

The Agency notes that section 401 does not provide an independent regulatory enforcement role for certifying authorities for conditions included in federal licenses or permits. The role of the certifying authority is to review the proposed project and either grant certification, grant with conditions, deny, or waive certification. Once the certifying authority acts on a certification request, section 401 does not provide an additional or ongoing role for certifying authorities to enforce certification conditions under federal law; rather, that role is reserved to the federal agency issuing the federal license or permit. The Agency solicits comment on this interpretation and whether clarification on this point may be appropriate to include in the regulatory text.

Enforcement plays an essential role in maintaining robust compliance with section 401 certification conditions and a critical part of any strong enforcement program is the appropriate use of enforcement discretion. *Heckler* v. *Chaney,* 470 U.S. 821, 831 (1985) (''This Court has recognized on several occasions over many years that an agency's decision not to prosecute or enforce, whether through civil or criminal process, is a decision generally committed to an agency's absolute discretion.''). Enforcement programs exercise discretion and make careful and informed choices about where to conduct investigations, identifying the most serious violations and reserving limited enforcement resources for the cases that can make the most difference. *Sierra Club* v. *Whitman,* 268 F.3d 898 (9th Cir. 2001). It is important for enforcement programs to retain their enforcement discretion because federal agencies are in the best position to (1) determine whether the action is likely to succeed, (2) assess whether the enforcement action requested fits the agency's policies, and (3) determine whether they have enough resources to undertake the action. *See Heckler,* 470 U.S. at 831. Further, federal agencies' decisions not to enforce generally are not subject to judicial review, because they involve balancing several factors. *Id.* These factors include ''whether a violation has occurred, . . . whether agency resources are best spent on this violation or another, whether the agency is likely to succeed if it acts, whether the particular action requested best fits the federal agency's overall policies, and, indeed, whether the agency has enough resources to undertake the action at all.'' *Id.*

Section 401(a)(4) and the EPA's existing regulations at 40 CFR part 121.26 through 121.28 describe circumstances where the certifying authority may inspect a facility that has received certification prior to operation [47] and notify the federal agency to determine if the facility will comply with applicable water quality requirements. 33 U.S.C. 1341(a)(4). The Agency proposes to update these regulations to reflect the scope of certification review under the modern CWA in the proposed regulations at § 121.9 (see section III.D in this preamble). Additionally, consistent with section 401, the EPA proposes to expand this inspection function to all certifying authorities and clarify the process by which certifying authorities should notify the federal agency and project proponent of any concerns.

Consistent with section 401, this proposal provides certifying authorities the opportunity to inspect the project facility or activity prior to operations, in order to determine if the discharge from the certified project will comply with the certification. After an inspection, the certifying authority would be required to notify the project proponent and federal agency in writing if the discharge from the certified project will violate the certification. The certifying authority would also be required to specify recommendations of measures that may be necessary to bring the certified project into compliance with the certification. The Agency solicits comment on whether there are

[47] The Agency notes that operation may include implementation of a certified project.

additional procedures or clarifications that would provide greater regulatory certainty for certifying authorities, federal agencies, and project proponents.

K. Modifications

Section 401 does not provide an express oversight role for the EPA with respect to the issuance or modification of individual water quality certifications by certifying authorities, other than the requirement that the EPA provide technical assistance under section 401(b) and the limited role the EPA is expected to play for ensuring the protection of other states' waters under section 401(a)(2). However, the EPA's existing certification regulations provide the Agency a unique oversight role in the context of a modification to an existing water quality certification. 40 CFR 121.2(b). The EPA is proposing to remove this provision from the regulatory text as it is inconsistent with the Agency's role for new certifications. In the alternative, the Agency requests comment on whether it should maintain the existing oversight provision for certification modifications to provide a regulatory backstop for ensuring consistency with the CWA, given the relative infrequency of occurrence and the unique nature the circumstances giving rise to a modification request.

The Agency also solicits comment on the appropriate scope of the EPA's general oversight role under section 401, whether the EPA should play any role in oversight of state or tribal certifications or modifications, and, if so, what that role should be. The Agency also requests comment on the legal authority for a more involved oversight role in individual water quality certifications or modifications. In addition, in light of the statute's one-year time limit for acting on a section 401 certification, the EPA solicits comment on whether and to what extent states or tribes should be able to modify a previously issued certification, either before or after the time limit expires, before or after the license or permit is issued, or to correct an aspect of a certification or its conditions remanded or found unlawful by a federal or state court or administrative body.

IV. Economic Analysis

Pursuant to Executive Orders 12866 and 13563, the Agency conducted an economic analysis to better understand the potential effects of this proposal on certifying authorities and project proponents. While the economic analysis is informative in the rulemaking context, the EPA is not relying on the analysis as a basis for this proposed rule. *See, e.g., Nat'l. Assn. of Homebuilders* v. *EPA,* 682 F.3d 1032, 1039–40 (D.C. Cir. 2012). The analysis is contained and described more fully in the document *Economic Analysis for the Proposed Clean Water Act Section 401 Rulemaking.* A copy of this document is available in the docket for this action.

Section 401 certification decisions have varying effects on certifying authorities and project proponents. The Economic Analysis provides a qualitative analysis of the current and proposed section 401 certification process to make the best use of limited information to assess the potential impacts of this proposed rule on project proponents and certifying authorities. Using the current practice as the baseline, the document assesses the potential impacts to certifying authorities and project proponents from the proposed revisions to the section 401 certification process. In particular, the Economic Analysis focuses on the proposed revisions to the time period for review, the scope of review, and the proposed process requirements applicable when the EPA is the certifying authority. The Economic Analysis explores these changes in more detail through four case studies.

This proposal will help certifying authorities, federal agencies, and project proponents understand what is required and expected during the section 401 certification process, thereby reducing regulatory uncertainty. The Economic Analysis concludes that improved clarity on the scope and reasonable period of time for certification review may make the certification process more efficient for project proponents and certifying authorities.

The Agency solicits comments on all aspects of the analysis, including assumptions made and information used, and requests any data that may assist the Agency in evaluating and characterizing the potential impacts of the proposed revisions to the section 401 certification process. The Agency also solicits comment on the utility of using case studies to inform the Agency's analysis, the utility of the specific case studies selected, and if there are other examples that could also serve as informative case studies.

V. Statutory and Executive Order Reviews

Additional information about these statutes and Executive Orders can be found at *https://www.epa.gov/laws-regulations/laws-and-executive-orders.*

A. Executive Order 13771: Reducing Regulation and Controlling Regulatory Costs

Pursuant to Executive Order 13771 (82 FR 9339, February 3, 2017), this proposed rule is expected to be a deregulatory action. Although the proposed revisions in certain circumstances may limit the authority of some states and tribes relative to current practice, the Agency believes the net effect of the proposal on the certification process will likely be deregulatory. See *Economic Analysis for the Proposed Clean Water Act Section 401 Rulemaking* for further discussion about the potential effects of this rule.

B. Executive Order 12866: Regulatory Planning and Review; Executive Order 13563: Improving Regulation and Regulatory Review

This action is a significant regulatory action that was submitted to the Office of Management and Budget (OMB) for review. Any changes made in response to OMB recommendations have been documented in the docket for this action. In addition, the Agency prepared an analysis of potential costs and benefits associated with this action. This analysis is contained in the document *Economic Analysis for the Proposed Clean Water Act Section 401 Rulemaking,* which is available in the docket and briefly summarized in section IV in this preamble. Because of the limitations in data availability and uncertainty in the way in which certifying authorities and project proponents may respond following a change in the section 401 certification process, the potential effects of the proposed rule are discussed qualitatively. While economic analyses are informative in the rulemaking context, the agencies are not relying on the economic analysis performed pursuant to Executive Orders 12866 and 13563 and related procedural requirements as a basis for this proposed action.

C. Paperwork Reduction Act

The information collection activities in this proposed rule have been submitted for approval to the Office of Management and Budget (OMB) under the PRA. The Information Collection Request (ICR) document that the EPA prepared has been assigned EPA ICR number 2603.02 (OMB Control No. XXXX).

The information collected under section 401 is used by the certifying authorities for reviewing proposed projects for potential water quality impacts from discharges from an activity that requires a federal license or permit, and by the EPA to evaluate potential effects on downstream or neighboring states and tribes. Except for when the EPA evaluates potential downstream impacts and acts as a certifying authority, information collected under section 401 is not directly collected by or managed by the EPA. The primary collection of information is performed by other federal agencies and states and tribes acting as certifying authorities. Information collected directly by the EPA under section 401 in support of the section 402 program is already captured under existing EPA ICR No. 0229.22 (OMB Control No. 2040).

The revisions in the proposed rule clarify the information project proponents must provide to request a section 401 certification, introduce a preliminary meeting requirement for project proponents where the EPA acts as the certifying authority. The proposed revisions also remove information requirements in the certification modification and 401(a)(2) contexts and provide additional transparency by identifying information necessary to support certification actions. The EPA expects these proposed revisions to provide greater clarity on section 401 requirements, reduce the overall preparation time spent by a project proponent on certification requests, and reduce the review time for certifying authorities. The EPA solicits comment on whether there are ways it can increase clarity, reduce the burden, or improve the quality or utility of the collection of information in general.

In the interest of transparency and public understanding, the EPA has provided here relevant portions of the burden assessment associated with the EPA's existing certification regulations. The EPA does not expect any measurable change in information collection burden associated with the proposed changes.

Respondents/affected entities: Project proponents, state and tribal reviewers (certifying authorities).

Respondent's obligation to respond: Required to obtain 401 certification.

Estimated number of respondents: 41,000 per year.

Frequency of response: Per federal application.

Total estimated burden: 328,000 hours (per year). Burden is defined at 5 CFR 1320.3(b).

Total estimated cost: $18,000,000 (per year).

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 numbers for the EPA's regulations in 40 CFR are listed in 40 CFR part 9.

Submit your comments on the Agency's need for this information, the accuracy of the provided burden estimates and any suggested methods for minimizing respondent burden to the EPA using the docket identified at the beginning of this rule. You may also send your ICR-related comments to OMB's Office of Information and Regulatory Affairs via email to *OIRA_submission@omb.eop.gov,* Attention: Desk Officer for the EPA. Since OMB is required to make a decision concerning the ICR between 30 and 60 days after receipt, OMB must receive comments no later than September 23, 2019. The EPA will respond to any ICR-related comments in the final rule.''

D. Regulatory Flexibility Act

The Agency certifies that this action will not have a significant economic impact on a substantial number of small entities under the Regulatory Flexibility Act (RFA). In making this determination, the impact of concern is any significant adverse economic impact on small entities. An agency may certify that a rule will not have a significant economic impact on a substantial number of small entities if the rule relieves regulatory burden, has no net burden or otherwise has a positive economic effect on the small entities subject to the rule. Section 401 requires federal license or permit project applicants to request certification from the certifying authority. This action will provide project applicants with greater clarity and certainty on the contents of and procedures for a request for certification.

The Regulatory Flexibility Act (RFA) of 1980, as amended by the Small Business Regulatory Enforcement Fairness Act (SBREFA) of 1996, requires Federal agencies to consider the impact of their regulatory proposals on small entities, to analyze alternatives that minimize those impacts, and to make their analyses available for public comments. The RFA addresses three types of small entities: Small businesses, small nonprofits, and small government jurisdictions.

These entities have the following definitions under the RFA: (1) A small business that is a small industrial entity as defined in the U.S. Small Business Administration's size standards (see 13 CFR 121.201); (2) a small organization that is any not-for-profit enterprise that is independently owned and operated and is not dominant in its fields; or (3) a small governmental jurisdiction that is a government of a city, county, town, school district, or special district with a population of less than 50,000.

The RFA describes the regulatory flexibility analyses and procedures that must be completed by federal agencies unless they certify that this rule, if promulgated, would not have a significant economic impact on a substantial number of small entities. This certification must be supported by a statement of factual basis, such as addressing the number of small entities affected by the proposed action, expected cost impacts on these entities, and evaluation of the economic impacts.

These revisions to section 401 do not establish any new requirements directly applicable to regulated entities. This rule may impact states and authorized tribes that implement section 401 in the form of administrative burden and cost. States and tribes are not small entities under the RFA. As such, this rule will not result in impacts to small entities.

E. Unfunded Mandates Reform Act

This proposed rule does not contain an unfunded mandate of $100 million or more as described in the Unfunded Mandates Reform Act of 1995 (UMRA), 2 U.S.C. 1531–1538. The action imposes no enforceable duty on any state, local or tribal governments or the private sector. The proposed rule does not contain regulatory requirements that significantly or uniquely affect small governments.

F. Executive Order 13132: Federalism

The Agency consulted with state and local government officials, or their representative national organizations, during the development of this action as required under the terms of Executive Order 13132 (64 FR 43255, August 10, 1999). On April 24, 2019, the Agency initiated a 30-day Federalism consultation period prior to proposing this rule to allow for meaningful input from state and local governments. The kickoff Federalism consultation meeting occurred on April 23, 2019; attendees included intergovernmental associations and other associations representing state and local governments. Organizations in attendance included: National Governors' Association, U.S. Conference of Mayors, National Conference of State Legislatures, the Environmental Council of States, National League of Cities, Council of State Governments, National Association of Counties, National Association of Towns and Townships, Association of Clean Water Administrators, Western States Water Council, Conference of Western Attorneys' General, Association of State Wetland Managers, and Western

Governors Association. Additionally, one in-person meeting was held with the National Governors' Association on May 7, 2019. The Agency also held an informational webinar for states and tribes on May 8, 2019. At the webinars and meetings, the EPA provided a presentation and sought input on areas of section 401 that may require clarification, including timeframe, scope of certification review, and coordination among project proponents, certifying authorities, and federal licensing or permitting agencies. See section II.C in this preamble for more information on outreach with states prior to federalism consultation. Letters and webinar attendee feedback received by the agency before and during Federalism consultation may be found on the pre-proposal recommendations docket (Docket ID No. EPA–HQ–OW–2018–0855). These webinars, meetings, and letters provided a wide and diverse range of interests, positions, and recommendations to the Agency. See section II.C in this preamble for a summary of recommendations.

This action may change how states administer the section 401 program. Under the technical requirements of Executive Order 13132, the Agency has determined that this proposed rule may not have federalism implications, but believe that the requirements of the Executive Order have been satisfied in any event.

G. Executive Order 13175: Consultation and Coordination With Indian Tribal Governments

The Agency consulted with tribal officials during the development of this action to permit meaningful and timely tribal input, consistent with the EPA Policy on Consultation and Coordination with Indian Tribes. The EPA initiated a tribal consultation and coordination process before proposing this rule by sending a ''Notification of Consultation and Coordination'' letter dated April 22, 2019, to all 573 Federally recognized tribes. The letter invited tribal leaders and designated consultation representatives to participate in the tribal consultation and coordination process. The Agency held two identical webinars on this action for tribal representatives on May 7 and May 15, 2019. The Agency also presented on this action at the Region 9 Regional Tribal Operations Committee Spring meeting on May 22, 2019. Additionally, tribes were invited to two webinars for states, Tribes, and local governments on April 17, 2019 and May 8, 2019. Tribes and tribal organizations sent 14 pre-proposal recommendation letters to the agency as part of the consultation process. All tribal and tribal organization letters and webinar feedback may be found on the pre-proposal recommendations docket (Docket ID No. EPA–HQ–OW–2018–0855). The Agency met with three Tribes at the staff-level. See the section II.C on ''Pre-proposal engagement'' for a summary of recommendations.

This action may change how tribes with TAS for section 401 administer the section 401 program, but will not have an administrative impact on tribes for whom EPA certifies on their behalf. The proposal will not impose substantial direct compliance costs on federally recognized tribal governments nor preempt tribal law.

H. Executive Order 13045: Protection of Children From Environmental Health and Safety Risks

This action is not subject to Executive Order 13045 (62 FR 19885, April 23, 1997) because the environmental health or safety risks addressed by this action do not present a disproportionate risk to children.

I. Executive Order 13211: Actions Concerning Regulations That Significantly Affect Energy Supply, Distribution, or Use

This action is not a ''significant energy action'' as defined in Executive Order 13211 (66 FR 28355, May 22, 2001), because it is not likely to have a significant adverse effect on the supply, distribution, or use of energy.

J. National Technology Transfer and Advancement Act

This proposed rule does not involve technical standards.

K. Executive Order 12898: Federal Actions To Address Environmental Justice in Minority Populations and Low-Income Populations

The human health or environmental risks addressed by this action will not have potential disproportionately high and adverse human health or environmental effects on minority populations, low income populations, and/or indigenous populations, as specified in Executive Order 12898 (59 FR 7629, February 11, 1994).

List of Subjects in 40 CFR Part 121

Environmental protection, Administrative practice and procedure, Intergovernmental relations, Water pollution control.

Dated: August 8, 2019.

Andrew R. Wheeler,

Administrator.

■ For the reasons set forth in the preamble, the EPA proposes to revise 40 CFR part 121 as follows:

PART 121—STATE CERTIFICATION OF ACTIVITIES REQUIRING A FEDERAL LICENSE OR PERMIT

Authority: 33 U.S.C. 1251 *et. seq.*

Subpart A—General

§ 121.1 Definitions.

(a) *Administrator* means the Administrator of the Environmental Protection Agency or the appropriate Regional Administrator to whom the Administrator has delegated Clean Water Act section 401 authority.

(b) *Certification* means a water quality certification issued in accordance with Clean Water Act section 401 and this part.

(c) *Certification request* means a written, signed, and dated communication from a project proponent to the appropriate certifying authority that:

(1) Identifies the project proponent(s) and a point of contact;

(2) Identifies the proposed project;

(3) Identifies the applicable federal license or permit;

(4) Identifies the location and type of any discharge that may result from the proposed project and the location of receiving waters;

(5) Includes a description of any methods and means proposed to monitor the discharge and the equipment or measures planned to treat or control the discharge;

(6) Includes a list of all other federal, interstate, tribal, state, territorial, or local agency authorizations required for the proposed project, including all approvals or denials already received; and

(7) Contains the following statement: '*The project proponent hereby requests that the certifying authority review and take action on this CWA 401 certification request within the applicable reasonable period of time.*'

(d) *Certified project* means a proposed project that has received a Clean Water Act section 401 certification or for which the certification requirement has been waived.

(e) *Certifying authority* means the agency designated by law to certify compliance with applicable water quality requirements in accordance with Clean Water Act section 401.

(f) *Condition* means a specific requirement included in a certification that is within the scope of certification.

(g) *Discharge* for purposes of this part means a discharge from a point source into navigable waters.

(h) *Fail or refuse to act* means the certifying authority actually or constructively fails or refuses to grant or deny certification, or waive the certification requirement, within the scope of certification and within the reasonable period of time.

(i) *Federal agency* means any agency of the Federal Government to which application is made for a license or permit that is subject to Clean Water Act section 401.

(j) *License or permit* means any license or permit granted by an agency of the Federal Government to conduct any activity which may result in a discharge.

(k) *Neighboring jurisdictions* means any other state or authorized tribe whose water quality the Administrator determines may be affected by a discharge for which a certification is granted pursuant to Clean Water Act section 401 and this part.

(l) *Project proponent* means the applicant for a license or permit.

(m) *Proposed project* means the activity or facility for which the project proponent has applied for a license or permit.

(n) *Reasonable period of time* means the time period during which a certifying authority may act on a certification request, established in accordance with § 121.4.

(o) *Receipt* means the date that a certification request is documented as received by a certifying authority in accordance with applicable submission procedures.

(p) *Water quality requirements* means applicable provisions of §§ 301, 302, 303, 306, and 307 of the Clean Water Act and EPA-approved state or tribal Clean Water Act regulatory program provisions.

Subpart B—Certification Procedures

§ 121.2 When certification is required.

Any applicant for a license or permit to conduct any activity which may result in a discharge shall provide the Federal agency a certification from the certifying authority in accordance with this part.

§ 121.3 Scope of certification.

The scope of a Clean Water Act section 401 certification is limited to assuring that a discharge from a Federally licensed or permitted activity will comply with water quality requirements.

§ 121.4 Establishing the reasonable period of time.

(a) The Federal agency shall establish the reasonable period of time categorically or on a case by case basis, which shall not exceed one year from receipt.

(b) Upon submittal of a certification request, the project proponent shall contact the Federal agency in writing to provide notice of the certification request.

(c) Within 15 days of receiving notice of the certification request from the project proponent, the Federal agency shall provide, in writing, the following information to the certifying authority:

(1) The applicable reasonable period of time to act on the certification request;

(2) The date of receipt of the certification request; and

(3) The date upon which waiver will occur if the certifying authority fails or refuses to act on the certification request.

(d) In establishing the reasonable period of time, Federal agencies shall consider:

(1) The complexity of the proposed project;

(2) The potential for any discharge; and

(3) The potential need for additional study or evaluation of water quality effects from the discharge.

(e) The Federal agency may modify an established reasonable period of time, but in no case shall it exceed one year from receipt.

(1) Any request by a certifying authority or project proponent to the Federal agency to extend the reasonable period of time shall be in writing.

(2) If the Federal agency agrees to modify the reasonable period of time, it shall notify the certifying authority and project proponent in writing.

(f) The certifying authority is not authorized to request the project proponent to withdraw a certification request or to take any other action for the purpose of modifying or restarting the established reasonable period of time.

§ 121.5 Action on a certification request.

(a) Any action to grant, grant with conditions, or deny a certification request must be within the scope of certification and completed within the established reasonable period of time. Alternatively, a certifying authority may expressly waive the certification requirement.

(b) If the certifying authority determines that the discharge from a proposed project will comply with water quality requirements it may issue a certification. If the certifying authority cannot certify that the discharge from a proposed project will comply with water quality requirements, it may deny or waive certification.

(c) Any grant of certification shall be in writing and shall include a statement that the discharge from the proposed project will comply with water quality requirements.

(d) Any grant of certification with conditions shall be in writing and shall for each condition include, at a minimum:

(1) A statement explaining why the condition is necessary to assure that the discharge from the proposed project will comply with water quality requirements;

(2) A citation to federal, state, or tribal law that authorizes the condition; and

(3) A statement of whether and to what extent a less stringent condition could satisfy applicable water quality requirements.

(e) Any denial of certification shall be in writing and shall include:

(1) The specific water quality requirements with which the proposed project will not comply;

(2) A statement explaining why the proposed project will not comply with the identified water quality requirements; and

(3) The specific water quality data or information, if any, that would be needed to assure that the discharge from the proposed project complies with water quality requirements.

(f) If the certifying authority determines that no water quality requirements are applicable to the waters receiving the discharge from the proposed project, the certifying authority shall grant or waive certification.

§ 121.6 Effect of denial of certification.

(a) A certification denial shall not preclude a project proponent from submitting a new certification request, in accordance with the substantive and procedural requirements of this part.

(b) Where a Federal agency determines that a certifying authority's denial satisfies the requirements of Clean Water Act section 401 and §§ 121.3 and 121.5(e), the Federal agency must provide written notice of such determination to the certifying authority and project proponent, and the license or permit shall not be granted.

(c) Where a Federal agency determines that a certifying authority's denial did not satisfy the requirements of Clean Water Act section 401 and §§ 121.3 and 121.5(e), the Federal agency must provide written notice of such determination to the certifying authority and indicate which provision(s) of Clean Water Act section 401 and this part the certifying authority failed to satisfy.

(1) If the Federal agency receives the certifying authority's certification decision prior to the end of the reasonable period of time, the Federal agency may offer the certifying authority the opportunity to remedy the identified deficiencies in the remaining period of time.

(2) If the certifying authority does not provide a certification decision that satisfies the requirements of Clean Water Act section 401 and this part by the end of the reasonable period of time, the Federal agency shall treat the certification in a similar manner as waiver.

§ 121.7 Waiver.

(a) The certification requirement for a license or permit shall be waived upon:

(1) Written notification from the certifying authority to the project proponent and the Federal agency that it expressly waives its authority to act on a certification request; or

(2) The certifying authority's failure or refusal to act on a certification request.

(b) If the certifying authority fails or refuses to act, the Federal agency shall provide written notice to the Administrator, certifying agency, and project proponent that waiver has occurred. This notice must be in writing and include the notice that the Federal agency provided to the certifying authority pursuant to § 121.4(c).

(c) A written notice of waiver from the Federal agency shall satisfy the project proponent's requirement to obtain a certification.

(d) Upon issuance of a written notice of waiver, the Federal agency may issue the license or permit.

§ 121.8 Incorporation of conditions into the license or permit.

(a) All conditions that satisfy the definition of § 121.1(f) and meet the requirements of § 121.5(d) shall be incorporated into the license or permit and shall be federally enforceable.

(1) If the Federal agency determines that a condition does not satisfy the definition of § 121.1(f) and meet the requirements of § 121.5(d), such condition shall not be incorporated into the license or permit. The Federal agency must provide written notice of such determination to the certifying authority and indicate which conditions are deficient and why they do not satisfy provisions of this part.

(2) If the Federal agency receives a certification with conditions that do not satisfy the definition of § 121.1(f) and the requirements of § 121.5(d) prior to the end of the reasonable period of time, the Federal agency may notify the certifying authority and provide an opportunity in the remaining period of time for the certifying authority to remedy the deficient conditions. If the certifying authority does not remedy the deficient conditions by the end of the reasonable period of time, the Federal agency shall not incorporate them in the license or permit.

(b) The license or permit must clearly identify any conditions that are based on the certification.

§ 121.9 Enforcement and compliance of certification conditions.

(a) The certifying authority, prior to the initial operation of a certified project, shall be afforded the opportunity to inspect the proposed discharge location for the purpose of determining if the discharge from the certified project will comply with the certification.

(b) If the certifying authority, after an inspection, determines that the discharge from the certified project will violate the certification, the certifying authority shall notify the project proponent and the Federal agency in writing, and recommend remedial measures necessary to bring the certified project into compliance with the certification.

(c) The Federal agency shall be responsible for enforcing certification conditions that are incorporated into a federal license or permit.

Subpart C—Determination of Effect on Other States

§ 121.10 Determination of effects on neighboring jurisdictions.

(a) Upon receipt of a federal license or permit application and the related certification, the Federal agency shall notify the Administrator.

(b) Within 30 days of receipt of the notice provided by the Federal agency, the Administrator at his or her discretion may determine that the discharge from the certified project may affect water quality in a neighboring jurisdiction. In making this determination and in accordance with applicable law, the Administrator may request copies of the certification and the federal license or permit application.

(c) If the Administrator determines that the discharge from the certified project may affect water quality in a neighboring jurisdiction, the Administrator shall notify the affected neighboring jurisdiction, the certifying authority, the Federal agency, and the project proponent, and the federal license or permit may not be issued pending the conclusion of the processes in this paragraph and paragraph (d) of this section.

(1) Notification from the Administrator shall be in writing, dated, identify the materials provided by the Federal agency, and inform the affected neighboring jurisdiction that it has 60 days to notify the Administrator and the Federal agency, in writing, whether it has determined that the discharge will violate any of its water quality requirements, object to the issuance of the federal license or permit, and request a public hearing from the Federal agency.

(2) Notification of objection from the neighboring jurisdiction shall be in writing, shall identify the receiving waters it determined will be affected by the discharge and the specific water quality requirements it determines will be violated by the certified project, and state whether the neighboring jurisdiction requests a hearing.

(d) If the affected neighboring jurisdiction requests a hearing in accordance with this paragraph, the Federal agency shall hold a public hearing on the affected neighboring jurisdiction's objection to the license or permit.

(1) The Federal agency shall provide the hearing notice to the Administrator at least 30 days before the hearing takes place.

(2) At the hearing, the Administrator shall submit to the Federal agency its

evaluation and recommendation(s) concerning the objection.

(3) The Federal agency shall consider recommendations from the neighboring jurisdiction and the Administrator, and any additional evidence presented to the Federal agency at the hearing and determine if additional conditions are necessary to assure that the discharge from the certified project will comply with water quality requirements.

(4) If additional conditions cannot assure that the discharge from the certified project will comply with water quality requirements, the Federal agency shall not issue the license or permit.

Subpart D—Certification by the Administrator

§ 121.11 When the Administrator certifies.

(a) Certification by the Administrator that the discharge from a proposed project will comply with water quality requirements will be required where no state, tribe, or interstate agency has authority to give such a certification.

(b) In taking action pursuant to this paragraph, the Administrator shall comply with the requirements of the Clean Water Act section 401 and this part.

(c) For purposes of this subpart, the certifying authority is the Administrator.

§ 121.12 Pre-request procedures.

(a) At least 30 days prior to submitting a certification request, the project proponent shall request a pre-filing meeting with the certifying authority.

(b) The certifying authority shall timely grant the pre-filing meeting request or provide written notice to the project proponent that a pre-filing meeting is not necessary.

(c) At the pre-filing meeting, the project proponent and the certifying authority shall discuss the nature of the proposed project and potential water quality effects. The project proponent shall provide a list of applicable state and federal licenses and permits and describe the anticipated timeline for construction and operation.

(d) After the pre-filing meeting, the certifying authority shall contact the Federal agency and identify points of contact at each agency to facilitate information sharing throughout the certification process.

§ 121.13 Request for additional information.

(a) The certifying authority shall have 30 days from receipt to request additional information from the project proponent.

(b) The certifying authority shall only request additional information that is within the scope of certification and directly related to the discharge from the proposed project and its potential effect on the receiving waters.

(c) The certifying authority shall only request information that can be collected or generated within the established reasonable period of time.

(d) In any request for additional information, a certifying authority shall include a deadline for the project proponent to respond.

(1) Project proponents shall comply with deadlines established by the certifying authority.

(2) The deadline must allow sufficient time for the certifying authority to review the additional information and act on the certification request within the established reasonable period of time.

(e) Failure of a project proponent to timely provide the certifying authority with additional information does not modify the established reasonable period of time.

§ 121.14 Notice and hearing.

(a) Within 20 days of receipt of a certification request, the Administrator shall provide appropriate public notice of receipt of such request, including to parties known to be interested in the proposed project or the receiving waters into which the discharge may occur, such as tribal, state, county, and municipal authorities, heads of state agencies responsible for water quality, adjacent property owners, and conservation organizations.

(b) If the Administrator in his or her discretion determines that a public hearing is appropriate or necessary, the agency shall schedule such hearing at an appropriate time and place and, to the extent practicable, give all interested and affected parties the opportunity to present evidence or testimony in person or by other means at a public hearing.

Subpart E—Consultations

§ 121.15 Review and advice.

(a) The Administrator may, and upon request shall, provide federal agencies, certifying authorities, and project proponents with assistance regarding determinations, definitions and interpretations with respect to the meaning and content of water quality requirements, as well as assistance with respect to the application of water quality requirements in particular cases and in specific circumstances concerning a discharge from a proposed project or a certified project.

(b) A certifying authority, Federal agency, or project proponent may request assistance from the Administrator to evaluate whether a condition is intended to address water quality effects from the discharge.

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Part IV

Department of Justice

Antitrust Division

United States v. Sinclair Broadcast Group, Inc., et al.; Proposed Final Judgments and Competitive Impact Statement; Notice

DEPARTMENT OF JUSTICE

Antitrust Division

United States v. Sinclair Broadcast Group, Inc., et al., Proposed Final Judgments and Competitive Impact Statement

Notice is hereby given pursuant to the Antitrust Procedures and Penalties Act, 15 U.S.C. 16(b)–(h), that proposed Final Judgments, Stipulations, and a Competitive Impact Statement as to CBS Corporation (''CBS''), Cox Enterprises, Inc. (''Cox''), The E.W. Scripps Company (''Scripps''), Fox Corporation (''Fox''), and TEGNA Inc. (''TEGNA'') have been filed with the United States District Court for the District of Columbia in *United States of America* v. *Sinclair Broadcast Group, Inc., et al.,* Civil Action No. 1:18–cv–2609. On August 1, 2019, a Second Amended Complaint was filed, alleging that CBS, Cox, Scripps, Fox, and TEGNA, among others, violated Section 1 of the Sherman Act, 15 U.S.C. 1, by agreeing to unlawfully exchange station-specific, competitively sensitive information regarding spot advertising revenues. The proposed Final Judgments, filed on August 13, 2019, prohibit sharing of competitively sensitive information, require Defendants to implement antitrust compliance training programs, and impose cooperation and reporting requirements on Defendants.

Copies of the Complaint, proposed Final Judgments, and Competitive Impact Statement are available for inspection on the Antitrust Division's website at *http://www.justice.gov/atr* and at the Office of the Clerk of the United States District Court for the District of Columbia. Copies of these materials may be obtained from the Antitrust Division upon request and payment of the copying fee set by Department of Justice regulations.

Public comment is invited within 60 days of the date of this notice. Such comments, including the name of the submitter, and responses thereto, will be posted on the Antitrust Division's website, filed with the Court, and, under certain circumstances, published in the **Federal Register**. Comments should be directed to Owen Kendler, Chief, Media, Entertainment, and Professional Services Section, Antitrust Division, Department of Justice, 450 Fifth Street NW, Suite 4000, Washington, DC 20530 (telephone: 202–616–5935).

Amy R. Fitzpatrick,

Counsel to the Director of Civil Enforcement.

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

United States Of America, 450 Fifth Street NW, Washington, DC 20530; Plaintiff, v. *Sinclair Broadcast Group, Inc., 10706 Beaver Dam Road, Hunt Valley, MD 21030; Raycom Media, Inc., 201 Monroe Street, Montgomery, AL 36104; Tribune Media Company, 435 North Michigan Avenue, Chicago, IL 60611; Meredith Corporation, 1716 Locust Street, Des Moines, IA 50309; Griffin Communications, LLC, 7401 N. Kelley Avenue, Oklahoma City, OK 73111; Dreamcatcher Broadcasting, LLC, 2016 Broadway, Santa Monica, CA 90404; Nexstar Media Group, Inc., 545 E. John Carpenter Freeway, Suite 700, Irving, TX 75062; CBS Corporation, 51 West 52nd Street, New York, NY 10019; Cox Enterprises, Inc., 6205-A Peachtree Dunwoody Road, Atlanta, GA 30328;, The E.W. Scripps Company, Scripps Center, 312 Walnut Street, Suite 2800, Cincinnati, OH 45202; Fox Corporation, 1211 Avenue of the Americas, New York, NY 10036; and, TEGNA Inc., 8350 Broad Street, Suite 2000, McLean, VA 22102,* Defendants.

Case No. 1:18–cv–2609–TSC

SECOND AMENDED COMPLAINT

The United States of America, acting under the direction of the Attorney General of the United States, brings this civil antitrust action to obtain equitable relief against Defendants Sinclair Broadcast Group, Inc. (''Sinclair''), Raycom Media, Inc. (''Raycom''), Tribune Media Company (''Tribune''), Meredith Corporation (''Meredith''), Griffin Communications, LLC (''Griffin''), Dreamcatcher Broadcasting, LLC (''Dreamcatcher''), Nexstar Media Group, Inc. (''Nexstar''), CBS Corporation (''CBS''), Cox Enterprises, Inc. (''Cox''), The E.W. Scripps Company (''Scripps''), Fox Corporation (''Fox''), and TEGNA Inc. (''TEGNA'') alleging as follows:

I. NATURE OF THE ACTION

1. This action challenges under Section 1 of the Sherman Act Defendants' agreements to unlawfully exchange competitively sensitive information among broadcast television stations.

2. Sinclair, Raycom, Tribune, Meredith, Griffin, Dreamcatcher, Nexstar, CBS, Cox, Scripps, Fox, and TEGNA (''Defendants'') and certain other television broadcast station groups (''Other Broadcasters'') compete in various configurations in a number of designated marketing areas (''DMAs'') in the market for broadcast television spot advertising. Certain national sales representation firms (''Sales Rep Firms''), including Cox subsidiary Cox Reps, Inc. (''Cox Reps'') represent broadcast station groups, including the Defendants, in their sales of spot advertising to advertisers. Defendants', Other Broadcasters', and Sales Rep Firms' concerted behavior in exchanging competitively sensitive information has enabled the Defendants and Other Broadcasters to reduce competition in the sale of broadcast television spot advertising where they purport to compete head to head.

3. Defendants' agreements are restraints of trade that are unlawful under Section 1 of the Sherman Act, 15 U.S.C. § 1. The Court should therefore enjoin Defendants from exchanging competitively sensitive information with and among competing broadcast television stations.

II. JURISDICTION AND VENUE

4. Each Defendant sells spot advertising to advertisers throughout the United States, or owns and operates broadcast television stations in multiple states or in DMAs that cross state lines. Sales Rep Firms represent broadcast stations throughout the United States, including each of the Defendants, in the sale of spot advertising to advertisers throughout the United States. Such activities, including the exchanges of competitively sensitive information featured in this Complaint, are in the flow of and substantially affect interstate commerce. The Court has subject matter jurisdiction under Section 4 of the Sherman Act, 15 U.S.C. § 4, and under 28 U.S.C. §§ 1331 and 1337, to prevent and restrain the Defendants from violating Section 1 of the Sherman Act, 15 U.S.C. § 1.

5. Defendants have consented to venue and personal jurisdiction in this District. Venue is proper in this judicial district under Section 12 of the Clayton Act, 15 U.S.C. § 22, and 28 U.S.C. § 1391.

III. DEFENDANTS

6. Defendant Sinclair is a Maryland corporation with its principal place of business in Hunt Valley, Maryland. Sinclair owns or operates 191 television stations in 89 DMAs and had over $3.0 billion in revenues in 2018.

7. Defendant Raycom was a Delaware corporation with its principal place of business in Montgomery, Alabama. Raycom owned or operated 55 television stations in 43 DMAs and had over $670 million in revenues in 2017. On January 2, 2019, Gray Television, Inc. closed on its acquisition of Raycom.

8. Defendant Tribune is a Delaware corporation with its principal place of business in Chicago, Illinois. Tribune

owns or operates 44 television stations in 33 DMAs and had over $2.0 billion in revenues in 2018.

9. Defendant Meredith is an Iowa corporation with its principal place of business in Des Moines, Iowa. Meredith owns or operates 17 television stations in 12 DMAs and had over $2.2 billion in revenues in 2018.

10. Defendant Griffin is an Oklahoma corporation with its principal place of business in Oklahoma City, Oklahoma. Griffin owns or operates four television stations in two DMAs and had over $74 million in revenues in 2018.

11. Defendant Dreamcatcher is a Delaware limited liability company with its principal place of business in Santa Monica, California. Dreamcatcher owns or operates three television stations in two DMAs and had over $50 million in revenues in 2017.

12. Defendant Nexstar is a Delaware corporation with its principal place of business in Irving, Texas. Nexstar owns or operates 171 television stations in 100 DMAs and had over $2.8 billion in revenues in 2018.

13. Defendant CBS is a Delaware corporation with its principal place of business in New York, New York. CBS owns or operates 28 television stations in 18 DMAs, and had over $14.5 billion in revenues in 2018.

14. Defendant Cox is a Delaware corporation with its principal place of business in Atlanta, Georgia. Cox owns or operates 14 television stations in 10 DMAs, owns Cox Reps, and had an estimated $20 billion in revenues in 2018.

15. Defendant Scripps is an Ohio corporation with its principal place of business in Cincinnati, Ohio. Scripps owns or operates 60 television stations in 42 DMAs, and had over $917 million in revenues in 2018.

16. Defendant Fox is a Delaware corporation with its principal place of business in New York, New York. Fox owns or operates 17 television stations in 17 DMAs. Fox is a corporate entity recently created from certain former 21st Century Fox assets, including its broadcast station assets, after The Walt Disney Company acquired 21st Century Fox and spun-out Fox. 21st Century Fox's television segment earned over $5 billion in 2017.

17. Defendant TEGNA is a Delaware corporation with its principal place of business in McLean, Virginia. TEGNA owns or operates 49 television stations in 41 DMAs, and had $2.2 billion in revenues in 2018.

IV. INDUSTRY BACKGROUND

18. Broadcast television is important to both viewers and advertisers. For viewers, broadcast stations, including local affiliates of the networks ABC, CBS, FOX, and NBC (collectively, the ''Big 4'' stations), offer not only highly rated entertainment and sports programming, but also local reporting of the news and events in their own communities and regions. The wide popularity of broadcast station programming—and the concomitant opportunity to reach a large local audience—also make broadcast television critical to advertisers, including local businesses that seek to reach potential customers in their own communities.

19. Broadcast stations sell advertising ''spots'' during breaks in their programming. An advertiser purchases spots from a broadcast station to communicate its message to viewers within the DMA in which the broadcast television station is located.

20. Broadcast stations typically divide their sale of spot advertising into two categories: local sales and national sales. Local sales are sales a broadcast station makes through its own local sales staff, typically to advertisers located within the DMA. National sales are sales a broadcast station makes through either a Sales Rep Firm or through a centrally located broadcast group staff, typically to regional or national advertisers.

21. Sales Rep Firms represent broadcast stations in negotiations with advertisers' or advertisers' agents regarding the sale of broadcast stations' spot advertising. There are two primary Sales Rep Firms in the United States, including Cox Reps. Often a Sales Rep Firm represents two or more competing stations in the same DMA. In those cases, the Sales Rep Firms purportedly erect firewalls to prevent coordination and information sharing between sales teams representing competing stations.

V. THE UNLAWFUL AGREEMENTS

22. Defendants, Other Broadcasters, and Sales Rep Firms have agreed in many DMAs across the United States to reciprocally exchange revenue pacing information. Certain Defendants also engaged in the exchange of other forms of competitively sensitive sales information in certain DMAs. Pacing compares a broadcast station's revenues booked for a certain time period to the revenues booked for the same point in time in the previous year. Pacing indicates how each station is performing versus the rest of the market and provides insight into each station's remaining spot advertising inventory for the period.

23. Defendants' exchange of competitively sensitive information has taken at least two forms.

24. First, Defendants and Other Broadcasters regularly exchanged pacing information through the Sales Rep Firms, exchanges which the Sales Rep Firms agreed to facilitate or knowingly facilitated. At least once per quarter, but frequently more often, the Sales Rep Firms representing the Big 4 stations in a DMA exchanged real-time pacing information regarding each station's revenues, and reported the information to the Defendants and the other Big 4 station owners in the DMA. Typically, the exchanges included data on individual stations' booked sales for current and future months as well as a comparison to past periods. To the extent a Sales Rep Firm represents more than one Big 4 station in a DMA through sales teams separated by a supposed firewall, the exchange of pacing and other competitively sensitive information occurred between the sales teams and through those firewalls. Once given to the Defendants and Other Broadcasters in the DMA, the competitors' pacing information was then disseminated to the stations' sales managers and other individuals with authority over pricing and sales for the broadcast stations. These exchanges occurred with Defendants' knowledge and frequently at Defendants' instruction, and occurred in DMAs across the United States.

25. Second, in some DMAs, Defendants and Other Broadcasters exchanged competitively sensitive information, including real-time pacing information for booked sales for current and future months, directly between broadcast station employees. These exchanges predominantly concerned local sales, but sometimes pertained to all sales or national sales.

26. These exchanges of pacing information allowed stations to better understand, in real time, the availability of inventory on competitors' stations, which is often a key factor affecting negotiations with buyers over spot advertising prices. The exchanges also helped stations to anticipate whether competitors were likely to raise, maintain, or lower spot advertising prices. Understanding competitors' pacing can help stations gauge competitors' and advertisers' negotiation strategies, inform their own pricing strategies, and help them resist more effectively advertisers' attempts to obtain lower prices by playing stations off of one another. Defendants' information exchanges therefore distorted the normal price-setting mechanism in the spot advertising market and harmed the competitive process.

27. Defendants' and Other Broadcasters' regular information exchanges, directly and through the Sales Rep Firms, reflect concerted action between horizontal competitors in the broadcast television spot advertising market.

VI. VIOLATION ALLEGED

(Violation of Section 1 of the Sherman Act)

28. The United States repeats and realleges paragraphs 1 through 26 as if fully set forth herein.

29. Defendants violated Section 1 of the Sherman Act, 15 U.S.C. § 1, by agreeing to exchange competitively sensitive information, either directly or through Sales Rep Firms. Cox Reps also violated Section 1 of the Sherman Act, 15 U.S.C. § 1, by agreeing to or knowingly facilitating the exchange of competitively sensitive information among another Sales Rep Firm, certain Defendants, and Other Broadcasters. Defendants' exchange of pacing information resulted in anticompetitive effects in the broadcast television spot advertising markets in many DMAs throughout the United States.

30. The scheme consists of exchanges between Defendants and Other Broadcasters, either directly or through the Sales Rep Firms, in many DMAs, of their stations' revenue pacing information or, for certain Defendants in certain DMAs, other competitively sensitive information concerning spot advertising sales.

31. These unlawful information sharing agreements between Defendants, Other Broadcasters, and Sales Rep Firms have had, and likely will continue to have, anticompetitive effects in spot advertising markets by disrupting the normal mechanisms for negotiating and setting prices and harming the competitive process.

32. Defendants' agreements to exchange competitively sensitive information are unreasonable restraints of interstate trade and commerce. This offense is likely to continue and recur unless the requested relief is granted.

VII. REQUESTED RELIEF

33. The United States requests that the Court:

a. adjudge that the information sharing agreements unreasonably restrain trade and are unlawful under Section 1 of the Sherman Act, 15 U.S.C. § 1;

b. permanently enjoin and restrain Defendants from sharing pacing or other competitively sensitive information or agreeing to share such information with any other broadcast station or broadcast station group, directly or indirectly, and requiring Defendants to take such internal measures as are necessary to ensure compliance with that injunction;

c. permanently enjoin and restrain Cox, acting through Cox Reps, from sharing competitively sensitive information, agreeing to share competitively sensitive information, facilitating the sharing of pacing or other competitively sensitive information or agreeing to facilitate the sharing of such information among any broadcast stations or broadcast station groups, directly or indirectly, and requiring Cox to take such internal measures as are necessary to ensure compliance with that injunction;

d. award the United States the costs of this action; and

e. award such other relief to the United States as the Court may deem just and proper.

Dated: June 17, 2019

Respectfully submitted,

FOR PLAINTIFF UNITED STATES OF AMERICA,

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UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

United States of America; Plaintiff, v. *Sinclair Broadcast Group, Inc.*, et al., Defendants.

Case No.

[PROPOSED] FINAL JUDGMENT

WHEREAS, Plaintiff, United States of America, filed its Second Amended Complaint on ______, 2019, alleging that Defendant CBS Corporation, among others, violated Section 1 of the Sherman Act, 15 U.S.C. § 1, the United States and Defendant, by their respective attorneys, have consented to the entry of this Final Judgment without trial or adjudication of any issue of fact or law;

AND WHEREAS, this Final Judgment does not constitute any evidence against or admission by any party regarding any issue of fact or law;

AND WHEREAS, the United States and Defendant agree to be bound by the provisions of this Final Judgment pending its approval by this Court;

AND WHEREAS, the Defendant agrees to undertake certain actions and to refrain from engaging in certain forms of information sharing with its competitors;

NOW THEREFORE, before any testimony is taken, without trial or adjudication of any issue of fact or law, and upon consent of the parties, it is ORDERED, ADJUDGED, AND DECREED:

I. JURISDICTION

This Court has jurisdiction over the subject matter and each of the parties to this action. The allegations in the Second Amended Complaint arise under Section 1 of the Sherman Act, as amended, 15 U.S.C. § 1. *See* 28 U.S.C. § 1331.

II. DEFINITIONS

As used in this Final Judgment:

A. ''Advertiser'' means an advertiser, an advertiser's buying agent, or an advertiser's representative.

B. ''Agreement'' means any agreement, understanding, pact, contract, or arrangement, formal or informal, oral or written, between two or more Persons.

C. ''Communicate,'' ''Communicating,'' and ''Communication(s)'' means to provide, send, discuss, circulate, exchange, request, or solicit information, whether directly or indirectly, and regardless of the means by which it is accomplished, including orally or by written means of any kind, such as electronic communications, e-mails, facsimiles, telephone communications, voicemails, text messages, audio recordings, meetings, interviews, correspondence, exchange of written or recorded information, or face-to-face meetings.

D. ''Competitively Sensitive Information'' means any of the following information, less than eighteen months old, of Defendant, or any broadcast television station regarding the sale of spot advertising on broadcast television stations: Non-Public Information relating to pricing or pricing strategies, pacing, holding capacity, revenues, or market shares. Reports containing only aggregated market-level or national data are not Competitively Sensitive Information, but reports (including by paid subscription) that are customized or confidential to a particular Station or broadcast television station group are Competitively Sensitive Information. For the avoidance of doubt, spot advertising does not include network television advertising sold by the Defendant or television advertising sold by the Defendant in its capacity as an agent of the owners of syndicated programming.

E. ''Cooperative Agreement'' means (1) joint sales agreements, joint operating agreements, local marketing agreements, news share agreements, or shared services agreements, or (2) any agreement through which a Person exercises control over any broadcast television station not owned by the Person.

F. ''CTS'' means the CBS Television Stations group, its successors and assigns, and its officers and employees. CTS is an unincorporated division of CBS Corporation that consists of Defendant's 29 owned-and-operated broadcast television stations. CTS functions as an independent operating group within Defendant with its own officers and directors. To the extent any Defendant-owned broadcast television station comes under the control or operation of a division or subsidiary of Defendant other than the CBS Television Stations group, that other division or subsidiary is included in the definition of ''CTS.''

G. ''CTS Management'' means all directors and officers of CTS, or any other Defendant employee with management or supervisory responsibilities for CTS's business or operations related to the sale of spot advertising on any Station.

H. ''Defendant'' means CBS Corporation, a Delaware corporation with its headquarters in New York, New York, its successors and assigns, and its subsidiaries, divisions, and Stations, and their directors, officers, and employees.

I. ''DMA'' means Designated Market Area as defined by A.C. Nielsen Company and used by the *Investing in Television BIA Market Report 2018.*

J. ''Management'' means all directors and executive officers of Defendant, or any other employee with management or supervisory responsibilities for Defendant's business or operations related to the sale of spot advertising on any Station.

K. ''Non-Public Information'' means information that is not available from public sources or generally available to the public. Measurement or quantification of a Station's future holding capacity is Non-Public Information, but measurement or quantification of a Station's past holding capacity is not Non-Public Information. For the avoidance of doubt, the fact that information is available by paid subscription does not on its own render the information public.

L. ''Person'' means any natural person, corporation, company, partnership, joint venture, firm, association, proprietorship, agency, board, authority, commission, office, or other business or legal entity, whether private or governmental.

M. ''Sales Representative Firm'' means any organization, including without limitation Katz Media Group, Inc. and Cox Reps, Inc., and their respective subsidiaries and divisions, that represents a Station or its owner in the sale of spot advertising.

N. ''Sales Staff'' means Defendant's employees with responsibility for the sale of spot advertising on any Station.

O. ''Station'' means any broadcast television station, its successors and assigns, and its subsidiaries, divisions, groups, and its owner or operator and its directors, officers, managers, and employees, unless a Station owns, is owned by, or is under common ownership with a Sales Representative Firm, in which case that Sales Representative Firm will not be considered a Station.

III. APPLICABILITY

This Final Judgment applies to Defendant, other Persons in active concert or participation with Defendant who receive actual notice of this Final Judgment by personal service or otherwise, and any Person that signs an Acknowledgment of Applicability, attached as Exhibit 2, to the extent set forth therein, as a condition of the purchase of a Station owned by Defendant as of February 1, 2019. This Final Judgment applies to Defendant's actions performed under any Cooperative Agreement, even if those actions are taken on behalf of a third party. This Final Judgment is fully enforceable, including by penalty of contempt, against all of the foregoing.

IV. PROHIBITED CONDUCT

A. Defendant's Management and Sales Staff shall not, directly or indirectly:

1. Communicate Competitively Sensitive Information to any Station in the same DMA Defendant does not own or operate;

2. Knowingly use Competitively Sensitive Information from or regarding any Station in the same DMA Defendant does not own or operate;

3. Encourage or facilitate the Communication of Competitively Sensitive Information to or from any Station in the same DMA Defendant does not own or operate; or

4. Attempt to enter into, enter into, maintain, or enforce any agreement to Communicate Competitively Sensitive Information with any Station in the same DMA Defendant does not own or operate.

B. The prohibitions under Paragraph IV(A) apply to Defendant's Communicating or agreeing to Communicate through a Sales Representative Firm or a third-party agent at Defendant's instruction or request.

C. Defendant shall not sell any Station owned by the Defendant as of February 1, 2019 to any Person unless that Person has first executed the Acknowledgment of Applicability, attached as Exhibit 2. Defendant shall submit any Acknowledgement of Applicability to the United States within 15 days of consummating the sale of such Station. The United States, in its sole discretion, may waive the prohibition in this Paragraph IV(C) on a Station-by-Station basis. Alternatively, the United States and the Person signing the Acknowledgement of Applicability may agree to void the Acknowledgement of Applicability at any time. The first sentence of this paragraph shall not apply to the sale of any Station to a Person already bound to a final judgment entered by a court regarding the Communication of Competitively Sensitive Information.

V. CONDUCT NOT PROHIBITED

A. Nothing in Section IV shall prohibit Defendant from Communicating, using, or encouraging or facilitating the Communication of, Competitively Sensitive Information with an actual or prospective Advertiser, except that, if the Advertiser is another Station, Defendant's Communicating, using, or encouraging or facilitating the Communication of, Competitively Sensitive Information is excluded from the prohibitions of Section IV only insofar as is reasonably necessary to negotiate the sale of spot advertising on broadcast television stations. For the avoidance of doubt, Defendant is not prohibited from internally using Competitively Sensitive Information received from an Advertiser that is a Station under the preceding sentence, but Defendant is prohibited from Communicating that Competitively

Sensitive Information to a Station in the same DMA that it does not own or operate.

B. Nothing in Section IV shall prohibit Defendant from, after securing advice of counsel and in consultation with the Antitrust Compliance Officer, Communicating, using, encouraging or facilitating the Communication of, or attempting to enter into, entering into, maintaining, or enforcing any agreement to Communicate Competitively Sensitive Information with any Station when such Communication or use is (a) for the purpose of evaluating or effectuating a bona fide acquisition, disposition, or exchange of Stations or related assets, or (b) reasonably necessary for achieving the efficiencies of any other legitimate competitor collaboration. With respect to any such agreement:

1. For all agreements under Part V(B)(a) with any other Station to Communicate Competitively Sensitive Information that Defendant enters into, renews, or affirmatively extends after the date of entry of this Final Judgment, Defendant shall maintain documents sufficient to show:

i. the specific transaction or proposed transaction to which the sharing of Competitively Sensitive Information relates;

ii. the employees, identified with reasonable specificity, who are involved in the sharing of Competitively Sensitive Information; and

iii. the termination date or event of the sharing of Competitively Sensitive Information.

2. All agreements under Part V(B)(b) with any other Station to Communicate Competitively Sensitive Information that Defendant enters into, renews, or affirmatively extends after the date of entry of this Final Judgment shall be in writing, and shall:

i. identify and describe, with specificity, the collaboration to which it is ancillary;

ii. be narrowly tailored to permit the Communication of Competitively Sensitive Information only when reasonably necessary and only to the employees reasonably necessary to effectuate the collaboration;

iii. identify with reasonable specificity the Competitively Sensitive Information Communicated pursuant to the agreement and identify the employees to receive the Competitively Sensitive Information;

iv. contain a specific termination date or event; and

v. be signed by all parties to the agreement, including any modifications to the agreement.

3. For Communications under Part V(B)(a) above, Defendant shall maintain copies of all materials required under Paragraph V(B)(1) for five years or the duration of the Final Judgment, whichever is shorter, following entry into any agreement to Communicate or receive Competitively Sensitive Information, and Defendant shall make such documents available to the United States upon request, if such request is made during the preservation period.

4. For Communications under Part V(B)(b) above, Defendant shall furnish a copy of all materials required under Paragraph V(B)(2) to the United States within thirty days of the entry, renewal, or extension of the agreement.

5. For purposes of this Section V(B) only, a joint sales agreement, local marketing agreement, or similar agreement pursuant to which Defendant Communicates, uses, encourages or facilitates the Communication of, or attempts to enter into, enters into, maintains, or enforces any agreement to Communicate Competitively Sensitive Information related solely to the sale of spot advertising for which Defendant is responsible on a Station, shall be considered a ''legitimate competitor collaboration'' under Part V(B)(b).

C. Nothing in Section IV shall prohibit Defendant from engaging in conduct in accordance with the doctrine established in *Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961), *United Mine Workers v. Pennington*, 381 U.S. 657 (1965), and their progeny.

D. Nothing in Section IV prohibits Defendant from (1) Communicating, encouraging or facilitating the Communication of, or attempting to enter into, entering into, maintaining, or enforcing any agreement to Communicate Competitively Sensitive Information for the purpose of aggregation if (a) Competitively Sensitive Information is sent to or received from, and the aggregation is managed by, a third party not owned or operated by any Station; (b) the information disseminated by the aggregator is limited to historical total broadcast television station revenue or other geographic or characteristic categorization (e.g., national, local, or political sales revenue); and (c) any information disseminated is sufficiently aggregated such that it would not allow a recipient to identify, deduce, or estimate the prices or pacing of any individual broadcast television station not owned or operated by that recipient; or (2) using information that meets the requirements of Parts V(D)(1)(a)-(c).

VI. REQUIRED CONDUCT

A. Within ten days of entry of this Final Judgment, Defendant shall appoint an Antitrust Compliance Officer who is an internal employee or officer of Defendant, and identify to the United States the Antitrust Compliance Officer's name, business address, telephone number, and email address. Within forty-five days of a vacancy in the Antitrust Compliance Officer position, Defendant shall appoint a replacement, and shall identify to the United States the Antitrust Compliance Officer's name, business address, telephone number, and email address. Defendant's initial or replacement appointment of an Antitrust Compliance Officer is subject to the approval of the United States, in its sole discretion.

B. The Antitrust Compliance Officer shall have, or shall retain outside counsel who has, the following minimum qualifications:

1. be an active member in good standing of the bar in any U.S. jurisdiction; and

2. have at least five years' experience in legal practice, including experience with antitrust matters, unless finding an Antitrust Compliance Officer or outside counsel meeting this experience requirement is a hardship on or is not reasonably available to Defendant, under which circumstances Defendant may select an Antitrust Compliance Officer or shall retain outside counsel who has at least five years' experience in legal practice, including experience with regulatory or compliance matters.

C. The Antitrust Compliance Officer shall, directly or through the employees or counsel working at the Antitrust Compliance Officer's responsibility and direction:

1. within fourteen days of entry of the Final Judgment, furnish to all of Defendant's Management and Sales Staff a copy of this Final Judgment, the Competitive Impact Statement filed by the United States with the Court, and a cover letter in a form attached as Exhibit 1;

2. within fourteen days of entry of the Final Judgment, in a manner to be devised by Defendant and approved by the United States, provide Defendant's Management and Sales Staff reasonable notice of the meaning and requirements of this Final Judgment;

3. annually brief CTS Management and Sales Staff on the meaning and requirements of this Final Judgment and the U.S. antitrust laws;

4. brief any Person who succeeds a Person in any position identified in Paragraph VI(C)(3), within sixty days of such succession;

5. obtain from each Person designated in Paragraph VI(C)(3) or VI(C)(4), within thirty days of that Person's receipt of the Final Judgment, a certification that the Person (i) has read and understands and agrees to abide by the terms of this Final Judgment; (ii) is not aware of any violation of the Final Judgment that has not been reported to Defendant; and (iii) understands that failure to comply with this Final Judgment may result in an enforcement action for civil or criminal contempt of court;

6. annually communicate to Defendant's Management and Sales Staff that they may disclose to the Antitrust Compliance Officer, without reprisal for such disclosure, information concerning any violation or potential violation of this Final Judgment or the U.S. antitrust laws by Defendant;

7. within thirty days of the latest filing of the Second Amended Complaint, Proposed Final Judgment, or Competitive Impact Statement in this action, Defendant shall provide notice, in each DMA in which Defendant owns or operates a Station, to every full power Station in that DMA that sells broadcast television spot advertising that Defendant does not own or operate of the Second Amended Complaint, Proposed Final Judgment, and Competitive Impact Statement in a form and manner to be proposed by Defendant and approved by the United States in its sole discretion. Defendant shall provide the United States with its proposal, including the list of recipients, within ten days of the filing of the Second Amended Complaint; and

8. maintain for five years or until expiration of the Final Judgment, whichever is shorter, a copy of all materials required to be issued under Paragraph VI(C), and furnish them to the United States within ten days if requested to do so, except documents protected under the attorney-client privilege or the attorney work-product doctrine. For all materials required to be furnished under Paragraph VI(C) which Defendant claims are protected under the attorney-client privilege or the attorney work-product doctrine, Defendant shall furnish to the United States a privilege log.

D. Defendant shall:

1. upon Management (including CTS Management) or the Antitrust Compliance Officer learning of any violation or potential violation of any of the terms and conditions contained in this Final Judgment, (i) promptly take appropriate action to investigate, and in the event of a violation, terminate or modify the activity so as to comply with this Final Judgment, (ii) maintain all documents related to any violation or potential violation of this Final Judgment for a period of five years or the duration of this Final Judgment, whichever is shorter, and (iii) maintain, and furnish to the United States at the United States' request, a log of (a) all such documents and documents for which Defendant claims protection under the attorney- client privilege or the attorney work product doctrine, and (b) all potential and actual violations, even if no documentary evidence regarding the violations exist;

2. within thirty days of Management or the Antitrust Compliance Officer learning of any such violation or potential violation of any of the terms and conditions contained in this Final Judgment, file with the United States a statement describing any violation or potential violation of any of the terms and conditions contained in this Final Judgment, which shall include a description of any Communications constituting the violation or potential violation, including the date and place of the Communication, the Persons involved, and the subject matter of the Communication;

3. establish a whistleblower protection policy, which provides that any employee may disclose, without reprisal for such disclosure, to the Antitrust Compliance Officer information concerning any violation or potential violation by the Defendant of this Final Judgment or U.S. antitrust laws;

4. have Defendant's CEO, President, or Executive Vice President, General Counsel certify in writing to the United States annually on the anniversary date of the entry of this Final Judgment that CTS has complied with the provisions of this Final Judgment;

5. maintain and produce to the United States upon request: (i) a list identifying all employees having received the annual antitrust briefing required under Paragraphs VI(C)(3) and VI(C)(4); and (ii) copies of all materials distributed as part of the annual antitrust briefing required under Paragraphs VI(C)(3) and VI(C)(4). For all materials requested to be produced under this Paragraph VI(D)(5) for which Defendant claims is protected under the attorney-client privilege or the attorney work-product doctrine, Defendant shall furnish to the United States a privilege log; and

E. For the avoidance of doubt, the term ''potential violation'' as used in Paragraph VI(D) does not include the discussion of future conduct.

F. If Defendant acquires a Station after entry of this Final Judgment, this Section VI will not apply to that acquired Station or the employees of that acquired Station until 120 days after closing of the acquisition of that acquired Station.

VII. DEFENDANT'S COOPERATION

A. Defendant shall cooperate fully and truthfully with the United States in any investigation or litigation concerning whether or alleging that Defendant, any Station that Defendant does not own or operate, or any Sales Representative Firm Communicated Competitively Sensitive Information with or among Defendant or any other Station or any Sales Representative Firm in violation of Section 1 of the Sherman Act, as amended, 15 U.S.C. § 1. Defendant shall use its best efforts to ensure that all current and former officers, directors, employees, and agents also fully and promptly cooperate with the United States, as described herein. The full, truthful, and continuing cooperation of Defendant shall include, but not be limited to:

1. providing sworn testimony, that is not protected by the attorney-client privilege or the attorney work product doctrine, to the United States regarding the Communicating of Competitively Sensitive Information or any agreement with any other Station Defendant does not own or such other Station's Sales Representative Firm to Communicate Competitively Sensitive Information while an employee of the Defendant;

2. producing, upon request of the United States, all documents, data, and other materials, wherever located, to the extent not protected under the attorney-client privilege or the attorney work-product doctrine, in the possession, custody, or control of Defendant, that relate to the Communication of Competitively Sensitive Information or any agreement with any other Station or such other Station's Sales Representative Firm to Communicate Competitively Sensitive Information, and a log of documents protected by the attorney-client privilege or the attorney work product doctrine;

3. making available for interview any officers, directors, and employees of Defendant if so requested on reasonable notice by the United States; and

4. testifying at trial and other judicial proceedings fully, truthfully, and under oath, when called upon to do so by the United States;

5. provided however, that the obligations of Defendant to cooperate fully with the United States as described in this Section VII shall cease upon the conclusion of all of the United States' investigations and the United States' litigations examining whether or alleging that Defendant, any Station that Defendant does not own or operate or

such other Station's Sales Representative Firm Communicated Competitively Sensitive Information with or among Defendant or any other Station or any Sales Representative Firm in violation of Section 1 of the Sherman Act, as amended, 15 U.S.C. § 1, including exhaustion of all appeals or expiration of time for all appeals of any Court ruling in each such matter, at which point the United States will provide written notice to Defendant that its obligations under this Section VII have expired.

B. Defendant is obligated to impose a litigation hold until the United States provides written notice to the Defendant that its obligations under this Section VII have expired. This Paragraph VII(B) does not apply to documents created after entry of this Final Judgment.

C. Subject to the full, truthful, and continuing cooperation of Defendant, as defined in Paragraph VII(A), the United States will not bring any further civil action or any criminal charges against Defendant related to any Communication of Competitively Sensitive Information or any agreement to Communicate Competitively Sensitive Information with any other Station it does not own or operate or such other Station's Sales Representative Firm when that Communication or agreement:

1. was Communicated, entered into and terminated on or before the date of the filing of the Second Amended Complaint in this action (or in the case of a Station that is acquired by Defendant after entry of this Final Judgment, was Communicated or entered into before the acquisition and terminated within 120 days after the closing of the acquisition); and

2. does not constitute or include an agreement to fix prices or divide markets.

D. The United States' agreement set forth in Paragraph VII(C) does not apply to any acts of perjury or subornation of perjury (18 U.S.C. §§ 1621-22), making a false statement or declaration (18 U.S.C. §§ 1001, 1623), contempt (18 U.S.C. §§ 401-402), or obstruction of justice (18 U.S.C. § 1503, *et seq.*) by the Defendant or its officers, directors, and employees. The United States' agreement set forth in Paragraph VII(C) does not release any claims against any Sales Representative Firm.

VIII. COMPLIANCE INSPECTION

A. For the purposes of determining or securing compliance with this Final Judgment or of any related orders, or of determining whether the Final Judgment should be modified, and subject to any legally recognized privilege, from time to time authorized representatives of the United States Department of Justice, including consultants and other persons retained by the United States, shall, upon written request of an authorized representative of the Assistant Attorney General in charge of the Antitrust Division, and on reasonable notice to Defendant, be permitted:

1. to access during Defendant's office hours to inspect and copy, or at the option of the United States, to require Defendant to provide electronic or hard copies of all books, ledgers, accounts, records, data, and documents in the possession, custody, or control of Defendant, relating to any matters that are the subject of this Final Judgment, not protected by the attorney- client privilege or the attorney work product doctrine; and

2. to interview, either informally or on the record, Defendant's officers, employees, or agents, who may have their individual counsel present, regarding such matters. The interviews shall be subject to the reasonable convenience of the interviewee and without restraint or interference by Defendant; and

3. to obtain from Defendant written reports or responses to written interrogatories, of information not protected by the attorney-client privilege or attorney work product doctrine, under oath if requested, relating to any matters that are the subject of this Final Judgment as may be requested.

B. No information or documents obtained by the means provided in this Section VIII shall be divulged by the United States to any Person other than an authorized representative of the executive branch of the United States, except in the course of legal proceedings to which the United States is a party (including grand jury proceedings), or for the purpose of securing compliance with this Final Judgment, or for law enforcement purposes, or as otherwise required by law.

C. If at the time information or documents are furnished by Defendant to the United States, Defendant represents and identifies in writing the material in any such information or documents to which a claim of protection may be asserted under Rule 26(c)(1)(G) of the Federal Rules of Civil Procedure, and Defendant marks each pertinent page of such material, ''Subject to claim of protection under Rule 26(c)(1)(G) of the Federal Rules of Civil Procedure,'' then the United States shall give Defendant ten calendar days' notice prior to divulging such material in any legal proceeding (other than a grand jury proceeding).

IX. RETENTION OF JURISDICTION

This Court retains jurisdiction to enable any party to this Final Judgment to apply to this Court at any time for further orders and directions as may be necessary or appropriate to carry out or construe this Final Judgment, to modify any of its provisions, to enforce compliance, and to punish violations of its provisions.

X. ENFORCEMENT OF FINAL JUDGMENT

A. The United States retains and reserves all rights to enforce the provisions of this Final Judgment, including its right to seek an order of contempt from this Court. Defendant agrees that in any civil contempt action, any motion to show cause, or any similar civil action brought by the United States regarding an alleged violation of this Final Judgment, the United States may establish a violation of the Final Judgment and the appropriateness of any remedy therefor by a preponderance of the evidence, and Defendant waives any argument that a different standard of proof should apply.

B. The Final Judgment should be interpreted to give full effect to the procompetitive purposes of the antitrust laws and to restore all competition the United States alleged was harmed by the challenged conduct. Defendant agrees that it may be held in contempt of, and that the Court may enforce, any provision of this Final Judgment that, as interpreted by the Court in light of these procompetitive principles and applying ordinary tools of interpretation, is stated specifically and in reasonable detail, whether or not it is clear and unambiguous on its face. In any such interpretation, the terms of this Final Judgment should not be construed against either party as the drafter.

C. In any enforcement proceeding in which the Court finds that Defendant has violated this Final Judgment, the United States may apply to the Court for a one-time extension of this Final Judgment, together with such other relief as may be appropriate. In connection with any successful effort by the United States to enforce this Final Judgment against Defendant, whether litigated or resolved prior to litigation, Defendant agrees to reimburse the United States for the fees and expenses of its attorneys, as well as any other costs including experts' fees, incurred in connection with that enforcement effort, including in the investigation of the potential violation.

XI. EXPIRATION OF FINAL JUDGMENT

Unless this Court grants an extension, this Final Judgment shall expire seven years from the date of its entry, except that after five years from the date of its entry, this Final Judgment may be terminated upon notice by the United States to the Court and Defendant that the continuation of the Final Judgment no longer is necessary or in the public interest.

XII. NOTICE

For purposes of this Final Judgment, any notice or other communication required to be provided to the United States shall be sent to the person at the address set forth below (or such other addresses as the United States may specify in writing to Defendant): Chief, Media, Entertainment, and Professional Services Section, U.S. Department of Justice Antitrust Division, 450 Fifth Street NW, Suite 4000, Washington, DC 20530.

For purposes of this Final Judgment, any notice or other communication required to be provided to Defendant shall be sent to the person at the address set forth below (or such other addresses as Defendant may specify in writing to the United States): Andrew J. Siegel, Senior Vice President, Law CBS Law Department, CBS Television Stations, 51 West 52nd Street, New York, NY 10019.

With a courtesy copy sent to: Yehudah L. Buchweitz, Partner, Weil, Gotshal & Manges LLP, 767 Fifth Avenue, New York, NY 10153. *Counsel for Defendant*.

XIII. PUBLIC INTEREST DETERMINATION

Entry of this Final Judgment is in the public interest. The parties have complied with the requirements of the Antitrust Procedures and Penalties Act, 15 U.S.C. § 16, including making copies available to the public of this Final Judgment, the Competitive Impact Statement, and any comments thereon and the United States' responses to comments. Based upon the record before the Court, which includes the Competitive Impact Statement and any comments and response to comments filed with the Court, entry of this Final Judgment is in the public interest.

IT IS SO ORDERED by the Court, this____ day of______, 201__.

Court approval subject to procedures of Antitrust Procedures and Penalties Act, 15 U.S.C. § 16

____

United States District Judge

EXHIBIT 1

[Company Letterhead]

Andrew J. Siegel
Senior Vice President, Law
CBS Law Department
CBS Television Stations
51 West 52nd Street
New York, NY 10019 T: 212-975-4480

Re: *Prohibitions Against Sharing of Competitively Sensitive Information*

Dear [XX]:

I provide you this notice regarding a judgment recently entered by a federal judge in Washington, D.C. prohibiting the sharing of certain information with other broadcast television station(s).

The judgment applies to our company and all of its employees, including you, so it is important that you understand the obligations it imposes on us. CEO or President of CBS Corp. has asked me to let each of you know that he expects you to take these obligations seriously and abide by them.

The judgment prohibits us from sharing or receiving, directly or indirectly (including through a national sales representative firm), competitively sensitive information with or from any employee, agent, or representative of another broadcast television station in the same DMA it does not own or operate. Competitively sensitive information means any non-public information regarding the sale of spot advertising on broadcast television stations, including information relating to any pricing or pricing strategies, pacing, holding capacity, revenues, or market shares. There are limited exceptions to this restriction, which are listed in the judgment. We will provide briefing on the legitimate or illegitimate exchange of information. You must consult with me if you have any questions on whether a particular circumstance is subject to an exception under the judgment.

A copy of the judgment is attached. Please read it carefully and familiarize yourself with its terms. The judgment, rather than the above description, is controlling. If you have any questions about the judgment or how it affects your sale of spot advertising, please contact me as soon as possible.

Please sign and return the attached Employee Certification to [Defendant's Antitrust Compliance Officer] within thirty days of your receipt of this letter. Thank you for your cooperation.

Sincerely,
Andrew J. Siegel
Senior Vice President, Law
CBS Law Department
CBS Television Stations

Employee Certification

I,________[name], ________[position] at ________[station or location] do hereby certify that I (i) have read and understand, and agree to abide by, the terms of the Final Judgment; (ii) am not aware of any violation of the Final Judgment that has not been reported to CBS Corporation; and (iii) understand that my failure to comply with this Final Judgment may result in an enforcement action for civil or criminal contempt of court.

____

Name:
Date:

EXHIBIT 2

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

United States of America; Plaintiff, v. *Sinclair Broadcast Group, Inc., et al.,* Defendants.

Case No.

ACKNOWLEDGEMENT OF APPLICABILITY

The undersigned acknowledges that [*Full Buyer Name*], including its successors and assigns, and its subsidiaries, divisions, and broadcast television stations, and their directors, officers, and employees (''Acquirer''), following consummation of the Acquirer's acquisition of [*insert names of station or stations acquired*] (each, an ''Acquired Station''), is bound by the Final Judgment entered by this Court in the above-captioned action (''Final Judgment''), as if the Acquirer were a Defendant under the Final Judgment, as follows:

1. The Acquirer shall be bound in full by all Sections of the Consent Decree not specifically discussed below.

2. As to Sections IV, V, and VII of the Final Judgment, the Acquirer is bound to the Final Judgment only as to (i) each Acquired Station, each Acquired Station's successors and assigns, and each Acquired Station's subsidiaries and divisions, and each Acquired Station's directors, officers, and employees, (ii) Acquirer's officers and directors only with respect to any responsibilities or actions regarding any Acquired Stations, and (iii) employees with management or supervisory responsibilities for Acquirer's business or operations related to the sale of spot advertising on any Acquired Station, only with respect to those responsibilities.

3. As to Section VI(C)(3), VI(C)(4), VI(C)(6), VI(C)(8), VI(D), VI(E), and VIII of the Final Judgment, the Acquirer is bound to the Final Judgment only as to (i) each Acquired Station, each

Acquired Station's successors and assigns, and each Acquired Station's subsidiaries and divisions, and each Acquired Station's directors, officers, and employees, (ii) Acquirer's officers and directors, and (iii) employees with management or supervisory responsibilities for Acquirer's business or operations related to the sale of spot advertising on any Acquired Station.

4. The release contained in Sections VII(C) and (D) applies to the Acquirer, but only to civil actions or criminal charges arising from actions taken by any Acquired Station.

5. The Acquirer shall not be bound by Sections VI(C)(1), VI(C)(2),VI(C)(5), VI(C)(7), and VI(F) of the Final Judgment at all, unless the Acquirer acquires the Acquired Stations earlier than 45 days after entry of the Final Judgment.

6. Section VI(A) applies to the Acquirer, but, unless the Acquirer acquires the Acquired Stations earlier than 45 days after entry of the Final Judgment, Section VI(A) is modified to make the initial period for appointing an Antitrust Compliance Officer in the first sentence 120 days from consummation of the Acquirer's acquisition of the Acquired Station or Acquired Stations.

This Acknowledgement of Applicability may be voided by a joint written agreement between the United States and the Acquirer.

Dated: [ ]

Respectfully submitted,

____

[Counsel for Acquirer]

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

United States of America; Plaintiff, v. *Sinclair Broadcast Group, Inc., et al.,* Defendants.

Case No.

[PROPOSED] FINAL JUDGMENT

WHEREAS, Plaintiff, United States of America, filed its Second Amended Complaint on ______, 2019, alleging that Defendant Cox Enterprises, Inc., among others, violated Section 1 of the Sherman Act, 15 U.S.C. § 1, the United States and Defendant, by their respective attorneys, have consented to the entry of this Final Judgment without trial or adjudication of any issue of fact or law;

AND WHEREAS, this Final Judgment does not constitute any evidence against or admission by any party regarding any issue of fact or law;

AND WHEREAS, the United States and Defendant agree to be bound by the provisions of this Final Judgment pending its approval by this Court;

AND WHEREAS, the Defendant agrees to undertake certain actions and to refrain from engaging in certain forms of information sharing with its competitors and with its clients' competitors referenced herein;

NOW THEREFORE, before any testimony is taken, without trial or adjudication of any issue of fact or law, and upon consent of the parties, it is ORDERED, ADJUDGED, AND DECREED:

I. JURISDICTION

This Court has jurisdiction over the subject matter and each of the parties to this action. The allegations in the Second Amended Complaint arise under Section 1 of the Sherman Act, as amended, 15 U.S.C. § 1. *See* 28 U.S.C. § 1331.

II. DEFINITIONS

As used in this Final Judgment:

A. ''Advertiser'' means an advertiser, an advertiser's buying agent, or an advertiser's representative.

B. ''Agreement'' means any agreement, understanding, pact, contract, or arrangement, formal or informal, oral or written, between two or more Persons.

C. ''Client Station'' means a Station for which Defendant, including through Cox Reps, acts as a Sales Representative Firm. If Defendant, including through Cox Reps, represents a Cox Station, the Cox Station is a Client Station, notwithstanding any corporate relationship between Defendant and the Cox Station.

D. ''Client Station Group'' means a broadcast station group that owns or operates one or more Client Stations, including all, each and any of the stations the broadcast station group owns.

E. ''Communicate,'' ''Communicating,'' and ''Communication(s)'' means to provide, send, discuss, circulate, exchange, request, or solicit information, whether directly or indirectly, and regardless of the means by which it is accomplished, including orally or by written means of any kind, such as electronic communications, e-mails, facsimiles, telephone communications, voicemails, text messages, audio recordings, meetings, interviews, correspondence, exchange of written or recorded information, or face-to-face meetings.

F. ''Competitively Sensitive Information'' means any of the following information, less than eighteen months old, of Defendant, a Client Station, a Client Station Group, or any broadcast television station regarding the sale of spot advertising on broadcast television stations: Non-Public Information relating to pricing or pricing strategies, pacing, holding capacity, revenues, or market shares. Reports containing only aggregated market-level or national data are not Competitively Sensitive Information, but reports (including by paid subscription) that are customized or confidential to a particular Station or broadcast television station group are Competitively Sensitive Information. For the avoidance of doubt, spot advertising does not include network television advertising sold by the Defendant or television advertising sold by the Defendant in its capacity as an agent of the owners of syndicated programming.

G. ''Cooperative Agreement'' means (1) joint sales agreements, joint operating agreements, local marketing agreements, news share agreements, or shared services agreements, or (2) any agreement through which a Person exercises control over any broadcast television station not owned by the Person.

H. ''Cox Media Group'' means Defendant's subsidiary Cox Media Group, LLC, a Delaware corporation with its headquarters in Atlanta, Georgia, its successors and assigns, and its subsidiaries, divisions, and groups, and their directors, officers, and employees, including without limitation each Cox Station.

I. ''Cox Station'' means any Station owned or operated by Defendant.

J. ''Cox Reps'' means Defendant's indirect subsidiary Cox Reps, Inc., a Delaware corporation with its headquarters in New York, its successors and assigns, and its subsidiaries, divisions, and groups, and their directors, officers, and employees, including Harrington Richter & Parsons LLC, MMT Sales, LLC, and Telerep, LLC.

K. ''Defendant'' means Cox Enterprises, Inc., a Delaware corporation with its headquarters in Atlanta, Georgia, its successors and assigns, and its subsidiaries, divisions, and Stations, and their directors, officers, and employees, including without limitation Cox Media Group, each Cox Station, and Cox Reps.

L. ''DMA'' means Designated Market Area as defined by A.C. Nielsen Company and used by the *Investing in Television BIA Market Report 2018.*

M. ''Management'' means all directors and executive officers of Defendant, or any other employee with management or supervisory responsibilities for Defendant's business or operations related to the sale of spot advertising on any Cox Station or Client Station.

N. ''Non-Public Information'' means information that is not available from public sources or generally available to the public. Measurement or quantification of a Station's future holding capacity is Non-Public Information, but measurement or quantification of a Station's past holding capacity is not Non-Public Information. For the avoidance of doubt, the fact that information is available by paid subscription does not on its own render the information public.

O. ''Person'' means any natural person, corporation, company, partnership, joint venture, firm, association, proprietorship, agency, board, authority, commission, office, or other business or legal entity, whether private or governmental.

P. ''Sales Representative Firm'' means any organization, including without limitation Katz Media Group, Inc. and Cox Reps, Inc., and their respective subsidiaries and divisions, that represents or assists a Station or its owner in the sale of spot advertising.

Q. ''Sales Staff'' means Defendant's employees or contractors with responsibility for

(1) the sale of spot advertising on any Station, or (2) representation of a Client Station or Client Station Group in the sale of spot advertising on any Station.

R. ''Station'' means any broadcast television station, its successors and assigns, and its subsidiaries, divisions, groups, and its owner or operator and its directors, officers, managers, and employees.

S. ''Station Group'' means a broadcast station group that owns one or more Stations, including all, each and any of the Stations the broadcast station group owns.

III. APPLICABILITY

This Final Judgment applies to Defendant, other Persons in active concert or participation with Defendant who receive actual notice of this Final Judgment by personal service or otherwise, and any Person that signs an Acknowledgment of Applicability, attached as Exhibit 2, to the extent set forth therein, as a condition of the purchase of either Cox Reps or a Station owned by Defendant as of February 1, 2019. This Final Judgment applies to Defendant's actions performed under any Cooperative Agreement of Defendant, a Client Station, or a Client Station Group, even if those actions are taken on behalf of a third party or a party that is not a Client Station or Client Station Group. This Final Judgment is fully enforceable, including by penalty of contempt, against all of the foregoing.

IV. PROHIBITED CONDUCT

A. As to any Cox Station, Defendant's Management and Sales Staff shall not, directly or indirectly:

1. Communicate Competitively Sensitive Information to any Station in the same DMA it does not own or operate;

2. Knowingly use Competitively Sensitive Information from or regarding any Station in the same DMA it does not own or operate;

3. Encourage or facilitate the Communication of Competitively Sensitive Information to or from any Station in the same DMA it does not own or operate; or

4. Attempt to enter into, enter into, maintain, or enforce any Agreement to Communicate Competitively Sensitive Information with any Station in the same DMA it does not own or operate.

B. As to Cox Reps, Defendant's Management and Sales Staff shall not, directly or indirectly:

1. Communicate to any Station, or to any Sales Staff or other Sales Representative Firm representing that Station, Competitively Sensitive Information from or regarding another Station in the same DMA that is not part of the same Station Group;

2. Communicate to any Station Group, or to any Sales Staff or other Sales Representative Firm representing that Station Group, Competitively Sensitive Information from or regarding any Station, not part of that Station Group, that operates in the same DMA as one or more of that Station Group's Stations;

3. Communicate Competitively Sensitive Information to any other Sales Representative Firm;

4. Knowingly use Competitively Sensitive Information on behalf of any Station operating in a given DMA from or regarding any other Station in that same DMA that is not within the same Client Station Group;

5. Encourage or facilitate the Communication of Competitively Sensitive Information between two or more Stations in the same DMA that are not part of the same Client Station Group; or

6. Attempt to enter into, enter into, maintain, or enforce any agreement to Communicate Competitively Sensitive Information between two or more Stations in the same DMA that are not part of the same Client Station Group.

C. The prohibitions under Paragraph IV(A) apply to Cox Media Group's Communicating or agreeing to Communicate through a Sales Representative Firm or a third- party agent at Cox Media Group's instruction or request. The prohibitions of Paragraph IV(A) do not apply to Cox Reps' Management and Sales Staff to the extent Cox Reps' Management or Sales Staff acts in their capacity as representatives of a Client Station other than a Cox Station.

D. Defendant shall not sell Cox Reps or any Station owned by Defendant as of February 1, 2019 to any Person unless that Person has first executed the Acknowledgment of Applicability, attached as Exhibit 2. Defendant shall submit any Acknowledgement of Applicability to the United States within 15 days of consummating the sale of such Station. The United States, in its sole discretion, may waive the prohibition in this Paragraph IV(D) as to Cox Reps or as to any Cox Station on a Station-by-Station basis. Alternatively, the United States and the Person signing the Acknowledgement of Applicability may agree to void the Acknowledgement of Applicability at any time. The first sentence of this paragraph shall not apply to the sale of Cox Reps or any Station to a Person already bound to a final judgment entered by a court regarding the Communication of Competitively Sensitive Information.

V. CONDUCT NOT PROHIBITED

A. Nothing in Section IV shall prohibit Defendant from Communicating, using, or encouraging or facilitating the Communication of, Competitively Sensitive Information with an actual or prospective Advertiser, except that, if the Advertiser is a Station, Defendant's Communicating, using, or encouraging or facilitating the Communication of, Competitively Sensitive Information is excluded from the prohibitions of Section IV only insofar as is reasonably necessary to negotiate the sale of spot advertising on broadcast television stations. Nothing in Section IV shall prohibit a Cox Station's Management and Sales Staff from internally using Competitively Sensitive Information received from an Advertiser, but Defendant is prohibited from Communicating that Competitively Sensitive Information to a Station in the same DMA that, with respect to Cox Media, it does not own or operate or, with respect to Cox Reps, is not part of the same Client Station Group. Nothing in Section IV shall prohibit Cox Reps' Management and Sales Staff from internally using Competitively Sensitive Information received from an Advertiser for purposes of the Client Station or Client Station Group they represented when receiving that Competitively Sensitive Information, but Defendant is prohibited from Communicating that

Competitively Sensitive Information to any other Station that is not part of the same Client Station Group Cox Reps represented when receiving that Competitively Sensitive Information and that operates in the same DMA(s) as the Client Station or Client Station Group that Cox Reps represented when receiving the Competitively Sensitive Information.

B. Nothing in Section IV shall prohibit Defendant from, after securing advice of counsel and in consultation with the Antitrust Compliance Officer, Communicating, using, encouraging or facilitating the Communication of, or attempting to enter into, entering into, maintaining, or enforcing any Agreement to Communicate Competitively Sensitive Information with any Station when such Communication or use is (a) for the purpose of evaluating or effectuating a bona fide acquisition, disposition, or exchange of Stations or related assets, or (b) reasonably necessary for achieving the efficiencies of any other legitimate competitor collaboration. With respect to any such agreement:

1. For all Agreements under Part V(B)(a) with any other Station to Communicate Competitively Sensitive Information that Defendant enters into, renews, or affirmatively extends after the date of entry of this Final Judgment, Defendant shall maintain documents sufficient to show:

i. the specific transaction or proposed transaction to which the sharing of Competitively Sensitive Information relates;

ii. the employees, identified with reasonable specificity, who are involved in the sharing of Competitively Sensitive Information; and

iii. the termination date or event of the sharing of Competitively Sensitive Information.

2. All Agreements under Part V(B)(b) with any other Station to Communicate Competitively Sensitive Information that Defendant enters into, renews, or affirmatively extends after the date of entry of this Final Judgment shall be in writing, and shall:

i. identify and describe, with specificity, the collaboration to which it is ancillary;

ii. be narrowly tailored to permit the Communication of Competitively Sensitive Information only when reasonably necessary and only to the employees reasonably necessary to effectuate the collaboration;

iii. identify with reasonable specificity the Competitively Sensitive Information Communicated pursuant to the agreement and identify the employees to receive the Competitively Sensitive Information;

iv. contain a specific termination date or event; and

v. be signed by all parties to the agreement, including any modifications to the agreement.

3. For Communications under Part V(B)(a) above, Defendant shall maintain copies of all materials required under Paragraph V(B)(1) for five years or the duration of the Final Judgment, whichever is shorter, following entry into any agreement to Communicate or receive Competitively Sensitive Information, and Defendant shall make such documents available to the United States upon request, if such request is made during the preservation period.

4. For Communications under Part V(B)(b) above, Defendant shall furnish a copy of all materials required under Paragraph V(B)(2) to the United States within thirty days of the entry, renewal, or extension of the agreement.

5. For purposes of this Section V(B) only, a Joint Sales Agreement, Local Marketing Agreement, or similar Agreement pursuant to which the Defendant Communicates, uses, encourages or facilitates the Communication of, or attempts to enter into, enters into, maintains, or enforces any Agreement to Communicate Competitively Sensitive Information related solely to the sale of spot advertising for which Defendant is responsible on a Station, shall be considered a ''legitimate competitor collaboration'' under Part V(B)(b).

C. Nothing in Section IV shall prohibit Defendant from engaging in conduct in accordance with the doctrine established in *Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961), *United Mine Workers v. Pennington*, 381 U.S. 657 (1965), and their progeny.

D. Nothing in Section IV prohibits Defendant from (1) Communicating, encouraging or facilitating the Communication of, or attempting to enter into, entering into, maintaining, or enforcing any Agreement to Communicate Competitively Sensitive Information for the purpose of aggregation if (a) Competitively Sensitive Information is sent to or received from, and the aggregation is managed by, a third party not owned or operated by any Station; (b) the information disseminated by the aggregator is limited to historical total broadcast television station revenue or other geographic or characteristic categorization (e.g., national, local, or political sales revenue); and (c) any information disseminated is sufficiently aggregated such that it would not allow a recipient to identify, deduce, or estimate the prices or pacing of any individual broadcast television station not owned or operated by that recipient; or (2) using information that meets the requirements of Parts V(D)(1)(a)-(c).

VI. REQUIRED CONDUCT

A. Within ten days of entry of this Final Judgment, Defendant shall appoint an Antitrust Compliance Officer who is an internal employee or Officer of Defendant, and identify to the United States the Antitrust Compliance Officer's name, business address, telephone number, and email address. Within forty-five days of a vacancy in the Antitrust Compliance Officer position, Defendant shall appoint a replacement, and shall identify to the United States the Antitrust Compliance Officer's name, business address, telephone number, and email address. Defendant's initial or replacement appointment of an Antitrust Compliance Officer is subject to the approval of the United States, in its sole discretion.

B. The Antitrust Compliance Officer shall have, or shall retain outside counsel who has, the following minimum qualifications:

1. be an active member in good standing of the bar in any U.S. jurisdiction; and

2. have at least five years' experience in legal practice, including experience with antitrust matters, unless finding an Antitrust Compliance Officer or outside counsel meeting this experience requirement is a hardship on or is not reasonably available to Defendant, under which circumstances Defendant may select an Antitrust Compliance Officer or shall retain outside counsel who has at least five years' experience in legal practice, including experience with regulatory or compliance matters.

C. The Antitrust Compliance Officer shall, directly or through the employees or counsel working at the Antitrust Compliance Officer's responsibility and direction:

1. within fourteen days of entry of the Final Judgment, furnish to all of Defendant's Management and Sales Staff a copy of this Final Judgment, the Competitive Impact Statement filed by the United States with the Court, and a cover letter in a form attached as Exhibit 1(A), and to Defendant's Client Stations and Client Station Groups a copy of this Final Judgment, the Competitive Impact Statement filed by the United States with the Court, and a cover letter in a form attached as Exhibit 1(B);

2. within fourteen days of entry of the Final Judgment, in a manner to be devised by Defendant and approved by the United States, provide Defendant's

Management and Sales Staff reasonable notice of the meaning and requirements of this Final Judgment;

3. annually brief (i) Management of Cox Media Group, (ii) Management of Cox Reps, and (iii) Sales Staff on the meaning and requirements of this Final Judgment and the U.S. antitrust laws;

4. brief any Person who succeeds a Person in any position identified in Paragraph VI(C)(3), within sixty days of such succession;

5. obtain from each Person designated in Paragraph VI(C)(3) or VI(C)(4), within thirty days of that Person's receipt of the Final Judgment, a certification that the Person (i) has read and understands and agrees to abide by the terms of this Final Judgment; (ii) is not aware of any violation of the Final Judgment that has not been reported to Defendant; and (iii) understands that failure to comply with this Final Judgment may result in an enforcement action for civil or criminal contempt of court;

6. annually communicate to Defendant's Management and Sales Staff that they may disclose to the Antitrust Compliance Officer, without reprisal for such disclosure, information concerning any violation or potential violation of this Final Judgment or the U.S. antitrust laws by Defendant;

7. within thirty days of the latest filing of the Second Amended Complaint, Proposed Final Judgment, or Competitive Impact Statement in this action, Defendant shall provide notice of the Second Amended Complaint, Proposed Final Judgment, and Competitive Impact Statement, in each DMA in which Defendant owns or operates a Station or in which Defendant's Client Station operates, to every full power Station in that DMA that sells broadcast television spot advertising. Excluded from the preceding sentence is any Cox Station or Client Station. Such notice shall be in a form and manner to be proposed by Defendant and approved by the United States in its sole discretion. Defendant shall provide the United States with its proposal, including the list of recipients, within ten days of the filing of the Second Amended Complaint; and

8. maintain for five years or until expiration of the Final Judgment, whichever is shorter, a copy of all materials required to be issued under Paragraph VI(C), and furnish them to the United States within ten days if requested to do so, except documents protected under the attorney-client privilege or the attorney work-product doctrine. For all materials required to be furnished under Paragraph VI(C) which Defendant claims are protected under the attorney-client privilege or the attorney work-product doctrine, Defendant shall furnish to the United States a privilege log.

D. Defendant shall:

1. upon Management or the Antitrust Compliance Officer learning of any violation or potential violation of any of the terms and conditions contained in this Final Judgment involving a Station or Sales Representative Firm in which Defendant has a controlling interest at the time of the violation or potential violation, (i) promptly take appropriate action to investigate, and in the event of a violation, terminate or modify the activity so as to comply with this Final Judgment, (ii) maintain all documents related to any violation or potential violation of this Final Judgment for a period of five years or the duration of this Final Judgment, whichever is shorter, and (iii) maintain, and furnish to the United States at the United States' request, a log of (a) all such documents and documents for which Defendant claims protection under the attorney-client privilege or the attorney work product doctrine, and (b) all potential and actual violations, even if no documentary evidence regarding the violations exist;

2. within thirty days of Management or the Antitrust Compliance Officer learning of any such violation or potential violation of any of the terms and conditions contained in this Final Judgment, file with the United States a statement describing any violation or potential violation of any of the terms and conditions contained in this Final Judgment, which shall include a description of any Communications constituting the violation or potential violation, including the date and place of the Communication, the Persons involved, and the subject matter of the Communication;

3. establish a whistleblower protection policy, which provides that any employee may disclose, without reprisal for such disclosure, to the Antitrust Compliance Officer information concerning any violation or potential violation by the Defendant of this Final Judgment or U.S. antitrust laws;

4. put into place, maintain, and monitor policies and procedures at Cox Reps that ensure that Management and Sales Staff representing a Client Station do not have access to the Competitively Sensitive Information of any other Client Station Group operating in the same DMA as the Client Station, including without limitation database access restrictions;

5. have its CEO, General Counsel or Chief Legal Officer certify in writing to the United States annually on the anniversary date of the entry of this Final Judgment that Defendant has complied with the provisions of this Final Judgment;

6. maintain and produce to the United States upon request: (i) a list identifying all employees having received the annual antitrust briefing required under Paragraphs VI(C)(3) and VI(C)(4); (ii) copies of all materials distributed as part of the annual antitrust briefing required under Paragraphs VI(C)(3) and VI(C)(4); and (iii) copies of policies and procedures, or descriptions of policies and procedures not documented in writing, required under Paragraph VI(D)(4). For all materials requested to be produced under this Paragraph VI(D)(6) for which Defendant claims is protected under the attorney-client privilege or the attorney work-product doctrine, Defendant shall furnish to the United States a privilege log; and

7. in a form and manner to be proposed by Defendant and approved by the United States in its sole discretion, maintained and produced to the United States upon request, notify each Client Station and Client Station Group that the Defendant will refuse any explicit or implicit instruction or request to Communicate any of the Client Station's or Client Station Group's Competitively Sensitive Information or Communicate another Station's Competitively Sensitive Information in a way that would violate Sections IV and V of this Final Judgment, within 14 days of entry of the Final Judgment.

E. For the avoidance of doubt, the term ''potential violation'' as used in Paragraph VI(D) does not include the discussion of future conduct.

F. If Defendant acquires a Station after entry of this Final Judgment, this Section VI will not apply to that acquired Station or the employees of that acquired Station until 120 days after closing of the acquisition of that acquired Station.

G. Subsections (i), (ii) and (iii) of Paragraph VI(C)(3), and the provisions of Paragraphs VI(C)(4), VI(C)(5), and VI(D)(4) shall not apply if (1) Defendant no longer has a controlling interest in Cox Reps, Cox Media Group, or a Cox Station, as specified in those subsections or paragraphs, and (2) the Person acquiring the controlling interest in Cox Reps, Cox Media Group, or a Cox Station, as specified in those subsections or paragraphs, has executed the Acknowledgement of Applicability as to those entities.

VII. DEFENDANT'S COOPERATION

A. Defendant shall cooperate fully and truthfully with the United States in any investigation or litigation concerning whether or alleging that Defendant, any Station that Defendant does not own or operate, or any Sales Representative Firm Communicated Competitively Sensitive Information or agreed to Communicate Competitively Sensitive Information, in a manner that violated Section 1 of the Sherman Act, as amended, 15 U.S.C. § 1. Defendant shall use its best efforts to ensure that all current and former officers, directors, employees, and agents also fully and promptly cooperate with the United States. The full, truthful, and continuing cooperation of Defendant shall include, but not be limited to:

1. providing sworn testimony, excluding testimony that is protected by the attorney-client privilege or the attorney work product doctrine, to the United States regarding the Communicating of Competitively Sensitive Information or any Agreement to Communicate Competitively Sensitive Information;

2. producing, upon request of the United States, all documents, data, and other materials, wherever located, to the extent not protected under the attorney-client privilege or the attorney work-product doctrine, in the possession, custody, or control of Defendant, that relate to the Communication of Competitively Sensitive Information or any Agreement to Communicate Competitively Sensitive Information, and a log of any such documents protected by the attorney-client privilege or the attorney work product doctrine;

3. making available for interview any officers, directors, employees, and agents of Defendant if so requested on reasonable notice by the United States; and

4. testifying at trial and other judicial proceedings fully, truthfully, and under oath, when called upon to do so by the United States;

5. provided however, that the obligations of Defendant to cooperate fully with the United States as described in this Section VII shall cease upon the conclusion of all of the United States' investigations and the United States' litigations examining whether or alleging that Defendant, any Station that Defendant does not own or operate, or any Sales Representative Firm Communicated Competitively Sensitive Information or agreed to Communicate Competitively Sensitive Information, in violation of Section 1 of the Sherman Act, as amended, 15 U.S.C. § 1, including exhaustion of all appeals or expiration of time for all appeals of any Court ruling in each such matter, at which point the United States will provide written notice to Defendant that its obligations under this Section VII have expired.

B. Defendant is obligated to impose a litigation hold until the United States provides written notice to the Defendant that its obligations under this Section VII have expired. This Paragraph VII(B) does not apply to documents created after entry of this Final Judgment.

C. Subject to the full, truthful, and continuing cooperation of Defendant, as defined in Paragraph VII(A), the United States will not bring any further civil action or any criminal charges against Defendant related to any Communication of Competitively Sensitive Information or any Agreement to Communicate Competitively Sensitive Information provided such Communication or Agreement:

1. occurred before the date of the filing of the Second Amended Complaint in this action (or in the case of a Station that is acquired by Defendant after entry of this Final Judgment, was Communicated or entered into before the acquisition and terminated within 120 days after the closing of the acquisition);

2. does not involve the Defendant acting as a joint sales agent for Stations from different Station Groups competing in the same DMA; and

3. does not constitute or include an agreement to fix prices or divide markets.

D. The United States' agreement set forth in Paragraph VII(C) does not apply to any acts of perjury or subornation of perjury (18 U.S.C. §§ 1621-22), making a false statement or declaration (18 U.S.C. §§ 1001, 1623), contempt (18 U.S.C. §§ 401-402), or obstruction of justice (18 U.S.C. § 1503, *et seq.*) by the Defendant or its officers, directors, and employees. The United States' agreement set forth in Paragraph VII(C) does not release any claims against any Client Station (except any Cox Station), Client Station Group (except Cox Media Group), any Station that is not a Cox Station, or any Sales Representative Firm (except Cox Reps).

VIII. COMPLIANCE INSPECTION

A. For the purposes of determining or securing compliance with this Final Judgment or of any related orders, or of determining whether the Final Judgment should be modified, and subject to any legally recognized privilege, from time to time authorized representatives of the United States Department of Justice, including consultants and other persons retained by the United States, shall, upon written request of an authorized representative of the Assistant Attorney General in charge of the Antitrust Division, and on reasonable notice to Defendant, be permitted:

1. to access during Defendant's office hours to inspect and copy, or at the option of the United States, to require Defendant to provide electronic or hard copies of all books, ledgers, accounts, records, data, and documents in the possession, custody, or control of Defendant, relating to any matters that are the subject of this Final Judgment, not protected by the attorney- client privilege or the attorney work product doctrine; and

2. to interview, either informally or on the record, Defendant's officers, employees, or agents, who may have their individual counsel present, regarding such matters. The interviews shall be subject to the reasonable convenience of the interviewee and without restraint or interference by Defendant; and

3. to obtain from Defendant written reports or responses to written interrogatories, of information not protected by the attorney-client privilege or attorney work product doctrine, under oath if requested, relating to any matters that are the subject of this Final Judgment as may be requested.

B. No information or documents obtained by the means provided in this Section VIII shall be divulged by the United States to any Person other than an authorized representative of the executive branch of the United States, except in the course of legal proceedings to which the United States is a party (including grand jury proceedings), or for the purpose of securing compliance with this Final Judgment, or for law enforcement purposes, or as otherwise required by law.

C. If at the time information or documents are furnished by Defendant to the United States, Defendant represents and identifies in writing the material in any such information or documents to which a claim of protection may be asserted under Rule 26(c)(1)(G) of the Federal Rules of Civil Procedure, and Defendant marks each pertinent page of such material, ''Subject to claim of protection under Rule 26(c)(1)(G) of the Federal Rules of Civil Procedure,'' then the United States shall give Defendant ten calendar days' notice prior to divulging such material in any legal proceeding (other than a grand jury proceeding).

IX. RETENTION OF JURISDICTION

This Court retains jurisdiction to enable any party to this Final Judgment to apply to this Court at any time for further orders and directions as may be necessary or appropriate to carry out or construe this Final Judgment, to modify any of its provisions, to enforce compliance, and to punish violations of its provisions.

X. ENFORCEMENT OF FINAL JUDGMENT

A. The United States retains and reserves all rights to enforce the provisions of this Final Judgment, including its right to seek an order of contempt from this Court. Defendant agrees that in any civil contempt action, any motion to show cause, or any similar civil action brought by the United States regarding an alleged violation of this Final Judgment, the United States may establish a violation of the Final Judgment and the appropriateness of any remedy therefor by a preponderance of the evidence, and Defendant waives any argument that a different standard of proof should apply.

B. The Final Judgment should be interpreted to give full effect to the procompetitive purposes of the antitrust laws and to restore all competition the United States alleged was harmed by the challenged conduct. Defendant agrees that it may be held in contempt of, and that the Court may enforce, any provision of this Final Judgment that, as interpreted by the Court in light of these procompetitive principles and applying ordinary tools of interpretation, is stated specifically and in reasonable detail, whether or not it is clear and unambiguous on its face. In any such interpretation, the terms of this Final Judgment should not be construed against either party as the drafter.

C. In any enforcement proceeding in which the Court finds that Defendant has violated this Final Judgment, the United States may apply to the Court for a one-time extension of this Final Judgment, together with such other relief as may be appropriate. In connection with any successful effort by the United States to enforce this Final Judgment against Defendant, whether litigated or resolved prior to litigation, Defendant agrees to reimburse the United States for the fees and expenses of its attorneys, as well as any other costs including experts' fees, incurred in connection with that enforcement effort, including in the investigation of the potential violation.

XI. EXPIRATION OF FINAL JUDGMENT

Unless this Court grants an extension, this Final Judgment shall expire seven years from the date of its entry, except that after five years from the date of its entry, this Final Judgment may be terminated upon notice by the United States to the Court and Defendant that the continuation of the Final Judgment no longer is necessary or in the public interest.

XII. NOTICE

For purposes of this Final Judgment, any notice or other communication required to be provided to the United States shall be sent to the person at the address set forth below (or such other addresses as the United States may specify in writing to Defendant): Chief, Media, Entertainment, and Professional Services Section, U.S. Department of Justice Antitrust Division, 450 Fifth Street NW, Suite 4000, Washington, DC 20530.

XIII. PUBLIC INTEREST DETERMINATION

Entry of this Final Judgment is in the public interest. The parties have complied with the requirements of the Antitrust Procedures and Penalties Act, 15 U.S.C. § 16, including making copies available to the public of this Final Judgment, the Competitive Impact Statement, and any comments thereon and the United States' responses to comments. Based upon the record before the Court, which includes the Competitive Impact Statement and any comments and response to comments filed with the Court, entry of this Final Judgment is in the public interest.

IT IS SO ORDERED by the Court, this ____ day of ____, 201__.

Court approval subject to procedures of Antitrust Procedures and Penalties Act, 15 U.S.C. § 16

____

United States District Judge

EXHIBIT 1(A)

[Company Letterhead]

[Name and Address of Antitrust Compliance Officer]

Re: *Prohibitions Against Sharing of Competitively Sensitive Information*

Dear [XX]:

I provide you this notice regarding a judgment recently entered by a federal judge in Washington, D.C. prohibiting the sharing of certain information with or among stations competing in the same DMA, other national sales representative firms, or Cox Reps' sales staff representing client stations in the same DMA that are not part of the same station group.

The judgment applies to our company and all of its employees, including you, so it is important that you understand the obligations it imposes on us. [CEO Name] has asked me to let each of you know that [s/he] expects you to take these obligations seriously and abide by them.

The judgment prohibits us from sharing or receiving, directly or indirectly, including through another national sales representative firm, competitively sensitive information with or from any employee, agent, or representative of another broadcast television station in the same DMA we do not own or operate or that Cox Reps does not represent. In addition, while the judgment does not prevent Cox Reps from obtaining competitively sensitive information from our client stations, we cannot share client's competitively sensitive information with another station in the same DMA that is not part of the same station group, even if that other station is also a client of Cox Reps. Competitively sensitive information means any non-public information regarding the sale of spot advertising on broadcast television stations, including information relating to any pricing or pricing strategies, pacing, holding capacity, revenues, or market shares. There are limited exceptions to this restriction, which are listed in the judgment. The company will provide further training on what exchanges of information are appropriate. You must consult with me if you have any questions on whether a particular circumstance is subject to an exception under the judgment.

A copy of the judgment is attached. Please read it carefully and familiarize yourself with its terms. The judgment, rather than the above description, is controlling. If you have any questions about the judgment or how it affects your sale of spot advertising or representation of our client broadcast stations, please contact me as soon as possible.

Please sign and return the attached Employee Certification to [Defendant's Antitrust Compliance Officer] within thirty days of your receipt of this letter. Thank you for your cooperation.

Sincerely,

[Defendant's Antitrust Compliance Officer]

Employee Certification

I, ________ [name], ________ [position] at ________ [station or location] do hereby certify that I (i) have read and understand, and agree to abide by, the terms of the Final Judgment; (ii) am not aware of any violation of the Final Judgment that has not been reported to [Defendant]; and (iii) understand that my failure to comply with this Final Judgment may result in an enforcement action for civil or criminal contempt of court.

____

Name:

Date:

EXHIBIT 1(B)

[Company Letterhead]

[Name and Address of Antitrust Compliance Officer]

Re: *Prohibitions Against Sharing of Competitively Sensitive Information*

Dear [XX]:

I provide you this notice regarding a judgment recently entered by a federal judge in Washington, D.C. prohibiting the sharing of certain information with or among stations competing in the same DMA, other national sales representative firms, or Cox Reps' sales staff representing client stations in the same DMA that are not part of the same station group.

The judgment prohibits Cox Reps from sharing with or receiving from any employee, agent, or representative of a broadcast television station—whether directly or indirectly, including through another national sales representative firm—competitively sensitive information from or regarding another station in the same DMA that is not part of the same broadcast station group. In addition, while the judgment does not prevent Cox Reps from obtaining competitively sensitive information from its client stations, Cox Reps cannot share a client's competitively sensitive information with another station in the same DMA that is not part of the same station group, even if that other station is also a client of Cox Reps. Competitively sensitive information means any non-public information regarding the sale of spot advertising on broadcast television stations, including information relating to any pricing or pricing strategies, pacing, holding capacity, revenues, or market shares. There are limited exceptions to this restriction, which are listed in the judgment.

A copy of the judgment is attached. The judgment, rather than the above description, is controlling. If you have any questions about this letter, please feel free to contact me.

Sincerely,

[Defendant's Antitrust Compliance Officer]

EXHIBIT 2

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

United States of America; Plaintiff, v. *Sinclair Broadcast Group, Inc., et al.,* Defendants.

Case No.

ACKNOWLEDGEMENT OF APPLICABILITY

The undersigned acknowledges that [*Full Buyer Name*], including its successors and assigns, and its subsidiaries, divisions, and broadcast television stations, and their directors, officers, and employees (''Acquirer''), following consummation of the Acquirer's acquisition of [*insert names of Cox Reps or station or stations acquired*] (each, an ''Acquired Station'' [1]), is bound by the Final Judgment entered by this Court in the above-captioned action against Cox Enterprises, Inc. (''Final Judgment''), as if the Acquirer were a Defendant under the Final Judgment, as follows:

1. The Acquirer shall be bound in full by all Sections of the Consent Decree not specifically discussed below.

2. As to Sections IV, V, and VII of the Final Judgment, the Acquirer is bound to the Final Judgment only as to (i) each Acquired Station, each Acquired Station's successors and assigns, and each Acquired Station's subsidiaries and divisions, and each Acquired Station's directors, officers, and employees, (ii) Acquirer's officers and directors only with respect to any responsibilities or actions regarding any Acquired Stations, and (iii) employees with management or supervisory responsibilities for Acquirer's business or operations related to the sale of spot advertising on any Acquired Station, only with respect to those responsibilities.

3. As to Sections VI(C)(3), VI(C)(4), VI(C)(6), VI(C)(8), VI(D), VI(E), and VIII of the Final Judgment, the Acquirer is bound to the Final Judgment only as to (i) each Acquired Station, each Acquired Station's successors and assigns, and each Acquired Station's subsidiaries and divisions, and each Acquired Station's directors, officers, and employees, (ii) Acquirer's officers and directors, and (iii) employees with management or supervisory responsibilities for Acquirer's business or operations related to the sale of spot advertising on any Acquired Station.

4. The release contained in Sections VII(C) and (D) applies to the Acquirer, but only to civil actions or criminal charges arising from actions taken by any Acquired Station.

5. The Acquirer shall not be bound by Sections VI(C)(1), VI(C)(2), VI(C)(5), VI(C)(7), and VI(F) of the Final Judgment at all, unless the Acquirer acquires the Acquired Stations earlier than 45 days after entry of the Final Judgment.

6. Section VI(A) applies to the Acquirer, but, unless the Acquirer acquires the Acquired Stations earlier than 45 days after entry of the Final Judgment, Section VI(A) is modified to make the initial period for appointing an Antitrust Compliance Officer in the first sentence 120 days from consummation of the Acquirer's acquisition of the Acquired Station or Acquired Stations.

This Acknowledgement of Applicability may be voided by a joint written agreement between the United States and the Acquirer.

Dated: [ ]

Respectfully submitted,

/s/ ____________

[Counsel for Acquirer]

[1] The term ''Cox Reps'' can be substituted for ''Acquired Station'' throughout this Acknowledgement if the acquired asset is Cox Reps. If both Cox Reps and a Cox Station are acquired, use both terms.

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

United States Of America; Plaintiff, v. *Sinclair Broadcast Group, Inc., et al.,* Defendants.

Case No.

[PROPOSED] FINAL JUDGMENT

WHEREAS, Plaintiff, United States of America, filed its Amended Complaint on ______, 2019, alleging that Defendant Fox Corporation, among others, violated Section 1 of the Sherman Act, 15 U.S.C. § 1, the United States and Defendant, by their respective attorneys, have consented to the entry of this Final Judgment without trial or adjudication of any issue of fact or law;

AND WHEREAS, this Final Judgment does not constitute any evidence against or admission by any party regarding any issue of fact or law;

AND WHEREAS, the United States and Defendant agree to be bound by the provisions of this Final Judgment pending its approval by this Court;

AND WHEREAS, the Defendant agrees to undertake certain actions and to refrain from engaging in certain forms of information sharing with its competitors;

NOW THEREFORE, before any testimony is taken, without trial or adjudication of any issue of fact or law, and upon consent of the parties, it is ORDERED, ADJUDGED, AND DECREED:

I. JURISDICTION

This Court has jurisdiction over the subject matter and each of the parties to this action.

The allegations in the Complaint arise under Section 1 of the Sherman Act, as amended, 15 U.S.C. § 1. *See* 28 U.S.C. § 1331.

II. DEFINITIONS

As used in this Final Judgment:

A. ''Advertiser'' means an advertiser, an advertiser's buying agent, or an advertiser's representative.

B. ''Agreement'' means any agreement, understanding, pact, contract, or arrangement, formal or informal, oral or written, between two or more Persons.

C. ''Communicate,'' ''Communicating,'' and ''Communication(s)'' means to provide, send, discuss, circulate, exchange, request, or solicit information, whether directly or indirectly, and regardless of the means by which it is accomplished, including orally or by written means of any kind, such as electronic communications, e-mails, facsimiles, telephone communications, voicemails, text messages, audio recordings, meetings, interviews, correspondence, exchange of written or recorded information, or face-to-face meetings.

D. ''Competitively Sensitive Information'' means any of the following information, less than eighteen months old, of Defendant or any broadcast television station regarding the sale of spot advertising on broadcast television stations: Non-Public Information relating to pricing or pricing strategies, pacing, holding capacity, revenues, or market shares. Reports containing only aggregated market-level or national data are not Competitively Sensitive Information, but reports (including by paid subscription) that are customized or confidential to a particular Station or broadcast television station group are Competitively Sensitive Information. For the avoidance of doubt, spot advertising does not include network television advertising sold by the Defendant or television advertising sold by the Defendant in its capacity as an agent of the owners of syndicated programming.

E. ''Cooperative Agreement'' means (1) joint sales agreements, joint operating agreements, local marketing agreements, news share agreements, or shared services agreements, or (2) any agreement through which a Person exercises control over any broadcast television station not owned by the Person.

F. ''Defendant'' means Fox Corporation, a Delaware corporation with its headquarters in New York, New York, its successors and assigns, and its subsidiaries, divisions, and Stations, and their directors, officers, and employees.

G. ''DMA'' means Designated Market Area as defined by A.C. Nielsen Company and used by the *Investing in Television BIA Market Report 2018.*

H. ''Management'' means all directors and executive officers of Defendant, or any other employee with management or supervisory responsibilities for Defendant's business or operations related to the sale of spot advertising on any Station.

I. ''Non-Public Information'' means information that is not available from public sources or generally available to the public. Measurement or quantification of a Station's future holding capacity is Non-Public Information, but measurement or quantification of a Station's past holding capacity is not Non-Public Information. For the avoidance of doubt, the fact that information is available by paid subscription does not on its own render the information public.

J. ''Person'' means any natural person, corporation, company, partnership, joint venture, firm, association, proprietorship, agency, board, authority, commission, office, or other business or legal entity, whether private or governmental.

K. ''Sales Representative Firm'' means any organization, including without limitation Katz Media Group, Inc. and Cox Reps, Inc., and their respective subsidiaries and divisions, that represents a Station or its owner in the sale of spot advertising.

L. ''Sales Staff'' means Defendant's employees with responsibility for the sale of spot advertising on any Station.

M. ''Station'' means any broadcast television station, its successors and assigns, and its subsidiaries, divisions, groups, and its owner or operator and its directors, officers, managers, and employees, unless a Station owns, is owned by, or is under common ownership with a Sales Representative Firm, in which case that Sales Representative Firm will not be considered a Station.

III. APPLICABILITY

This Final Judgment applies to Defendant, other Persons in active concert or participation with Defendant who receive actual notice of this Final Judgment by personal service or otherwise, and any Person that signs an Acknowledgment of Applicability, attached as Exhibit 2, to the extent set forth therein, as a condition of the purchase of a Station owned by Defendant as of February 1, 2019. This Final Judgment applies to Defendant's actions performed under any Cooperative Agreement, even if those actions are taken on behalf of a third party. This Final Judgment is fully enforceable, including by penalty of contempt, against all of the foregoing.

IV. PROHIBITED CONDUCT

A. Defendant's Management and Sales Staff shall not, directly or indirectly: Communicate Competitively Sensitive Information to any Station in the same DMA it does not own or operate;

1. Knowingly use Competitively Sensitive Information from or regarding any Station in the same DMA it does not own or operate;

2. Encourage or facilitate the Communication of Competitively Sensitive Information to or from any Station in the same DMA it does not own or operate; or

3. Attempt to enter into, enter into, maintain, or enforce any agreement to Communicate Competitively Sensitive Information with any Station in the same DMA it does not own or operate.

B. The prohibitions under Paragraph IV(A) apply to Defendant's Communicating or agreeing to Communicate through a Sales Representative Firm or a third-party agent at Defendant's instruction or request.

C. Defendant shall not sell any Station owned by the Defendant as of February 1, 2019 to any Person unless that Person has first executed the Acknowledgment of Applicability, attached as Exhibit 2. Defendant shall submit any Acknowledgement of Applicability to the United States within 15 days of consummating the sale of such Station. The United States, in its sole discretion, may waive the prohibition in this Paragraph IV(C) on a Station-by-Station basis. Alternatively, the United States and the Person signing the Acknowledgement of Applicability may agree to void the Acknowledgement of Applicability at any time. The first sentence of this paragraph shall not apply to the sale of any Station to a Person already bound to a final judgment entered by a court regarding the Communication of Competitively Sensitive Information.

V. CONDUCT NOT PROHIBITED

A. Nothing in Section IV shall prohibit Defendant from Communicating, using, or encouraging or facilitating the Communication of, Competitively Sensitive Information with an actual or prospective Advertiser, except that, if the Advertiser is another Station, Defendant's Communicating, using, or encouraging or facilitating the Communication of, Competitively Sensitive Information is excluded from the prohibitions of Section IV only insofar as is reasonably necessary to negotiate the sale of spot advertising on broadcast television stations. For the avoidance of doubt, Defendant is not prohibited from internally using Competitively Sensitive Information received from an Advertiser that is a Station under the preceding sentence, but Defendant is prohibited from Communicating that Competitively Sensitive Information to a Station in the same DMA that it does not own or operate.

B. Nothing in Section IV shall prohibit Defendant from, after securing advice of counsel and in consultation with the Antitrust Compliance Officer, Communicating, using, encouraging or facilitating the Communication of, or attempting to enter into, entering into, maintaining, or enforcing any agreement to Communicate Competitively Sensitive Information with any Station when such Communication or use is (a) for the purpose of evaluating or effectuating a bona fide acquisition, disposition, or exchange of Stations or related assets, or (b) reasonably necessary for achieving the efficiencies of any other legitimate competitor collaboration. With respect to any such agreement:

1. For all agreements under Part V(B)(a) with any other Station to Communicate Competitively Sensitive Information that Defendant enters into, renews, or affirmatively extends after the date of entry of this Final Judgment, Defendant shall maintain documents sufficient to show:

i. the specific transaction or proposed transaction to which the sharing of Competitively Sensitive Information relates;

ii. the employees, identified with reasonable specificity, who are involved in the sharing of Competitively Sensitive Information; and

iii. the termination date or event of the sharing of Competitively Sensitive Information.

2. All agreements under Part V(B)(b) with any other Station to Communicate Competitively Sensitive Information that Defendant enters into, renews, or affirmatively extends after the date of entry of this Final Judgment shall be in writing, and shall:

i. identify and describe, with specificity, the collaboration to which it is ancillary;

ii. be narrowly tailored to permit the Communication of Competitively Sensitive Information only when reasonably necessary and only to the employees reasonably necessary to effectuate the collaboration;

iii. identify with reasonable specificity the Competitively Sensitive Information Communicated pursuant to the agreement and identify the employees to receive the Competitively Sensitive Information;

iv. contain a specific termination date or event; and

v. be signed by all parties to the agreement, including any modifications to the agreement.

3. For Communications under Part V(B)(a) above, Defendant shall maintain copies of all materials required under Paragraph V(B)(1) for five years or the duration of the Final Judgment, whichever is shorter, following entry into any agreement to Communicate or receive Competitively Sensitive Information, and Defendant shall make such documents available to the United States upon request, if such request is made during the preservation period.

4. For Communications under Part V(B)(b) above, Defendant shall furnish a copy of all materials required under Paragraph V(B)(2) to the United States within thirty days of the entry, renewal, or extension of the agreement.

5. For purposes of this Section V(B) only, a Joint Sales Agreement, Local Marketing Agreement, or similar agreement pursuant to which the Defendant Communicates, uses, encourages or facilitates the Communication of, or attempts to enter into, enters into, maintains, or enforces any agreement to Communicate Competitively Sensitive Information related solely to the sale of spot advertising for which Defendant is responsible on a Station, shall be considered a ''legitimate competitor collaboration'' under Part V(B)(b).

C. Nothing in Section IV shall prohibit Defendant from engaging in conduct in accordance with the doctrine established in *Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961), *United Mine Workers v. Pennington*, 381 U.S. 657 (1965), and their progeny.

D. Nothing in Section IV prohibits Defendant from (1) Communicating, encouraging or facilitating the Communication of, or attempting to enter into, entering into, maintaining, or enforcing any agreement to Communicate Competitively Sensitive Information for the purpose of aggregation if (a) Competitively Sensitive Information is sent to or received from, and the aggregation is managed by, a third party not owned or operated by any Station; (b) the information disseminated by the aggregator is limited to historical total broadcast television station revenue or other geographic or characteristic categorization (e.g., national, local, or political sales revenue); and (c) any information disseminated is sufficiently aggregated such that it would not allow a recipient to identify, deduce, or estimate the prices or pacing of any individual broadcast television station not owned or operated by that recipient; or (2) using information that meets the requirements of Parts V(D)(1)(a)-(c).

VI. REQUIRED CONDUCT

A. Within ten days of entry of this Final Judgment, Defendant shall appoint an Antitrust Compliance Officer who is an internal employee or Officer of the Defendant, and identify to the United States the Antitrust Compliance Officer's name, business address, telephone number, and email address. Within forty-five days of a vacancy in the Antitrust Compliance Officer position, Defendant shall appoint a replacement, and shall identify to the United States the Antitrust Compliance Officer's name, business address, telephone number, and email address. Defendant's initial or replacement appointment of an Antitrust Compliance Officer is subject to the approval of the United States, in its sole discretion.

B. The Antitrust Compliance Officer shall have, or shall retain outside counsel who has, the following minimum qualifications:

1. be an active member in good standing of the bar in any U.S. jurisdiction; and

2. have at least five years' experience in legal practice, including experience with antitrust matters, unless finding an Antitrust Compliance Officer or outside counsel meeting this experience requirement is a hardship on or is not reasonably available to the Defendant, under which circumstances the Defendant may select an Antitrust Compliance Officer or shall retain outside counsel who has at least five years' experience in legal practice, including experience with regulatory or compliance matters.

C. The Antitrust Compliance Officer shall, directly or through the employees or counsel working at the Antitrust Compliance Officer's responsibility and direction:

1. within fourteen days of entry of the Final Judgment, furnish to all of Defendant's Management and Sales Staff a copy of this Final Judgment, the Competitive Impact Statement filed by the United States with the Court, and a cover letter in a form attached as Exhibit 1;

2. within fourteen days of entry of the Final Judgment, in a manner to be devised by Defendant and approved by the United States, provide Defendant's Management and Sales Staff reasonable notice of the meaning and requirements of this Final Judgment;

3. annually brief Defendant's Management and Sales Staff on the meaning and requirements of this Final Judgment and the U.S. antitrust laws;

4. brief any Person who succeeds a Person in any position identified in Paragraph VI(C)(3), within sixty days of such succession;

5. obtain from each Person designated in Paragraph VI(C)(3) or VI(C)(4), within thirty days of that Person's receipt of the Final Judgment, a certification that the Person (i) has read and understands and agrees to abide by the terms of this Final Judgment; (ii) is not aware of any violation of the Final Judgment that has not been reported to Defendant; and (iii) understands that failure to comply with this Final Judgment may result in an enforcement action for civil or criminal contempt of court;

6. annually communicate to Defendant's Management and Sales Staff that they may disclose to the Antitrust Compliance Officer, without reprisal for such disclosure, information concerning any violation or potential violation of this Final Judgment or the U.S. antitrust laws by Defendant;

7. within thirty days of the latest filing of the Complaint, Proposed Final Judgment, or Competitive Impact Statement in this action, Defendant shall provide notice, in each DMA in which Defendant owns or operates a Station, to every full power Station in that DMA that sells broadcast television spot advertising that Defendant does not own or operate, of the Complaint, Proposed Final Judgment, and Competitive Impact Statement in a form and manner to be proposed by Defendant and approved by the United States in its sole discretion. Defendant shall provide the United States with its proposal, including the list of recipients, within ten days of the filing of the Complaint; and

8. maintain for five years or until expiration of the Final Judgment, whichever is shorter, a copy of all materials required to be issued under Paragraph VI(C), and furnish them to the United States within ten days if requested to do so, except documents protected under the attorney-client privilege or the attorney work-product doctrine. For all materials required to be furnished under Paragraph VI(C) which Defendant claims are protected under the attorney-client privilege or the attorney work-product doctrine, Defendant shall furnish to the United States a privilege log.

D. Defendant shall:

1. upon Management or the Antitrust Compliance Officer learning of any violation or potential violation of any of the terms and conditions contained in this Final Judgment, (i) promptly take appropriate action to investigate, and in the event of a violation, terminate or modify the activity so as to comply with this Final Judgment, (ii) maintain all documents related to any violation or potential violation of this Final Judgment for a period of five years or the duration of this Final Judgment, whichever is shorter, and (iii) maintain, and furnish to the United States at the United States' request, a log of (a) all such documents and documents for which Defendant claims protection under the attorney-client privilege or the attorney work product doctrine, and (b) all potential and actual violations, even if no documentary evidence regarding the violations exist;

2. within thirty days of Management or the Antitrust Compliance Officer learning of any such violation or potential violation of any of the terms and conditions contained in this Final Judgment, file with the United States a statement describing any violation or potential violation of any of the terms and conditions contained in this Final Judgment, which shall include a description of any Communications constituting the violation or potential violation, including the date and place of the Communication, the Persons involved, and the subject matter of the Communication;

3. establish a whistleblower protection policy, which provides that any employee may disclose, without reprisal for such disclosure, to the Antitrust Compliance Officer information concerning any violation or potential violation by the Defendant of this Final Judgment or U.S. antitrust laws;

4. have its CEO, General Counsel or Chief Legal Officer certify in writing to the United States annually on the anniversary date of the entry of this Final Judgment that Defendant has complied with the provisions of this Final Judgment; and

5. maintain and produce to the United States upon request: (i) a list identifying all employees having received the annual antitrust briefing required under Paragraphs VI(C)(3) and VI(C)(4); and (ii) copies of all materials distributed as part of the annual antitrust briefing required under Paragraphs VI(C)(3) and VI(C)(4). For all materials requested to be produced under this Paragraph VI(D)(5) for which Defendant claims is protected under the attorney-client privilege or the attorney work-product doctrine, Defendant shall furnish to the United States a privilege log.

E. For the avoidance of doubt, the term ''potential violation'' as used in Paragraph VI(D) does not include the discussion of future conduct.

F. If Defendant acquires a Station after entry of this Final Judgment, this Section VI will not apply to that acquired Station or the employees of that acquired Station until 120 days after closing of the acquisition of that acquired Station.

VII. DEFENDANT'S COOPERATION

A. Defendant shall cooperate fully and truthfully with the United States in any investigation or litigation concerning whether or alleging that Defendant, any Station that Defendant does not own or operate, or any Sales Representative Firm Communicated Competitively Sensitive Information with or among Defendant or any other Station or any Sales Representative Firm in violation of Section 1 of the Sherman Act, as amended, 15 U.S.C. § 1. Defendant shall use its best efforts to ensure that all current and former officers, directors, employees, and agents also fully and promptly cooperate with the United States. The full, truthful, and continuing cooperation of Defendant shall include, but not be limited to:

1. providing sworn testimony, that is not protected by the attorney-client privilege or the attorney work product doctrine, to the United States regarding the Communicating of Competitively Sensitive Information or any agreement with any other Station it does not own or such other Station's Sales Representative Firm to Communicate Competitively Sensitive Information while an employee of the Defendant;

2. producing, upon request of the United States, all documents, data, and other materials, wherever located, to the extent not protected under the attorney-client privilege or the attorney work-product doctrine, in the possession, custody, or control of Defendant, that relate to the Communication of Competitively Sensitive Information or any agreement with any other Station or such other Station's Sales Representative Firm to Communicate Competitively Sensitive Information, and a log of documents protected by the attorney-client privilege or the attorney work product doctrine;

3. making available for interview any officers, directors, employees, and agents of Defendant if so requested on reasonable notice by the United States; and

4. testifying at trial and other judicial proceedings fully, truthfully, and under oath, when called upon to do so by the United States;

5. provided however, that the obligations of Defendant to cooperate

fully with the United States as described in this Section VII shall cease upon the conclusion of all of the United States' investigations and the United States' litigations examining whether or alleging that Defendant, any Station that Defendant does not own or operate or such other Station's Sales Representative Firm Communicated Competitively Sensitive Information or with or among Defendant or any other Station or any Sales Representative Firm in violation of Section 1 of the Sherman Act, as amended, 15 U.S.C. § 1, including exhaustion of all appeals or expiration of time for all appeals of any Court ruling in each such matter, at which point the United States will provide written notice to Defendant that its obligations under this Section VII have expired.

B. Defendant is obligated to impose a litigation hold until the United States provides written notice to the Defendant that its obligations under this Section VII have expired. This Paragraph VII(B) does not apply to documents created after entry of this Final Judgment.

C. Subject to the full, truthful, and continuing cooperation of Defendant, as defined in Paragraph VII(A), the United States will not bring any further civil action or any criminal charges against Defendant related to any Communication of Competitively Sensitive Information or any agreement to Communicate Competitively Sensitive Information with any other Station it does not own or operate or such other Station's Sales Representative Firm when that agreement:

1. was Communicated, entered into and terminated on or before the date of the filing of the Complaint in this action (or in the case of a Station that is acquired by Defendant after entry of this Final Judgment, was Communicated or entered into before the acquisition and terminated within 120 days after the closing of the acquisition); and

2. does not constitute or include an agreement to fix prices or divide markets.

D. The United States' agreement set forth in Paragraph VII(C) does not apply to any acts of perjury or subornation of perjury (18 U.S.C. §§ 1621-22), making a false statement or declaration (18 U.S.C. §§ 1001, 1623), contempt (18 U.S.C. §§ 401-402), or obstruction of justice (18 U.S.C. § 1503, *et seq.*) by the Defendant or its officers, directors, and employees. The United States' agreement set forth in Paragraph VII(C) does not release any claims against any Sales Representative Firm.

VIII. COMPLIANCE INSPECTION

A. For the purposes of determining or securing compliance with this Final Judgment or of any related orders, or of determining whether the Final Judgment should be modified, and subject to any legally recognized privilege, from time to time authorized representatives of the United States Department of Justice, including consultants and other persons retained by the United States, shall, upon written request of an authorized representative of the Assistant Attorney General in charge of the Antitrust Division, and on reasonable notice to Defendant, be permitted:

1. to access during Defendant's office hours to inspect and copy, or at the option of the United States, to require Defendant to provide electronic or hard copies of all books, ledgers, accounts, records, data, and documents in the possession, custody, or control of Defendant, relating to any matters that are the subject of this Final Judgment, not protected by the attorney- client privilege or the attorney work product doctrine; and

2. to interview, either informally or on the record, Defendant's officers, employees, or agents, who may have their individual counsel present, regarding such matters. The interviews shall be subject to the reasonable convenience of the interviewee and without restraint or interference by Defendant; and

3. to obtain from Defendant written reports or responses to written interrogatories, of information not protected by the attorney-client privilege or attorney work product doctrine, under oath if requested, relating to any matters that are the subject of this Final Judgment as may be requested.

B. No information or documents obtained by the means provided in this Section VIII shall be divulged by the United States to any Person other than an authorized representative of the executive branch of the United States, except in the course of legal proceedings to which the United States is a party (including grand jury proceedings), or for the purpose of securing compliance with this Final Judgment, or for law enforcement purposes, or as otherwise required by law.

C. If at the time information or documents are furnished by Defendant to the United States, Defendant represents and identifies in writing the material in any such information or documents to which a claim of protection may be asserted under Rule 26(c)(1)(G) of the Federal Rules of Civil Procedure, and Defendant marks each pertinent page of such material, "Subject to claim of protection under Rule 26(c)(1)(G) of the Federal Rules of Civil Procedure," then the United States shall give Defendant ten calendar days' notice prior to divulging such material in any legal proceeding (other than a grand jury proceeding).

IX. RETENTION OF JURISDICTION

This Court retains jurisdiction to enable any party to this Final Judgment to apply to this Court at any time for further orders and directions as may be necessary or appropriate to carry out or construe this Final Judgment, to modify any of its provisions, to enforce compliance, and to punish violations of its provisions.

X. ENFORCEMENT OF FINAL JUDGMENT

A. The United States retains and reserves all rights to enforce the provisions of this Final Judgment, including its right to seek an order of contempt from this Court. Defendant agrees that in any civil contempt action, any motion to show cause, or any similar civil action brought by the United States regarding an alleged violation of this Final Judgment, the United States may establish a violation of the Final Judgment and the appropriateness of any remedy therefor by a preponderance of the evidence, and Defendant waives any argument that a different standard of proof should apply.

B. The Final Judgment should be interpreted to give full effect to the procompetitive purposes of the antitrust laws and to restore all competition the United States alleged was harmed by the challenged conduct. Defendant agrees that it may be held in contempt of, and that the Court may enforce, any provision of this Final Judgment that, as interpreted by the Court in light of these procompetitive principles and applying ordinary tools of interpretation, is stated specifically and in reasonable detail, whether or not it is clear and unambiguous on its face. In any such interpretation, the terms of this Final Judgment should not be construed against either party as the drafter.

C. In any enforcement proceeding in which the Court finds that Defendant has violated this Final Judgment, the United States may apply to the Court for a one-time extension of this Final Judgment, together with such other relief as may be appropriate. In connection with any successful effort by the United States to enforce this Final Judgment against Defendant, whether litigated or resolved prior to litigation, Defendant agrees to reimburse the United States for the fees and expenses of its attorneys, as well as any other costs including experts' fees, incurred in connection with that enforcement effort, including in the investigation of the potential violation.

XI. EXPIRATION OF FINAL JUDGMENT

Unless this Court grants an extension, this Final Judgment shall expire seven years from the date of its entry, except that after five years from the date of its entry, this Final Judgment may be terminated upon notice by the United States to the Court and Defendant that the continuation of the Final Judgment no longer is necessary or in the public interest.

XII. NOTICE

For purposes of this Final Judgment, any notice or other communication required to be provided to the United States shall be sent to the person at the address set forth below (or such other addresses as the United States may specify in writing to Defendant): Chief, Media, Entertainment, and Professional Services Section, U.S. Department of Justice Antitrust Division, 450 Fifth Street NW, Suite 4000, Washington, DC 20530.

XIII. PUBLIC INTEREST DETERMINATION

Entry of this Final Judgment is in the public interest. The parties have complied with the requirements of the Antitrust Procedures and Penalties Act, 15 U.S.C. § 16, including making copies available to the public of this Final Judgment, the Competitive Impact Statement, and any comments thereon and the United States' responses to comments. Based upon the record before the Court, which includes the Competitive Impact Statement and any comments and response to comments filed with the Court, entry of this Final Judgment is in the public interest.

IT IS SO ORDERED by the Court, this ____ day of ______, 201__.

Court approval subject to procedures of Antitrust Procedures and Penalties Act, 15 U.S.C. § 16

____

United States District Judge

EXHIBIT 1

[Company Letterhead]

[Name and Address of Antitrust Compliance Officer]

Re: *Prohibitions Against Sharing of Competitively Sensitive Information*

Dear [XX]:

I provide you this notice regarding a judgment recently entered by a federal judge in Washington, D.C. prohibiting the sharing of certain information with other broadcast television station(s).

The judgment applies to our company and all of its employees, including you, so it is important that you understand the obligations it imposes on us. [CEO Name] has asked me to let each of you know that [s/he] expects you to take these obligations seriously and abide by them.

The judgment prohibits us from sharing or receiving, directly or indirectly (including through a national sales representative firm), competitively sensitive information with or from any employee, agent, or representative of another broadcast television station in the same DMA it does not own or operate. Competitively sensitive information means any non-public information regarding the sale of spot advertising on broadcast television stations, including information relating to any pricing or pricing strategies, pacing, holding capacity, revenues, or market shares. There are limited exceptions to this restriction, which are listed in the judgment. The company will provide briefing on the legitimate or illegitimate exchange of information.

You must consult with me if you have any questions on whether a particular circumstance is subject to an exception under the judgment.

A copy of the judgment is attached. Please read it carefully and familiarize yourself with its terms. The judgment, rather than the above description, is controlling. If you have any questions about the judgment or how it affects your sale of spot advertising, please contact me as soon as possible.

Please sign and return the attached Employee Certification to [Defendant's Antitrust Compliance Officer] within thirty days of your receipt of this letter. Thank you for your cooperation.

Sincerely,

[Defendant's Antitrust Compliance Officer]

Employee Certification

I, ________ [name], ________ [position] at ________ [station or location] do hereby certify that I (i) have read and understand, and agree to abide by, the terms of the Final Judgment; (ii) am not aware of any violation of the Final Judgment that has not been reported to [Defendant]; and (iii) understand that my failure to comply with this Final Judgment may result in an enforcement action for civil or criminal contempt of court.

Name:

Date:

____

EXHIBIT 2

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

United States of America; Plaintiff, v. *Sinclair Broadcast Group, Inc., et al.,* Defendants.

Case No.

ACKNOWLEDGEMENT OF APPLICABILITY

The undersigned acknowledges that [*Full Buyer Name*], including its successors and assigns, and its subsidiaries, divisions, and broadcast television stations, and their directors, officers, and employees (''Acquirer''), following consummation of the Acquirer's acquisition of [*insert names of station or stations acquired*] (each, an ''Acquired Station''), is bound by the Final Judgment entered by this Court in the above-captioned action (''Final Judgment''), as if the Acquirer were a Defendant under the Final Judgment, as follows:

1. The Acquirer shall be bound in full by all Sections of the Consent Decree not specifically discussed below.

2. As to Sections IV, V, and VII of the Final Judgment, the Acquirer is bound to the Final Judgment only as to (i) each Acquired Station, each Acquired Station's successors and assigns, and each Acquired Station's subsidiaries and divisions, and each Acquired Station's directors, officers, and employees, (ii) Acquirer's officers and directors only with respect to any responsibilities or actions regarding any Acquired Stations, and (iii) employees with management or supervisory responsibilities for Acquirer's business or operations related to the sale of spot advertising on any Acquired Station, only with respect to those responsibilities.

3. As to Section VI(C)(3), VI(C)(4), VI(C)(6), VI(C)(8), VI(D), VI(E), and VIII of the Final Judgment, the Acquirer is bound to the Final Judgment only as to (i) each Acquired Station, each Acquired Station's successors and assigns, and each Acquired Station's subsidiaries and divisions, and each Acquired Station's directors, officers, and employees, (ii) Acquirer's officers and directors, and (iii) employees with management or supervisory responsibilities for Acquirer's business or operations related to the sale of spot advertising on any Acquired Station.

4. The release contained in Sections VII(C) and (D) applies to the Acquirer, but only to civil actions or criminal charges arising from actions taken by any Acquired Station.

5. The Acquirer shall not be bound by Sections VI(C)(1), VI(C)(2),VI(C)(5), VI(C)(7), and VI(F) of the Final Judgment at all, unless the Acquirer acquires the Acquired Stations earlier than 45 days after entry of the Final Judgment.

6. Section VI(A) applies to the Acquirer, but, unless the Acquirer acquires the Acquired Stations earlier than 45 days after entry of the Final Judgment, Section VI(A) is modified to make the initial period for appointing an Antitrust Compliance Officer in the first sentence 120 days from consummation of the Acquirer's acquisition of the Acquired Station or Acquired Stations.

This Acknowledgement of Applicability may be voided by a joint written agreement between the United States and the Acquirer.

Dated: [ ]

Respectfully submitted,

[Counsel for Acquirer]

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

United States of America; Plaintiff, v. *Sinclair Broadcast Group, Inc., et al.,* Defendants.

Case No.

[PROPOSED] FINAL JUDGMENT

WHEREAS, Plaintiff, United States of America, filed its Amended Complaint on______, 2019, alleging that Defendant The E.W. Scripps Company, among others, violated Section 1 of the Sherman Act, 15 U.S.C. § 1, the United States and Defendant, by their respective attorneys, have consented to the entry of this Final Judgment without trial or adjudication of any issue of fact or law;

AND WHEREAS, this Final Judgment does not constitute any evidence against or admission by any party regarding any issue of fact or law;

AND WHEREAS, the United States and Defendant agree to be bound by the provisions of this Final Judgment pending its approval by this Court;

AND WHEREAS, the Defendant agrees to undertake certain actions and to refrain from engaging in certain forms of information sharing with its competitors;

NOW THEREFORE, before any testimony is taken, without trial or adjudication of any issue of fact or law, and upon consent of the parties, it is ORDERED, ADJUDGED, AND DECREED:

I. JURISDICTION

This Court has jurisdiction over the subject matter and each of the parties to this action. The allegations in the Complaint arise under Section 1 of the Sherman Act, as amended, 15 U.S.C. § 1. *See* 28 U.S.C. § 1331.

II. DEFINITIONS

As used in this Final Judgment:

A. ''Advertiser'' means an advertiser, an advertiser's buying agent, or an advertiser's representative.

B. ''Agreement'' means any agreement, understanding, pact, contract, or arrangement, formal or informal, oral or written, between two or more Persons.

C. ''Communicate,'' ''Communicating,'' and ''Communication(s)'' means to provide, send, discuss, circulate, exchange, request, or solicit information, whether directly or indirectly, and regardless of the means by which it is accomplished, including orally or by written means of any kind, such as electronic communications, e-mails, facsimiles, telephone communications, voicemails, text messages, audio recordings, meetings, interviews, correspondence, exchange of written or recorded information, or face-to-face meetings.

D. ''Competitively Sensitive Information'' means any of the following information, less than eighteen months old, of Defendant or any broadcast television station regarding the sale of spot advertising on broadcast television stations: Non-Public Information relating to pricing or pricing strategies, pacing, holding capacity, revenues, or market shares. Reports containing only aggregated market-level or national data are not Competitively Sensitive Information, but reports (including by paid subscription) that are customized or confidential to a particular Station or broadcast television station group are Competitively Sensitive Information. For the avoidance of doubt, spot advertising does not include network television advertising sold by the Defendant or television advertising sold by the Defendant in its capacity as an agent of the owners of syndicated programming.

E. ''Cooperative Agreement'' means (1) joint sales agreements, joint operating agreements, local marketing agreements, news share agreements, or shared services agreements, or (2) any agreement through which a Person exercises control over any broadcast television station not owned by the Person.

F. ''Defendant'' means The E.W. Scripps Company, an Ohio corporation with its headquarters in Cincinnati, Ohio, its successors and assigns, and its subsidiaries, divisions, and Stations, and their directors, officers, and employees.

G. ''DMA'' means Designated Market Area as defined by A.C. Nielsen Company and used by the *Investing in Television BIA Market Report 2018.*

H. ''Management'' means all directors and executive officers of Defendant, or any other employee with management or supervisory responsibilities for Defendant's business or operations related to the sale of spot advertising on any Station.

I. ''Non-Public Information'' means information that is not available from public sources or generally available to the public. Measurement or quantification of a Station's future holding capacity is Non-Public Information, but measurement or quantification of a Station's past holding capacity is not Non-Public Information. For the avoidance of doubt, the fact that information is available by paid subscription does not on its own render the information public.

J. ''Person'' means any natural person, corporation, company, partnership, joint venture, firm, association, proprietorship, agency, board, authority, commission, office, or other business or legal entity, whether private or governmental.

K. ''Sales Representative Firm'' means any organization, including without limitation Katz Media Group, Inc. and Cox Reps, Inc., and their respective subsidiaries and divisions, that represents a Station or its owner in the sale of spot advertising.

L. ''Sales Representative Firm Manager'' means, for each of Defendant's Sales Representative Firms, the employee of the Sales Representative Firm with primary responsibility for the relationship with Defendant.

M. ''Sales Staff'' means Defendant's employees with responsibility for the sale of spot advertising on any Station.

N. ''Station'' means any broadcast television station, its successors and assigns, and its subsidiaries, divisions, groups, and its owner or operator and its directors, officers, managers, and employees, unless a Station owns, is owned by, or is under common ownership with a Sales Representative Firm, in which case that Sales Representative Firm will not be considered a Station.

III. APPLICABILITY

This Final Judgment applies to Defendant, other Persons in active concert or participation with Defendant who receive actual notice of this Final Judgment by personal service or otherwise, and any Person that signs an

Acknowledgment of Applicability, attached as Exhibit 2, to the extent set forth therein, as a condition of the purchase of a Station owned by Defendant as of February 1, 2019. This Final Judgment applies to Defendant's actions performed under any Cooperative Agreement, even if those actions are taken on behalf of a third party. This Final Judgment is fully enforceable, including by penalty of contempt, against all of the foregoing.

IV. PROHIBITED CONDUCT

A. Defendant's Management and Sales Staff shall not, directly or indirectly:

1. Communicate Competitively Sensitive Information to any Station in the same DMA it does not own or operate;

2. Knowingly use Competitively Sensitive Information from or regarding any Station in the same DMA it does not own or operate;

3. Encourage or facilitate the Communication of Competitively Sensitive Information to or from any Station in the same DMA it does not own or operate; or

4. Attempt to enter into, enter into, maintain, or enforce any agreement to Communicate Competitively Sensitive Information with any Station in the same DMA it does not own or operate.

B. The prohibitions under Paragraph IV(A) apply to Defendant's Communicating or agreeing to Communicate through a Sales Representative Firm or a third-party agent at Defendant's instruction or request.

C. Defendant shall not sell any Station owned by the Defendant as of February 1, 2019 to any Person unless that Person has first executed the Acknowledgment of Applicability, attached as Exhibit 2. Defendant shall submit any Acknowledgement of Applicability to the United States within 15 days of consummating the sale of such Station. The United States, in its sole discretion, may waive the prohibition in this Paragraph IV(C) on a Station-by-Station basis. Alternatively, the United States and the Person signing the Acknowledgement of Applicability may agree to void the Acknowledgement of Applicability at any time. The first sentence of this paragraph shall not apply to the sale of any Station to a Person already bound to a final judgment entered by a court regarding the Communication of Competitively Sensitive Information.

V. CONDUCT NOT PROHIBITED

A. Nothing in Section IV shall prohibit Defendant from Communicating, using, or encouraging or facilitating the Communication of, Competitively Sensitive Information with an actual or prospective Advertiser, except that, if the Advertiser is another Station, Defendant's Communicating, using, or encouraging or facilitating the Communication of, Competitively Sensitive Information is excluded from the prohibitions of Section IV only insofar as is reasonably necessary to negotiate the sale of spot advertising on broadcast television stations. For the avoidance of doubt, Defendant is not prohibited from internally using Competitively Sensitive Information received from an Advertiser that is a Station under the preceding sentence, but Defendant is prohibited from Communicating that Competitively Sensitive Information to a Station in the same DMA that it does not own or operate.

B. Nothing in Section IV shall prohibit Defendant from, after securing advice of counsel and in consultation with the Antitrust Compliance Officer, Communicating, using, encouraging or facilitating the Communication of, or attempting to enter into, entering into, maintaining, or enforcing any agreement to Communicate Competitively Sensitive Information with any Station when such Communication or use is (a) for the purpose of evaluating or effectuating a bona fide acquisition, disposition, or exchange of Stations or related assets, or (b) reasonably necessary for achieving the efficiencies of any other legitimate competitor collaboration. With respect to any such agreement:

1. For all agreements under Part V(B)(a) with any other Station to Communicate Competitively Sensitive Information that Defendant enters into, renews, or affirmatively extends after the date of entry of this Final Judgment, Defendant shall maintain documents sufficient to show:

i. the specific transaction or proposed transaction to which the sharing of Competitively Sensitive Information relates;

ii. the employees, identified with reasonable specificity, who are involved in the sharing of Competitively Sensitive Information; and

iii. the termination date or event of the sharing of Competitively Sensitive Information.

2. All agreements under Part V(B)(b) with any other Station to Communicate Competitively Sensitive Information that Defendant enters into, renews, or affirmatively extends after the date of entry of this Final Judgment shall be in writing, and shall:

i. identify and describe, with specificity, the collaboration to which it is ancillary;

ii. be narrowly tailored to permit the Communication of Competitively Sensitive Information only when reasonably necessary and only to the employees reasonably necessary to effectuate the collaboration;

iii. identify with reasonable specificity the Competitively Sensitive Information Communicated pursuant to the agreement and identify the employees to receive the Competitively Sensitive Information;

iv. contain a specific termination date or event; and

v. be signed by all parties to the agreement, including any modifications to the agreement.

3. For Communications under Part V(B)(a) above, Defendant shall maintain copies of all materials required under Paragraph V(B)(1) for five years or the duration of the Final Judgment, whichever is shorter, following entry into any agreement to Communicate or receive Competitively Sensitive Information, and Defendant shall make such documents available to the United States upon request, if such request is made during the preservation period.

4. For Communications under Part V(B)(b) above, Defendant shall furnish a copy of all materials required under Paragraph V(B)(2) to the United States within thirty days of the entry, renewal, or extension of the agreement.

5. For purposes of this Section V(B) only, a Joint Sales Agreement, Local Marketing Agreement, or similar agreement pursuant to which the Defendant Communicates, uses, encourages or facilitates the Communication of, or attempts to enter into, enters into, maintains, or enforces any agreement to Communicate Competitively Sensitive Information related solely to the sale of spot advertising for which Defendant is responsible on a Station, shall be considered a ''legitimate competitor collaboration'' under Part V(B)(b).

C. Nothing in Section IV shall prohibit Defendant from engaging in conduct in accordance with the doctrine established in *Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961), *United Mine Workers v. Pennington*, 381 U.S. 657 (1965), and their progeny.

D. Nothing in Section IV prohibits Defendant from (1) Communicating, encouraging or facilitating the Communication of, or attempting to enter into, entering into, maintaining, or enforcing any agreement to Communicate Competitively Sensitive Information for the purpose of aggregation if (a) Competitively Sensitive Information is sent to or received from, and the aggregation is managed by, a third party not owned or operated by any Station; (b) the information disseminated by the aggregator is limited to historical total broadcast television station revenue or other geographic or characteristic categorization (e.g., national, local, or political sales revenue); and (c) any information disseminated is sufficiently aggregated such that it would not allow a recipient to identify, deduce, or estimate the prices or pacing of any individual broadcast television station not owned or operated by that recipient; or (2) using information that meets the requirements of Parts V(D)(1)(a)-(c).

VI. REQUIRED CONDUCT

A. Within ten days of entry of this Final Judgment, Defendant shall appoint an Antitrust Compliance Officer who is an internal employee or Officer of the Defendant, and identify to the United States the Antitrust Compliance Officer's name, business address, telephone number, and email address. Within forty-five days of a vacancy in the Antitrust Compliance Officer position, Defendant shall appoint a replacement, and shall identify to the United States the Antitrust Compliance Officer's name, business address, telephone number, and email address. Defendant's initial or replacement appointment of an Antitrust Compliance Officer is subject to the approval of the United States, in its sole discretion.

B. The Antitrust Compliance Officer shall have, or shall retain outside counsel who has, the following minimum qualifications:

1. be an active member in good standing of the bar in any U.S. jurisdiction; and

2. have at least five years' experience in legal practice, including experience with antitrust matters, unless finding an Antitrust Compliance Officer or outside counsel meeting this experience requirement is a hardship on or is not reasonably available to the Defendant, under which circumstances the Defendant may select an Antitrust Compliance Officer or shall retain outside counsel who has at least five years' experience in legal practice, including experience with regulatory or compliance matters.

C. The Antitrust Compliance Officer shall, directly or through the employees or counsel working at the Antitrust Compliance Officer's responsibility and direction:

1. within fourteen days of entry of the Final Judgment, furnish to all of Defendant's Management and Sales Staff and Sales Representative Firm Managers a copy of this Final Judgment, the Competitive Impact Statement filed by the United States with the Court, and a cover letter in a form attached as Exhibit 1;

2. within fourteen days of entry of the Final Judgment, in a manner to be devised by Defendant and approved by the United States, provide Defendant's Management and Sales Staff reasonable notice of the meaning and requirements of this Final Judgment;

3. annually brief Defendant's Management and Sales Staff on the meaning and requirements of this Final Judgment and the U.S. antitrust laws;

4. brief any Person who succeeds a Person in any position identified in Paragraph VI(C)(3), within sixty days of such succession;

5. obtain from each Person designated in Paragraph VI(C)(3) or VI(C)(4), within thirty days of that Person's receipt of the Final Judgment, a certification that the Person (i) has read and understands and agrees to abide by the terms of this Final Judgment; (ii) is not aware of any violation of the Final Judgment that has not been reported to Defendant; and (iii) understands that failure to comply with this Final Judgment may result in an enforcement action for civil or criminal contempt of court;

6. annually communicate to Defendant's Management and Sales Staff that they may disclose to the Antitrust Compliance Officer, without reprisal for such disclosure, information concerning any violation or potential violation of this Final Judgment or the U.S. antitrust laws by Defendant;

7. within thirty days of the latest filing of the Complaint, Proposed Final Judgment, or Competitive Impact Statement in this action, Defendant shall provide notice, in each DMA in which Defendant owns or operates a Station, to (i) every full power Station in that DMA that sells broadcast television spot advertising that Defendant does not own or operate and (ii) any Sales Representative Firm selling advertising in that DMA on behalf of Defendant, of the Complaint, Proposed Final Judgment, and Competitive Impact Statement in a form and manner to be proposed by Defendant and approved by the United States in its sole discretion. Defendant shall provide the United States with its proposal, including the list of recipients, within ten days of the filing of the Complaint; and

8. maintain for five years or until expiration of the Final Judgment, whichever is shorter, a copy of all materials required to be issued under Paragraph VI(C), and furnish them to the United States within ten days if requested to do so, except documents protected under the attorney-client privilege or the attorney work-product doctrine. For all materials required to be furnished under Paragraph VI(C) which Defendant claims are protected under the attorney-client privilege or the attorney work-product doctrine, Defendant shall furnish to the United States a privilege log.

D. Defendant shall:

1. upon Management or the Antitrust Compliance Officer learning of any violation or potential violation of any of the terms and conditions contained in this Final Judgment, (i) promptly take appropriate action to investigate, and in the event of a violation, terminate or modify the activity so as to comply with this Final Judgment, (ii) maintain all documents related to any violation or potential violation of this Final Judgment for a period of five years or the duration of this Final Judgment, whichever is shorter, and (iii) maintain, and furnish to the United States at the United States' request, a log of (a) all such documents and documents for which Defendant claims protection under the attorney-client privilege or the attorney work product doctrine, and (b) all potential and actual violations, even if no documentary evidence regarding the violations exist;

2. within thirty days of Management or the Antitrust Compliance Officer learning of any such violation or potential violation of any of the terms and conditions contained in this Final Judgment, file with the United States a statement describing any violation or potential violation of any of the terms and conditions contained in this Final Judgment, which shall include a description of any Communications constituting the violation or potential violation, including the date and place of the Communication, the Persons involved, and the subject matter of the Communication;

3. establish a whistleblower protection policy, which provides that any employee may disclose, without reprisal for such disclosure, to the Antitrust Compliance Officer information concerning any violation or potential violation by the Defendant of this Final Judgment or U.S. antitrust laws;

4. have its CEO, General Counsel or Chief Legal Officer certify in writing to the United States annually on the anniversary date of the entry of this Final Judgment that Defendant has complied with the provisions of this Final Judgment;

5. maintain and produce to the United States upon request: (i) a list identifying

all employees having received the annual antitrust briefing required under Paragraphs VI(C)(3) and VI(C)(4); and (ii) copies of all materials distributed as part of the annual antitrust briefing required under Paragraphs VI(C)(3) and V(C)(4). For all materials requested to be produced under this Paragraph VI(D)(5) for which Defendant claims is protected under the attorney-client privilege or the attorney work-product doctrine, Defendant shall furnish to the United States a privilege log; and

6. within 14 days of entry of the Final Judgment, instruct each Sales Representative Firm Manager that the Sales Representative Firm shall not Communicate any of Defendant's Competitively Sensitive Information in a way that would violate Sections IV and V of this Final Judgment if the Sales Representative Firm were included in the definition of ''Defendant'' in Paragraph II(F), in a form and manner to be proposed by Defendant and approved by the United States in its sole discretion, maintained and produced to the United States upon request.

E. For the avoidance of doubt, the term ''potential violation'' as used in Paragraph VI(D) does not include the discussion of future conduct.

F. If Defendant acquires a Station after entry of this Final Judgment, this Section VI will not apply to that acquired Station or the employees of that acquired Station until 120 days after closing of the acquisition of that acquired Station.

VII. DEFENDANT'S COOPERATION

A. Defendant shall cooperate fully and truthfully with the United States in any investigation or litigation concerning whether or alleging that Defendant, any Station that Defendant does not own or operate, or any Sales Representative Firm Communicated Competitively Sensitive Information with or among Defendant or any other Station or any Sales Representative Firm in violation of Section 1 of the Sherman Act, as amended, 15 U.S.C. § 1.

Defendant shall use its best efforts to ensure that all current and former officers, directors, employees, and agents also fully and promptly cooperate with the United States. The full, truthful, and continuing cooperation of Defendant shall include, but not be limited to:

1. providing sworn testimony, that is not protected by the attorney-client privilege or the attorney work product doctrine, to the United States regarding the Communicating of Competitively Sensitive Information or any agreement with any other Station it does not own or such other Station's Sales Representative Firm to Communicate Competitively Sensitive Information while an employee of the Defendant;

2. producing, upon request of the United States, all documents, data, and other materials, wherever located, to the extent not protected under the attorney-client privilege or the attorney work-product doctrine, in the possession, custody, or control of Defendant, that relate to the Communication of Competitively Sensitive Information or any agreement with any other Station or such other Station's Sales Representative Firm to Communicate Competitively Sensitive Information, and a log of documents protected by the attorney-client privilege or the attorney work product doctrine;

3. making available for interview any officers, directors, employees, and agents of Defendant if so requested on reasonable notice by the United States; and

4. testifying at trial and other judicial proceedings fully, truthfully, and under oath, when called upon to do so by the United States;

5. provided however, that the obligations of Defendant to cooperate fully with the United States as described in this Section VII shall cease upon the conclusion of all of the United States' investigations and the United States' litigations examining whether or alleging that Defendant, any Station that Defendant does not own or operate or such other Station's Sales Representative Firm Communicated Competitively Sensitive Information or with or among Defendant or any other Station or any Sales Representative Firm in violation of Section 1 of the Sherman Act, as amended, 15 U.S.C. § 1, including exhaustion of all appeals or expiration of time for all appeals of any Court ruling in each such matter, at which point the United States will provide written notice to Defendant that its obligations under this Section VII have expired.

B. Defendant is obligated to impose a litigation hold until the United States provides written notice to the Defendant that its obligations under this Section VII have expired. This Paragraph VII(B) does not apply to documents created after entry of this Final Judgment.

C. Subject to the full, truthful, and continuing cooperation of Defendant, as defined in Paragraph VII(A), the United States will not bring any further civil action or any criminal charges against Defendant related to any Communication of Competitively Sensitive Information or any agreement to Communicate Competitively Sensitive Information with any other Station it does not own or operate or such other Station's Sales Representative Firm when that agreement:

1. was Communicated, entered into and terminated on or before the date of the filing of the Complaint in this action (or in the case of a Station that is acquired by Defendant after entry of this Final Judgment, was Communicated or entered into before the acquisition and terminated within 120 days after the closing of the acquisition); and

2. does not constitute or include an agreement to fix prices or divide markets.

D. The United States' agreement set forth in Paragraph VII(C) does not apply to any acts of perjury or subornation of perjury (18 U.S.C. §§ 1621-22), making a false statement or declaration (18 U.S.C. §§ 1001, 1623), contempt (18 U.S.C. §§ 401-402), or obstruction of justice (18 U.S.C. § 1503, *et seq.*) by the Defendant or its officers, directors, and employees. The United States' agreement set forth in Paragraph VII(C) does not release any claims against any Sales Representative Firm.

VIII. COMPLIANCE INSPECTION

A. For the purposes of determining or securing compliance with this Final Judgment or of any related orders, or of determining whether the Final Judgment should be modified, and subject to any legally recognized privilege, from time to time authorized representatives of the United States Department of Justice, including consultants and other persons retained by the United States, shall, upon written request of an authorized representative of the Assistant Attorney General in charge of the Antitrust Division, and on reasonable notice to Defendant, be permitted:

1. to access during Defendant's office hours to inspect and copy, or at the option of the United States, to require Defendant to provide electronic or hard copies of all books, ledgers, accounts, records, data, and documents in the possession, custody, or control of Defendant, relating to any matters that are the subject of this Final Judgment, not protected by the attorney-client privilege or the attorney work product doctrine; and

2. to interview, either informally or on the record, Defendant's officers, employees, or agents, who may have their individual counsel present, regarding such matters. The interviews shall be subject to the reasonable convenience of the interviewee and without restraint or interference by Defendant; and

3. to obtain from Defendant written reports or responses to written

interrogatories, of information not protected by the attorney-client privilege or attorney work product doctrine, under oath if requested, relating to any matters that are the subject of this Final Judgment as may be requested.

B. No information or documents obtained by the means provided in this Section VIII shall be divulged by the United States to any Person other than an authorized representative of the executive branch of the United States, except in the course of legal proceedings to which the United States is a party (including grand jury proceedings), or for the purpose of securing compliance with this Final Judgment, or for law enforcement purposes, or as otherwise required by law.

C. If at the time information or documents are furnished by Defendant to the United States, Defendant represents and identifies in writing the material in any such information or documents to which a claim of protection may be asserted under Rule 26(c)(1)(G) of the Federal Rules of Civil Procedure, and Defendant marks each pertinent page of such material, ''Subject to claim of protection under Rule 26(c)(1)(G) of the Federal Rules of Civil Procedure,'' then the United States shall give Defendant ten calendar days' notice prior to divulging such material in any legal proceeding (other than a grand jury proceeding).

IX. RETENTION OF JURISDICTION

This Court retains jurisdiction to enable any party to this Final Judgment to apply to this Court at any time for further orders and directions as may be necessary or appropriate to carry out or construe this Final Judgment, to modify any of its provisions, to enforce compliance, and to punish violations of its provisions.

X. ENFORCEMENT OF FINAL JUDGMENT

A. The United States retains and reserves all rights to enforce the provisions of this Final Judgment, including its right to seek an order of contempt from this Court. Defendant agrees that in any civil contempt action, any motion to show cause, or any similar civil action brought by the United States regarding an alleged violation of this Final Judgment, the United States may establish a violation of the Final Judgment and the appropriateness of any remedy therefor by a preponderance of the evidence, and Defendant waives any argument that a different standard of proof should apply.

B. The Final Judgment should be interpreted to give full effect to the procompetitive purposes of the antitrust laws and to restore all competition the United States alleged was harmed by the challenged conduct. Defendant agrees that it may be held in contempt of, and that the Court may enforce, any provision of this Final Judgment that, as interpreted by the Court in light of these procompetitive principles and applying ordinary tools of interpretation, is stated specifically and in reasonable detail, whether or not it is clear and unambiguous on its face. In any such interpretation, the terms of this Final Judgment should not be construed against either party as the drafter.

C. In any enforcement proceeding in which the Court finds that Defendant has violated this Final Judgment, the United States may apply to the Court for a one-time extension of this Final Judgment, together with such other relief as may be appropriate. In connection with any successful effort by the United States to enforce this Final Judgment against Defendant, whether litigated or resolved prior to litigation, Defendant agrees to reimburse the United States for the fees and expenses of its attorneys, as well as any other costs including experts' fees, incurred in connection with that enforcement effort, including in the investigation of the potential violation.

XI. EXPIRATION OF FINAL JUDGMENT

Unless this Court grants an extension, this Final Judgment shall expire seven years from the date of its entry, except that after five years from the date of its entry, this Final Judgment may be terminated upon notice by the United States to the Court and Defendant that the continuation of the Final Judgment no longer is necessary or in the public interest.

XII. NOTICE

For purposes of this Final Judgment, any notice or other communication required to be provided to the United States shall be sent to the person at the address set forth below (or such other addresses as the United States may specify in writing to Defendant): Chief, Media, Entertainment, and Professional Services Section, U.S. Department of Justice Antitrust Division, 450 Fifth Street NW, Suite 4000, Washington, DC 20530.

XIII. PUBLIC INTEREST DETERMINATION

Entry of this Final Judgment is in the public interest. The parties have complied with the requirements of the Antitrust Procedures and Penalties Act, 15 U.S.C. § 16, including making copies available to the public of this Final Judgment, the Competitive Impact Statement, and any comments thereon and the United States' responses to comments. Based upon the record before the Court, which includes the Competitive Impact Statement and any comments and response to comments filed with the Court, entry of this Final Judgment is in the public interest.

IT IS SO ORDERED by the Court, this ____ day of ______, 201__.

Court approval subject to procedures of Antitrust Procedures and Penalties Act, 15 U.S.C. § 16

United States District Judge

EXHIBIT 1

[Company Letterhead]

[Name and Address of Antitrust Compliance Officer]

Re: *Prohibitions Against Sharing of Competitively Sensitive Information*

Dear [XX]:

I provide you this notice regarding a judgment recently entered by a federal judge in Washington, D.C. prohibiting the sharing of certain information with other broadcast television station(s).

The judgment applies to our company and all of its employees, including you, so it is important that you understand the obligations it imposes on us. [CEO Name] has asked me to let each of you know that [s/he] expects you to take these obligations seriously and abide by them.

The judgment prohibits us from sharing or receiving, directly or indirectly (including through our national sales representative firm), competitively sensitive information with or from any employee, agent, or representative of another broadcast television station in the same DMA it does not own or operate. Competitively sensitive information means any non-public information regarding the sale of spot advertising on broadcast television stations, including information relating to any pricing or pricing strategies, pacing, holding capacity, revenues, or market shares. There are limited exceptions to this restriction, which are listed in the judgment. The company will provide briefing on the legitimate or illegitimate exchange of information.

You must consult with me if you have any questions on whether a particular circumstance is subject to an exception under the judgment.

A copy of the judgment is attached. Please read it carefully and familiarize yourself with its terms. The judgment, rather than the above description, is controlling. If you have any questions about the judgment or how it affects your sale of spot advertising, please contact me as soon as possible.

Please sign and return the attached Employee Certification to [Defendant's Antitrust Compliance Officer] within thirty days of your receipt of this letter. Thank you for your cooperation.

Sincerely,
[Defendant's Antitrust Compliance Officer]

Employee Certification

I, ________[name], ________[position] at ________ [station or location] do hereby certify that I (i) have read and understand, and agree to abide by, the terms of the Final Judgment; (ii) am not aware of any violation of the Final Judgment that has not been reported to [Defendant]; and (iii) understand that my failure to comply with this Final Judgment may result in an enforcement action for civil or criminal contempt of court.

____

Name:
Date:

EXHIBIT 2

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

United States of America; Plaintiff, v. *Sinclair Broadcast Group, Inc., et al.,* Defendants.

Case No.

ACKNOWLEDGEMENT OF APPLICABILITY

The undersigned acknowledges that [*Full Buyer Name*], including its successors and assigns, and its subsidiaries, divisions, and broadcast television stations, and their directors, officers, and employees (''Acquirer''), following consummation of the Acquirer's acquisition of [*insert names of station or stations acquired*] (each, an ''Acquired Station''), is bound by the Final Judgment entered by this Court in the above-captioned action (''Final Judgment''), as if the Acquirer were a Defendant under the Final Judgment, as follows:

1. The Acquirer shall be bound in full by all Sections of the Consent Decree not specifically discussed below.

2. As to Sections IV, V, and VII of the Final Judgment, the Acquirer is bound to the Final Judgment only as to (i) each Acquired Station, each Acquired Station's successors and assigns, and each Acquired Station's subsidiaries and divisions, and each Acquired Station's directors, officers, and employees, (ii) Acquirer's officers and directors only with respect to any responsibilities or actions regarding any Acquired Stations, and (iii) employees with management or supervisory responsibilities for Acquirer's business or operations related to the sale of spot advertising on any Acquired Station, only with respect to those responsibilities.

3. As to Section VI(C)(3), VI(C)(4), VI(C)(6), VI(C)(8), VI(D), VI(E), and VIII of the Final Judgment, the Acquirer is bound to the Final Judgment only as to (i) each Acquired Station, each Acquired Station's successors and assigns, and each Acquired Station's subsidiaries and divisions, and each Acquired Station's directors, officers, and employees, (ii) Acquirer's officers and directors, and (iii) employees with management or supervisory responsibilities for Acquirer's business or operations related to the sale of spot advertising on any Acquired Station.

4. The release contained in Sections VII(C) and (D) applies to the Acquirer, but only to civil actions or criminal charges arising from actions taken by any Acquired Station.

5. The Acquirer shall not be bound by Sections VI(C)(1), VI(C)(2),VI(C)(5), VI(C)(7), and VI(F) of the Final Judgment at all, unless the Acquirer acquires the Acquired Stations earlier than 45 days after entry of the Final Judgment.

6. Section VI(A) applies to the Acquirer, but, unless the Acquirer acquires the Acquired Stations earlier than 45 days after entry of the Final Judgment, Section VI(A) is modified to make the initial period for appointing an Antitrust Compliance Officer in the first sentence 120 days from consummation of the Acquirer's acquisition of the Acquired Station or Acquired Stations.

This Acknowledgement of Applicability may be voided by a joint written agreement between the United States and the Acquirer.

Dated: [ ]

Respectfully submitted,

____

[Counsel for Acquirer]

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

United States of America; Plaintiff, v. *Sinclair Broadcast Group, Inc., et al.,* Defendants.

Case No.

[PROPOSED] FINAL JUDGMENT

WHEREAS, Plaintiff, United States of America, filed its Amended Complaint on____, 2019, alleging that Defendant TEGNA Inc., among others, violated Section 1 of the Sherman Act, 15 U.S.C. § 1, the United States and Defendant, by their respective attorneys, have consented to the entry of this Final Judgment without trial or adjudication of any issue of fact or law;

AND WHEREAS, this Final Judgment does not constitute any evidence against or admission by any party regarding any issue of fact or law;

AND WHEREAS, the United States and Defendant agree to be bound by the provisions of this Final Judgment pending its approval by this Court;

AND WHEREAS, the Defendant agrees to undertake certain actions and to refrain from engaging in certain forms of information sharing with its competitors;

NOW THEREFORE, before any testimony is taken, without trial or adjudication of any issue of fact or law, and upon consent of the parties, it is ORDERED, ADJUDGED, AND DECREED:

I. JURISDICTION

This Court has jurisdiction over the subject matter and each of the parties to this action. The allegations in the Complaint arise under Section 1 of the Sherman Act, as amended, 15 U.S.C. § 1. *See* 28 U.S.C. § 1331.

II. DEFINITIONS

As used in this Final Judgment:

A. ''Advertiser'' means an advertiser, an advertiser's buying agent, or an advertiser's representative.

B. ''Agreement'' means any agreement, understanding, pact, contract, or arrangement, formal or informal, oral or written, between two or more Persons.

C. ''Communicate,'' ''Communicating,'' and ''Communication(s)'' means to provide, send, discuss, circulate, exchange, request, or solicit information, whether directly or indirectly, and regardless of the means by which it is accomplished, including orally or by written means of any kind, such as electronic communications, e-mails, facsimiles, telephone communications, voicemails, text messages, audio recordings, meetings, interviews, correspondence, exchange of written or recorded information, or face-to-face meetings.

D. ''Competitively Sensitive Information'' means any of the following information, less than eighteen months old, of Defendant or any broadcast television station regarding the sale of spot advertising on broadcast television stations: Non-Public Information relating to pricing or pricing strategies, pacing, holding capacity, revenues, or market shares. Reports containing only aggregated market-level or national data are not

Competitively Sensitive Information, but reports (including by paid subscription) that are customized or confidential to a particular Station or broadcast television station group are Competitively Sensitive Information. For the avoidance of doubt, spot advertising does not include network television advertising sold by the Defendant or television advertising sold by the Defendant in its capacity as an agent of the owners of syndicated programming.

E. ''Cooperative Agreement'' means (1) joint sales agreements, joint operating agreements, local marketing agreements, news share agreements, or shared services agreements, or (2) any agreement through which a Person exercises control over any broadcast television station not owned by the Person.

F. ''Defendant'' means TEGNA Inc., a Delaware corporation with its headquarters in McLean, Virginia, its successors and assigns, and its subsidiaries, divisions, and Stations, and their directors, officers, and employees.

G. ''DMA'' means Designated Market Area as defined by A.C. Nielsen Company and used by the *Investing in Television BIA Market Report 2018.*

H. ''Management'' means all directors and executive officers of Defendant, or any other employee with management or supervisory responsibilities for Defendant's business or operations related to the sale of spot advertising on any Station.

I. ''Non-Public Information'' means information that is not available from public sources or generally available to the public. Measurement or quantification of a Station's future holding capacity is Non-Public Information, but measurement or quantification of a Station's past holding capacity is not Non-Public Information. For the avoidance of doubt, the fact that information is available by paid subscription does not on its own render the information public.

J. ''Person'' means any natural person, corporation, company, partnership, joint venture, firm, association, proprietorship, agency, board, authority, commission, office, or other business or legal entity, whether private or governmental.

K. ''Sales Representative Firm'' means any organization, including without limitation Katz Media Group, Inc. and Cox Reps, Inc., and their respective subsidiaries and divisions, that represents a Station or its owner in the sale of spot advertising.

L. ''Sales Representative Firm Manager'' means, for each of Defendant's Sales Representative Firms, the employee of the Sales Representative Firm with primary responsibility for the relationship with Defendant.

M. ''Sales Staff'' means Defendant's employees with responsibility for the sale of spot advertising on any Station.

N. ''Station'' means any broadcast television station, its successors and assigns, and its subsidiaries, divisions, groups, and its owner or operator and its directors, officers, managers, and employees, unless a Station owns, is owned by, or is under common ownership with a Sales Representative Firm, in which case that Sales Representative Firm will not be considered a Station.

III. APPLICABILITY

This Final Judgment applies to Defendant, other Persons in active concert or participation with Defendant who receive actual notice of this Final Judgment by personal service or otherwise, and any Person that signs an Acknowledgment of Applicability, attached as Exhibit 2, to the extent set forth therein, as a condition of the purchase of a Station owned by Defendant as of February 1, 2019. This Final Judgment applies to Defendant's actions performed under any Cooperative Agreement, even if those actions are taken on behalf of a third party. This Final Judgment is fully enforceable, including by penalty of contempt, against all of the foregoing.

IV. PROHIBITED CONDUCT

A. Defendant's Management and Sales Staff shall not, directly or indirectly:

1. Communicate Competitively Sensitive Information to any Station in the same DMA it does not own or operate;

2. Knowingly use Competitively Sensitive Information from or regarding any Station in the same DMA it does not own or operate;

3. Encourage or facilitate the Communication of Competitively Sensitive Information to or from any Station in the same DMA it does not own or operate; or

4. Attempt to enter into, enter into, maintain, or enforce any agreement to Communicate Competitively Sensitive Information with any Station in the same DMA it does not own or operate.

B. The prohibitions under Paragraph IV(A) apply to Defendant's Communicating or agreeing to Communicate through a Sales Representative Firm or a third-party agent at Defendant's instruction or request.

C. Defendant shall not sell any Station owned by the Defendant as of February 1, 2019 to any Person unless that Person has first executed the Acknowledgment of Applicability, attached as Exhibit 2. Defendant shall submit any Acknowledgement of Applicability to the United States within 15 days of consummating the sale of such Station. The United States, in its sole discretion, may waive the prohibition in this Paragraph IV(C) on a Station-by-Station basis. Alternatively, the United States and the Person signing the Acknowledgement of Applicability may agree to void the Acknowledgement of Applicability at any time. The first sentence of this paragraph shall not apply to the sale of any Station to a Person already bound to a final judgment entered by a court regarding the Communication of Competitively Sensitive Information.

V. CONDUCT NOT PROHIBITED

A. Nothing in Section IV shall prohibit Defendant from Communicating, using, or encouraging or facilitating the Communication of, Competitively Sensitive Information with an actual or prospective Advertiser, except that, if the Advertiser is another Station, Defendant's Communicating, using, or encouraging or facilitating the Communication of, Competitively Sensitive Information is excluded from the prohibitions of Section IV only insofar as is reasonably necessary to negotiate the sale of spot advertising on broadcast television stations. For the avoidance of doubt, Defendant is not prohibited from internally using Competitively Sensitive Information received from an Advertiser that is a Station under the preceding sentence, but Defendant is prohibited from Communicating that Competitively Sensitive Information to a Station in the same DMA that it does not own or operate.

B. Nothing in Section IV shall prohibit Defendant from, after securing advice of counsel and in consultation with the Antitrust Compliance Officer, Communicating, using, encouraging or facilitating the Communication of, or attempting to enter into, entering into, maintaining, or enforcing any agreement to Communicate Competitively Sensitive Information with any Station when such Communication or use is (a) for the purpose of evaluating or effectuating a bona fide acquisition, disposition, or exchange of Stations or related assets, or (b) reasonably necessary for achieving the efficiencies of any other legitimate competitor collaboration. With respect to any such agreement:

1. For all agreements under Part V(B)(a) with any other Station to Communicate Competitively Sensitive Information that Defendant enters into, renews, or affirmatively extends after the date of entry of this Final Judgment, Defendant shall maintain documents sufficient to show:

i. the specific transaction or proposed transaction to which the sharing of Competitively Sensitive Information relates;

ii. the employees, identified with reasonable specificity, who are involved in the sharing of Competitively Sensitive Information; and

iii. the termination date or event of the sharing of Competitively Sensitive Information.

2. All agreements under Part V(B)(b) with any other Station to Communicate Competitively Sensitive Information that Defendant enters into, renews, or affirmatively extends after the date of entry of this Final Judgment shall be in writing, and shall:

i. identify and describe, with specificity, the collaboration to which it is ancillary;

ii. be narrowly tailored to permit the Communication of Competitively Sensitive Information only when reasonably necessary and only to the employees reasonably necessary to effectuate the collaboration;

iii. identify with reasonable specificity the Competitively Sensitive Information Communicated pursuant to the agreement and identify the employees to receive the Competitively Sensitive Information;

iv. contain a specific termination date or event; and

v. be signed by all parties to the agreement, including any modifications to the agreement.

3. For Communications under Part V(B)(a) above, Defendant shall maintain copies of all materials required under Paragraph V(B)(1) for five years or the duration of the Final Judgment, whichever is shorter, following entry into any agreement to Communicate or receive Competitively Sensitive Information, and Defendant shall make such documents available to the United States upon request, if such request is made during the preservation period.

4. For Communications under Part V(B)(b) above, Defendant shall furnish a copy of all materials required under Paragraph V(B)(2) to the United States within thirty days of the entry, renewal, or extension of the agreement.

5. For purposes of this Section V(B) only, a Joint Sales Agreement, Local Marketing Agreement, or similar agreement pursuant to which the Defendant Communicates, uses, encourages or facilitates the Communication of, or attempts to enter into, enters into, maintains, or enforces any agreement to Communicate Competitively Sensitive Information related solely to the sale of spot advertising for which Defendant is responsible on a Station, shall be considered a ''legitimate competitor collaboration'' under Part V(B)(b).

C. Nothing in Section IV shall prohibit Defendant from engaging in conduct in accordance with the doctrine established in *Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961), *United Mine Workers v. Pennington*, 381 U.S. 657 (1965), and their progeny.

D. Nothing in Section IV prohibits Defendant from (1) Communicating, encouraging or facilitating the Communication of, or attempting to enter into, entering into, maintaining, or enforcing any agreement to Communicate Competitively Sensitive Information for the purpose of aggregation if (a) Competitively Sensitive Information is sent to or received from, and the aggregation is managed by, a third party not owned or operated by any Station; (b) the information disseminated by the aggregator is limited to historical total broadcast television station revenue or other geographic or characteristic categorization (e.g., national, local, or political sales revenue); and (c) any information disseminated is sufficiently aggregated such that it would not allow a recipient to identify, deduce, or estimate the prices or pacing of any individual broadcast television station not owned or operated by that recipient; or (2) using information that meets the requirements of Parts V(D)(1)(a)-(c).

VI. REQUIRED CONDUCT

A. Within ten days of entry of this Final Judgment, Defendant shall appoint an Antitrust Compliance Officer who is an internal employee or Officer of the Defendant, and identify to the United States the Antitrust Compliance Officer's name, business address, telephone number, and email address. Within forty-five days of a vacancy in the Antitrust Compliance Officer position, Defendant shall appoint a replacement, and shall identify to the United States the Antitrust Compliance Officer's name, business address, telephone number, and email address. Defendant's initial or replacement appointment of an Antitrust Compliance Officer is subject to the approval of the United States, in its sole discretion.

B. The Antitrust Compliance Officer shall have, or shall retain outside counsel who has, the following minimum qualifications:

1. be an active member in good standing of the bar in any U.S. jurisdiction; and

2. have at least five years' experience in legal practice, including experience with antitrust matters, unless finding an Antitrust Compliance Officer or outside counsel meeting this experience requirement is a hardship on or is not reasonably available to the Defendant, under which circumstances the Defendant may select an Antitrust Compliance Officer or shall retain outside counsel who has at least five years' experience in legal practice, including experience with regulatory or compliance matters.

C. The Antitrust Compliance Officer shall, directly or through the employees or counsel working at the Antitrust Compliance Officer's responsibility and direction:

1. within fourteen days of entry of the Final Judgment, furnish to all of Defendant's Management and Sales Staff and Sales Representative Firm Managers a copy of this Final Judgment, the Competitive Impact Statement filed by the United States with the Court, and a cover letter in a form attached as Exhibit 1;

2. within fourteen days of entry of the Final Judgment, in a manner to be devised by Defendant and approved by the United States, provide Defendant's Management and Sales Staff reasonable notice of the meaning and requirements of this Final Judgment;

3. annually brief Defendant's Management and Sales Staff on the meaning and requirements of this Final Judgment and the U.S. antitrust laws;

4. brief any Person who succeeds a Person in any position identified in Paragraph VI(C)(3), within sixty days of such succession;

5. obtain from each Person designated in Paragraph VI(C)(3) or VI(C)(4), within thirty days of that Person's receipt of the Final Judgment, a certification that the Person (i) has read and understands and agrees to abide by the terms of this Final Judgment; (ii) is not aware of any violation of the Final Judgment that has not been reported to Defendant; and (iii) understands that failure to comply with this Final Judgment may result in an enforcement action for civil or criminal contempt of court;

6. annually communicate to Defendant's Management and Sales Staff that they may disclose to the Antitrust Compliance Officer, without reprisal for such disclosure, information concerning any violation or potential violation of this Final Judgment or the U.S. antitrust laws by Defendant;

7. within thirty days of the latest filing of the Complaint, Proposed Final Judgment, or Competitive Impact Statement in this action, Defendant shall provide notice, in each DMA in which Defendant owns or operates a Station, to (i) every full power Station in that DMA that sells broadcast television spot advertising that Defendant does not own or operate and (ii) any Sales Representative Firm selling advertising in that DMA on behalf of Defendant, of the Complaint, Proposed Final Judgment, and Competitive Impact Statement in a form and manner to be proposed by Defendant and approved by the United States in its sole discretion. Defendant shall provide the United States with its proposal, including the list of recipients, within ten days of the filing of the Complaint; and

8. maintain for five years or until expiration of the Final Judgment, whichever is shorter, a copy of all materials required to be issued under Paragraph VI(C), and furnish them to the United States within ten days if requested to do so, except documents protected under the attorney-client privilege or the attorney work-product doctrine. For all materials required to be furnished under Paragraph VI(C) which Defendant claims are protected under the attorney-client privilege or the attorney work-product doctrine, Defendant shall furnish to the United States a privilege log.

D. Defendant shall:

1. upon Management or the Antitrust Compliance Officer learning of any violation or potential violation of any of the terms and conditions contained in this Final Judgment, (i) promptly take appropriate action to investigate, and in the event of a violation, terminate or modify the activity so as to comply with this Final Judgment, (ii) maintain all documents related to any violation or potential violation of this Final Judgment for a period of five years or the duration of this Final Judgment, whichever is shorter, and (iii) maintain, and furnish to the United States at the United States' request, a log of (a) all such documents and documents for which Defendant claims protection under the attorney-client privilege or the attorney work product doctrine, and (b) all potential and actual violations, even if no documentary evidence regarding the violations exist;

2. within thirty days of Management or the Antitrust Compliance Officer learning of any such violation or potential violation of any of the terms and conditions contained in this Final Judgment, file with the United States a statement describing any violation or potential violation of any of the terms and conditions contained in this Final Judgment, which shall include a description of any Communications constituting the violation or potential violation, including the date and place of the Communication, the Persons involved, and the subject matter of the Communication;

3. establish a whistleblower protection policy, which provides that any employee may disclose, without reprisal for such disclosure, to the Antitrust Compliance Officer information concerning any violation or potential violation by the Defendant of this Final Judgment or U.S. antitrust laws;

4. have its CEO, General Counsel or Chief Legal Officer certify in writing to the United States annually on the anniversary date of the entry of this Final Judgment that Defendant has complied with the provisions of this Final Judgment;

5. maintain and produce to the United States upon request: (i) a list identifying all employees having received the annual antitrust briefing required under Paragraphs VI(C)(3) and VI(C)(4); and (ii) copies of all materials distributed as part of the annual antitrust briefing required under Paragraphs VI(C)(3) and V(C)(4). For all materials requested to be produced under this Paragraph VI(D)(5) for which Defendant claims is protected under the attorney-client privilege or the attorney work-product doctrine, Defendant shall furnish to the United States a privilege log; and

6. within 14 days of entry of the Final Judgment, instruct each Sales Representative Firm Manager that the Sales Representative Firm shall not Communicate any of Defendant's Competitively Sensitive Information in a way that would violate Sections IV and V of this Final Judgment if the Sales Representative Firm were included in the definition of ''Defendant'' in Paragraph II(F), in a form and manner to be proposed by Defendant and approved by the United States in its sole discretion, maintained and produced to the United States upon request.

E. For the avoidance of doubt, the term ''potential violation'' as used in Paragraph VI(D) does not include the discussion of future conduct.

F. If Defendant acquires a Station after entry of this Final Judgment, this Section VI will not apply to that acquired Station or the employees of that acquired Station until 120 days after closing of the acquisition of that acquired Station.

VII. DEFENDANT'S COOPERATION

A. Defendant shall cooperate fully and truthfully with the United States in any investigation or litigation concerning whether or alleging that Defendant, any Station that Defendant does not own or operate, or any Sales Representative Firm Communicated Competitively Sensitive Information with or among Defendant or any other Station or any Sales Representative Firm in violation of Section 1 of the Sherman Act, as amended, 15 U.S.C. § 1. Defendant shall use its best efforts to ensure that all current and former officers, directors, employees, and agents also fully and promptly cooperate with the United States. The full, truthful, and continuing cooperation of Defendant shall include, but not be limited to:

1. providing sworn testimony, that is not protected by the attorney-client privilege or the attorney work product doctrine, to the United States regarding the Communicating of Competitively Sensitive Information or any agreement with any other Station it does not own or such other Station's Sales Representative Firm to Communicate Competitively Sensitive Information while an employee of the Defendant;

2. producing, upon request of the United States, all documents, data, and other materials, wherever located, to the extent not protected under the attorney-client privilege or the attorney work-product doctrine, in the possession, custody, or control of Defendant, that relate to the Communication of Competitively Sensitive Information or any agreement with any other Station or such other Station's Sales Representative Firm to Communicate Competitively Sensitive Information, and a log of documents protected by the attorney-client privilege or the attorney work product doctrine;

3. making available for interview any officers, directors, employees, and agents of Defendant if so requested on reasonable notice by the United States; and

4. testifying at trial and other judicial proceedings fully, truthfully, and under oath, when called upon to do so by the United States; provided however, that the obligations of Defendant to cooperate fully with the United States as described in this Section VII shall cease upon the conclusion of all of the United States' investigations and the United States' litigations examining whether or alleging that Defendant, any Station that Defendant does not own or operate or such other Station's Sales Representative Firm Communicated Competitively Sensitive Information or

with or among Defendant or any other Station or any Sales Representative Firm in violation of Section 1 of the Sherman Act, as amended, 15 U.S.C. § 1, including exhaustion of all appeals or expiration of time for all appeals of any Court ruling in each such matter, at which point the United States will provide written notice to Defendant that its obligations under this Section VII have expired.

B. Defendant is obligated to impose a litigation hold until the United States provides written notice to the Defendant that its obligations under this Section VII have expired. This Paragraph VII(B) does not apply to documents created after entry of this Final Judgment.

C. Subject to the full, truthful, and continuing cooperation of Defendant, as defined in Paragraph VII(A), the United States will not bring any further civil action or any criminal charges against Defendant related to any Communication of Competitively Sensitive Information or any agreement to Communicate Competitively Sensitive Information with any other Station it does not own or operate or such other Station's Sales Representative Firm when that agreement:

1. was Communicated, entered into and terminated on or before the date of the filing of the Complaint in this action (or in the case of a Station that is acquired by Defendant after entry of this Final Judgment, was Communicated or entered into before the acquisition and terminated within 120 days after the closing of the acquisition); and

2. does not constitute or include an agreement to fix prices or divide markets.

D. The United States' agreement set forth in Paragraph VII(C) does not apply to any acts of perjury or subornation of perjury (18 U.S.C. §§ 1621-22), making a false statement or declaration (18 U.S.C. §§ 1001, 1623), contempt (18 U.S.C. §§ 401-402), or obstruction of justice (18 U.S.C. § 1503, *et seq.*) by the Defendant or its officers, directors, and employees. The United States' agreement set forth in Paragraph VII(C) does not release any claims against any Sales Representative Firm.

VIII. COMPLIANCE INSPECTION

A. For the purposes of determining or securing compliance with this Final Judgment or of any related orders, or of determining whether the Final Judgment should be modified, and subject to any legally recognized privilege, from time to time authorized representatives of the United States Department of Justice, including consultants and other persons retained by the United States, shall, upon written request of an authorized representative of the Assistant Attorney General in charge of the Antitrust Division, and on reasonable notice to Defendant, be permitted:

1. to access during Defendant's office hours to inspect and copy, or at the option of the United States, to require Defendant to provide electronic or hard copies of all books, ledgers, accounts, records, data, and documents in the possession, custody, or control of Defendant, relating to any matters that are the subject of this Final Judgment, not protected by the attorney- client privilege or the attorney work product doctrine; and

2. to interview, either informally or on the record, Defendant's officers, employees, or agents, who may have their individual counsel present, regarding such matters. The interviews shall be subject to the reasonable convenience of the interviewee and without restraint or interference by Defendant; and

3. to obtain from Defendant written reports or responses to written interrogatories, of information not protected by the attorney-client privilege or attorney work product doctrine, under oath if requested, relating to any matters that are the subject of this Final Judgment as may be requested.

B. No information or documents obtained by the means provided in this Section VIII shall be divulged by the United States to any Person other than an authorized representative of the executive branch of the United States, except in the course of legal proceedings to which the United States is a party (including grand jury proceedings), or for the purpose of securing compliance with this Final Judgment, or for law enforcement purposes, or as otherwise required by law.

C. If at the time information or documents are furnished by Defendant to the United States, Defendant represents and identifies in writing the material in any such information or documents to which a claim of protection may be asserted under Rule 26(c)(1)(G) of the Federal Rules of Civil Procedure, and Defendant marks each pertinent page of such material, ''Subject to claim of protection under Rule 26(c)(1)(G) of the Federal Rules of Civil Procedure,'' then the United States shall give Defendant ten calendar days' notice prior to divulging such material in any legal proceeding (other than a grand jury proceeding).

IX. RETENTION OF JURISDICTION

This Court retains jurisdiction to enable any party to this Final Judgment to apply to this Court at any time for further orders and directions as may be necessary or appropriate to carry out or construe this Final Judgment, to modify any of its provisions, to enforce compliance, and to punish violations of its provisions.

X. ENFORCEMENT OF FINAL JUDGMENT

A. The United States retains and reserves all rights to enforce the provisions of this Final Judgment, including its right to seek an order of contempt from this Court. Defendant agrees that in any civil contempt action, any motion to show cause, or any similar civil action brought by the United States regarding an alleged violation of this Final Judgment, the United States may establish a violation of the Final Judgment and the appropriateness of any remedy therefor by a preponderance of the evidence, and Defendant waives any argument that a different standard of proof should apply.

B. The Final Judgment should be interpreted to give full effect to the procompetitive purposes of the antitrust laws and to restore all competition the United States alleged was harmed by the challenged conduct. Defendant agrees that it may be held in contempt of, and that the Court may enforce, any provision of this Final Judgment that, as interpreted by the Court in light of these procompetitive principles and applying ordinary tools of interpretation, is stated specifically and in reasonable detail, whether or not it is clear and unambiguous on its face. In any such interpretation, the terms of this Final Judgment should not be construed against either party as the drafter.

C. In any enforcement proceeding in which the Court finds that Defendant has violated this Final Judgment, the United States may apply to the Court for a one-time extension of this Final Judgment, together with such other relief as may be appropriate. In connection with any successful effort by the United States to enforce this Final Judgment against Defendant, whether litigated or resolved prior to litigation, Defendant agrees to reimburse the United States for the fees and expenses of its attorneys, as well as any other costs including experts' fees, incurred in connection with that enforcement effort, including in the investigation of the potential violation.

XI. EXPIRATION OF FINAL JUDGMENT

Unless this Court grants an extension, this Final Judgment shall expire seven years from the date of its entry, except that after five years from the date of its entry, this Final Judgment may be terminated upon notice by the United States to the Court and Defendant that the continuation of the Final Judgment no longer is necessary or in the public interest.

XII. NOTICE

For purposes of this Final Judgment, any notice or other communication required to be provided to the United States shall be sent to the person at the address set forth below (or such other addresses as the United States may specify in writing to Defendant): Chief, Media, Entertainment, and Professional Services Section, U.S. Department of Justice Antitrust Division, 450 Fifth Street NW, Suite 4000, Washington, DC 20530.

XIII. PUBLIC INTEREST DETERMINATION

Entry of this Final Judgment is in the public interest. The parties have complied with the requirements of the Antitrust Procedures and Penalties Act, 15 U.S.C. § 16, including making copies available to the public of this Final Judgment, the Competitive Impact Statement, and any comments thereon and the United States' responses to comments. Based upon the record before the Court, which includes the Competitive Impact Statement and any comments and response to comments filed with the Court, entry of this Final Judgment is in the public interest.

IT IS SO ORDERED by the Court, this ____ day of ______, 201__.

Court approval subject to procedures of Antitrust Procedures and Penalties Act, 15 U.S.C. § 16

United States District Judge

EXHIBIT 1

[Company Letterhead]

[Name and Address of Antitrust Compliance Officer]

Re: *Prohibitions Against Sharing of Competitively Sensitive Information*

Dear [XX]:

I provide you this notice regarding a judgment recently entered by a federal judge in Washington, D.C. prohibiting the sharing of certain information with other broadcast television station(s).

The judgment applies to our company and all of its employees, including you, so it is important that you understand the obligations it imposes on us. [CEO Name] has asked me to let each of you know that [s/he] expects you to take these obligations seriously and abide by them.

The judgment prohibits us from sharing or receiving, directly or indirectly (including through our national sales representative firm), competitively sensitive information with or from any employee, agent, or representative of another broadcast television station in the same DMA it does not own or operate. Competitively sensitive information means any non-public information regarding the sale of spot advertising on broadcast television stations, including information relating to any pricing or pricing strategies, pacing, holding capacity, revenues, or market shares. There are limited exceptions to this restriction, which are listed in the judgment. The company will provide briefing on the legitimate or illegitimate exchange of information.

You must consult with me if you have any questions on whether a particular circumstance is subject to an exception under the judgment.

A copy of the judgment is attached. Please read it carefully and familiarize yourself with its terms. The judgment, rather than the above description, is controlling. If you have any questions about the judgment or how it affects your sale of spot advertising, please contact me as soon as possible.

Please sign and return the attached Employee Certification to [Defendant's Antitrust Compliance Officer] within thirty days of your receipt of this letter. Thank you for your cooperation.

Sincerely,

[Defendant's Antitrust Compliance Officer]

Employee Certification

I, ________ [name], ________ [position] at ________ [station or location] do hereby certify that I (i) have read and understand, and agree to abide by, the terms of the Final Judgment; (ii) am not aware of any violation of the Final Judgment that has not been reported to [Defendant]; and (iii) understand that my failure to comply with this Final Judgment may result in an enforcement action for civil or criminal contempt of court.

Name:

Date:

EXHIBIT 2

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

United States of America; Plaintiff, v. *Sinclair Broadcast Group, Inc., et al.,* Defendants.

Case No.

ACKNOWLEDGEMENT OF APPLICABILITY

The undersigned acknowledges that [*Full Buyer Name*], including its successors and assigns, and its subsidiaries, divisions, and broadcast television stations, and their directors, officers, and employees (''Acquirer''), following consummation of the Acquirer's acquisition of [*insert names of station or stations acquired*] (each, an ''Acquired Station''), is bound by the Final Judgment entered by this Court in the above-captioned action (''Final Judgment''), as if the Acquirer were a Defendant under the Final Judgment, as follows:

1. The Acquirer shall be bound in full by all Sections of the Consent Decree not specifically discussed below.

2. As to Sections IV, V, and VII of the Final Judgment, the Acquirer is bound to the Final Judgment only as to (i) each Acquired Station, each Acquired Station's successors and assigns, and each Acquired Station's subsidiaries and divisions, and each Acquired Station's directors, officers, and employees, (ii) Acquirer's officers and directors only with respect to any responsibilities or actions regarding any Acquired Stations, and (iii) employees with management or supervisory responsibilities for Acquirer's business or operations related to the sale of spot advertising on any Acquired Station, only with respect to those responsibilities.

3. As to Section VI(C)(3), VI(C)(4), VI(C)(6), VI(C)(8), VI(D), VI(E), and VIII of the Final Judgment, the Acquirer is bound to the Final Judgment only as to (i) each Acquired Station, each Acquired Station's successors and assigns, and each Acquired Station's subsidiaries and divisions, and each Acquired Station's directors, officers, and employees, (ii) Acquirer's officers and directors, and (iii) employees with management or supervisory responsibilities for Acquirer's business or operations related to the sale of spot advertising on any Acquired Station.

4. The release contained in Sections VII(C) and (D) applies to the Acquirer, but only to civil actions or criminal charges arising from actions taken by any Acquired Station.

5. The Acquirer shall not be bound by Sections VI(C)(1), VI(C)(2),VI(C)(5), VI(C)(7), and VI(F) of the Final Judgment at all, unless the Acquirer acquires the Acquired Stations earlier than 45 days after entry of the Final Judgment.

6. Section VI(A) applies to the Acquirer, but, unless the Acquirer

acquires the Acquired Stations earlier than 45 days after entry of the Final Judgment, Section VI(A) is modified to make the initial period for appointing an Antitrust Compliance Officer in the first sentence 120 days from consummation of the Acquirer's acquisition of the Acquired Station or Acquired Stations.

This Acknowledgement of Applicability may be voided by a joint written agreement between the United States and the Acquirer.

Dated: [ ]

Respectfully submitted,

[Counsel for Acquirer]

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

United States of America; Plaintiff, v. *Sinclair Broadcast Group, Inc.; Raycom Media, Inc.; Tribune Media Company; Meredith Corporation; Griffin Communications, LLC; Dreamcatcher Broadcasting, LLC, Nexstar Media Group, Inc.; CBS Corporation; Cox Enterprises, Inc.; The E.W. Scripps Company; Fox Corporation; and TEGNA Inc.,* Defendants.

Case No. 1:18–cv–2609–TSC

COMPETITIVE IMPACT STATEMENT

Plaintiff United States of America (''United States''), pursuant to Section 2(b) of the Antitrust Procedures and Penalties Act, 15 U.S.C. § 16(b)-(h) (''APPA'' or ''Tunney Act''), files this Competitive Impact Statement relating to the proposed Final Judgments against Defendants CBS Corporation (''CBS''), Cox Enterprises, Inc. (''Cox''), The E.W. Scripps Company (''Scripps''), Fox Corporation (''Fox''), and TEGNA Inc. (''TEGNA'') submitted for entry in this civil antitrust proceeding.

I. Nature and Purpose of the Proceeding

On November 13, 2018, the United States filed a civil antitrust complaint alleging that six Defendants agreed among themselves and other broadcast television stations in many local markets to reciprocally exchange station-specific, competitively sensitive information regarding spot advertising revenues. The Complaint alleges those Defendants' agreements are unreasonable restraints of trade that are unlawful under Section 1 of the Sherman Act, 15 U.S.C. § 1. The Complaint seeks injunctive relief to prevent those Defendants from exchanging competitively sensitive information with and among competing broadcast television stations. On December 13, 2018, the United States filed an Amended Complaint, adding a seventh defendant. On June 17, 2019, the United States filed a Second Amended Complaint, adding CBS, Cox, Scripps, Fox, and TEGNA as defendants. Besides these additions and some additional allegations regarding agreements with certain national sales representation firms, the Second Amended Complaint is the same as the Amended Complaint in all material respects.

Along with the Second Amended Complaint, the United States filed proposed Final Judgments for CBS, Cox, Scripps, Fox, and TEGNA.[2] The proposed Final Judgments prohibit sharing of competitively sensitive information, require CBS, Cox, Scripps, Fox, and TEGNA to implement antitrust compliance training programs, and impose cooperation and reporting requirements.

The United States and each of CBS, Cox, Scripps, Fox, and TEGNA have stipulated that the proposed Final Judgments may be entered after compliance with the APPA, unless the United States withdraws its consent. Entry of the proposed Final Judgments would terminate this action, except that the Court would retain jurisdiction to construe, modify, or enforce the provisions of the proposed Final Judgments and to punish violations thereof.

II. Description of the Events Giving Rise to the Alleged Violation

A. *Industry Background*

Broadcast television stations sell advertising time to businesses that want to advertise their products to television viewers. Broadcast television ''spot'' advertising,[3] which typically comprises the majority of a station's revenues, is sold directly by the station itself or through its sales representatives to advertisers who want to target viewers in specific geographic areas called Designated Market Areas (''DMAs'').[4]

Broadcast stations typically make their spot advertising sales through two channels: (1) local sales, which are sales made by the station's own local sales staff to advertisers who are usually located within the DMA; and (2) national sales, which are sales made either by the broadcast group's national sales staff or by a national sales representative firm (''Sales Rep Firm'') to regional or national advertisers.

CBS is a Delaware corporation with its principal place of business in New York, New York. CBS owns or operates 28 television stations in 18 DMAs, and had over $14.5 billion in revenues in 2018.

Cox is a Delaware corporation with its principal place of business in Atlanta, Georgia. Cox owns or operates 14 television stations in 10 DMAs, owns Cox Reps, and had an estimated $20 billion in revenues in 2018.

Scripps is an Ohio corporation with its principal place of business in Cincinnati, Ohio. Scripps owns or operates 60 television stations in 42 DMAs, and had over $917 million in revenues in 2018.

Fox is a Delaware corporation with its principal place of business in New York, New York. Fox owns or operates 17 television stations in 17 DMAs. Fox is a corporate entity recently created from certain former 21st Century Fox assets, including its broadcast station assets, after The Walt Disney Company acquired 21st Century Fox and spun-out Fox. 21st Century Fox's television segment earned over $5 billion in 2017.

Defendant TEGNA is a Delaware corporation with its principal place of business in McLean, Virginia. TEGNA owns or operates 49 television stations in 41 DMAs, and had $2.2 billion in revenues in 2018.

CBS, Cox, Scripps, Fox, and TEGNA, along with certain other television broadcast station groups, compete in various configurations in multiple DMAs across the United States. CBS, Cox, Scripps, Fox, and TEGNA sell spot advertising time to advertisers that seek to target viewers in the DMAs in which they operate. Prices are individually negotiated with advertisers, and advertisers are able to ''play off'' the stations against each other to obtain competitive rates.

There are two primary Sales Rep Firms in the United States today, including Cox's subsidiary Cox Reps, Inc. (''Cox Reps''), and each represents hundreds of television stations throughout the country in the sale of national advertising time. It is common for one Sales Rep Firm to represent multiple competing stations in the same DMA. In such cases, the stations and the Sales Rep Firms purportedly create firewalls to prevent coordination and

[2] On May 22, 2019, the Court issued orders granting Final Judgment with respect to the seven other defendants. *See U.S. v. Sinclair*, No. 1:18–cv–02609–TSC, Dkt. Nos. 34–40 (May 22, 2019).

[3] Spot advertising differs from other types of television advertising, such as network and syndicated television advertising, which are sold by television networks and producers of syndicated programs on a nationwide basis and broadcast in every market where the network or syndicated program is aired.

[4] A DMA is a geographical unit designated by the A.C. Nielsen Company, a company that surveys television viewers and furnishes data to aid in evaluating television audiences. There are 210 DMAs in the United States. DMAs are widely accepted by television stations, advertisers, and advertising agencies as the standard geographic area to use in evaluating television audience size and demographic composition.

information sharing between the sales teams representing competing stations.

B. *The Exchanges of Competitively Sensitive Information*

The Second Amended Complaint alleges that CBS, Cox, Scripps, Fox, and TEGNA and other broadcasters and Sales Rep Firms have agreed in many DMAs to reciprocally exchange station-specific revenue pacing data. Revenue pacing data compares a station's revenues booked for a certain time period to the revenues booked for the same point in time in the previous year, indicating how each station is performing versus the rest of the market and providing insight into each station's remaining spot advertising inventory for the current period or future periods. The exchanges were systematic and typically included non-public pacing data on national revenues, local revenues, or both, depending on the DMA. The Second Amended Complaint further alleges that CBS, Cox, Scripps, Fox, and TEGNA engaged in the exchange of other forms of competitively sensitive information relating to spot advertising in certain DMAs.

The Second Amended Complaint alleges that CBS, Cox, Scripps, Fox, and TEGNA exchanged pacing information in at least two ways. First, CBS, Cox, Scripps, Fox, and TEGNA and other television broadcast stations exchanged information through the Sales Rep Firms, exchanges which the Sales Rep Firms agreed to facilitate or knowingly facilitated. The information was passed both within and between Sales Rep Firms representing competing stations, and was done with CBS's, Cox's, Scripps', Fox's, and TEGNA's knowledge and frequently at those Defendants' instruction. Second, in some DMAs, CBS, Cox, Scripps, Fox, and TEGNA and other broadcasters exchanged pacing information directly between local station employees.

The Second Amended Complaint alleges that these exchanges of pacing information allowed stations to better understand, in real time, the availability of inventory on competitors' stations, which is often a key factor affecting negotiations with buyers over spot advertising prices. The exchanges also helped stations to anticipate whether competitors were likely to raise, maintain, or lower spot advertising prices. Understanding competitors' pacing can help stations gauge competitors' and advertisers' negotiation strategies, inform their own pricing strategies, and help them resist more effectively advertisers' attempts to obtain lower prices by playing stations off of one another. CBS's, Cox's, Scripps', Fox's, and TEGNA's information exchanges therefore distorted the normal price-setting mechanism in the spot advertising market and harmed the competitive process within the affected DMAs.

III. Explanation of the Proposed Final Judgments

The provisions of the proposed Final Judgments closely track the relief sought in the Second Amended Complaint and are intended to provide prompt, certain, and effective remedies that will ensure that CBS, Cox, Scripps, Fox, and TEGNA and their employees and Sales Rep Firms will not impede competition by sharing competitively sensitive information, directly or indirectly, including through Sales Rep Firms, with its rival broadcast television stations. The requirements and prohibitions in the proposed Final Judgments will terminate CBS's, Cox's, Scripps', Fox's, and TEGNA's illegal conduct, prevent recurrence of the same or similar conduct, ensure that CBS, Cox, Scripps, Fox, and TEGNA establish antitrust compliance programs, and provide the United States with cooperation in its ongoing investigation. The proposed Final Judgments protect competition and consumers by putting a stop to the anticompetitive information sharing alleged in the Second Amended Complaint.

A. *Prohibited Conduct*

The proposed Final Judgments broadly prohibit CBS, Cox, Scripps, Fox, and TEGNA from sharing competitively sensitive information with rival broadcast television stations in the same DMA. Specifically, Section IV ensures that CBS, Cox, Scripps, Fox, and TEGNA will not, directly or indirectly, communicate competitively sensitive information, including pricing or pricing strategies, pacing, holding capacity, revenues, or market shares, to broadcast television stations in the same DMA or to those stations' sales representatives and agents. Regarding Cox, Section IV of the proposed Final Judgment also ensures that Cox will not facilitate the communication of competitively sensitive information between rival broadcast television stations through Cox Reps.

The proposed Final Judgments provide that their provisions will apply to stations owned by CBS, Cox, Scripps, Fox, and TEGNA even if they sell those stations to new buyers. In particular, Paragraph IV(C) provides that each of CBS, Cox, Scripps, Fox, and TEGNA may not sell any stations it owns as of October 1, 2018, unless the buyer has executed an Acknowledgement that each station will continue to be bound by the terms of the proposed Final Judgment. The United States, in its discretion, may waive this requirement on a station-by-station basis, or alternatively the buyer and the United States may agree to void the Acknowledgement after the sale has been consummated.

B. *Conduct Not Prohibited*

Section V makes clear that the proposed Final Judgments do not prohibit CBS, Cox, Scripps, Fox, and TEGNA from sharing or receiving competitively sensitive information in certain specified circumstances where the information sharing appears unlikely to cause harm to competition. Paragraph V(A) allows CBS, Cox, Scripps, Fox, and TEGNA to communicate competitively sensitive information to advertising customers or prospective customers. Paragraph V(B) allows for the communication of competitively sensitive information with other broadcasters (i) for purposes of evaluating or effectuating a transaction, such as the purchase or sale of a station; or (ii) when reasonably necessary for achieving the efficiencies of a legitimate collaboration among competitors, such as a lawful joint venture.[5] Paragraph V(C) confirms that the proposed Final Judgments do not prohibit petitioning conduct protected by the Noerr-Pennington doctrine. Paragraph V(D) permits the exchange of competitively sensitive information through certain third-party aggregation services under the conditions listed in that paragraph, including that the aggregated data does not permit individual stations to identify, deduce, or estimate the prices or pacing of their competitors.

C. *Antitrust Compliance Obligations*

Under Section VI of the proposed Final Judgments, CBS, Cox, Scripps, Fox, and TEGNA each must designate an Antitrust Compliance Officer who is responsible for implementing training and antitrust compliance programs and ensuring compliance with the Final

[5] Paragraph V(B)(5) states that, for purposes of Paragraph V(B) only, certain types of Joint Sales Agreements, Local Marketing Agreements, and similar agreements qualify as a ''legitimate competitor collaboration'' under Paragraph V(B)(b). Paragraph V(B)(5) was included in recognition of the fact that some broadcasters have entered into a number of these agreements in various DMAs. The question of whether these agreements have any effect on competition was outside the scope of the United States' investigation in this matter. Accordingly, Paragraph V(B)(5) should not be read as an admission that such agreements otherwise comply with the antitrust laws, and the United States takes no position on that question for purposes of this proceeding.

Judgments. Among other duties, each Antitrust Compliance Officer will be required to distribute copies of that Defendant's Final Judgment and ensure that training on the Final Judgment and the antitrust laws is provided to each of CBS's, Cox's, Scripps', Fox's, and TEGNA's respective management and sales staff. Section VI also requires CBS, Cox, Scripps, Fox, and TEGNA each to establish an antitrust whistleblower policy and remedy and report violations of the Final Judgment. Under Paragraph VI(D)(5) of Cox's proposed Final Judgment, Cox is required to establish policies and procedures at Cox Reps that ensure employees representing one station do not have access to the competitively sensitive information of any other client station operating in the same DMA, including database access restrictions. Under Section VI, CBS, Cox, Scripps, Fox, and TEGNA, through their respective CEO, General Counsel, or Chief Legal Officer, must certify annual compliance with the Final Judgments. This compliance program is necessary in light of the extensive history of communications among rival stations that facilitated CBS's, Cox's, Scripps', Fox's, and TEGNA's agreements.

D. *Defendants' Cooperation*

As outlined in Section VII, CBS, Cox, Scripps, Fox, and TEGNA must cooperate fully and truthfully with the United States in any investigation or litigation relating to the sharing of competitively sensitive information in the broadcast television industry. The required cooperation may include providing sworn testimony, employee interviews, and/or documents and data.

Paragraph VII(C) provides that, subject to each of CBS's, Cox's, Scripps', Fox's, and TEGNA's truthful and continuing cooperation as defined in Paragraphs VII(A) and (B), the United States will not bring further civil actions or criminal charges against that Defendant for any agreement to share competitively sensitive information with any other station or Sales Rep Firm when the agreement: (1) was entered into and terminated before the date of the filing of the Complaint and (2) does not constitute or include an agreement to fix prices or divide markets. As to Cox, an additional requirement for application of this release is that the agreement not involve Cox, including through Cox Reps, acting as a joint sales agent for Stations from different broadcast station groups competing in the same DMA.

E. *Enforcement of Final Judgments*

The proposed Final Judgments contain provisions designed to promote compliance and make the enforcement of Division consent decrees as effective as possible. Paragraph X(A) provides that the United States retains and reserves all rights to enforce the provisions of the proposed Final Judgments, including its rights to seek an order of contempt from the Court. CBS, Cox, Scripps, Fox, and TEGNA have agreed that in any civil contempt action, any motion to show cause, or any similar action brought by the United States regarding an alleged violation of the Final Judgment, the United States may establish the violation and the appropriateness of any remedy by a preponderance of the evidence and that CBS, Cox, Scripps, Fox, and TEGNA have waived any argument that a different standard of proof should apply. This provision aligns the standard for compliance obligations with the standard of proof that applies to the underlying offense that the compliance commitments address.

Paragraph X(B) provides additional clarification regarding the interpretation of the provisions of the proposed Final Judgments. The proposed Final Judgments were drafted to restore all competition the United States alleged was harmed by CBS's, Cox's, Scripps', Fox's, and TEGNA's challenged conduct. CBS, Cox, Scripps, Fox, and TEGNA agree that they will abide by the proposed Final Judgments, and that they may be held in contempt of this Court for failing to comply with any provision of the proposed Final Judgments that is stated specifically and in reasonable detail, whether or not it is clear and unambiguous on its face, and as interpreted in light of this procompetitive purpose.

Paragraph X(C) further provides that, should the Court find in an enforcement proceeding that CBS, Cox, Scripps, Fox, or TEGNA has violated the Final Judgment, the United States may apply to the Court for a one-time extension of the respective Final Judgment, together with such other relief as may be appropriate. In addition, in order to compensate American taxpayers for any costs associated with the investigation and enforcement of violations of a proposed Final Judgment, Paragraph X(C) provides that in any successful effort by the United States to enforce a Final Judgment against CBS, Cox, Scripps, Fox, or TEGNA whether litigated or resolved before litigation, each respective Defendant agrees to reimburse the United States for any attorneys' fees, experts' fees, or costs incurred in connection with any enforcement effort against that particular Defendant, including the investigation of the potential violation.

Finally, Section XI of the proposed Final Judgments provides that each Final Judgment shall expire seven years from the date of its entry, except that after five years from the date of its entry, the Final Judgment may be terminated upon notice by the United States to the Court and CBS, Cox, Scripps, Fox, or TEGNA, respectively, that the continuation of the Final Judgments is no longer necessary or in the public interest.

IV. Remedies Available to Potential Private Litigants

Section 4 of the Clayton Act, 15 U.S.C. § 15, provides that any person who has been injured as a result of conduct prohibited by the antitrust laws may bring suit in federal court to recover three times the damages the person has suffered, as well as costs and reasonable attorneys' fees. Entry of the proposed Final Judgments will neither impair nor assist the bringing of any private antitrust damage action. Under the provisions of Section 5(a) of the Clayton Act, 15 U.S.C. § 16(a), the proposed Final Judgments have no prima facie effect in any subsequent private lawsuit that may be brought against CBS, Cox, Scripps, Fox, or TEGNA.

V. Procedures Available for Modification of the Proposed Final Judgments

The United States and CBS, Cox, Scripps, Fox, and TEGNA have stipulated that the Court may enter the proposed Final Judgments after compliance with the provisions of the APPA, provided that the United States has not withdrawn its consent. The APPA conditions entry upon the Court's determination that the proposed Final Judgments are in the public interest.

The APPA provides a period of at least sixty days preceding the effective date of the proposed Final Judgments within which any person may submit to the United States written comments regarding the proposed Final Judgments. Any person who wishes to comment should do so within sixty days of the date of publication of this Competitive Impact Statement in the **Federal Register**, or the last date of publication in a newspaper of the summary of this Competitive Impact Statement, whichever is later. All comments received during this period will be considered by the United States Department of Justice, which remains free to withdraw its consent to the proposed Final Judgments at any time before the Court's entry of judgment. The comments and the response of the United States will be filed with the Court. In addition, comments will be posted on the U.S. Department of Justice, Antitrust Division's website and, under certain circumstances, published in the **Federal Register**.

Written comments should be submitted to: Owen M. Kendler, Chief, Media, Entertainment, & Professional Services Section, Antitrust Division, United States Department of Justice, 450 5th Street NW, Suite 4000, Washington, DC 20530.

Under Section IX, the proposed Final Judgments provide that the Court retains jurisdiction over this action, and the parties may apply to the Court for any order necessary or appropriate for the modification, interpretation, or enforcement of the Final Judgments.

VI. Alternatives to the Proposed Final Judgments

The United States considered, as an alternative to the proposed Final Judgments, seeking injunctive relief against CBS's, Cox's, Scripps', Fox's, and TEGNA's conduct through a full trial on the merits. The United States is satisfied, however, that the relief sought in the proposed Final Judgments will terminate the anticompetitive conduct alleged in the Second Amended Complaint and more quickly restore the benefits of competition to advertisers. Thus, the proposed Final Judgments would achieve the relief the United States might have obtained through litigation, but avoid the time, expense, and uncertainty of a full trial on the merits.

VII. Standard of Review Under the APPA for the Proposed Final Judgments

The Clayton Act, as amended by the APPA, requires that proposed consent judgments in antitrust cases brought by the United States be subject to a 60-day comment period, after which the court shall determine whether entry of the proposed Final Judgments ''is in the public interest.'' 15 U.S.C. § 16(e)(1). In making that determination, the court, in accordance with the statute as amended in 2004, is required to consider:

> (A) the competitive impact of such judgment, including termination of alleged violations, provisions for enforcement and modification, duration of relief sought, anticipated effects of alternative remedies actually considered, whether its terms are ambiguous, and any other competitive considerations bearing upon the adequacy of such judgment that the court deems necessary to a determination of whether the consent judgment is in the public interest; and
>
> (B) the impact of entry of such judgment upon competition in the relevant market or markets, upon the public generally and individuals alleging specific injury from the violations set forth in the complaint including consideration of the public benefit, if any, to be derived from a determination of the issues at trial.

15 U.S.C. § 16(e)(1)(A) & (B). In considering these statutory factors, the court's inquiry is necessarily a limited one as the government is entitled to ''broad discretion to settle with the defendant within the reaches of the public interest.'' *United States v. Microsoft Corp.*, 56 F.3d 1448, 1461 (D.C. Cir. 1995); *United States v. U.S. Airways Grp., Inc.*, 38 F. Supp. 3d 69, 75 (D.D.C. 2014) (explaining that the ''court's inquiry is limited'' in Tunney Act settlements); *United States v. InBev N.V./S.A.*, No. 08-1965 (JR), 2009 U.S. Dist. LEXIS 84787, at *3 (D.D.C. Aug. 11, 2009) (noting that the court's review of a consent judgment is limited and only inquires ''into whether the government's determination that the proposed remedies will cure the antitrust violations alleged in the complaint was reasonable, and whether the mechanism to enforce the final judgment are clear and manageable'').

As the United States Court of Appeals for the District of Columbia Circuit has held, under the APPA a court considers, among other things, the relationship between the remedy secured and the specific allegations in the government's complaint, whether the decree is sufficiently clear, whether its enforcement mechanisms are sufficient, and whether the decree may positively harm third parties. *See Microsoft*, 56 F.3d at 1458-62. With respect to the adequacy of the relief secured by the decree, a court may not ''engage in an unrestricted evaluation of what relief would best serve the public.'' *United States v. BNS, Inc.*, 858 F.2d 456, 462 (9th Cir. 1988) (quoting *United States v. Bechtel Corp.*, 648 F.2d 660, 666 (9th Cir. 1981)); *see also Microsoft*, 56 F.3d at 1460-62; *United States v. Alcoa, Inc.*, 152 F. Supp. 2d 37, 40 (D.D.C. 2001); *InBev*, 2009 U.S. Dist. LEXIS 84787, at *3. Instead:

> [t]he balancing of competing social and political interests affected by a proposed antitrust consent decree must be left, in the first instance, to the discretion of the Attorney General. The court's role in protecting the public interest is one of insuring that the government has not breached its duty to the public in consenting to the decree. The court is required to determine not whether a particular decree is the one that will best serve society, but whether the settlement is ''*within the reaches of the public interest*.'' More elaborate requirements might undermine the effectiveness of antitrust enforcement by consent decree.

Bechtel, 648 F.2d at 666 (emphasis added) (citations omitted).[6]

The United States' predictions with respect to the efficacy of the remedy are to be afforded deference by the Court. *See, e.g., Microsoft*, 56 F.3d at 1461 (recognizing courts should give ''due respect to the Justice Department's . . . view of the nature of its case'''); *United States v. Iron Mountain, Inc.*, 217 F. Supp. 3d 146, 152–53 (D.D.C. 2016) (''In evaluating objections to settlement agreements under the Tunney Act, a court must be mindful that [t]he government need not prove that the settlements will perfectly remedy the alleged antitrust harms[;] it need only provide a factual basis for concluding that the settlements are reasonably adequate remedies for the alleged harms.'' (internal citations omitted)); *United States v. Republic Servs., Inc.*, 723 F. Supp. 2d 157, 160 (D.D.C. 2010) (noting ''the deferential review to which the government's proposed remedy is accorded''); *United States v. Archer-Daniels-Midland Co.*, 272 F. Supp. 2d 1, 6 (D.D.C. 2003) (''A district court must accord due respect to the government's prediction as to the effect of proposed remedies, its perception of the market structure, and its view of the nature of the case.''). The ultimate question is whether ''the remedies [obtained in the decree are] so inconsonant with the allegations charged as to fall outside of the 'reaches of the public interest.''' *Microsoft*, 56 F.3d at 1461 (*quoting United States v. Western Elec. Co.*, 900 F.2d 283, 309 (D.C. Cir. 1990)).

Moreover, the court's role under the APPA is limited to reviewing the remedy in relationship to the violations that the United States has alleged in its complaint, and does not authorize the court to ''construct [its] own hypothetical case and then evaluate the decree against that case.'' *Microsoft*, 56 F.3d at 1459; *see also U.S. Airways*, 38 F. Supp. 3d at 75 (noting that the court must simply determine whether there is a factual foundation for the government's decisions such that its conclusions regarding the proposed settlements are reasonable); *InBev*, 2009 U.S. Dist. LEXIS 84787, at *20 (''the 'public interest' is not to be measured by comparing the violations alleged in the complaint against those the court

[6] *See also BNS*, 858 F.2d at 464 (holding that the court's ''ultimate authority under the [APPA] is limited to approving or disapproving the consent decree''); *United States v. Gillette Co.*, 406 F. Supp. 713, 716 (D. Mass. 1975) (noting that, in this way, the court is constrained to ''look at the overall picture not hypercritically, nor with a microscope, but with an artist's reducing glass'').

believes could have, or even should have, been alleged''). Because the ''court's authority to review the decree depends entirely on the government's exercising its prosecutorial discretion by bringing a case in the first place,'' it follows that ''the court is only authorized to review the decree itself,'' and not to ''effectively redraft the complaint'' to inquire into other matters that the United States did not pursue. *Microsoft*, 56 F.3d at 1459-60.

In its 2004 amendments to the APPA,[7] Congress made clear its intent to preserve the practical benefits of utilizing consent decrees in antitrust enforcement, adding the unambiguous instruction that ''[n]othing in this section shall be construed to require the court to conduct an evidentiary hearing or to require the court to permit anyone to intervene.'' 15 U.S.C. § 16(e)(2); *see also U.S. Airways*, 38 F. Supp. 3d at 76 (indicating that a court is not required to hold an evidentiary hearing or to permit intervenors as part of its review under the Tunney Act). This language explicitly wrote into the statute what Congress intended when it first enacted the Tunney Act in 1974. As Senator Tunney explained: ''[t]he court is nowhere compelled to go to trial or to engage in extended proceedings which might have the effect of vitiating the benefits of prompt and less costly settlement through the consent decree process.'' 119 Cong. Rec. 24,598 (1973) (statement of Sen. Tunney). ''A court can make its public interest determination based on the competitive impact statement and response to public comments alone.'' *U.S. Airways*, 38 F. Supp. 3d at 76 (citing *United States v. Enova Corp.*, 107 F. Supp. 2d 10, 17 (D.D.C. 2000)).

[7] Pub. L. 108–237, § 221.

VIII. Determinative Documents

There are no determinative materials or documents within the meaning of the APPA that were considered by the United States in formulating the proposed Final Judgments.

Dated: June 17, 2019

Respectfully submitted,

Lee F. Berger * (D.C. Bar #482435),
Trial Attorney.

U.S. Department of Justice, Antitrust Division, Media, Entertainment, and Professional Services Section, 450 Fifth Street NW, Suite 4000, Washington, DC 20530, Phone: 202–598–2698, Facsimile: 202–514–7308, Email: Lee.Berger@usdoj.gov.

* Attorney of Record

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Part V

Department of Transportation

Federal Motor Carrier Safety Administration

49 CFR Parts 350, 355, and 388

Motor Carrier Safety Assistance Program; Proposed Rule

DEPARTMENT OF TRANSPORTATION

Federal Motor Carrier Safety Administration

49 CFR Parts 350, 355, and 388

[Docket No. FMCSA–2017–0370]

RIN 2126–AC02

Motor Carrier Safety Assistance Program

AGENCY: Federal Motor Carrier Safety Administration (FMCSA), DOT.

ACTION: Notice of proposed rulemaking.

SUMMARY: FMCSA proposes amendments to the Agency's financial assistance programs resulting from the Fixing America's Surface Transportation (FAST) Act, including amendments based on the funding formula recommendations derived from the Motor Carrier Safety Assistance Program (MCSAP) Formula Working Group (working group). This proposal would reorganize the Agency's regulations to create a standalone subpart for the High Priority Program. It would also include other programmatic changes to reduce redundancies, require the use of 3-year MCSAP commercial vehicle safety plans (CVSPs), and align the financial assistance programs with FMCSA's current enforcement and compliance programs.

DATES: Comments on this notice must be received on or before October 7, 2019.

ADDRESSES: You may submit comments identified by Docket Number FMCSA–2017–0370 using any of the following methods:

- *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the online instructions for submitting comments.
- *Mail:* Docket Management Facility, U.S. Department of Transportation, 1200 New Jersey Avenue SE, West Building, Ground Floor, Room W12–140, Washington, DC 20590–0001.
- *Hand Delivery or Courier:* 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.
- *Fax:* (202) 493–2251.

To avoid duplication, please use only one of these four methods. See the "Public Participation and Request for Comments" portion of the **SUPPLEMENTARY INFORMATION** section for instructions on submitting comments.

FOR FURTHER INFORMATION CONTACT: Jack Kostelnik, State Programs Division, Federal Motor Carrier Safety Administration, 1200 New Jersey Avenue SE, Washington, DC 20590–0001, by telephone at (202) 366–5721 or by email at *jack.kostelnik@dot.gov.* If you have questions on viewing or submitting material to the docket, contact Docket Services, telephone (202) 366–9826.

SUPPLEMENTARY INFORMATION: This notice of proposed rulemaking (NPRM) is organized as follows:

I. Public Participation and Request for Comments

A. Submitting Comments

If you submit a comment, please include the docket number for this NPRM (Docket No. FMCSA–2017–0370), indicate the specific section of this document to which each comment applies, 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. FMCSA recommends that you include your name and a mailing address, an email address, or a telephone number in the body of your document so that FMCSA can contact you if there are questions regarding your submission.

To submit your comment online, go to *http://www.regulations.gov,* put the docket number, FMCSA–2017–0370, in the keyword box, and click "Search." When the new screen appears, click on the "Comment Now!" button and type your comment into the text box on the following screen. Choose whether you are submitting your comment as an individual or on behalf of a third party and then submit.

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.

FMCSA will consider all comments and material received during the comment period and may change this proposed rule based on your comments. FMCSA may issue a final rule at any time after the close of the comment period.

Confidential Business Information

Confidential Business Information (CBI) is commercial or financial information that is customarily not made available to the general public by the submitter. Under the Freedom of Information Act (5 U.S.C. 552), CBI is eligible for protection from public disclosure. If you have CBI that is relevant or responsive to this NPRM, it is important that you clearly designate the submitted comments as CBI. Accordingly, please mark each page of your submission as "confidential" or "CBI." Submissions designated as CBI and meeting the definition noted above will not be placed in the public docket of this NPRM. Submissions containing CBI should be sent to Brian Dahlin, Chief, Regulatory Evaluation Division, Federal Motor Carrier Safety Administration, 1200 New Jersey Avenue SE, Washington, DC 20590–0001. Any commentary that FMCSA receives that is not specifically designated as CBI will be placed in the public docket for this rulemaking.

B. Viewing Comments and Documents

To view comments, as well as any documents mentioned in this preamble as being available in the docket, go to *http://www.regulations.gov.* Insert the docket number, FMCSA–2017–0370, in the keyword box, and click ''Search.'' Next, click the ''Open Docket Folder'' button and choose the document to review. 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 DOT West Building, 1200 New Jersey Avenue SE, Washington, DC 20590, between 9 a.m. and 5 p.m. ET, Monday through Friday, except Federal holidays.

C. Privacy Act

In accordance with 5 U.S.C. 553(c), DOT solicits comments from the public to better inform its rulemaking process. DOT posts these comments, without edit, including any personal information the commenter provides, to *www.regulations.gov,* as described in the system of records notice (DOT/ALL 14–FDMS), which can be reviewed at *www.transportation.gov/privacy.*

D. Waiver of Advance Notice of Proposed Rulemaking

Under section 5202 of the FAST Act, Public Law 114–94, 129 Stat. 1312, 1534–5 (2015), if a regulatory proposal is likely to lead to the promulgation of a major rule,[1] FMCSA is required to publish an advance notice of proposed rulemaking (ANPRM), unless the Agency finds good cause that an ANPRM is impracticable, unnecessary, or contrary to the public interest (49 U.S.C. 31136(g)). The Agency does not anticipate that this rulemaking would result in a major rule. Thus, publication of an ANPRM is not necessary. However, a key component of this rulemaking involves a new allocation formula governing the distribution of MCSAP funds. This NPRM reflects the allocations derived from the recommendations of the working group that was appointed by the Secretary of Transportation (Secretary) in accordance with section 5106 of the FAST Act.

While this working group was not a negotiated rulemaking committee, which is an alternative to an ANPRM under the statute, its recommendations were developed through a collaborative effort by relevant stakeholders.

II. Executive Summary

A. Purpose and Summary of the Regulatory Action

The purpose of this regulatory action is to amend and reorganize 49 CFR part 350, including adding relevant sections that are currently located in part 355. Certain regulations are no longer necessary or are redundant. Moreover, the FAST Act required FMCSA to implement a multi-year CVSP with annual updates for States applying for MCSAP funds and to provide a new MCSAP allocation formula. This proposal would provide a new MCSAP allocation formula, require States to adopt 3-year CVSPs, and reorganize the Agency's regulations to create a standalone subpart for the High Priority Program. FMCSA's primary legal authority for this rulemaking is derived from Title V, Subtitle A of the FAST Act, Public Law 114–94, 129 Stat. 1312, 1514–1534 (2015).

B. Summary of Major Provisions

The rule proposes a new MCSAP allocation formula. The FAST Act required the Secretary to assemble a working group to recommend a new MCSAP allocation formula. The Agency fully considered and is proposing to fully adopt the recommendations of the working group.

The new MCSAP allocation formula would include three components: State, Border, and Territory. Each component would be assigned a percentage of MCSAP funds. Funds would be allocated under the State Component using five equally-weighted factors and then applying minimum and maximum caps to the allocated funding. The Border Component would allocate funding based on the number of United States ports of entry and the number of commercial motor vehicle (CMV) crossings at those ports of entry, subject to minimum and maximum funding levels. This Border Component accounts for differences in the number of crossings per port of entry at the Northern border compared to the Southern border of the United States. Finally, the Territory Component would ensure that each Territory, except for Puerto Rico (which is allocated funding under the State Component), receives a minimum funding amount of $350,000. Any funds not allocated under the Border or Territory Components would be added to the State Component for allocation. The proposed formula would promote stability in funding and protect States from experiencing significant and unpredicted changes by including a hold-harmless provision and a funding cap.

This proposed rule would require States to use CVSPs in accordance with the FAST Act. The rule would provide direction to States on how and when to submit CVSPs, which would be on 3-year cycles. In the first year of the CVSP, States would submit quantitative performance objectives, analysis of past performance, and other documents traditionally provided in an annual CVSP, as well as a budget for the initial year. In the second and third years of the CVSP, States would submit an annual update that includes changes to the CVSP (including updates to performance objectives and adjustments to activities), a budget for the applicable fiscal year, and other documents required on an annual basis.

FMCSA proposes to clarify a State's obligation to cooperate in the enforcement of hazardous materials safety permits for interstate and intrastate carriers, as required under subpart E of 49 CFR part 385, to transport certain hazardous materials.

The rule also proposes to revise and reorganize part 350. Currently, the High Priority Program and MCSAP regulations are intertwined in part 350, but some regulations do not apply to both programs. To provide clarity for the eligible recipients, this NPRM separates the two programs into different subparts in part 350. In addition, relevant sections of part 355 would be added to part 350. These proposed changes address regulatory compatibility and would reduce redundancy and make part 350 more clear and concise.

Finally, FMCSA proposes to remove part 388, titled ''Cooperative Agreements with States,'' because FMCSA does not rely on part 388 provisions.

C. Costs and Benefits

This rule proposes a new MCSAP allocation formula to replace the current

[1] A ''major rule'' means any rule that the Administrator of the Office of Information and Regulatory Affairs at the Office of Management and Budget (OMB) finds has resulted in or is likely to result in (a) an annual effect on the economy of $100 million or more; (b) a major increase in costs or prices for consumers, individual industries, Federal agencies, State agencies, local government agencies, or geographic regions; or (c) significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic and export markets (5 U.S.C. 804(2)).

formula that has been in use for more than a decade with little modification. The proposed MCSAP allocation formula would make several improvements over the current formula. The proposed formula would result in a reallocation of fiscal year (FY) 2020 grant funding that would be considered a transfer payment, in that it would not change the total amount of funds distributed. In accordance with OMB guidance on conducting regulatory analysis (as discussed in OMB Circular A–4, ''Regulatory Analysis''), transfer payments within the U.S. are not included in the estimates of the costs and benefits of rulemakings. Thus, FMCSA does not include transfers resulting from the proposed changes to the MCSAP allocation formula in its estimate of the rule's costs or benefits.

The proposed rule would require States to use CVSPs in accordance with the FAST Act. The rule would provide direction to States on how and when to submit CVSPs, which would be on 3-year cycles. Under the current regulations, States must submit lengthy CVSP applications annually to receive MCSAP funding, unless they volunteer to submit 3-year CVSPs. The proposed rule would require States to submit robust 3-year CVSP applications for the first year, with annual updates for the second and third years. FMCSA expects that 3-year CVSPs will be less burdensome and time consuming for States than submitting lengthy CVSP applications annually, which will result in lower program administrative costs. All 55 States [2] have transitioned voluntarily to 3-year CVSPs, and thus, there is no impact from this proposed change.

If a continuing resolution in FY 2020 were to occur, FMCSA would utilize the same process it has employed during recent budget cycles. State lead agencies would complete the CVSP utilizing an estimated annual award total based on the statutorily authorized funding level. Should the final appropriation be less than the authorized amount, FMCSA would publish a revised funding table and provide MCSAP recipients the opportunity to modify their proposed activities and budget accordingly.

FMCSA will also engage in continuous outreach with its MCSAP recipients regarding the implementation of the proposed formula and related impacts. The Agency anticipates including this as a key topic of discussion during its annual meeting of MCSAP grantees, providing ongoing updates through its quarterly webinars with grant recipients, and developing printed materials relating to the new formula implementation.

FMCSA, through its Division Offices, will work directly with individual MCSAP partners to ensure that stakeholders are informed and that questions are addressed quickly. In addition, FMCSA has already developed and distributed via its website a series of frequently asked questions (FAQs) and an executive summary of the working group's report to facilitate this process.

Due to the nature of grants as transfer payments (which are not considered costs or benefits), FMCSA anticipates that the proposed changes would not result in any societal costs or benefits.

III. Abbreviations and Acronyms

ANPRM Advance notice of proposed rulemaking
BEG Border Enforcement Grant
CBI Confidential Business Information
CE Categorical Exclusion
CFR Code of Federal Regulations
CMV Commercial motor vehicle
CVSP Commercial vehicle safety plan
DOT Department of Transportation
eCVSP Electronic commercial vehicle safety plan
E.O. Executive Order
FAST Act Fixing America's Surface Transportation Act
FHWA Federal Highway Administration
FMCSA Federal Motor Carrier Safety Administration
FMCSRs Federal Motor Carrier Safety Regulations
FR Federal Register
FTE Full-time employees
FY Fiscal year
HMRs Federal Hazardous Materials Regulations
MCSAP Motor Carrier Safety Assistance Program
MOE Maintenance of effort
NOFO Notice of Funding Opportunity
NPRM Notice of proposed rulemaking
OMB Office of Management and Budget
PRISM Performance and Registration Information Systems Management
RFA Regulatory Flexibility Act
§ Section
Secretary Secretary of Transportation
SBREFA Small Business Regulatory Enforcement Fairness Act of 1996 working group MCSAP Formula Working Group
U.S.C. United States Code
VMT Vehicle miles traveled

IV. Legal Basis for the Rulemaking

This rule is based primarily on Title V, Subtitle A of the FAST Act, Public Law 114–94, 129 Stat. 1312, 1514–1534 (2015), which consolidated several of FMCSA's financial assistance programs and authorized program funding levels through fiscal year (FY) 2020. Key provisions, effective FY 2017, include section 5101, which amended 49 U.S.C. 31102, consolidating the former New Entrant, Performance and Registration Information Systems Management (PRISM), Safety Data Improvement Program, and Border Enforcement grant programs into the revised MCSAP formula grant. In addition, it established the High Priority Program as a separate discretionary financial assistance program for qualifying entities and projects relating to motor carrier safety and Innovative Technology Deployment. Section 5101 also amended 49 U.S.C. 31104, which prescribes, among other things, authorized funding levels through FY 2020, the minimum Federal funding share applicable to these (and other) FMCSA financial assistance programs, and the periods of time in which awarded funds may be used.

Section 5106 of the FAST Act (note following 49 U.S.C. 31102) required the Secretary to appoint a working group, consisting of prescribed stakeholder interests, to develop and recommend to the Secretary a new MCSAP allocation formula reflecting specified factors for the award of MCSAP funds. Following receipt of the working group's recommendations, the Secretary is required to issue an NPRM. The working group submitted its report on April 7, 2017, and an addendum to the report on January 8, 2019. Section 5107 of the FAST Act (note following 49 U.S.C. 31102) addresses the maintenance of effort calculations for FY 2017 and subsequent fiscal years until the new MCSAP allocation formula is in place.

FMCSA has authority under Federal hazardous materials transportation law, 49 U.S.C. 5101–5128, to require States to cooperate in the enforcement of Federal hazardous materials safety permit requirements as a condition to qualify for MCSAP funds. The purpose of the hazardous materials transportation law is ''to protect against the risks to life, property, and the environment that are inherent in the transportation of hazardous material in intrastate, interstate, and foreign commerce'' (49 U.S.C. 5101). Section 5109(a) provides that a ''motor carrier may transport or cause to be transported by motor vehicle in commerce hazardous material only if the carrier holds a safety permit'' issued by FMCSA. The Secretary has authority to prescribe what hazardous materials require a safety permit (49 U.S.C. 5109(b)). Exercising this authority, this NPRM proposes to clarify that States are required to cooperate in ensuring carriers transporting certain hazardous

[2] Unless otherwise provided in this preamble, we use the term ''State'' as including the District of Columbia and the Territories. FMCSA estimated that there are 55 respondents consisting of the 50 States minus Oregon, plus the District of Columbia and the 5 Territories.

materials possess the required FMCSA hazardous materials safety permit (49 U.S.C. 31102(c)(1)).

FMCSA is authorized to implement these statutory provisions by delegation from the Secretary in 49 CFR 1.87.

V. Background

A. History of MCSAP

The Surface Transportation Assistance Act of 1982, Public Law 97–424, 96 Stat. 2097, 2155 (1983), authorized MCSAP. MCSAP is a Federal financial assistance program that provides formula grants to States (unless otherwise stated, defined in this proposed rule to include the Territories and the District of Columbia) to reduce the number and severity of injuries and the number of fatalities resulting from crashes involving CMVs and to promote the safe transportation of passengers and hazardous materials. MCSAP funds are essential to maintaining FMCSA's national CMV safety enforcement programs, and those of States. MCSAP establishes the conditions to participate in the program and promotes the adoption and uniform enforcement of State safety rules, regulations, and standards that are compatible with the Federal Motor Carrier Safety Regulations (FMCSRs) and Federal Hazardous Materials Regulations (HMRs) for both interstate and intrastate motor carriers and drivers.[3]

Before FY 2017, MCSAP consisted of the Basic Program funds and Incentive funds calculated using a formula, and set-asides for the discretionary High Priority and New Entrant grant programs. Until a new MCSAP allocation formula is implemented, the Basic Program funds and Incentive funds ensure that FMCSA and States continue to work in partnership to establish programs to improve motor carrier, CMV, and driver safety to support a safe and efficient transportation system.

The Basic Program funds currently distribute MCSAP funds proportionally to States using the following four, equally-weighted factors:

(1) 1997 road miles (all highways) as defined by the Federal Highway Administration (FHWA);

(2) Vehicle miles traveled (VMT) as defined by the FHWA;

(3) Population based on annual census estimates issued by the U.S. Census Bureau; and

(4) Special fuel consumption (net after reciprocity adjustment) as defined by the FHWA.

The Incentive funds are a portion of MCSAP funds distributed to States, but not to the Territories. A State's share of the Incentive funds is based on:

(1) Reduction of large truck-involved fatal crashes;

(2) Reduction of large truck-involved fatal crash rate or maintenance of a large truck-involved fatal crash rate that is among the lowest 10 percent among MCSAP recipients;

(3) Uploads of CMV crash reports in accordance with current FMCSA policy;

(4) Verification of commercial driver's licenses during inspections; and

(5) Uploads of CMV inspection data in accordance with FMCSA policy.

The High Priority Program was a set-aside of MCSAP funds with an authorization level of up to $15 million prior to FY 2017. Eligible recipients included State agencies, local governments, and organizations representing government agencies that used and trained qualified officers and employees in coordination with State motor vehicle safety agencies. FMCSA provided High Priority Program funds to enable recipients to carry out enforcement activities and projects that improved CMV safety and compliance with CMV regulations. Funding was also available for projects that were national in scope, increased public awareness and education, demonstrated new technologies, and reduced the number and rate of CMV crashes. The grant period of performance was the fiscal year of obligation and the next fiscal year.

The New Entrant grant program was also a set-aside of MCSAP funds with an authorization level of up to $32 million prior to FY 2017. Eligible recipients included State agencies and local governments. The grant program funded safety audits on new entrant motor carriers to ensure that they had effective safety management programs. The grant period of performance was the fiscal year of obligation and the next fiscal year.

The Border Enforcement Grant (BEG) program was a standalone grant program with an authorization level of up to $32 million prior to FY 2017. FMCSA provided BEG program funds to eligible recipients, which included State governments or entities that share a land border with Canada or Mexico and any local government or entity in that State, for carrying out border CMV safety programs and related enforcement activities and projects. The grant period of performance was the fiscal year of obligation and the next fiscal year.

The PRISM program was a standalone grant program with an authorization level of up to $5 million prior to FY 2017. Eligible recipients included State agencies, the District of Columbia, Puerto Rico, and the Territories. FMCSA provided PRISM funds to enable recipients to link State CMV registration and licensing systems with Federal motor carrier safety information systems. The grant period of performance was from the date of execution through the award end date, as provided in the grant agreement.

The Safety Data Improvement Program was a standalone grant program with an authorization level of up to $3 million prior to FY 2017. Eligible recipients included State governments such as departments of public safety, departments of transportation, or State law enforcement agencies in any State, the District of Columbia, Puerto Rico, and the Territories, or any agency or instrumentality of a State exclusive of local governments. FMCSA provided Safety Data Improvement Program funds to eligible recipients that collected, analyzed, and reported large truck and bus crash and inspection data to improve the quality of the CMV data reported by States to FMCSA. The grant period of performance was from the date of execution through the award end date, as provided in the grant agreement.

The Commercial Vehicle Information Systems and Networks (CVISN) was a standalone grant program with an authorization level of up to $25 million prior to FY 2017. Eligible recipients included agencies of States, the District of Columbia, Puerto Rico, and the Territories. FMCSA provided funding to advance technological capability and promote the deployment of intelligent transportation systems applications for commercial vehicle operations, including CMV, commercial driver, and carrier-specific information systems and networks. The grant period of performance was from the date of execution through the award end date, as provided in the grant agreement.

B. FAST Act

The FAST Act restructured FMCSA's financial assistance programs. It created a standalone High Priority Program that

[3] The program was subsequently modified by the Intermodal Surface Transportation Efficiency Act of 1991, Public Law 102–240, 4002, 105 Stat. 1914, 2140 (1991); the ICC Termination Act of 1995, Public Law 104–88, 104(a), 109 Stat. 803, 918 (1995); the Transportation Equity Act for the 21st Century, Public Law 105–178, 4003(b), (c), 112 Stat. 107, 395 (1998); the Motor Carrier Safety Improvement Act of 1999, Public Law 106–159, 207, 113 Stat. 1748, 1764 (1999); the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users, Public Law 109–59, 4106, 4307(b), 119 Stat. 1144, 1717, 1774 (2005); and the Moving Ahead for Progress in the 21st Century Act, Public Law 112–141, 126 Stat. 405 (2012). The most recent modifications to MCSAP were enacted as part of Title V, Subtitle A of the FAST Act, Public Law 114–94, 129 Stat. 1312, 1514–1534 (2015).

is a competitive financial assistance program. It has two major purposes: (1) Supporting, enriching, and augmenting activities related to motor carrier safety; and (2) promoting Innovative Technology Deployment. The Innovative Technology Deployment program modifies and replaces FMCSA's Commercial Vehicle Information Systems and Networks program. The Safety Data Improvement Program and PRISM, which were previously standalone grant programs, were merged into both the High Priority Program and MCSAP. The New Entrant grant program and standalone BEG were also merged into MCSAP.

Section 5106(d) of the FAST Act prescribed the MCSAP interim funding formula for FY 2017 and later fiscal years, as necessary. The interim formula uses the MCSAP funding formula used in FY 2016 plus the average funding awarded to a State in FYs 2013, 2014, and 2015 for BEG and New Entrant program grant funds. Subject to the availability of funding and notwithstanding fluctuations in the data elements, the initial amounts in FY 2017 were adjusted to ensure that, for each State, the amount provided while using the interim formula was not less than 97 percent of the average amount of funding received in FYs 2013, 2014, and 2015, or other equitable amounts.

In FY 2018, FMCSA awarded $294,416,500 for MCSAP formula grants using the interim formula, and $42,424,178 for the High Priority Program through a competitive financial assistance process. Additional information on the Agency's financial assistance programs may be found at *https://www.fmcsa.dot.gov/mission/grants.*

The FAST Act added 49 U.S.C. 31102(f), which created additional allowances for States when determining their average levels of expenditure for purposes of the MCSAP-required maintenance of effort.[4] States may exclude expenditures for activities related to border enforcement and new entrant safety audits. In addition, section 5107 of the FAST Act permits States to request a one-time adjustment to their maintenance of effort baselines in the first year a new MCSAP allocation formula is implemented. The adjusted baseline will become the State's baseline maintenance of effort that is required each fiscal year as part of the CVSP or annual update. This adjustment eases the burden on FMCSA's State partners by accounting for the potentially increased match requirements under MCSAP grant consolidation. States must request this adjustment before September 30 of the fiscal year in which the new formula is implemented. Furthermore, if a State subsequently identifies new information, the State may request a modification to its maintenance of effort baseline (49 U.S.C. 31102(f)(2)).

C. FAST Act Omnibus Rule

On October 14, 2016, FMCSA published a final rule titled "Amendments To Implement Grants Provisions of the Fixing America's Surface Transportation Act" (81 FR 71002). That rule made nondiscretionary, ministerial changes to FMCSA regulations, consistent with the FAST Act. For example, it consolidated the BEG, New Entrant grant, and parts of the Safety Data Improvement Program, PRISM, and Innovative Technology Deployment grants into the MCSAP formula grant. This grant consolidation reduced the administrative burden on eligible recipients, provided more flexibility to eligible recipients, and streamlined the grant application process. In addition, the rule required that each State establish and maintain a new entrant safety audit program as a condition of MCSAP funding. To continue to receive MCSAP funding for border enforcement, eligible States were required to maintain a border enforcement program. Furthermore, FMCSA amended its regulations to remove the requirement for an annual CVSP. This change allowed States to use a 3-year CVSP, but did not require it (discussed in full below). Finally, the rule provided that lead State agencies (*i.e.,* those State agencies responsible for MCSAP administration) are not eligible to apply for High Priority Program funds for Safety Data Improvement Program and PRISM capabilities, unless such projects exceed the minimum requirements.

D. MCSAP Formula Working Group

The FAST Act required the Secretary to establish a working group to analyze requirements and factors to recommend a new MCSAP allocation formula to the Secretary. The FAST Act mandated that the group be composed of representatives from State CMV safety agencies, an organization representing State CMV enforcement agencies, FMCSA, and any other persons that the Secretary considered necessary for the development of a new MCSAP allocation formula. Congress mandated that State safety agency participation make up at least 51 percent of the working group and exempted the group from the Federal Advisory Committee Act.

FMCSA requested applications for working group members through a notice posted on the Agency's website and through direct solicitation of MCSAP lead State agencies. An FMCSA panel reviewed applications and recommended applicants who would create a diverse working group, taking into consideration a State's location and size.

The working group was established in March 2016. It held six in-person meetings and several web conferences to discuss various factors and issues relevant to the creation of a new MCSAP allocation formula. The working group created a web page[5] that contains meeting summaries for both in-person and web-based discussions.

To develop its recommendation, the working group used the following guiding principles and agreed the new formula should:

- Be safety-based (primary objective);
- Improve the previous formula;
- Address FAST Act grant changes;
- Meet FAST Act formula requirements;
- Promote stability in funding;
- Respond to changes in States' exposure to crashes; and
- Use quality data sources.

In applying these principles, the working group studied the current allocation formula's design and data elements and used it as a baseline. To improve motor carrier safety, the primary consideration was to develop a new MCSAP allocation formula that provides States with an appropriate level of funding based on exposure to crashes. The working group chose to base the formula on factors correlated with crashes, rather than the number of crashes itself, because using CMV crashes as a factor in the allocation formula has undesired impacts, such as punishing States for having an effective CMV safety program.

The working group applied a variety of analytical methods to:

- Identify areas in the current formula to improve;
- Create alternative formula designs; and
- Evaluate impacts of the proposed formulas with respect to the guiding principles.

The analytical methods used by the working group are described in the working group's report and the

[4] Each fiscal year, a State must maintain the average aggregate expenditure (maintenance of effort) of the Lead State Agency, exclusive of Federal funds and State matching funds, for CMV safety programs eligible for MCSAP funding at a level at least equal to the average level of that expenditure for fiscal years 2004 and 2005.

[5] See *www.fmcsa.dot.gov/mission/grants/fast-act-mcsap-formula-working-group.*

appendices. These methods include, but are not limited to:

- Analyzing the correlation between each proposed factor and the next year's CMV crashes using linear regression. (Note that this was tested over the course of 5 years for each factor to ensure consistency in the results.)
- Generating and evaluating histograms of changes in proposed formula factors over time to quantify the stability of each potential formula factor.
- Experimenting with different formula structures (*e.g.,* assigning different weights to each factor).
- Generating simulated formula allocation results with each iteration of the proposed formula to understand and evaluate the impacts of each proposed change.

The working group submitted a report titled ''Recommendations to the U.S. Department of Transportation for the Development of the New MCSAP Grant Allocation Formula'' to FMCSA, which was received on April 7, 2017. FMCSA reviewed the report and agreed with the majority of the working group's recommendations. To facilitate additional input from the working group and transparency in the development of a new MCSAP allocation formula, the FMCSA Administrator requested that the working group reconvene for further deliberation on three of its recommendations. The working group submitted an addendum to its report on January 8, 2019. A full discussion of this process can be found below. Copies of the report and addendum are included in the docket.

E. Voluntary Implementation of CVSPs

Section 5101 of the FAST Act requires the Secretary to prescribe procedures for a State to submit a multi-year CVSP with annual updates for MCSAP grants. In a **Federal Register** notice published on October 27, 2016, FMCSA asked 14 questions to assist the Agency in developing an information technology system format and procedures for submission of such a CVSP (81 FR 74862). FMCSA considered comments in response to the **Federal Register** notice,[6] the status of the working group's recommendation, and necessary electronic CVSP (eCVSP) tool modifications. As a result, the Agency created a CVSP with a 3-year plan cycle.

The Agency elected to test both the 3-year CVSP and revised eCVSP tool. The Agency sought volunteers and selected 18 States and 1 Territory to complete a 3-year CVSP for FY 2018. The selection of volunteers was based on geography, program size, and programmatic structure variety to allow the Agency to fully test the functionality of the CVSP. The 3-year plan cycle for this first group of States included FYs 2018, 2019, and 2020.

Using the experience and feedback of the 3-year CVSP users, FMCSA made modifications to the CVSP and eCVSP tool prior to the FY 2019 MCSAP application. FMCSA worked with the second group of 13 volunteer States to submit their CVSPs by August 1, 2018. The 3-year plan cycle for this second group of States is FYs 2019, 2020, and 2021. States that did not move to 3-year CVSPs for FY 2018 or FY 2019 were required to submit an annual CVSP by August 1, 2018.

FMCSA notes that the remaining States voluntarily submitted a 3-year CVSP by August 1, 2019. This third group of States completed their CVSPs for FYs 2020, 2021, and 2022.

FMCSA expects that States will remain on one of these 3-year planning cycles. For example, States that began submitting 3-year CVSPs in FY 2017 for FY 2018–20 grants will submit a 3-year CVSP again in 2020 for the FY 2021–23 grants.

VI. Discussion of the Proposed Rulemaking

A. Separation of MCSAP and the High Priority Program Provisions

This NPRM proposes to separate the regulations governing MCSAP and the standalone High Priority Program created by the FAST Act. Currently, the regulatory provisions for MCSAP and the High Priority Program are intermingled. This NPRM proposes to organize the programs into distinct regulatory subparts under 49 CFR part 350 to reflect the relevant information for each program. This separation would make it easier to find needed regulatory information. For MCSAP, the regulations have been reorganized and modified to comply with FAST Act requirements, provide clarity, and remove redundancies. For the High Priority Program, the regulations have been modified to clarify eligibility conditions.

The Agency proposes to implement the changes to FMCSA's financial assistance programs required by the FAST Act beginning October 1, 2019, for FY 2020. However, consistent with section 5101(a) of the FAST Act and a prior rulemaking implementing select provisions of the FAST Act (81 FR 71002, October 14, 2016), mandatory participation in PRISM remains October 1, 2020 (49 U.S.C. 31102(c)(2)(Z)).

B. Proposed MCSAP Allocation Formula

Working Group Recommendation

The working group recommended that the formula consist of three separately calculated components: A Territory Component, Basic Component, and Border Component. As further explained below, the working group also recommended terminating the MCSAP Incentive Program.

The new MCSAP allocation formula recommended by the working group makes several improvements to the current formula. The FAST Act outlined several factors for the working group to consider.[7] The working group analyzed objective safety data and other information prior to making its MCSAP allocation formula recommendation. Various methods of research and analysis were used to understand each area of improvement, create alternative formula designs, and evaluate their impacts with respect to the guiding principles. These efforts included:

- Identifying and obtaining data sources.
- Evaluating data sources to determine if they met the criteria for formula inclusion, *e.g.,* through statistical analysis.
- Reviewing and considering programmatic needs and trends.
- Understanding the varying administrative needs of grant recipients.
- Understanding the investments that recipients made with grant funding (*e.g.,* personnel and benefits, contract services, equipment, etc.).
- Reviewing published reports by the Office of the Inspector General (OIG), the National Research Council (NRC), and a previous MCSAP formula evaluation by Oak Ridge National Laboratory.
- Conducting simulations to evaluate funding impacts.

The working group's recommended MCSAP allocation formula includes only those factors that are most highly correlated with a State's total CMV crashes, have data that are reliably obtainable, and meet the objectives mandated by the FAST Act.

With respect to the Territory Component, the data used to calculate

[6] 83 FR 691 (January 5, 2018).

[7] These factors must reflect, at a minimum ''(1) the relative needs of the States to comply with section 31102 of title 49, United States Code; (2) the relative administrative capacities of and challenges faced by States in complying with that section; (3) the average of each State's new entrant motor carrier inventory for the 3-year period prior to the date of enactment of this Act; (4) the number of international border inspection facilities and border crossings by commercial vehicles in each State; and (5) any other factors the Secretary considers appropriate.'' See § 5106(c) of the FAST Act, Public Law 114–94, 129 Stat. 1312, 1531 (2015).

the Basic Component (discussed below) is not available for the Territories, defined as American Samoa, the Commonwealth of the Northern Mariana Islands, Guam, and the Virgin Islands. Thus, the working group originally recommended that the Territories have a separate component that allocates a maximum of 0.65 percent of available MCSAP funds among these Territories. The allocation would be based on FMCSA's assessment of each Territory's proposed CMV projects and costs included in its CVSP. The working group recommended a funding floor to ensure that Territories would receive a minimum amount to maintain an effective program, and it tasked FMCSA with establishing this floor.

The Basic Component allocates funding to States, which includes the District of Columbia and Puerto Rico, based on factors that are highly correlated with the State's total CMV crashes. This allocation, as originally proposed by the working group, would represent at least 89.85 percent of available MCSAP funds, plus any unallocated Border and Territory Component amounts. The Basic Component allocation calculates a proportion for each State based on the following five equally-weighted factors, using the most recent data available:

(1) *National Highway System Road Length*—total National Highway System roadway miles contained within the jurisdictional boundaries of the State as measured by the FHWA;

(2) *Total VMT*—total VMT for all vehicles within the State as measured by the FHWA;

(3) *Total Population*—U.S. Census Bureau population estimates;

(4) *Special Fuel Consumption*—total consumption of special fuels within the State as measured by the FHWA; and

(5) *Motor Carrier Registrations*—the number of interstate carriers and intrastate hazardous materials carriers as measured by FMCSA to address a FAST Act requirement on new entrant carriers.

To equally weight the factors, each State's percentage of the national total for each factor would be determined. Then, the five percentages for each State are combined to result in the State's percentage.

While the new Basic Component includes all the factors included in the current formula, the working group proposed an update to an existing factor and one addition. For example, the existing formula factor of 1997 road miles is removed, and it is replaced with the more current National Highway System highway miles, which would be updated as new data becomes available (versus the static factor of 1997). Not only does the National Highway System miles formula factor provide a more recent measurement of roadway exposure, it is also more highly correlated with CMV crashes. The working group recommended adding carrier registrations to the Basic Component as a new factor because of its stability over time, correlation with crashes, and ability to account for new entrant safety audit workload (a FAST Act mandated MCSAP requirement).

The working group recommended adjustments to the proportions calculated under the Basic Component to ensure that each State receives at least 0.44 percent, but no more than 4.944 percent, of the MCSAP funds available for the Basic Component. After adjustment, each State's percentage would be multiplied by the total MCSAP funds available for the Basic Component to determine the dollar value of the State's allocation under the Basic Component.

In addition, the working group recommended eliminating the existing MCSAP Incentive funds in favor of a risk-based [8] and consistent formula in alignment with the goals of the working group and the FAST Act. The working group stated that funding can have a greater safety impact by allocating it to recipients who need it to address safety issues, rather than when it is used as an incentive for certain program areas. Furthermore, according to the working group, the existing program-oriented incentive factors are no longer relevant. In the past, they have helped improve compliance in certain program areas (especially data quality), but those areas are no longer the focus for improvement (almost all States have good data quality now). Finally, the working group noted that the FAST Act expanded MCSAP participation requirements so that program aspects that previously required incentivizing are now basic participation requirements. Thus, State performance in reaching safety objectives can be assessed through effective performance management techniques employed by FMCSA. To this end, FMCSA continues to modernize its existing Analysis and Information resources used to monitor MCSAP, and has instituted a performance, standards and benchmarks initiative with States to develop additional performance metrics, trend analysis, and reporting tools.

[8] The working group intended the term ''crash risk'' to refer to a State's total number of crashes expected to occur during a year, and not a crash rate. See Part II, Section 3D, and Part III, Section 2A of the report.

The Border Component aims to maintain safety gains attained through border CMV enforcement programs and to support continued performance of CMV safety inspections, traffic enforcement, and other activities pertaining to vehicles engaged in international commerce or occurring near our borders with Canada and Mexico. To provide adequate resources, the working group originally recommended that the Border Component should allocate a maximum of 9.5 percent of available MCSAP funds to border States.

Because funding for border activities is mostly used to pay for personnel conducting border activities, the funding would be allocated based on relative need for personnel in the southern and northern border States. The need for personnel would be estimated based on the volume of annual CMV crossings at each port of entry and represented as full-time employees (FTE).

The personnel needed at each port of entry would be calculated as follows:

(1) Allocate the minimum required FTE to each port of entry:

(a) 8 FTE per each Mexican port of entry.

(b) 0.25 FTE per each Canadian port of entry with more than 1,000 annual CMV crossings.

(2) Allocate FTEs according to annual CMV crossings (if not already covered by the minimum):

(a) 25,000 crossings per FTE for Mexican ports of entry.

(b) 200,000 crossings per FTE for Canadian ports of entry.

The FTEs at all ports in a border State would be totaled and divided by the national total of FTEs, as demonstrated by a percentage. There would be a minimum (0.075 percent) and maximum (50 percent) funding limit established to ensure equitable distribution of grant dollars among States sharing a land border with Canada or Mexico. Each border State's percentage would be multiplied by the total border allocation amount available to determine the dollar amount.

The new MCSAP allocation formula would include hold-harmless and cap provisions to ensure stable funding over fiscal years, which would apply to a State's total share of MCSAP funds allocated under the Basic and Border Components. The hold-harmless provision would be based on shares rather than dollar amounts. A State would receive no less than 97 percent and no more than 105 percent of its prior year's share of MCSAP funding. Neither the hold-harmless nor the cap would apply to Territories.

FMCSA agreed with the majority of the working group's recommendations, but requested that the working group reconvene for further deliberation on three of its recommendations. They related to the percentages of MCSAP funds allocated to the Territory and Border Components, and the maximum amount of the Border Component that a State could receive.

FMCSA questioned the percentage of total MCSAP funds allocated to the Territory Component. FMCSA determined that the current level of $350,000 per Territory (which equated to approximately 0.49 percent) adequately addresses the CMV safety needs in most of the Territories. Therefore, allocating 0.65 percent of the total MCSAP funds would exceed the amount necessary for most Territories to conduct their CMV safety programs.

FMCSA also suggested increasing the percentage of total MCSAP funds allocated to the Border Component from a maximum of 9.5 percent to 11 or 12 percent. This suggestion was made due to increased border activity in recent years and several recent policy changes, including the renegotiation of trade agreements, that may impact border activity. In addition, an allocation of 11 percent would maintain current Federal funding levels and an allocation of 11 or 12 percent would still align with CMV crashes.

Finally, FMCSA suggested removing the 50 percent maximum limit on the amount of the Border Component a State could receive. This suggestion was made because the 50 percent limit would not meet the growing needs of the State with the most border activity.

The working group reconvened and met four times via interactive web conferences to consider FMCSA's concerns. A process that was similar to the one used to develop the original recommendations was followed. The working group discussed the questions raised by FMCSA in relation to the original recommendations and the various options that were considered during the group's deliberations. Additional data relating to discretionary funding for border activities, with accompanying match requirements, prior to the FAST Act, as well as financial performance metrics and fund utilization for Territorial jurisdictions, was analyzed so the working group could understand and evaluate the potential impact of FMCSA's suggestions. All of FMCSA's suggestions were evaluated based on the established guiding principles.

The working group concurred, based on the information provided by FMCSA, that an allocation of not more than 0.49 percent for the Territory Component adequately addresses CMV safety needs in the Territories. With respect to the Border Component allocation, the group agreed that an increase in the maximum allocation to 11 percent maintained Federal funding levels that were based on border enforcement needs and that the group's recommendation should be adjusted accordingly. The working group continued to find that a border maximum is necessary to maintain the balance of the funding levels between larger and smaller border States and to promote funding stability. An increase to a maximum of 55 percent was recommended because it meets the current needs of the State with the most border activity.

FMCSA's Proposed MCSAP Allocation Formula

FMCSA has reviewed the amended recommendations provided by the working group, agrees with the rational for the proposed changes, and is adopting them in full. In this NPRM, FMCSA proposes a new MCSAP allocation formula as § 350.217. FMCSA proposes to adopt the working group's three components: A Territory Component; Border Component; and State Component.[9]

FMCSA supports establishing a separate Territory Component and the set-aside of not more than 0.49 percent of MCSAP funds for Territories. FMCSA proposes that each territory receive no less than $350,000, with the remaining MCSAP funds allocated among Territories in a manner proportional to the Territories' populations, as reflected in the decennial census issued by the U.S. Census Bureau.

FMCSA proposes establishing a separate Border Component, using the formula that the working group recommended. Therefore, a maximum of 11 percent of MCSAP funds would be allocated to the Border Component with each border State receiving at least 0.075 percent but no more than 55 percent of the total border allocation available. Additionally, FMCSA proposes using the term ''share'' instead of the term ''FTE'' used by the working group, because FMCSA does not want to inadvertently imply how many personnel should be employed at each port of entry as part of the funding allocation.

Under the share calculation, border States would receive 1 share per 25,000 annual CMV crossings at each United States port of entry on the Mexican border, with a minimum of 8 shares for each United States port of entry on the Mexican border, or 1 share per 200,000 annual CMV crossings at each United States port of entry on the Canadian border, with a minimum of 0.25 shares for each United States port of entry on the Canadian border with more than 1,000 annual CMV crossings.

FMCSA proposes establishing a State Component using the working group's Basic Component formula. At least 88.51 percent of MCSAP funds would be set aside for this component.

The table below shows estimated FY 2020 awards to each State and Territory under the interim funding formula, as prescribed by the FAST Act, and the new proposed formula. The FY 2020 FAST Act authorized amount of $304,069,500 (after a 1.5 percent administrative takedown fund set-aside) was used to calculate the estimated awards. The Agency calculated the estimated funding for FY 2020 using the FY 2018 formula factor data, which was the most recent available at the time of calculation. Data used to calculate the formula may change each year so the funding shown is an estimated amount at that point in time. Please note the below table also provides an estimation of percentage difference in funding allotment comparing the interim formula to the proposed new formula (using estimated FY 2020 dollars). The hold-harmless and cap provisions proposed in this NPRM would mitigate any gain or loss in funding from the previous year's formula calculation. For example, if the newly proposed formula were implemented in FY 2020, no State would lose more than 3 percent, or gain more than 5 percent, compared to their share of the formula grant calculation in FY 2019. Therefore, the estimated FY 2020 funding shown in the table is not guaranteed.

[9] FMCSA proposes changing the name of the ''Basic Component'' to the ''States Component'' to provide a distinction between the proposed formula and the interim formula.

ESTIMATED MCSAP FUNDING FORMULA COMPARISON [a b]

State/territory	Including Oregon			Excluding Oregon		
	FY 2020 estimated interim formula awards	FY 2020 estimated MCSAP formula award (new formula as proposed by FMCSA)	Percent difference	FY 2020 estimated interim formula awards	FY 2020 estimated MCSAP formula award (new formula as proposed by FMCSA)	Percent difference
Alabama	$5,981,155	$5,965,678	0	$6,084,689	$5,965,678	−2
Alaska	1,269,196	1,257,326	−1	1,269,068	1,257,326	−1
American Samoa	350,000	350,000	0	350,000	350,000	0
Arizona	11,234,838	10,804,840	−4	11,332,514	10,804,840	−5
Arkansas	4,371,959	4,138,170	−5	4,448,908	4,138,170	−7
California	18,590,048	19,145,982	3	18,587,874	19,368,217	4
Colorado	4,906,099	4,950,448	1	4,994,077	5,103,801	2
Connecticut	2,393,631	2,527,768	6	2,434,316	2,527,768	4
Delaware	1,251,260	1,166,066	−7	1,250,776	1,179,601	−6
District of Columbia	1,092,231	1,118,593	2	1,091,747	1,118,593	2
Florida	12,706,226	13,102,346	3	12,704,051	13,254,430	4
Georgia	10,223,708	10,443,179	2	10,394,519	10,443,179	0
Guam	350,000	439,941	26	350,000	439,941	26
Hawaii	1,066,679	1,099,298	3	1,066,422	1,099,298	3
Idaho	2,500,201	2,436,607	−3	2,541,685	2,436,607	−4
Illinois	11,177,027	11,285,176	1	11,359,365	11,634,765	2
Indiana	7,600,938	7,286,679	−4	7,728,822	7,286,679	−6
Iowa	5,004,354	4,837,215	−3	5,087,635	4,837,215	−5
Kansas	4,504,320	4,458,505	−1	4,584,021	4,458,505	−3
Kentucky	4,736,164	4,686,676	−1	4,819,511	4,784,186	−1
Louisiana	4,502,334	4,346,759	−3	4,581,061	4,346,759	−5
Maine	1,815,663	1,751,636	−4	1,842,792	1,751,636	−5
Maryland	3,898,791	4,175,980	7	3,970,778	4,175,980	5
Massachusetts	4,437,614	4,604,630	4	4,514,021	4,604,630	2
Michigan	8,663,352	8,967,604	4	8,805,741	9,224,388	5
Minnesota	6,711,732	6,422,249	−4	6,824,363	6,453,904	−5
Mississippi	4,008,984	3,893,741	−3	4,079,776	3,994,903	−2
Missouri	6,892,605	6,844,323	−1	7,014,924	6,975,820	−1
Montana	3,063,123	2,994,454	−2	3,102,581	2,994,454	−3
Nebraska	3,650,919	3,626,881	−1	3,709,539	3,626,881	−2
Nevada	2,596,460	2,584,009	0	2,643,932	2,664,056	1
New Hampshire	1,352,053	1,343,600	−1	1,351,569	1,384,743	2
New Jersey	7,038,352	6,943,724	−1	7,140,767	7,158,824	0
New Mexico	4,002,101	4,107,636	3	4,058,337	4,107,636	1
New York	13,199,642	12,842,509	−3	13,412,776	13,226,416	−1
North Carolina	8,730,173	8,972,029	3	8,880,140	9,249,962	4
North Dakota	2,889,717	2,696,955	−7	2,934,189	2,696,955	−8
Northern Marianas	350,000	350,000	0	350,000	350,000	0
Ohio	10,070,415	9,781,884	−3	10,250,889	10,046,336	−2
Oklahoma	5,927,263	5,769,781	−3	6,025,865	5,769,781	−4
Oregon	3,745,475	3,946,430	5	–	–	–
Pennsylvania	10,038,363	10,424,935	4	10,214,498	10,424,935	2
Puerto Rico	1,172,803	1,166,066	−1	1,195,818	1,179,601	−1
Rhode Island	1,356,289	1,300,175	−4	1,355,805	1,300,175	−4
South Carolina	4,824,547	4,796,236	−1	4,910,771	4,944,812	1
South Dakota	2,359,346	2,253,064	−5	2,400,857	2,253,064	−6
Tennessee	6,630,299	6,489,424	−2	6,743,955	6,683,303	−1
Texas	30,695,205	31,217,150	2	30,693,031	31,579,500	3
Utah	3,093,422	3,085,281	0	3,147,010	3,085,281	−2
Vermont	1,212,839	1,298,730	7	1,212,647	1,298,730	7
Virgin Islands	350,000	350,000	0	350,000	350,000	0
Virginia	6,760,878	6,895,938	2	6,879,407	7,109,558	3
Washington	6,566,316	6,457,545	−2	6,664,872	6,457,545	−3
West Virginia	2,297,186	2,171,592	−5	2,335,720	2,238,863	−4
Wisconsin	6,439,562	6,188,280	−4	6,548,726	6,363,493	−3
Wyoming	1,415,639	1,507,775	7	1,442,339	1,507,775	5
Total	304,069,500	304,069,500	0	304,069,500	304,069,500	0

[a] Estimated calculations for FY 2020 are shown both with and without the State of Oregon. Note that Oregon did not participate in FY 2019, but it may re-enter the program in the future.

[b] Calculation of funds for the proposed formula was made after setting aside 11 percent for the Border Component and 0.49 percent for the Territory Component of available MCSAP funds, and applying the hold-harmless and cap provisions as explained above.

C. CVSP

This rulemaking would implement the FAST Act requirement that States use multi-year CVSPs in proposed §§ 350.209 and 350.211. This NPRM proposes to require that all States submit a CVSP covering a 3-year period. Currently, States are voluntarily submitting CVSPs covering a 3-year period based upon the **Federal Register** notice published on January 5, 2018 (83 FR 691) and the explicit requirement for the establishment of multi-year plans in section 5101(a) of the FAST Act (49 U.S.C. 31102(c)(1)).

FMCSA would expect to have approximately one-third of MCSAP applicants completing 3-year CVSPs in each grant application year, with the other two-thirds submitting annual updates. States would submit the 3-year CVSP, or the second and third year annual updates, to FMCSA by the date prescribed in the MCSAP application memorandum for that fiscal year.

First Year of the CVSP

FMCSA proposes to require that States submit through the eCVSP online tool the following prior to the first year of the CVSP:

(1) Quantitative objectives regarding the national MCSAP elements and related State-specific objectives for all 3 years;

(2) Analysis of past performance;

(3) Budget and resource allocation information for the first year of the CVSP;

(4) Monitoring plan;

(5) List of MCSAP contacts;

(6) Certification of MCSAP conformance;

(7) Annual certification of compatibility;

(8) New or amended laws and regulations relevant to CMV safety; and

(9) Additional information as required in the MCSAP application memorandum.

Second and Third Years of the CVSP

For the second and third years of the CVSP, States would provide an annual update, including that year's budget, and revise program goals and certifications, if needed. States would submit through the eCVSP online tool the following for the second and third years of the CVSP:

(1) Revised program goals, if needed;

(2) Budget and resource allocation information for the applicable fiscal year;

(3) List of MCSAP contacts;

(4) Certification of MCSAP conformance;

(5) New or amended laws and regulations relevant to CMV safety;

(6) Annual certification of compatibility; and

(7) Additional information as required in the MCSAP application memorandum.

D. Performance and Registration Information Systems Management (PRISM)

To be eligible to receive MCSAP funding, each State must fully participate in PRISM by October 1, 2020, or use an alternative approach approved by FMCSA for identifying and immobilizing a motor carrier with serious safety deficiencies. To ''fully participate'' in PRISM, a State must satisfy the conditions of 49 U.S.C. 31106(b)(3), including the suspension (or revocation) and denial of a vehicle registration if the motor carrier responsible for safety of the vehicle is under any Federal out-of-service order. Therefore, this NPRM reflects the appropriate changes to MCSAP eligibility in proposed § 350.207(a)(27). However, the requirement for participation in PRISM by October 1, 2020, does not extend to the Territories, including Puerto Rico.

E. Authorization and Appropriations Related Changes

The distribution of MCSAP funding is often impacted by FMCSA's authorizations and appropriations. Thus, a new provision is proposed as § 350.219 to explain the FMCSA Administrator's discretion (found generally in 49 U.S.C. 31102) to distribute funding during an extension of the Agency's authorization or during a period the Agency is operating under a continuing resolution.

F. Relocation of 49 CFR Part 355—Compatibility of State Laws and Regulations Affecting Interstate Motor Carrier Operations

This NPRM would relocate relevant requirements of 49 CFR part 355 to part 350. FMCSA proposes this move to improve ease of use of the regulations and improve understanding of the interrelationship between MCSAP and State laws. Remaining provisions of part 355, including the Appendix, would be eliminated. FMCSA would reserve the current part 355 for future use.

G. 49 CFR Part 385 Subpart E—Hazardous Material Safety Permits

The rule proposes to clarify a State's obligation to cooperate in the enforcement of hazardous materials safety permits for interstate and intrastate carriers to transport certain hazardous materials, as required under subpart E of 49 CFR part 385. These regulations require a motor carrier to hold a safety permit issued by FMCSA and to keep a copy of the permit, or other proof of its existence, in the vehicle. Adding a requirement that States cooperate in the enforcement of subpart E of part 385 as a condition of MCSAP funding would clarify States' obligation to document compliance with hazardous materials permit requirements in the course of inspections that States conduct.

H. Removal of 49 CFR Part 388—Cooperative Agreements With States

FMCSA is proposing to remove 49 CFR part 388, titled ''Cooperative Agreements with States.'' Part 388 predates MCSAP. Under its current statutory authority, FMCSA provides financial assistance to States to address CMV safety and to reduce the number and severity of crashes involving CMVs. This is conducted primarily through MCSAP, governed by part 350. While Congress provides funding to support MCSAP, there is no specific funding source supporting a financial assistance program under part 388. Thus, FMCSA does not rely on part 388 to enter into agreements with States to enforce Federal and State safety laws and regulations concerning motor carrier operations. FMCSA would reserve part 388 for future use.

I. Other Proposed Changes

Because MCSAP has evolved through multiple authorization and appropriations acts, the existing regulations are redundant and not orderly. As stated above, this NPRM proposes an organizational change that separates MCSAP and the High Priority Program into distinct regulatory subparts under 49 CFR part 350. This NPRM proposes to reorganize part 350 so that the program requirements are clearer, more succinct, and presented chronologically from grant application through execution.

In addition, definitions would be updated and expanded to reflect the proposed changes to the grant programs or to otherwise provide consistency. For example, the definition of ''investigation'' is used rather than ''compliance review'' to reflect the revised national MCSAP elements. The definition of ''motor carrier'' in § 350.105 would be revised to be more consistent with the definition provided in § 390.5T. The definition of ''HMRs'' would be updated to include all of part 171 concerning HMRs. Specifically, the rule proposes to eliminate the exception to adopt §§ 171.15 and 171.16 by States participating in MCSAP. This would require those States that choose to conduct investigations to ensure compliance with the hazardous materials incident reporting requirements contained in these sections. The elimination of this exception to the HMRs would not create a new State hazardous materials reporting requirement.

FMCSA would clarify in proposed § 350.305(b) that a State may retain an exemption for a particular segment of the motor carrier industry from all or part of its laws or regulations that were in effect before April 1988. However, to retain the exemption, it must continue to be in effect, it must apply to specific industries operating in intrastate commerce, and the scope of the original exemption must not have been amended.

J. Request for Comments

FMCSA is requesting public comment on all provisions being proposed in this NPRM. Additionally, the Agency is specifically seeking comment on the following questions.

1. Are there other elements FMCSA should consider including in a new MCSAP allocation formula and, if so, what are they? Why should such elements be considered? How would they promote safety?

2. Should there be additional requirements in CVSPs to ensure MCSAP funding is used efficiently to promote safety and, if so, what are they? Why should such requirements be considered? How would they promote safety?

3. Should the Incentive fund be eliminated from a new MCSAP allocation formula? Why should the Incentive fund be kept or eliminated? How would keeping or eliminating the Incentive fund promote safety?

4. Should a new MCSAP allocation formula include variables connected with crash rates or risk? If so, what variables should be considered and why? How would such variables promote safety?

4. Should a new MCSAP allocation formula be more sensitive to changes in crash rates? If so, how could a new allocation formula be more sensitive to changes in crash rates and why would it be more sensitive to such changes? How would such a formula promote safety?

VII. International Impacts

The FMCSRs, and any exceptions to the FMCSRs, apply only within the United States (and, in some cases, United States Territories). Motor carriers and drivers are subject to the laws and regulations of the countries in which they operate, unless an international agreement states otherwise. Drivers and carriers should be aware of the regulatory differences among nations.

VIII. Section-by-Section Analysis

In addition to the substantive changes discussed below, FMCSA proposes stylistic, conforming, and organizational changes to the proposed rule for the purposes of clarity and consistency.

A. Subpart A—General

Proposed subpart A would provide a general overview and define the terms used in part 350 applicable to both MCSAP and the High Priority Program. Furthermore, the Agency proposes to restructure distinct provisions pertaining to MCSAP and the High Priority Program and codify them under separate subparts.

§ 350.101 What is the purpose of this part?

In this proposal, § 350.101 would be added to provide a general description of the purpose of part 350.

§ 350.103 When do the financial assistance program changes take effect?

Proposed § 350.103 would be added to specify the effective date of the financial assistance program changes.

§ 350.105 What definitions are used in this part?

FMCSA proposes to add the following definitions to reflect phraseology used in this rulemaking: ''border State,'' ''FMCSA,'' ''High Priority Program funds,'' ''investigation,'' and ''Motor Carrier Safety Assistance Program (MCSAP) funds.'' The term ''traffic enforcement,'' which is defined in existing § 350.111, would be added to this section.

The definition of ''commercial vehicle safety plan (CVSP)'' would be revised to reflect that States would be required to submit 3-year CVSPs. FMCSA also proposes to modify the definition of ''motor carrier'' to more closely reflect the definition in § 390.5T. Furthermore, FMCSA proposes to modify the definitions of ''FMCSRs'' and ''HMRs'' to reference standards and orders issued under the respective regulations in order to avoid repeating this phraseology throughout the regulatory text. Conversely, references to standards and orders would be added throughout the regulatory text where appropriate when referring to State laws and regulations for consistency. Finally, in the definition of ''HMRs,'' the Agency proposes to update the definition to eliminate the exceptions for §§ 171.15 and 171.16 in existing §§ 350.337 and 355.5 in order to be consistent with existing § 350.201(a) and current practice for those States that conduct investigations. Similarly, the inconsistency in existing § 355.5 concerning the definition of ''HMRs'' as it relates to the exception to part 107 would be eliminated. Consistent with existing § 350.337, the proposed definition would include subparts F and G of part 107.

The following existing definitions in § 350.105 would be eliminated because they are not used in this proposal: ''10-year average accident rate,'' ''Accident rate,'' ''Agency,'' ''Basic Program Funds,'' ''Incentive Funds,'' ''Innovative Technology Deployment funds,'' ''Large truck,'' ''Level of effort,'' ''Operating authority,'' and ''Plan.''

The remaining definitions that appear in existing §§ 350.105 and 355.5 would be revised for clarity.

B. Subpart B—Motor Carrier Safety Assistance Program Administration

Proposed subpart B would provide an overview of MCSAP only. Content regarding the High Priority Program would be addressed in proposed subpart D.

§ 350.201 What is MCSAP?

Proposed § 350.201(a) is derived, in part, from existing § 350.101(a), but would add references to PRISM and border enforcement requirements, as applicable to MCSAP. Proposed § 350.201(b) is derived without substantive change from existing § 350.103 as it relates to program requirements. Proposed § 350.201(c) would incorporate the substantive content from the last sentence of existing § 350.101(a).

§ 350.203 What are the national MCSAP elements?

Proposed § 350.203 is derived, in part, from existing § 350.109. New items (e), (f), (g), and (j) would be added as part of revisions to MCSAP. Item (d), investigations, would be substituted for the existing reference to compliance reviews.

§ 350.205 What entities are eligible for funding under MCSAP?

Proposed § 350.205 is derived from existing § 350.107(a) without substantive change. Governmental entities eligible for funding would be reflected in the definition of ''State.''

§ 350.207 What conditions must a State meet to qualify for MCSAP funds?

Proposed § 350.207(a) is derived, in part, from existing § 350.201, but is reorganized for clarity and to reduce redundancies. Proposed paragraph (a)(25) would be revised to reflect that certain exemptions are granted, not just to individual drivers or carriers, but to a particular class. Proposed paragraph (a)(28) would be added to clarify a State's obligation to cooperate in the enforcement of hazardous materials safety permits. Proposed § 350.207(b) would incorporate the substance of existing § 350.201(z) relating to third parties conducting new entrant safety audits. Proposed § 350.207(c) would be added to reflect exceptions applicable to Territories concerning new entrant safety audits and participation in PRISM.

§ 350.209 How and when does a State apply for MCSAP funds using a CVSP?

Proposed § 350.209 is derived, in part, from existing § 350.205, but revised to reflect the general requirements for submitting a 3-year CVSP. It also proposes that the deadline for the CVSP submission be changed from August 1 to a date that will be stated in the MCSAP application memorandum. It further proposes that the Administrator, rather than the Division Administrator, may extend the CVSP deadline.

§ 350.211 What must a State include for the first year of the CVSP?

Proposed § 350.211 is derived, in part, from existing §§ 350.209, 350.211, 350.213, and 350.331(b)(2). This proposed section would set forth information to be included for the first year of the CVSP. The required certifications would be consolidated in proposed paragraph (i) by referring to the conditions a State must meet to qualify for MCSAP funding in proposed § 350.207. Proposed paragraph (i)(3) would be added to clarify that the certifying official must have the necessary authority to certify the CVSP on behalf of the State. The proposed language would no longer require that a State training plan be included as part of the CVSP.

§ 350.213 What must a State include for the second and third years of the CVSP?

Proposed § 350.213 would be added to set forth the information to be submitted in the annual update for the second and third years of the CVSP.

§ 350.215 What response does a State receive to its CVSP or annual update?

Proposed § 350.215 is derived, in part, from existing § 350.207, but revised to reflect submissions under a 3-year CVSP. FMCSA would revise the proposed section to reflect current practice that a State receives a response to the CVSP within 30 days after FMCSA begins its review of the CVSP, rather than within 30 days of receipt of the CVSP. It would also clarify circumstances under which States would not be eligible for MCSAP funding.

§ 350.217 How are MCSAP funds allocated?

Proposed § 350.217 sets forth the proposed MCSAP allocation formula and would replace existing §§ 350.313, 350.315, 350.317, 350.323, and 350.327. Under this proposal, the availability of Basic Program funds and Incentive funds would be incorporated into the State Component of the proposed formula. The new MCSAP allocation formula would also add a separate Border Component and a separate Territory Component.

§ 350.219 How are MCSAP funds awarded under a continuing resolution appropriations act or an extension of FMCSA's authorization?

Proposed § 350.219 would be added to address MCSAP funding under a continuing resolution appropriations act or an extension of the Agency's authorization.

§ 350.221 How long are MCSAP funds available to a State?

Proposed § 350.221 is derived, in part, from existing § 350.307. Existing regulatory language requiring that funds be expended in the order that they are obligated would be eliminated because it is no longer necessary, given that FMCSA requires a fixed period of performance.

§ 350.223 What are the Federal and State shares of costs incurred under MCSAP?

Proposed § 350.223 would consolidate existing §§ 350.303 and 350.305. In paragraph (b), references to 2 CFR part 1201 would be added to accompany the current references to 2 CFR part 200 (OMB's Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards) to reflect that part 1201 addresses DOT's adoption and implementation of part 200. This reference is made in similar provisions throughout the proposed regulatory text. Language would be added in paragraph (c)(2) to clarify circumstances when a waiver of the State share may be granted.

§ 350.225 What MOE must a State maintain to qualify for MCSAP funds?

Proposed § 350.225 is derived, in part, from existing § 350.301. Language would be added to reflect an additional maintenance of effort baseline calculation option allowed under section 5101(f) of the FAST Act, as a one-time adjustment to the maintenance of effort permitted under section 5107 of the Act. Furthermore, a 120-day time period would be established for the Agency to evaluate requests for the maintenance of effort waivers. Finally, a provision would be added authorizing permanent adjustments after fiscal year 2020, reducing a State's maintenance of effort requirement, provided that new information was produced that was unavailable during fiscal year 2020.

§ 350.227 What activities are eligible for reimbursement under MCSAP?

Proposed § 350.227 would be generally the same as existing § 350.309 substantively, but would reflect the proposed expanded national program elements and changes to the MCSAP allocation formula.

§ 350.229 What specific costs are eligible for reimbursement under MCSAP?

Proposed § 350.229 is derived from existing §§ 350.311, 350.201(cc), and 350.341(h)(3). The list of reimbursable items in existing § 350.311 would be eliminated as unnecessary in light of the reference to the MCSAP application memorandum and title 2 of the CFR. Proposed paragraph (c)(2) would clarify that a State may not use MCSAP funds for the creation or maintenance of its own State registry of medical examiners.

§ 350.231 What are the consequences for failure to meet MCSAP conditions?

Proposed § 350.231 would not be substantively changed from existing § 350.215, but would be modified for clarity.

C. Subpart C—MCSAP Required Compatibility Review

Proposed subpart C would include information related to the MCSAP-required FMCSR and HMR compatibility review and variances available to States participating in MCSAP.

§ 350.301 What is the purpose of this subpart?

Proposed § 350.301 is derived, in part, from existing § 355.1. This proposed section would add an introductory paragraph for clarity and paragraph (d) to address the process for requesting exemptions for intrastate commerce.

§ 350.303 How does a State ensure compatibility?

Proposed § 350.303 is derived from existing §§ 350.331, 350.333, 355.21, 355.23, 355.25, and, in part, Appendix

A of part 355. It would consolidate the existing regulations to reduce redundancies. In proposed paragraph (c), language would be added to clarify that a review for compatibility must accompany any new or amended laws submitted to FMCSA in accordance to preferred practice. Proposed § 350.303(d) is revised to closer track the applicable statutory provision, 49 U.S.C. 31141. Proposed § 350.303(g)(2), addressing the opportunity for an administrative hearing, would be added to reflect a requirement under 49 U.S.C. 31141(d)(2). Language determined to be obsolete would be eliminated.

§ 350.305 What specific variances from the FMCSRs are allowed for State laws and regulations and not subject to Federal jurisdiction?

Proposed § 350.305 is derived from existing §§ 350.341 and 350.345. Language would be added in paragraph (b)(2) to clarify that the grandfathering of State exemptions issued before April 1988 only applies if the scope of the original exemption has not changed. Language determined to be obsolete would be eliminated, including § 350.341(g) that addresses grandfather clauses.

§ 350.307 How may a State obtain a new exemption for State laws and regulations for a specific industry involved in intrastate commerce?

Proposed § 350.307 is derived, in part, from existing § 350.343. Existing paragraph (j) would be removed from this section, given that it has no bearing on safety.

§ 350.309 What are the consequences if a State has provisions that are not compatible?

Proposed § 350.309 is derived from existing §§ 350.335 and 355.25(a). The reference to ''interstate'' commerce in § 355.25(a) would be eliminated as inconsistent with the MCSAP requirements.

D. Subpart D—High Priority Program

The Agency proposes to add a new subpart D, describing the High Priority Program.

§ 350.401 What is the High Priority Program?

Proposed § 350.401 is derived from existing §§ 350.101(b) and 350.107(b).

§ 350.403 What are the High Priority Program objectives?

Proposed § 350.403 is derived from existing § 350.110. It would reorganize existing § 350.110 and add an objective to reflect the Innovative Technology Deployment Program.

§ 350.405 What conditions must an applicant meet to qualify for High Priority Program funds?

Proposed § 350.405 is derived from existing § 350.203 and would clarify that all applicants must comply with the High Priority Program Notice of Funding Opportunity (NOFO). The reference to a State's obligation to provide a match of up to 15 percent under existing § 350.203(b)(5) would be eliminated as unnecessary in light of proposed § 350.413(a).

§ 350.407 How and when does an eligible entity apply for High Priority Program funds?

Proposed § 350.407 would not be substantively changed from existing § 350.206, but would be modified for clarity.

§ 350.409 What response will an applicant receive under the High Priority Program?

Proposed § 350.409 would not be substantively changed from existing § 350.208, but would be modified for clarity.

§ 350.411 How long are High Priority Program funds available to a recipient?

Proposed § 350.411 would not be substantively changed from existing § 350.308, but would be modified for clarity.

§ 350.413 What are the Federal and recipient shares of costs incurred under the High Priority Program?

Proposed § 350.413 is derived from existing § 350.303. Language would be added to clarify circumstances when a recipient share of costs waiver may be granted.

§ 350.415 What types of activities and projects are eligible for reimbursement under the High Priority Program?

Proposed § 350.415 is derived from § 350.310. It would cross-reference proposed § 350.403 for the High Priority Program objectives, rather than listing all eligible activities, for brevity.

§ 350.417 What specific costs are eligible for reimbursement under the High Priority Program?

Proposed § 350.417 is derived, in part, from existing § 350.311. The list of reimbursable items in existing § 350.311 would be eliminated as unnecessary in light of the reference to the NOFO and title 2 of the CFR. Proposed paragraph (b)(2) would be added to clarify that a State may not use High Priority Program funds for the creation or maintenance of its own State registry of medical examiners.

E. Miscellaneous

The term ''tolerance guidelines'' in existing § 350.339 is no longer being used; therefore; the section would be removed. This concept, addressing variances and exemptions that States may permit for motor carriers, CMV drivers, and CMVs engaged in intrastate commerce and that are not subject to Federal jurisdiction, is addressed under proposed §§ 350.305 and 350.307. Existing § 350.210, discussing how an applicant demonstrates that it satisfies the conditions for High Priority Program funding, would be deleted as unnecessary in light of proposed § 350.405.

Part 355 of title 49 of the CFR (Compatibility of State Laws and Regulations Affecting Interstate Motor Carrier Operations) would be removed and reserved. Substantive provisions of continued effect would be incorporated into this proposed rule. Remaining provisions of part 355, including the Appendix, would be eliminated. Part 388 (Cooperative Agreements with States) would be removed and reserved.

IX. Regulatory Analyses

A. Executive Order (E.O.) 12866 (Regulatory Planning and Review), E.O. 13563 (Improving Regulation and Regulatory Review), and DOT Regulatory Policies and Procedures

FMCSA performed an analysis of the impacts of the proposed rule and determined it is a significant regulatory action under section 3(f) of E.O. 12866, Regulatory Planning and Review (58 FR 51735, October 4, 1993), as supplemented by E.O. 13563, Improving Regulation and Regulatory Review (76 FR 3821, January 21, 2011). Therefore, the proposed rule requires an assessment of potential costs and benefits under section 6(a)(3) of that Order. Accordingly, OMB has reviewed it under that Order. It is also significant within the meaning of DOT regulatory policies and procedures because the Agency expects there will be substantial public interest in this rulemaking (DOT Order 2100.6 dated December 20, 2018).

E.O. 12866 directs each agency to identify the problem it intends to address, as well as the significance of that problem.[10] OMB Circular A–4 [11]

[10] Executive Office of the President. *Executive Order 12866 of September 30, 1993. Regulatory Planning and Review.* 58 FR 51735–51744. October 4, 1993. Page 51735.

[11] Office of Management and Budget (OMB). *Circular A–4. Regulatory Analysis.* September 17, 2003.

and the accompanying document ''Regulatory Impact Analysis: A Primer'' [12] provide guidance for how agencies should implement E.O. 12866, including guidance on identifying and describing the problem that the regulatory action intends to address, and whether ''the action is intended to address a market failure or promote some other goal.'' [13]

The purpose of this regulatory action is to amend and reorganize 49 CFR part 350, including adding relevant sections that are currently located in part 355. Certain regulations are no longer necessary or are redundant. Moreover, the FAST Act required FMCSA to implement a multi-year CVSP with annual updates for States applying for MCSAP funds and to provide a new MCSAP allocation formula. The proposed MCSAP formula would help the government to operate more efficiently by establishing a reallocation of grant funds based on changes in safety factors.

As explained elsewhere in this NPRM, this rule proposes a new MCSAP allocation formula to replace the current formula that has been in use for more than a decade with little modification. The proposed MCSAP allocation formula would make several improvements over the current formula. The proposed formula was constructed based on a careful statistical analysis of the relationship between numerous highway safety variables and crashes (fatal and non-fatal). While this analysis revealed that several of the existing formula factors (*e.g.,* population and special fuel consumption) remain highly correlated with crashes, newer data (carrier registration and highway miles) are available to more closely link the allocation of funding to safety risk.

The new formula also proposes changes that go beyond modifications to just the calculation methodology. First, the proposed formula discontinues the use of Incentive funds. Instead, the allocation of funds is based primarily on the calculation of the applicable formula factors. Further, mitigation measures are employed to ensure that State funding levels do not substantially fluctuate from year to year. Specifically, a State may not have a decrease of more than 3 percent, or an increase of more than 5 percent, from the prior year's share of MCSAP funding.[14] This helps the State ensure a degree of predictability to aid in budget planning while still allowing for fair allocation of funds.

The proposed MCSAP allocation formula would result in a reallocation of grant funding that would be considered a transfer payment, in that it would not change the total amount of funds distributed. In accordance with OMB guidance on conducting regulatory analysis (as discussed in OMB Circular A–4, ''Regulatory Analysis''), transfer payments within the U.S. are not included in the estimate of the costs and benefits of rulemakings. Thus, FMCSA does not include transfers resulting from the proposed changes to the MCSAP allocation formula in its estimate of the costs and benefits of the proposed rule. The following table displays the amounts that States could expect to receive under both the interim and proposed formulas in FY 2020, given certain criteria (*i.e.,* the inclusion of Oregon and the total amount of appropriated funds). The table is provided for informational purposes and is not a guarantee of a specific funding level.

ESTIMATED MCSAP FUNDING FORMULA COMPARISON [a b]

State/territory	FY 2020 Estimated interim formula awards		FY 2020 Estimated MCSAP formula award (new formula as proposed by FMCSA)	
	Including Oregon	Excluding Oregon	Including Oregon	Excluding Oregon
Alabama	$5,981,155	$6,084,689	$5,965,678	$5,965,678
Alaska	1,269,196	1,269,068	1,257,326	1,257,326
American Samoa	350,000	350,000	350,000	350,000
Arizona	11,234,838	11,332,514	10,804,840	10,804,840
Arkansas	4,371,959	4,448,908	4,138,170	4,138,170
California	18,590,048	18,587,874	19,145,982	19,368,217
Colorado	4,906,099	4,994,077	4,950,448	5,103,801
Connecticut	2,393,631	2,434,316	2,527,768	2,527,768
Delaware	1,251,260	1,250,776	1,166,066	1,179,601
District of Columbia	1,092,231	1,091,747	1,118,593	1,118,593
Florida	12,706,226	12,704,051	13,102,346	13,254,430
Georgia	10,223,708	10,394,519	10,443,179	10,443,179
Guam	350,000	350,000	439,941	439,941
Hawaii	1,066,679	1,066,422	1,099,298	1,099,298
Idaho	2,500,201	2,541,685	2,436,607	2,436,607
Illinois	11,177,027	11,359,365	11,285,176	11,634,765
Indiana	7,600,938	7,728,822	7,286,679	7,286,679
Iowa	5,004,354	5,087,635	4,837,215	4,837,215
Kansas	4,504,320	4,584,021	4,458,505	4,458,505
Kentucky	4,736,164	4,819,511	4,686,676	4,784,186
Louisiana	4,502,334	4,581,061	4,346,759	4,346,759
Maine	1,815,663	1,842,792	1,751,636	1,751,636
Maryland	3,898,791	3,970,778	4,175,980	4,175,980
Massachusetts	4,437,614	4,514,021	4,604,630	4,604,630
Michigan	8,663,352	8,805,741	8,967,604	9,224,388
Minnesota	6,711,732	6,824,363	6,422,249	6,453,904
Mississippi	4,008,984	4,079,776	3,893,741	3,994,903

[12] Office of Management and Budget (OMB). *Regulatory Impact Analysis: A Primer.*

[13] Office of Management and Budget (OMB). *Regulatory Impact Analysis: A Primer.* Page 2.

[14] In this respect, the States, the District of Columbia, and Puerto Rico are treated differently than the remaining Territories. The U.S. Census Bureau does not provide annual population estimates for Territories other than Puerto Rico. Thus, these percentage limitations governing funding levels do not apply to these Territories.

ESTIMATED MCSAP FUNDING FORMULA COMPARISON [a] [b]—Continued

State/territory	FY 2020 Estimated interim formula awards		FY 2020 Estimated MCSAP formula award (new formula as proposed by FMCSA)	
	Including Oregon	Excluding Oregon	Including Oregon	Excluding Oregon
Missouri	6,892,605	7,014,924	6,844,323	6,975,820
Montana	3,063,123	3,102,581	2,994,454	2,994,454
Nebraska	3,650,919	3,709,539	3,626,881	3,626,881
Nevada	2,596,460	2,643,932	2,584,009	2,664,056
New Hampshire	1,352,053	1,351,569	1,343,600	1,384,743
New Jersey	7,038,352	7,140,767	6,943,724	7,158,824
New Mexico	4,002,101	4,058,337	4,107,636	4,107,636
New York	13,199,642	13,412,776	12,842,509	13,226,416
North Carolina	8,730,173	8,880,140	8,972,029	9,249,962
North Dakota	2,889,717	2,934,189	2,696,955	2,696,955
Northern Marianas	350,000	350,000	350,000	350,000
Ohio	10,070,415	10,250,889	9,781,884	10,046,336
Oklahoma	5,927,263	6,025,865	5,769,781	5,769,781
Oregon	3,745,475		3,946,430	
Pennsylvania	10,038,363	10,214,498	10,424,935	10,424,935
Puerto Rico	1,172,803	1,195,818	1,166,066	1,179,601
Rhode Island	1,356,289	1,355,805	1,300,175	1,300,175
South Carolina	4,824,547	4,910,771	4,796,236	4,944,812
South Dakota	2,359,346	2,400,857	2,253,064	2,253,064
Tennessee	6,630,299	6,743,955	6,489,424	6,683,303
Texas	30,695,205	30,693,031	31,217,150	31,579,500
Utah	3,093,422	3,147,010	3,085,281	3,085,281
Vermont	1,212,839	1,212,647	1,298,730	1,298,730
Virgin Islands	350,000	350,000	350,000	350,000
Virginia	6,760,878	6,879,407	6,895,938	7,109,558
Washington	6,566,316	6,664,872	6,457,545	6,457,545
West Virginia	2,297,186	2,335,720	2,171,592	2,238,863
Wisconsin	6,439,562	6,548,726	6,188,280	6,363,493
Wyoming	1,415,639	1,442,339	1,507,775	1,507,775
Total	304,069,500	304,069,500	304,069,500	304,069,500

[a] Estimated calculations for FY 2020 are shown both with and without the State of Oregon. Note that Oregon did not participate in FY 2019, but it may re-enter the program in the future.

[b] Calculation of funds for the proposed formula was made after setting aside 11 percent for the Border Component and 0.49 percent for the Territory Component of available MCSAP funds, and applying the hold-harmless and cap provisions as explained above.

FMCSA proposes to clarify a State's obligation to cooperate in the enforcement of hazardous materials safety permits for interstate and intrastate carriers as required under subpart E of 49 CFR part 385 to transport certain hazardous materials. The proposed rule would ensure that all States would document compliance with hazardous materials safety permit requirements in the course of inspections that States conduct. State officials are already receiving training on subpart E of part 385, and FMCSA estimates that no new costs or benefits would result from this clarification.

This rule proposes to eliminate the exception to adopt §§ 171.15 and 171.16 in the HMRs by States participating in MCSAP. These provisions require incident reporting of certain hazardous materials incidents. This proposal would allow States to ensure compliance with these provisions during the course of investigations, but would not require States to conduct investigations. Additionally, eliminating the exception would not expand the incident reporting burden. State officials are already receiving investigation training, which would include training on enforcement of §§ 171.15 and 171.16. Therefore, FMCSA estimates that no new costs or benefits would result from this elimination.

The proposed rule would require States to use CVSPs in accordance with the FAST Act. The rule would provide direction to States on how and when to submit CVSPs, which would be on 3-year cycles. Under the current regulations, States must submit lengthy annual CVSP applications to receive MCSAP funding. The proposed rule would require States to submit robust 3-year CVSP applications for the first year, with annual updates for the second and third years. Specifically, for the first year of the CVSP, States would submit information regarding performance goals, past performance, and other documents traditionally provided in an annual CVSP, as well as a budget for the initial year. For the second and third years of the CVSP, States would submit an annual update that includes a budget for the applicable fiscal year, changes to the CVSP, and other documents required on an annual basis. As of FY 2020, all 55 States have transitioned voluntarily to 3-year CVSPs, and thus, the Agency does not estimate an impact from this proposed change.

When considering alternatives to the proposed requirements, FMCSA considered requiring a CVSP cycle other than the proposed 3-year CVSP cycle. In a **Federal Register** notice published October 27, 2016, FMCSA asked 14 questions that would assist the Agency in developing an information technology system form and procedures for submission of a multi-year plan. Regarding questions on the length of the multi-year plan, responses to this question varied with some States indicating that they are not interested in a multi-year plan and some States expressing interest in a 5-year plan. However, the largest number of States recommended a 3-year period. Regarding the accuracy of available data, all States confidently reported that they can provide complete and accurate data, with many States recommending 2 or 3 years for the multi-year plan. These States advised that their responses were specific to their recommended timeframes. These responses confirmed FMCSA's expectations. Section 5101 of the FAST Act requires the Secretary to prescribe procedures for a State to submit a multi-year CVSP with annual updates for MCSAP grants. The FAST Act provided discretion to FMCSA in choosing the length of the CVSP cycle. FMCSA is proposing to require a CVSP with a 3-year plan cycle. The 3-year CVSP proposal is informed by comments received to the October 27, 2016, **Federal Register** notice (81 FR 74862), the working group's recommendations, and necessary eCVSP tool modifications. Furthermore, FMCSA elected to test the 3-year CVSP with volunteers for the FY 2018 CVSP and receive feedback. FMCSA developed the 3-year CVSP proposal using the experience and feedback of the FY 2018 3-year CVSP users. As such, FMCSA believes that the 3-year CVSP would be the most advantageous for FMCSA and the CVSP users and is no longer considering a time-frame other than 3 years for the CVSP (see 83 FR 691, 692, January 5, 2018).

B. E.O. 13771 (Reducing Regulation and Controlling Regulatory Costs)

This proposed rule is neither expected to be an E.O. 13771 regulatory action nor an E.O. 13771 deregulatory action because there would be no cost impacts resulting from the rule.[15]

C. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) of 1980, as amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA) (Pub. L. 104–121, 110 Stat. 857; 5 U.S.C. 601 *et seq.*), requires Federal agencies to consider the impact of their regulatory proposals on small entities, analyze effective alternatives that minimize small entity impacts, and make their analyses available for public comment. The term ''small entities'' means small businesses and not-for-profit organizations that are independently owned and operated and are not dominant in their fields, and governmental jurisdictions with populations under 50,000 (5 U.S.C. 601(6)). Accordingly, DOT policy requires an analysis of the impact of all regulations on small entities, and mandates that agencies strive to lessen any adverse effects on these entities. Section 605 of the RFA allows an Agency to certify a rule, in lieu of preparing an analysis, if the rulemaking is not expected to have a significant economic impact on a substantial number of small entities.

This proposed rule primarily affects States applying for MCSAP funds due to the new MCSAP allocation formula governing distribution of MCSAP funds and the requirement to submit CVSPs on a 3-year cycle. Under the standards of the RFA, as amended, States are not considered small entities because they do not meet the definition of a small entity in Section 601 of the RFA. Specifically, States are not considered small governmental jurisdictions under Section 601(5) of the RFA, both because State government is not included among the various levels of government listed in Section 601(5), and because, even if this were the case, no State, including the District of Columbia, has a population of less than 50,000, which is the criterion for a governmental jurisdiction to be considered small under Section 601(5) of the RFA.

Although States would not be considered small entities, there is a possibility that other entities that could be considered small may be grant program applicants. These other entities include local governments, Federally-recognized Indian tribes, other political jurisdictions, universities, non-profit organizations, and other persons who, although not eligible for MCSAP funds, which are designated for States, would be eligible for funding under the High Priority Program. However, the estimated impact of the proposed rule results from changes to MCSAP, which do not affect the High Priority Program applicants. As such, FMCSA does not estimate that these non-State entities would experience economic impacts as a result of the proposed rule.

In summary, this proposed rule would only impact States, which are not small entities. The proposed rule thus does not have a significant economic impact on the regulated entities, and does not significantly impact a substantial number of small entities. Accordingly, I certify that the action does not have a significant economic impact on a substantial number of small entities.

D. Assistance for Small Entities

In accordance with section 213(a) of the SBREFA, FMCSA wants to assist small entities in understanding this proposed rule so that they can better evaluate its effects on themselves and participate in the rulemaking initiative. If the proposed rule would affect your small business, organization, or governmental jurisdiction and you have questions concerning its provisions or options for compliance, please consult the FMCSA point of contact, Jack Kostelnik, listed in the **FOR FURTHER INFORMATION CONTACT** section of this proposed rule.

Small businesses may send comments on the actions of Federal employees who enforce or otherwise determine compliance with Federal regulations to the Small Business Administration's Small Business and Agriculture Regulatory Enforcement Ombudsman and the Regional Small Business Regulatory Fairness Boards. The Ombudsman evaluates these actions annually and rates each agency's responsiveness to small business. If you wish to comment on actions by employees of FMCSA, call 1–888–REG–FAIR (1–888–734–3247). DOT has a policy regarding the rights of small entities to regulatory enforcement fairness and an explicit policy against retaliation for exercising these rights.

E. Unfunded Mandates Reform Act of 1995

The Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531–1538) requires Federal agencies to assess the effects of their discretionary regulatory actions. In particular, the Act addresses actions that may result in the expenditure by a State, local, or tribal government, in the aggregate, or by the private sector, of $161 million (which is the value equivalent of $100,000,000 in 1995, adjusted for inflation to 2017 levels) or more in any 1 year. Though this proposed rule would not result in such an expenditure, the Agency does discuss the effects of this rule elsewhere in this preamble.

F. Paperwork Reduction Act

This proposed rule would call for no new collection of information under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520). The Agency notes that MCSAP applications are not subject to OMB's standard application requirements pursuant to 2 CFR 1201.206. Entities apply for the Agency's other financial assistance programs using standardized forms found in *grants.gov,* which account for any information collection burden and are not impacted by this proposed rule.

[15] Executive Office of the President. *Executive Order 13771 of January 30, 2017. Reducing Regulation and Controlling Regulatory Costs.* 82 FR 9339–9341. February 3, 2017.

G. E.O. 13132 (Federalism)

A rule has implications for federalism under section 1(a) of E.O.13132 if it has ''substantial direct effects 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.'' FMCSA determined that this proposal would not have substantial direct costs on or for States, nor would it limit the policymaking discretion of States. Nothing in this document preempts any State law or regulation. Therefore, this rule does not have sufficient federalism implications to warrant the preparation of a Federalism Impact Statement.

H. E.O. 12988 (Civil Justice Reform)

This proposed rule meets applicable standards in sections 3(a) and 3(b)(2) of E.O. 12988, Civil Justice Reform, to minimize litigation, eliminate ambiguity, and reduce burden.

I. E.O. 13045 (Protection of Children)

E.O. 13045, Protection of Children from Environmental Health Risks and Safety Risks (62 FR 19885, April 23, 1997), requires agencies issuing ''economically significant'' rules, if the regulation also concerns an environmental health or safety risk that an agency has reason to believe may disproportionately affect children, to include an evaluation of the regulation's environmental health and safety effects on children. The Agency determined this proposed rule is not economically significant. Therefore, no analysis of the impacts on children is required. In any event, the Agency does not anticipate that this regulatory action could in any respect present an environmental or safety risk that could disproportionately affect children.

J. E.O. 12630 (Taking of Private Property)

FMCSA reviewed this proposed rule in accordance with E.O. 12630, Governmental Actions and Interference with Constitutionally Protected Property Rights, and has determined it will not effect a taking of private property or otherwise have taking implications.

K. Privacy

Section 522 of title I of division H of the Consolidated Appropriations Act, 2005, enacted December 8, 2004 (Pub. L. 108–447, 118 Stat. 2809, 3268, note following 5 U.S.C. 552a), requires the Agency to conduct a Privacy Impact Assessment of a regulation that will affect the privacy of individuals. The assessment considers impacts of the rule on the privacy of information in an identifiable form and related matters. The FMCSA Privacy Officer has evaluated the risks and effects the rulemaking might have on collecting, storing, and sharing personally identifiable information and has evaluated protections and alternative information handling processes in developing the rule to mitigate potential privacy risks. FMCSA determined that this rule does not require the collection of individual personally identifiable information.

Additionally, the Agency submitted a Privacy Threshold Assessment analyzing the rulemaking to the DOT, Office of the Secretary's Privacy Office. The DOT Privacy Office has determined that this rulemaking does not create privacy risk.

The E-Government Act of 2002, Public Law 107–347, § 208, 116 Stat. 2899, 2921 (Dec. 17, 2002), requires Federal agencies to conduct a Privacy Impact Assessment for new or substantially changed technology that collects, maintains, or disseminates information in an identifiable form. No new or substantially changed technology would collect, maintain, or disseminate information because of this rule.

L. E.O. 12372 (Intergovernmental Review)

The regulations implementing E.O. 12372 regarding intergovernmental consultation on Federal programs and activities do not apply to this program.

M. E.O. 13211 (Energy Supply, Distribution, or Use)

FMCSA has analyzed this proposed rule under E.O. 13211, Actions Concerning Regulations That Significantly Affect Energy Supply, Distribution, or Use. The Agency has determined that it is not a ''significant energy action'' under that order because it is not a ''significant regulatory action'' likely to have a significant adverse effect on the supply, distribution, or use of energy. Therefore, it does not require a Statement of Energy Effects under E.O. 13211.

N. E.O. 13783 (Promoting Energy Independence and Economic Growth)

E.O. 13783 directs executive departments and agencies to review existing regulations that potentially burden the development or use of domestically produced energy resources, and to appropriately suspend, revise, or rescind those that unduly burden the development of domestic energy resources. In accordance with E.O. 13783, DOT prepared and submitted a report to the Director of OMB that provides specific recommendations that, to the extent permitted by law, could alleviate or eliminate aspects of agency action that burden domestic energy production. This proposed rule has not been identified by DOT under E.O. 13783 as potentially alleviating unnecessary burdens on domestic energy production.

O. E.O. 13175 (Indian Tribal Governments)

This proposed rule does not have tribal implications under E.O. 13175, Consultation and Coordination with Indian Tribal Governments, because it does not have a substantial direct effect on one or more Indian tribes, on the relationship between the Federal government and Indian tribes, or on the distribution of power and responsibilities between the Federal government and Indian tribes.

P. National Technology Transfer and Advancement Act (Technical Standards)

The National Technology Transfer and Advancement Act (note following 15 U.S.C. 272) directs agencies to use voluntary consensus standards in their regulatory activities unless the agency provides Congress, through OMB, with an explanation of why using these standards would be inconsistent with applicable law or otherwise impractical. Voluntary consensus standards (*e.g.,* specifications of materials, performance, design, or operation; test methods; sampling procedures; and related management systems practices) are standards that are developed or adopted by voluntary consensus standards bodies. This rule does not use technical standards. Therefore, FMCSA did not consider the use of voluntary consensus standards.

Q. National Environmental Policy Act of 1969

FMCSA analyzed this proposed rule for the purpose of the National Environmental Policy Act of 1969 (42 U.S.C. 4321 *et seq.*) and determined this action is categorically excluded from further analysis and documentation in an environmental assessment or environmental impact statement under FMCSA Order 5610.1 (69 FR 9680, March 1, 2004), Appendix 2, paragraphs 6.f. and 6.g. The Categorical Exclusions (CEs) in paragraphs 6.f. and 6.g. cover regulations implementing activities, whether performed by FMCSA or by States pursuant to MCSAP, and procedures to promote adoption and enforcement of State laws and regulations pertaining to CMV safety that are compatible with the FMCSRs and HMRs, and procedures to provide guidelines for a continuous regulatory review of State laws and regulations. The proposed requirements in this rule are covered by these CEs and the proposed rule would not have any effect on the quality of the environment.

List of Subjects

49 CFR Part 350

Grant programs-transportation, Highway safety, Motor carriers, Motor vehicle safety, Reporting and recordkeeping requirements.

49 CFR Part 355

Highway safety, Intergovernmental relations, Motor carriers, Motor vehicle safety, Reporting and recordkeeping requirements.

49 CFR Part 388

Administrative practice and procedure, Highway safety, Motor carriers, Motor vehicle safety.

In consideration of the foregoing, FMCSA proposes to amend 49 CFR Chapter III as follows.

■ 1. Revise part 350 to read as follows:

PART 350—MOTOR CARRIER SAFETY ASSISTANCE PROGRAM (MCSAP) AND HIGH PRIORITY PROGRAM

Authority: 49 U.S.C. 13902, 31101–31104, 31108, 31136, 31141, 31161, 31310–31311, 31502; and 49 CFR 1.87.

Subpart A—General

§ 350.101 What is the purpose of this part?

The purpose of this part is to provide direction for entities seeking MCSAP or High Priority Program funding to improve motor carrier, CMV, and driver safety.

§ 350.103 When do the financial assistance program changes take effect?

Unless otherwise provided, the changes to the FMCSA financial assistance programs under this part take effect for fiscal year 2020, beginning October 1, 2019.

§ 350.105 What definitions are used in this part?

As used in this part:

Administrative takedown funds means funds FMCSA deducts each fiscal year from the amounts made available for MCSAP and the High Priority Program for expenses incurred by FMCSA for training State and local government employees and for the administration of the programs.

Administrator means the administrator of FMCSA.

Border State means a State that shares a land border with Canada or Mexico.

Commercial motor vehicle (CMV) means a motor vehicle that has any of the following characteristics:

(1) A gross vehicle weight (GVW), gross vehicle weight rating (GVWR), gross combination weight (GCW), or gross combination weight rating (GCWR) of 4,537 kilograms (10,001 pounds) or more.

(2) Regardless of weight, is designed or used to transport 16 or more passengers, including driver.

(3) Regardless of weight, is used in the transportation of hazardous materials and is required to be placarded pursuant to 49 CFR part 172, subpart F.

Commercial vehicle safety plan (CVSP) means a State's CMV safety objectives, strategies, activities, and performance measures that cover a 3-year period, including the submission of the CVSP for the first year and annual updates thereto for the second and third years.

Compatible or compatibility means State safety laws and regulations, standards, and orders:

(1) As applicable to interstate commerce, that are identical to, or have the same effect as, the FMCSRs;

(2) As applicable to intrastate commerce, that:

(i) Are identical to, or have the same effect as, the FMCSRs; or

(ii) Fall within the limited variances from the FMCSRs allowed under subpart C of this part; and

(3) As applicable to interstate and intrastate commerce involving the movement of hazardous materials, that are identical to the HMRs.

FMCSA means the Federal Motor Carrier Safety Administration of the United States Department of Transportation.

FMCSRs means:

(1) The Federal Motor Carrier Safety Regulations under parts 390, 391, 392, 393, 395, 396, and 397 of this subchapter; and

(2) Applicable standards and orders issued under these provisions.

HMRs means:

(1) The Federal Hazardous Materials Regulations under subparts F and G of part 107, and parts 171, 172, 173, 177, 178, and 180 of this title; and

(2) Applicable standards and orders issued under these provisions.

High Priority Program funds means total funds available for the High

Priority Program, less the administrative takedown funds.

Investigation means an examination of motor carrier operations and records, such as drivers' hours of service, maintenance and inspection, driver qualification, commercial driver's license requirements, financial responsibility, crashes, hazardous materials, and other safety and transportation records, to determine whether a motor carrier meets safety standards, including the safety fitness standard under § 385.5 of this chapter or, for intrastate motor carrier operations, the applicable State standard.

Lead State Agency means the State CMV safety agency responsible for administering the CVSP throughout a State.

Maintenance of effort (MOE) means the level of a State's financial expenditures, other than the required match, the Lead State Agency is required to expend each fiscal year in accordance with § 350.225.

Motor carrier means a for-hire motor carrier or private motor carrier. The term includes a motor carrier's agents, officers, and representatives as well as employees responsible for hiring, supervising, training, assigning, or dispatching a driver or an employee concerned with the installation, inspection, and maintenance of motor vehicle equipment or accessories.

Motor Carrier Safety Assistance Program (MCSAP) funds means total formula grant funds available for MCSAP, less the administrative takedown funds.

New entrant safety audit means the safety audit of an interstate motor carrier that is required as a condition of MCSAP eligibility under § 350.207(a)(26), and, at the State's discretion, an intrastate new entrant motor carrier under 49 U.S.C. 31144(g) that is conducted in accordance with subpart D of part 385 of this chapter.

North American Standard Inspection means the procedures used by certified safety inspectors to conduct various levels of safety inspections of the vehicle or driver.

State means a State of the United States, the District of Columbia, American Samoa, the Commonwealth of the Northern Mariana Islands, the Commonwealth of Puerto Rico, Guam, and the Virgin Islands.

Traffic enforcement means the stopping of vehicles operating on highways for moving violations of State, tribal, or local motor vehicle or traffic laws by State, tribal, or local officials.

Subpart B—Motor Carrier Safety Assistance Program Administration

§ 350.201 What is MCSAP?

(a) *General.* MCSAP is a Federal formula grant program that provides financial assistance to States to reduce the number and severity of crashes, and resulting injuries and fatalities, involving CMVs and to promote the safe transportation of passengers and hazardous materials. The goal of MCSAP is to reduce CMV-involved crashes, fatalities, and injuries through consistent, uniform, and effective CMV safety programs that include driver or vehicle inspections, traffic enforcement, carrier investigations, new entrant safety audits, border enforcement, safety data improvements, and Performance and Registration Information Systems Management (PRISM).

(b) *MCSAP requirements.* MCSAP requires States to:

(1) Make targeted investments to promote safe CMV transportation, including transportation of passengers and hazardous materials;

(2) Invest in activities likely to generate maximum reductions in the number and severity of CMV crashes and in fatalities resulting from CMV crashes;

(3) Adopt and enforce effective motor carrier, CMV, and driver safety regulations and practices consistent with Federal requirements; and

(4) Assess and improve State-wide performance of motor carrier, CMV, and driver safety by setting program goals and meeting performance standards, measurements, and benchmarks.

(c) *State participation.* MCSAP sets conditions of participation for States and promotes compatibility in the adoption and uniform enforcement of safety laws and regulations, standards, and orders.

§ 350.203 What are the national MCSAP elements?

The national MCSAP elements are:

(a) Driver inspections;

(b) Vehicle inspections;

(c) Traffic enforcement;

(d) Investigations;

(e) New entrant safety audits;

(f) CMV safety programs focusing on international commerce in border States;

(g) Beginning October 1, 2020, full participation in PRISM or an acceptable alternative as determined by the Administrator;

(h) Accurate, complete, timely, and corrected data;

(i) Public education and awareness; and

(j) Other elements that may be prescribed by the Administrator.

§ 350.205 What entities are eligible for funding under MCSAP?

Only States are eligible to receive MCSAP grants directly from FMCSA.

§ 350.207 What conditions must a State meet to qualify for MCSAP funds?

(a) *General.* To qualify for MCSAP funds, a State must:

(1) Designate a Lead State Agency;

(2) Assume responsibility for improving motor carrier safety by adopting and enforcing compatible safety laws and regulations, standards, and orders, except as may be determined by the Administrator to be inapplicable to a State enforcement program;

(3) Ensure that the State will cooperate in the enforcement of financial responsibility requirements under part 387 of this chapter;

(4) Provide that the State will enforce the registration requirements under 49 U.S.C. 13902 and 31134 by prohibiting the operation of any vehicle discovered to be operated by a motor carrier without a registration issued under those sections or operated beyond the scope of the motor carrier's registration;

(5) Provide a right of entry (or other method a State may use that is adequate to obtain necessary information) and inspection to carry out the CVSP;

(6) Give satisfactory assurances in its CVSP that the Lead State Agency has the legal authority, resources, and qualified personnel necessary to enforce compatible safety laws and regulations, standards, and orders;

(7) Provide satisfactory assurances that the State will undertake efforts that will emphasize and improve enforcement of State and local traffic laws and regulations related to CMV safety;

(8) Give satisfactory assurances that the State will devote adequate resources to the administration of the CVSP throughout the State, including the enforcement of compatible safety laws and regulations, standards, and orders;

(9) Provide that the MOE of the Lead State Agency will be maintained each fiscal year in accordance with § 350.225;

(10) Provide that all reports required in the CVSP be available to FMCSA upon request, meet the reporting requirements, and use the forms for recordkeeping, inspections, and investigations that FMCSA prescribes;

(11) Implement performance-based activities, including deployment and maintenance of technology, to enhance the efficiency and effectiveness of CMV safety programs;

(12) Establish and dedicate sufficient resources to a program to ensure that accurate, complete, and timely motor

carrier safety data are collected and reported, and to ensure the State's participation in a national motor carrier safety data correction system prescribed by FMCSA;

(13) Ensure that the Lead State Agency will coordinate the CVSP, data collection, and information systems with the State highway safety improvement program under 23 U.S.C. 148(c);

(14) Ensure participation in information technology and data systems as required by FMCSA for jurisdictions receiving MCSAP funding;

(15) Ensure that information is exchanged with other States in a timely manner;

(16) Grant maximum reciprocity for inspections conducted under the North American Standard Inspection Program through the use of a nationally accepted system that allows ready identification of previously inspected CMVs;

(17) Provide that the State will conduct comprehensive and highly visible traffic enforcement and CMV safety inspection programs in high-risk locations and corridors;

(18) Ensure that driver or vehicle inspections will be conducted at locations that are adequate to protect the safety of drivers and enforcement personnel;

(19) Except in the case of an imminent or obvious safety hazard, ensure that an inspection of a vehicle transporting passengers for a motor carrier of passengers is conducted at a bus station, terminal, border crossing, maintenance facility, destination, or other location where a motor carrier may make a planned stop (excluding a weigh station);

(20) Provide satisfactory assurances that the State will address activities in support of the national program elements listed in § 350.203, including activities:

(i) Aimed at removing impaired CMV drivers from the highways through adequate enforcement of regulations on the use of alcohol and controlled substances and by ensuring ready roadside access to alcohol detection and measuring equipment;

(ii) Aimed at providing training to MCSAP personnel to recognize drivers impaired by alcohol or controlled substances; and

(iii) Related to criminal interdiction, including human trafficking, when conducted with an appropriate CMV inspection and appropriate strategies for carrying out those interdiction activities, including interdiction activities that affect the transportation of controlled substances (as defined in section 102 of the Comprehensive Drug Abuse Prevention and Control Act of 1970 (21 U.S.C. 802) and listed in 21 CFR part 1308) by any occupant of a CMV;

(21) Ensure that detection of criminal activities and size and weight activities described in § 350.227(b), if financed through MCSAP funds, will not diminish the effectiveness of the development and implementation of the programs to improve motor carrier, CMV, and driver safety;

(22) Ensure consistent, effective, and reasonable sanctions;

(23) Provide that the State will include in the training manuals for the licensing examinations to drive a CMV and non-CMV information on best practices for driving safely in the vicinity of CMVs and non-CMVs;

(24) Require all registrants of CMVs to demonstrate their knowledge of applicable FMCSRs, HMRs, or compatible State laws or regulations, standards, and orders;

(25) Ensure that the State transmits to inspectors the notice of each Federal exemption granted under subpart C of part 381 and §§ 390.23 and 390.25 of this subchapter that relieves a person or class of persons in whole or in part from compliance with the FMCSRs or HMRs that has been provided to the State by FMCSA and identifies the person or class of persons granted the exemption and any terms and conditions that apply to the exemption;

(26) Subject to paragraphs (b) and (c)(1) of this section, conduct new entrant safety audits of interstate and, at the State's discretion, intrastate new entrant motor carriers in accordance with subpart D of part 385;

(27) Subject to paragraph (c)(2) of this section, beginning October 1, 2020, participate fully in PRISM by complying with the conditions for full participation, or receiving approval from the Administrator for an alternative approach for identifying and immobilizing a motor carrier with serious safety deficiencies in a manner that provides an equivalent level of safety;

(28) Ensure that the State will cooperate in the enforcement of hazardous materials safety permits issued under subpart E of part 385 of this chapter; and

(29) For border States, conduct a border CMV safety program focusing on international commerce that includes enforcement and related projects, or forfeit all funds allocated for border-related activities.

(b) *New entrant safety audits—Use of third parties.* If a State uses a third party to conduct new entrant safety audits under paragraph (a)(26) of this section, the State must verify the quality of the work and the State remains solely responsible for the management and oversight of the audits.

(c) *Territories.* (1) The new entrant safety audit requirement under paragraph (a)(26) does not apply to American Samoa, the Commonwealth of the Northern Mariana Islands, the Commonwealth of Puerto Rico, Guam, and the Virgin Islands.

(2) The required PRISM participation date under paragraph (a)(27) of this section does not apply to American Samoa, the Commonwealth of the Northern Mariana Islands, the Commonwealth of Puerto Rico, Guam, and the Virgin Islands.

§ 350.209 How and when does a State apply for MCSAP funds using a CVSP?

(a) *MCSAP Application Submission Format.* (1) The CVSP is a 3-year plan.

(2) The first year of the CVSP varies by State, depending on when the State implemented the CVSP.

(3) For the first year of the CVSP, the Lead State Agency must submit a CVSP projecting programs and projects covering 3 years and a budget for the first fiscal year for which the CVSP is submitted, as explained in § 350.211.

(4) For the second and third years of the CVSP, the Lead State Agency must submit an annual update and budget for that fiscal year and any other needed adjustments or changes to the CVSP, as explained in § 350.213.

(b) *MCSAP Application Submission Deadline.* (1) The Lead State Agency must submit the CVSP, or the annual updates, to FMCSA by the date prescribed in the MCSAP application memorandum for the fiscal year.

(2) The Administrator may extend for a period not exceeding 30 days the deadline prescribed in the MCSAP application memorandum for document submission for good cause.

§ 350.211 What must a State include for the first year of the CVSP?

(a) *General.* (1) The first year of the CVSP must comply with the MCSAP application memorandum and, at a minimum, provide a performance-based program with a general overview section that includes:

(i) A statement of the Lead State Agency's goal or mission; and

(ii) A program summary of the effectiveness of prior activities in reducing CMV crashes, injuries, and fatalities and in improving driver and motor carrier safety performance.

(2) The program summary must identify and address safety or performance problems in the State.

(3) The program summary must use 12-month data periods that are

consistent from year to year. This may be a calendar year, fiscal year, or any 12-month period for which the State's data is current.

(4) The program summary must show trends supported by safety and program performance data collected over several years.

(b) *National MCSAP elements.* (1) The first year of the CVSP must include a brief narrative describing how the State CVSP addresses the national program elements listed in § 350.203.

(2) The CVSP must address each national program element even if there are no planned activities in a program area.

(c) *Resource allocation.* The first year of the CVSP must explain the rationale for the State's resource allocation decisions.

(d) *Specific activities.* The first year of the CVSP must have a narrative section that includes a description of how the CVSP supports:

(1) Activities aimed at removing impaired CMV drivers from the highways through adequate enforcement of restrictions on the use of alcohol and controlled substances and by ensuring ready roadside access to alcohol detection and measuring equipment;

(2) Activities aimed at providing an appropriate level of training to MCSAP personnel to recognize drivers impaired by alcohol or controlled substances;

(3) Criminal interdiction activities and appropriate strategies for carrying out those interdiction activities, including human trafficking, and interdiction activities affecting the transportation of controlled substances by any occupant of a CMV; and

(4) Activities to enforce registration requirements and to cooperate in the enforcement of financial responsibility requirements under § 392.9a and part 387 of this subchapter.

(e) *Performance objectives.* The first year of the CVSP must include performance objectives, strategies, and activities stated in quantifiable terms, that are to be achieved through the CVSP.

(f) *Monitoring.* The first year of the CVSP must include a description of the State's method for ongoing monitoring of the progress of the CVSP.

(g) *Budget.* The first year of the CVSP must include a budget for that year that describes the expenditures for allocable costs, such as personnel and related costs, equipment purchases, printing, information systems costs, and other eligible costs consistent with § 350.229.

(h) *List of MCSAP contacts.* The first year of the CVSP must include a list of MCSAP contacts.

(i) *Certification.* (1) For the first year of the CVSP, the Lead State Agency must certify that it has:

(i) Met all the MCSAP conditions in § 350.207; and

(ii) Completed the annual review required by § 350.303 and determined that the State maintains required compatibility.

(2) If a State CMV safety law or regulation, standard, or order is no longer compatible, the certifying official must explain the State's plan to address the discrepancy.

(3) A certification under this paragraph must reflect that the certifying official has authority to make the certification on behalf of the State.

(j) *New or amended laws.* For the first year of the CVSP, the Lead State Agency must submit to FMCSA a copy of any new or amended law or regulation affecting CMV safety that was enacted by the State since the last CVSP or annual update was submitted.

(k) *Further submissions.* For the first year of the CVSP, the Lead State Agency must also submit other information required, as described in the MCSAP application memorandum for that fiscal year.

§ 350.213 What must a State include for the second and third years of the CVSP?

(a) *General.* For the second and third years of the CVSP, a State must submit an annual update that complies with the MCSAP application memorandum and, at a minimum, must include program goals, certifications, other information revised since the prior year's CVSP, and the items listed in paragraphs (b) to (g) of this section.

(b) *Budget.* For the second and third years of the CVSP, the Lead State Agency must include a budget that supports the applicable fiscal year of the CVSP and describes the expenditures for allocable costs, such as personnel and related costs, equipment purchases, printing, information systems costs, and other eligible costs consistent with § 350.229.

(c) *Resource allocation.* For the second and third years of the CVSP, the Lead State Agency must explain the rationale for the State's resource allocation decisions.

(d) *List of MCSAP contacts.* For the second and third years of the CVSP, the Lead State Agency must include a list of MCSAP contacts.

(e) *Certification.* (1) For the second and third years of the CVSP, the Lead State Agency must certify that it has:

(i) Met all the MCSAP conditions in § 350.207; and

(ii) Completed the annual review required by § 350.303 and determined that State CMV safety laws and regulations, standards, and orders are compatible.

(2) If a State CMV safety law or regulation, standard, or order is no longer compatible, the certifying official must explain the State's plan to address the discrepancy.

(3) A certification under this paragraph must reflect that the certifying official has authority to make the certification on behalf of the State.

(f) *New or amended laws.* For the second and third years of the CVSP, the Lead State Agency must submit to FMCSA a copy of any new or amended law or regulation affecting CMV safety that the State enacted since the last CVSP or annual update was submitted.

(g) *Further submissions.* For the second and third years of the CVSP, the Lead State Agency must submit other information required, as described in the MCSAP application memorandum for that fiscal year.

§ 350.215 What response does a State receive to its CVSP or annual update?

(a) *First year of the CVSP.* (1) FMCSA will notify the Lead State Agency within 30 days after FMCSA begins its review of a State's first year of the CVSP, including the budget, whether FMCSA:

(i) Approves the CVSP; or

(ii) Withholds approval because the CVSP:

(A) Does not meet the requirements of this part; or

(B) Is not adequate to ensure effective enforcement of compatible safety laws and regulations, standards, and orders.

(2) If FMCSA withholds approval of the CVSP, FMCSA will give the Lead State Agency a written explanation of the reasons for withholding approval and allow the Lead State Agency to modify and resubmit the CVSP for approval.

(3) The Lead State Agency has 30 days from the date of the notice under paragraph (a)(2) of this section to modify and resubmit the CVSP.

(4) Failure to resubmit the modified CVSP may delay funding or jeopardize MCSAP eligibility.

(5) Final disapproval of a resubmitted CVSP will result in disqualification for MCSAP funding for that fiscal year.

(b) *Annual update for the second or third year of the CVSP.* (1) FMCSA will notify the Lead State Agency within 30 days after FMCSA begins its review of the State's annual update, including the budget, whether FMCSA:

(i) Approves the annual update; or

(ii) Withholds approval.

(2) If FMCSA withholds approval of the annual update, FMCSA will give the Lead State Agency a written explanation

of the reasons for withholding approval and allow the Lead State Agency to modify and resubmit the annual update for approval.

(3) The Lead State Agency will have 30 days from the date of the notice under paragraph (b)(2) of this section to modify and resubmit the annual update.

(4) Failure to resubmit the modified annual update may delay funding or jeopardize MCSAP eligibility.

(5) Final disapproval of a resubmitted annual update will result in disqualification for MCSAP funding for that fiscal year.

(c) *Judicial review.* Any State aggrieved by an adverse decision under this section may seek judicial review under 5 U.S.C. chapter 7.

§ 350.217 How are MCSAP funds allocated?

(a) *General.* Subject to the availability of funding, FMCSA must allocate MCSAP funds to grantees with approved CVSPs in accordance with this section.

(b) *Territories—excluding Puerto Rico.* (1) Not more than 0.49 percent of the MCSAP funds may be allocated in accordance with this paragraph among the Territories of American Samoa, the Commonwealth of the Northern Mariana Islands, Guam, and the Virgin Islands.

(2) Half of the MCSAP funds available under paragraph (b)(1) of this section will be divided equally among the Territories.

(3) The remaining MCSAP funds available under paragraph (b)(1) will be allocated among the Territories in a manner proportional to the Territories' populations, as reflected in the decennial census issued by the U.S. Census Bureau.

(4) The amounts calculated under paragraphs (b)(2) and (b)(3) of this section will be totaled for each Territory.

(5) The amounts calculated under paragraph (b)(4) of this section will be adjusted proportionally, based on population, to ensure that each Territory receives at least $350,000.

(c) *Border States.* (1) Not more than 11 percent of the MCSAP funds may be allocated in accordance with this paragraph among border States that maintain a border enforcement program.

(2) The shares for each border State will be calculated based on the number of CMV crossings at each United States port of entry, as determined by Bureau of Transportation Statistics, with each border State receiving:

(i) 1 share per 25,000 annual CMV crossings at each United States port of entry on the Mexican border, with a minimum of 8 shares for each port of entry; or

(ii) 1 share per 200,000 annual CMV crossings at each United States port of entry on the Canadian border, with a minimum of 0.25 share for each port of entry with more than 1,000 annual CMV crossings.

(3) The shares of all border States calculated under paragraph (c)(2) of this section will be totaled.

(4) Each individual border State's shares calculated under paragraph (c)(2) of this section will be divided by the total shares calculated in paragraph (c)(3) of this section.

(5) The percentages calculated in paragraph (c)(4) of this section will be adjusted proportionally to ensure that each border State receives at least 0.075 percent but no more than 55 percent of the total border allocation available under paragraph (c)(1) of this section.

(6) Each border State's percentage calculated in paragraph (c)(5) of this section will be multiplied by the total border allocation available under this paragraph to determine the dollar amount of the border State's allocation.

(7) To maintain eligibility for an allocation under this paragraph, a border State must maintain a border enforcement program, but may expend more or less than the amounts allocated under this paragraph for border activities. Failure to maintain a border enforcement program will result in forfeiture of all funds allocated under this paragraph, but will not affect the border State's allocation under paragraph (d) of this section.

(8) Allocations made under this paragraph are in addition to allocations made under paragraph (d) of this section.

(d) *States.* (1)(i) At least 88.51 percent of the MCSAP funds must be allocated in accordance with this paragraph among the eligible States, including Puerto Rico, but excluding American Samoa, the Commonwealth of the Northern Mariana Islands, Guam, and the Virgin Islands.

(ii) The amounts made available under paragraphs (b) and (c) of this section that are not allocated under those paragraphs must be added to the total amount to be allocated in accordance with this paragraph.

(iii) In the case of reallocation of funds under paragraph (c) of this section by a border State that no longer maintains a border enforcement program, no portion of the reallocated funds will be allocated to that border State.

(2) The amount available under paragraph (d)(1) of this section must be calculated based on each State's percentage of the national total for each of the following equally-weighted factors:

(i) National Highway System Road Length Miles, as reported by the Federal Highway Administration (FHWA);

(ii) All Vehicle Miles Traveled, as reported by the FHWA;

(iii) Population (annual census estimates), as issued by the U.S. Census Bureau;

(iv) Special Fuel Consumption, as reported by the FHWA; and

(v) Carrier Registrations, as determined by FMCSA, based on the physical State of the carrier, and calculated as the sum of interstate carriers and intrastate hazardous materials carriers.

(3) Each State's percentages calculated in paragraph (d)(2) of this section will be averaged.

(4) The percentage calculated in paragraph (d)(3) of this section will be adjusted proportionally to ensure that each State receives at least 0.44 percent but no more than 4.944 percent of the MCSAP funds available under paragraph (d)(1) of this section.

(5) Each State's percentage will be multiplied by the total MCSAP funds available under this paragraph to determine the dollar amount of the State's allocation.

(e) *Hold-harmless and cap.* (1) The dollar amounts calculated under paragraphs (c)(6) and (d)(5) of this section will be totaled and then divided by the total MCSAP funds to determine a State's percentage of the total MCSAP funds.

(2) Each State's total percentage of its MCSAP funding in the fiscal year immediately prior to the year for which funding is being allocated will be determined by dividing the State's dollar allocation by the overall MCSAP funding in that prior year.

(3) Proportional adjustments will be made to ensure that each State's percentage of MCSAP funds as calculated under subparagraph (1) of this paragraph will be no less than 97 percent or more than 105 percent of the State's percentage of MCSAP funds allocated for the prior fiscal year.

(f) *Withholding.* (1) Allocations made under this section are subject to withholdings under § 350.231(d).

(2) Minimum or maximum allocations described in paragraphs (b), (c), and (d) of this section are to be applied prior to any reduction under § 350.231(d).

(3) State MCSAP funds affected by § 350.231(d) will be allocated to the unaffected States in accordance with paragraph (d) of this section.

(4) Paragraph (e) of this section does not apply after any reduction under § 350.231(d).

§ 350.219 How are MCSAP funds awarded under a continuing resolution appropriations act or an extension of FMCSA's authorization?

In the event of a continuing resolution appropriations act or an extension of FMCSA's authorization, subject to the availability of funding, FMCSA may first issue grants to States that have the lowest percent of undelivered obligations of the previous Federal fiscal year's funding, or as otherwise determined by the Administrator.

§ 350.221 How long are MCSAP funds available to a State?

MCSAP funds obligated to a State will remain available for the Federal fiscal year that the funds are obligated and the next full Federal fiscal year.

§ 350.223 What are the Federal and State shares of costs incurred under MCSAP?

(a) *Federal share.* FMCSA will reimburse at least 85 percent of the eligible costs incurred under MCSAP.

(b) *Match.* (1) In-kind contributions are acceptable in meeting a State's matching share under MCSAP if they represent eligible costs, as established by 2 CFR parts 200 and 1201 and FMCSA policy.

(2) States may use amounts generated under the Unified Carrier Registration Agreement as part of the State's match required for MCSAP, provided the amounts are not applied to the MOE required under § 350.225 and are spent on eligible costs, as established by 2 CFR parts 200 and 1201 and FMCSA policy.

(c) *Waiver.* (1) The Administrator waives the requirement for the matching share under MCSAP for American Samoa, the Commonwealth of the Northern Mariana Islands, Guam, and the Virgin Islands.

(2) The Administrator reserves the right to reduce or waive the matching share under MCSAP for other States in any fiscal year:

(i) As announced in the MCSAP application memorandum; or

(ii) As determined by the Administrator on a case-by-case basis.

§ 350.225 What MOE must a State maintain to qualify for MCSAP funds?

(a) *General.* Subject to paragraph (e) of this section, a State must maintain an MOE each fiscal year equal to the average aggregate expenditure of the Lead State Agency for CMV safety programs eligible for funding under this part at a level at least equal to:

(1) The average level of that expenditure for the base period of fiscal years 2004 and 2005; or

(2) The level of expenditure in fiscal year 2020, as adjusted under section 5107 of the Fixing America's Surface Transportation (FAST) Act (Pub. L. 114–94, 129 Stat. 1312, 1532–1534 (2015)).

(b) *Calculation.* In determining a State's MOE, FMCSA:

(1) May allow the State to exclude State expenditures for Federally-sponsored demonstration and pilot CMV safety programs and strike forces;

(2) May allow the State to exclude expenditures for activities related to border enforcement and new entrant safety audits;

(3) May allow the State to use amounts generated under the Unified Carrier Registration Agreement, provided the amounts are not applied to the match required under § 350.223;

(4) Requires the State to exclude Federal funds; and

(5) Requires the State to exclude State matching funds.

(c) *Costs.* (1) A State must include all eligible costs associated with activities performed during the base period by the Lead State Agency that receives funds under this part.

(2) A State must include only those activities that meet the current requirements for funding eligibility under the grant program.

(d) *Waivers and modifications.* (1) If a State requests, FMCSA may waive or modify the State's obligation to meet its MOE for a fiscal year if FMCSA determines that the waiver or modification is reasonable, based on circumstances described by the State.

(2) Requests to waive or modify the State's obligation to meet its MOE must be submitted to FMCSA in writing.

(3) FMCSA will review the request and provide a response as soon as practicable, but no later than 120 days following receipt of the request.

(e) *Permanent adjustment.* After Federal fiscal year 2020, at the request of a State, FMCSA may make a permanent adjustment to reduce the State's MOE only if a State has new information unavailable to it during Federal fiscal year 2020.

§ 350.227 What activities are eligible for reimbursement under MCSAP?

(a) *General.* The primary activities eligible for reimbursement under MCSAP are:

(1) Activities that support the national program elements listed in § 350.203; and

(2) Sanitary food transportation inspections performed under 49 U.S.C. 5701.

(b) *Additional activities.* If part of the approved CVSP and accompanied by an appropriate North American Standard Inspection and inspection report, additional activities eligible for reimbursement are:

(1) Enforcement of CMV size and weight limitations at locations, other than fixed-weight facilities, where the weight of a CMV can significantly affect the safe operation of the vehicle, such as near steep grades or mountainous terrains, or at ports where intermodal shipping containers enter and leave the United States; and

(2) Detection of, and enforcement activities taken as a result of, criminal activity involving a CMV or any occupant of the vehicle, including the trafficking of human beings.

(c) *Traffic enforcement.* Documented enforcement of State traffic laws and regulations designed to promote the safe operation of CMVs, including documented enforcement of such laws and regulations relating to non-CMVs when necessary to promote the safe operation of CMVs, are eligible for reimbursement under MCSAP if:

(1) The number of motor carrier safety activities, including safety inspections, is maintained at a level at least equal to the average level of such activities conducted in the State in fiscal years 2004 and 2005; and

(2) The State does not use more than 10 percent of its MCSAP funds for enforcement activities relating to non-CMVs necessary to promote the safe operation of CMVs, unless the Administrator determines that a higher percentage will result in significant increases in CMV safety.

§ 350.229 What specific costs are eligible for reimbursement under MCSAP?

(a) *General.* FMCSA must establish criteria for activities eligible for reimbursement and publish those criteria in policy or the MCSAP application memorandum before the MCSAP application period.

(b) *Costs eligible for reimbursement.* All costs relating to activities eligible for reimbursement must be necessary, reasonable, allocable, and allowable under this subpart and 2 CFR parts 200 and 1201. The eligibility of specific costs for reimbursement is addressed in the MCSAP application memorandum and is subject to review and approval by FMCSA.

(c) *Ineligible costs.* MCSAP funds may not be used for the:

(1) Acquisition of real property or buildings; or

(2) Development, implementation, or maintenance of a State registry of medical examiners.

§ 350.231 What are the consequences for failure to meet MCSAP conditions?

(a) *General.* (1) If a State is not performing according to an approved CVSP or not adequately meeting the conditions set forth in § 350.207, the Administrator may issue a written notice of proposed determination of nonconformity to the chief executive of the State or the official designated in the CVSP.

(2) The notice will set forth the reasons for the proposed determination.

(b) *Response.* The State has 30 days from the date of the notice to reply. The reply must address the discrepancy cited in the notice and must provide documentation as requested.

(c) *Final Agency decision.* (1) After considering the State's reply, the Administrator makes a final decision.

(2) In the event the State fails to timely reply to a notice of proposed determination of nonconformity, the notice becomes the Administrator's final determination of nonconformity.

(d) *Consequences.* Any adverse decision will result in FMCSA:

(1) Withdrawing approval of the CVSP and withholding all MCSAP funds to the State; or

(2) Finding the State in noncompliance in lieu of withdrawing approval of the CVSP and withholding:

(i) Up to 5 percent of MCSAP funds during the fiscal year that FMCSA notifies the State of its noncompliance;

(ii) Up to 10 percent of MCSAP funds for the first full fiscal year of noncompliance;

(iii) Up to 25 percent of MCSAP funds for the second full fiscal year of noncompliance; and

(iv) Up to 50 percent of MCSAP funds for the third and any subsequent full fiscal year of noncompliance.

(e) *Judicial review.* Any State aggrieved by an adverse decision under this section may seek judicial review under 5 U.S.C. chapter 7.

Subpart C—MCSAP Required Compatibility Review

§ 350.301 What is the purpose of this subpart?

The purpose of this subpart is to assist States receiving MCSAP funds to address compatibility, including the availability of variances or exemptions allowed under § 350.305 or § 350.307, to:

(a) Promote adoption and enforcement of compatible safety laws and regulations, standards, and orders;

(b) Provide for a continuous review of safety laws and regulations, standards, and orders;

(c) Establish deadlines for States to achieve compatibility; and

(d) Provide States with a process for requesting exemptions for intrastate commerce.

§ 350.303 How does a State ensure compatibility?

(a) *General.* The Lead State Agency is responsible for reviewing and analyzing State safety laws and regulations, standards, and orders to ensure compatibility.

(b) *Compatibility deadline.* As soon as practicable, but no later than 3 years after the effective date of any new addition or amendment to the FMCSRs or HMRs, the State must amend its laws and regulations, standards, and orders to ensure compatibility.

(c) *State adoption of CMV law or regulation.* A State must submit to FMCSA a copy of any new or amended State safety law and regulation, standard, and order relating to CMV safety immediately after its enactment or issuance and with the State's next annual compatibility review.

(d) *Annual State compatibility review.* (1) A State must conduct a review of its laws and regulations, standards, and orders relating to CMV safety, including those of its political subdivisions, for compatibility and report in the CVSP, or annual update, as part of its application for funding under § 350.209 each fiscal year.

(2)(i) The State must demonstrate whether its laws and regulations, standards, and orders relating to CMV safety are identical to or have the same effect as a corresponding provision of the FMCSRs, are in addition to or more stringent than provisions of the FMCSRs, or are less stringent than a corresponding provision of the FMCSRs.

(ii) If a State's law or regulation, standard, or order relating to CMV safety is identical to or has the same effect as the corresponding provision of the FMCSRs, the State provision is enforceable.

(iii) If a State's law or regulation, standard, or order relating to CMV safety is in addition to or more stringent than the provisions of the FMCSRs, in order to be enforceable, the State must demonstrate that:

(A) The State provision has a safety benefit;

(B) It is compatible with the FMCSRs; and

(C) Enforcement would not cause an unreasonable burden on interstate commerce.

(iv) If a State's law or regulation, standard, or order relating to CMV safety is less stringent than the FMCSRs, it is not enforceable, unless it falls within the provisions of §§ 350.305 or 350.307.

(3) The State must demonstrate that its laws and regulations, standards, and orders relating to CMV safety applicable to both interstate and intrastate commerce are identical to the corresponding provision of the HMRs.

(4) The State's laws and regulations, standards, and orders relating to CMV safety reviewed for the commercial driver's license compliance report are excluded from the compatibility review.

(5) Definitions of words or terms in a State's laws and regulations, standards, and orders relating to CMV safety must be compatible with those in the FMCSRs and HMRs.

(e) *Reporting to FMCSA.* (1) The reporting required by paragraph (d) of this section, to be submitted with the CVSP or annual update, must include:

(i) A copy of any State law or regulation, standard, or order relating to CMV safety that was adopted or amended since the State's last report; and

(ii) A certification that states the annual review was performed and State laws and regulations, standards, and orders relating to CMV safety remain compatible, and that provides the name of the individual responsible for the annual review.

(2) If State laws and regulations, standards, and orders relating to CMV safety are no longer compatible, the certifying official must explain the State's plan to correct the discrepancy.

(f) *FMCSA response.* Not later than 10 days after FMCSA determines that a State law or regulation, standard, or order may not be enforced, FMCSA must give written notice of the decision to the State.

(g) *Waiver of determination.* (1) A State or any person may petition the Administrator for a waiver of a decision by the Administrator that a State law or regulation, standard, or order may not be enforced.

(2) Before deciding whether to grant or deny a waiver under this paragraph, the Administrator shall give the petitioner an opportunity for a hearing on the record.

(3) If the State or person demonstrates to the satisfaction of the Administrator that the waiver is consistent with the public interest and the safe operation of CMVs, the Administrator shall grant the waiver as expeditiously as practicable.

§ 350.305 What specific variances from the FMCSRs are allowed for State laws and regulations and not subject to Federal jurisdiction?

(a) *General.* (1) Except as otherwise provided in this section, a State may exempt a CMV from all or part of its laws or regulations applicable to intrastate commerce, if the gross vehicle weight rating, gross combination weight rating, gross vehicle weight, or gross combination weight does not equal or exceed 11,801 kilograms (26,001 pounds).

(2) A State may not exempt a CMV from laws or regulations under paragraph (a)(1) of this section if the vehicle:

(i) Transports hazardous materials requiring a placard; or

(ii) Is designed or used to transport 16 or more people, including the driver.

(b) *Non-permissible exemptions—Type of business operation.* (1) Subject to paragraph (b)(2) of this section and § 350.307, State laws and regulations applicable to intrastate commerce may not grant exemptions based on the type of transportation being performed (*e.g.,* for-hire carrier, private carrier).

(2) A State may retain those exemptions from its motor carrier safety laws and regulations that were in effect before April 1988, are still in effect, and apply to specific industries operating in intrastate commerce, provided the scope of the original exemption has not been amended.

(c) *Non-permissible exemptions—Distance.* (1) Subject to paragraph (c)(2) of this section, State laws and regulations applicable to intrastate commerce must not include exemptions based on the distance a motor carrier or driver operates from the work reporting location.

(2) Paragraph (c)(1) of this section does not apply to distance exemptions contained in the FMCSRs.

(d) *Hours of service.* State hours-of-service limitations applied to intrastate transportation may vary to the extent that they allow:

(1) A 12-hour driving limit, provided that a driver of a CMV is not permitted to drive after having been on duty more than 16 hours;

(2) Driving prohibitions for drivers who have been on duty 70 hours in 7 consecutive days or 80 hours in 8 consecutive days; or

(3) Extending the 100-air mile radius under § 395.1(e)(1)(i) to a 150-air mile radius.

(e) *Age of CMV driver.* All intrastate CMV drivers must be at least 18 years of age.

(f) *Driver physical conditions.* (1) Intrastate drivers who do not meet the physical qualification standards in § 391.41 of this chapter may continue to be qualified to operate a CMV in intrastate commerce if:

(i) The driver was qualified under existing State law or regulation at the time the State adopted physical qualification standards consistent with the Federal standards in § 391.41 of this chapter;

(ii) The otherwise non-qualifying medical or physical condition has not substantially worsened; and

(iii) No other non-qualifying medical or physical condition has developed.

(2) The State may adopt or continue programs granting variances to intrastate drivers with medical or physical conditions that would otherwise be non-qualifying under the State's equivalent of § 391.41 of this chapter if the variances are based on sound medical judgment combined with appropriate performance standards ensuring no adverse effect on safety.

(3) A State that has in effect physical qualification standards or variances continued in effect or adopted by the State under this paragraph for drivers operating CMVs in intrastate commerce has the option not to adopt laws and regulations that establish a separate registry of medical examiners trained and qualified to apply such physical qualification standards or variances.

(g) *Additional variances.* A State may apply to the Administrator for a variance from the FMCSRs not otherwise covered by this section for intrastate commerce. The variance will be granted only if the State satisfactorily demonstrates that the State safety law or regulation, standard, or order:

(1) Achieves substantially the same purpose as the similar Federal regulation;

(2) Does not apply to interstate commerce; and

(3) Is not likely to have an adverse impact on safety.

§ 350.307 How may a State obtain a new exemption for State laws and regulations for a specific industry involved in intrastate commerce?

FMCSA will only consider a State's request to exempt a specific industry from all or part of a State's laws or regulations applicable to intrastate commerce if the State submits adequate documentation containing information allowing FMCSA to evaluate:

(a) The type and scope of the industry exemption request, including the percentage of the industry it affects, number of vehicles, mileage traveled, and number of companies it involves;

(b) The type and scope of the requirement to which the exemption would apply;

(c) The safety performance of that specific industry (*e.g.,* crash frequency, rates, and comparative figures);

(d) Inspection information (*e.g.,* number of violations per inspection, and driver and vehicle out-of-service information);

(e) Other CMV safety regulations that other State agencies not participating in MCSAP enforce;

(f) The commodity the industry transports (*e.g.,* livestock or grain);

(g) Similar exemptions granted and the circumstances under which they were granted;

(h) The justification for the exemption; and

(i) Any identifiable effects on safety.

§ 350.309 What are the consequences if a State has provisions that are not compatible?

(a) *General.* To remain eligible for MCSAP funding, a State may not have in effect or enforce any State law or regulation, standard, or order relating to CMV safety in commerce that the Administrator finds not to be compatible.

(b) *Process.* FMCSA may initiate a proceeding to withdraw the current CVSP approval or withhold MCSAP funds in accordance with § 350.231:

(1) If a State enacts a law or regulation, standard, or order relating to CMV safety that is not compatible;

(2) If a State fails to adopt a new or amended FMCSR or HMR within 3 years of its effective date; or

(3) If FMCSA finds, based on its own initiative or on a petition of a State or any person, that a State law, regulation, or enforcement practice relating to CMV safety, in either interstate or intrastate commerce, is not compatible.

(c) *Hazardous materials.* Any decision regarding the compatibility of a State law or regulation, standard, or order relating to CMV safety with the HMRs that requires an interpretation will be referred to the Pipeline and Hazardous Materials Safety Administration of the United States Department of Transportation for interpretation before proceeding under § 350.231.

Subpart D—High Priority Program

§ 350.401 What is the High Priority Program?

The High Priority Program is a competitive financial assistance program available to States, local governments, Federally-recognized Indian tribes, other political jurisdictions, and other persons to carry out high priority activities and projects that augment motor carrier safety activities and projects. The High Priority Program also promotes the deployment and use of innovative technology by States for CMV information systems and networks. Under this program, the Administrator may make competitive grants to and enter into cooperative agreements with eligible entities to carry out high priority activities and projects that augment motor carrier safety activities and projects. The Administrator also may award grants to

States for projects planned in accordance with the Innovative Technology Deployment Program.

§ 350.403 What are the High Priority Program objectives?

FMCSA may use the High Priority Program funds to support, enrich, or evaluate CMV safety programs and to:

(a) Target unsafe driving of CMVs and non-CMVs in areas identified as high-risk crash corridors;

(b) Improve the safe and secure movement of hazardous materials;

(c) Improve safe transportation of goods and passengers in foreign commerce;

(d) Demonstrate new technologies to improve CMV safety;

(e) Support participation in PRISM and safety data improvement projects by Lead State Agencies:

(1) Before October 1, 2020, to achieve full participation in PRISM; and

(2) Beginning on October 1, 2020, or once full participation in PRISM is achieved, whichever is sooner, to conduct special initiatives or projects that exceed routine operations for participation;

(f) Support participation in PRISM and safety data improvement projects by entities other than Lead State Agencies;

(g) Support safety data improvement projects conducted by:

(1) Lead State Agencies for projects that exceed MCSAP safety data requirements; or

(2) Entities other than Lead State Agencies for projects that meet or exceed MCSAP safety data requirements;

(h) Advance the technological capability and promote the Innovative Technology Deployment of intelligent transportation system applications for CMV operations;

(i) Increase public awareness and education on CMV safety; and

(j) Otherwise improve CMV safety.

§ 350.405 What conditions must an applicant meet to qualify for High Priority Program funds?

(a) *States.* To qualify for High Priority Program funds, a State must:

(1) Participate in MCSAP under subpart B of this part; and

(2) Prepare a proposal that is responsive to the High Priority Program Notice of Funding Opportunity (NOFO).

(b) *Other applicants.* To qualify for High Priority Program funds, applicants other than States must, to the extent applicable:

(1) Prepare a proposal that is responsive to the NOFO;

(2) Except for Federally-recognized Indian tribes, coordinate the proposal with the Lead State Agency to ensure the proposal is consistent with State and national CMV safety program priorities;

(3) Certify that the applicant has the legal authority, resources, and trained and qualified personnel necessary to perform the functions specified in the proposal;

(4) Designate an individual who will be responsible for implementation, reporting, and administering the approved proposal and who will be the primary contact for the project;

(5) Agree to prepare and submit all reports required in connection with the proposal or other conditions of the grant or cooperative agreement;

(6) Agree to use the forms and reporting criteria required by the Lead State Agency or FMCSA to record work activities to be performed under the proposal;

(7) Certify that a political jurisdiction will impose sanctions for violations of CMV and driver laws and regulations that are consistent with those of the State; and

(8) Certify participation in national databases appropriate to the project.

§ 350.407 How and when does an eligible entity apply for High Priority Program funds?

FMCSA publishes application instructions and criteria for eligible activities to be funded under this subpart in a NOFO at least 30 days before the financial assistance program application period closes.

§ 350.409 What response will an applicant receive under the High Priority Program?

(a) *Approval.* If FMCSA awards a grant or cooperative agreement, the applicant will receive a grant agreement to execute.

(b) *Denial.* If FMCSA denies the grant or cooperative agreement, the applicant will receive a notice of denial.

§ 350.411 How long are High Priority Program funds available to a recipient?

(a) *General.* High Priority Program funds related to motor carrier safety activities under § 350.403 paragraphs (a) through (g), (i), and (j) obligated to a recipient are available for the rest of the fiscal year that the funds are obligated and the next 2 full fiscal years.

(b) *Innovative Technology Deployment.* High Priority Program funds for Innovative Technology Deployment activities under § 350.403(h) obligated to a State are available for the rest of the fiscal year that the funds were obligated and the next 4 full fiscal years.

§ 350.413 What are the Federal and recipient shares of costs incurred under the High Priority Program?

(a) *Federal share.* FMCSA will reimburse at least 85 percent of the eligible costs incurred under the High Priority Program.

(b) *Match.* In-kind contributions are acceptable in meeting the recipient's matching share under the High Priority Program if they represent eligible costs, as established by 2 CFR parts 200 and 1201 and FMCSA policy.

(c) *Waiver.* The Administrator reserves the right to reduce or waive the recipient's matching share in any fiscal year:

(1) As announced in the NOFO; or

(2) As determined by the Administrator on a case-by-case basis.

§ 350.415 What types of activities and projects are eligible for reimbursement under the High Priority Program?

Activities that fulfill the objectives in § 350.403 are eligible for reimbursement under the High Priority Program.

§ 350.417 What specific costs are eligible for reimbursement under the High Priority Program?

(a) *Costs eligible for reimbursement.* All costs relating to activities eligible for reimbursement must be necessary, reasonable, allocable, and allowable under this subpart and 2 CFR parts 200 and 1201. The eligibility of specific costs for reimbursement is addressed in the NOFO and is subject to review and approval by FMCSA

(b) *Ineligible costs.* High Priority Program funds may not be used for the:

(1) Acquisition of real property or buildings; or

(2) Development, implementation, or maintenance of a State registry of medical examiners.

PART 355—[Removed and Reserved]

■ 2. Under the authority of 49 U.S.C. 504 and 31101 *et seq.,* remove and reserve part 355, consisting of §§ 355.1 through 355.25 and appendix A to part 355.

PART 388—[Removed and Reserved]

■ 3. Under the authority of 49 U.S.C. 113 and 502, remove and reserve part 388, consisting of §§ 388.1 through 388.8.

Issued under authority delegated in 49 CFR 1.87.

Dated: August 12, 2019.

Raymond P. Martinez,

Administrator.

[FR Doc. 2019–17763 Filed 8–21–19; 8:45 am]

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Part VI

Department of Transportation

Federal Motor Carrier Safety Administration

49 CFR Part 395

Hours of Service of Drivers; Proposed Rule

DEPARTMENT OF TRANSPORTATION

Federal Motor Carrier Safety Administration

49 CFR Part 395

[Docket No. FMCSA–2018–0248]

RIN 2126–AC19

Hours of Service of Drivers

AGENCY: Federal Motor Carrier Safety Administration (FMCSA), DOT.

ACTION: Notice of proposed rulemaking (NPRM).

SUMMARY: FMCSA proposes amendments to its hours-of-service (HOS) requirements to provide greater flexibility for drivers subject to the HOS rules without adversely affecting safety. This would be accomplished by altering the short-haul exception to the record of duty status (RODS) requirement available to certain commercial motor vehicle (CMV) drivers, modifying the adverse driving conditions exception, increasing flexibility for the 30-minute break rule by requiring a break after 8 hours of driving time (instead of on-duty time) and allowing on-duty/not driving periods as qualifying breaks from driving, modifying the sleeper berth exception to allow a driver to spend a minimum of 7 hours in the berth combined with a minimum 2-hour off-duty period, provided the combined periods total 10 hours (rather than the current 8/2 split), and allowing one off-duty break that would pause a truck driver's 14-hour driving window.

DATES: Comments on this notice must be received on or before October 7, 2019.

ADDRESSES: You may submit comments identified by Docket Number FMCSA–2018–0248 using any of the following methods:

• *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the online instructions for submitting comments.

• *Mail:* Docket Management Facility, U.S. Department of Transportation, 1200 New Jersey Avenue SE, West Building, Ground Floor, Room W12–140, Washington, DC 20590–0001.

• *Hand Delivery or Courier:* 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.

• *Fax:* (202) 493–2251.

To avoid duplication, please use only one of these four methods. See the ''Public Participation and Request for Comments'' portion of the **SUPPLEMENTARY INFORMATION** section for instructions on submitting comments.

FOR FURTHER INFORMATION CONTACT: Mr. Richard Clemente, Federal Motor Carrier Safety Administration, 1200 New Jersey Avenue SE, Washington, DC 20590–0001, by telephone at (202) 366–4325, or email at *MCPSD@dot.gov.* If you have questions on viewing or submitting material to the docket, contact Docket Services, telephone (202) 366–9826.

SUPPLEMENTARY INFORMATION: This NPRM is organized as follows:

I. Public Participation and Request for Comments

A. Submitting Comments

If you submit a comment, please include the docket number for this NPRM (Docket No. FMCSA–2018–0248), indicate the specific section of this document to which each comment applies, 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. FMCSA recommends that you include your name and a mailing address, an email address, or a telephone number in the body of your document so that FMCSA can contact you if there are questions regarding your submission.

To submit your comment online, go to *http://www.regulations.gov,* put the docket number, FMCSA–2018–0248, in the keyword box, and click ''Search.'' When the new screen appears, click on the ''Comment Now!'' button and type your comment into the text box on the following screen. Choose whether you are submitting your comment as an individual or on behalf of a third party and then submit.

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.

FMCSA will consider all comments and material received during the comment period and may change this proposed rule based on your comments. FMCSA may issue a final rule at any time after the close of the comment period.

Confidential Business Information

Confidential Business Information (CBI) is commercial or financial information that is customarily not made available to the general public by the submitter. Under the Freedom of Information Act (5 U.S.C. 552), CBI is eligible for protection from public disclosure. If you have CBI that is relevant or responsive to this NPRM, it is important that you clearly designate the submitted comments as CBI. Accordingly, please mark each page of your submission as ''confidential'' or ''CBI.'' Submissions designated as CBI and meeting the definition noted above will not be placed in the public docket of this NPRM. Submissions containing CBI should be sent to Brian Dahlin, Chief, Regulatory Evaluation Division, Federal Motor Carrier Safety Administration, 1200 New Jersey Avenue SE, Washington, DC 20590–0001. Any commentary that FMCSA receives that is not specifically designated as CBI will be placed in the public docket for this rulemaking.

B. Viewing Comments and Documents

To view comments, as well as any documents mentioned in this preamble as being available in the docket, go to *http://www.regulations.gov.* Insert the docket number, FMCSA–2018–0248, in the keyword box, and click ''Search.'' Next, click the ''Open Docket Folder'' button and choose the document to review. 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 DOT West Building, 1200 New Jersey Avenue SE, Washington, DC 20590–0001, between 9 a.m. and 5 p.m. ET, Monday through Friday, except Federal holidays.

C. Privacy Act

In accordance with 5 U.S.C. 553(c), DOT solicits comments from the public to better inform its rulemaking process. DOT posts these comments, without edit, including any personal information the commenter provides, to *www.regulations.gov,* as described in the system of records notice (DOT/ALL–14 FDMS), which can be reviewed at *www.transportation.gov/privacy.*

D. Advance Notice of Proposed Rulemaking

Under section 5202 of the Fixing America's Surface Transportation Act (FAST Act), Public Law 114–94, 129 Stat. 1312, 1534–1535 (Dec. 4, 2015), if a regulatory proposal is likely to lead to the promulgation of a major rule, FMCSA is required to engage in negotiated rulemaking or publish an advance notice of proposed rulemaking (ANPRM), unless the Agency finds good cause that an ANPRM is impracticable, unnecessary, or contrary to the public interest (49 U.S.C. 31136(g)). FMCSA published an ANPRM on August 23, 2018 (83 FR 42631).[1]

II. Executive Summary

A. Purpose and Summary of the Regulatory Action

The implementation of the Electronic Logging Device (ELD) rule (80 FR 78292, Dec. 16, 2015) and the ELD's ability to increase compliance with HOS regulations for drivers of CMVs prompted numerous requests from Congress and from CMV operators for FMCSA to consider revising certain HOS provisions. FMCSA has received petitions from multiple stakeholders requesting relief from the HOS rules, including the Owner-Operator Independent Drivers Association (OOIDA) and *TruckerNation.org* (TruckerNation).[2] In response, FMCSA published the August 23, 2018 ANPRM, and held five public listening sessions. Today's NPRM addresses the areas of concern discussed in the petitions, listening sessions, and in the ANPRM.

B. Summary of Major Provisions

Today's proposal would improve efficiency by providing flexibility in five areas, allowing operators to shift their work and drive time to mitigate the effect of certain variables (*e.g.,* weather, traffic, detention times). Today's proposal would extend the maximum duty period allowed under the short-haul exception available to certain CMV drivers under 49 CFR 395.1(e)(1) from 12 hours to 14 hours. It would also extend, from a 100 to a 150 air-mile radius, the maximum distance from the work-reporting location in which drivers qualifying for the short-haul exception may operate. FMCSA also proposes to modify the exception for adverse driving conditions in § 395.1(b)(1) by allowing such conditions to extend the maximum driving windows under §§ 395.3(a)(2) and 395.5(a)(2) by up to 2 hours. The Agency proposes to make the 30-minute break requirement for property-carrying CMV drivers in § 395.3(a)(3)(ii) applicable only in situations where a driver has driven for a period of 8 hours without at least a 30-minute non-driving interruption. If required, a 30-minute break could be satisfied with a period, either off duty, in the sleeper berth, or on-duty not-driving. FMCSA also proposes to modify the sleeper-berth requirements to allow drivers to take their required 10 hours off duty in two periods, provided one off-duty period (whether in or out of the sleeper berth) is at least 2 hours long and the other involves at least 7 consecutive hours spent in the sleeper berth. Neither time period would count against the maximum 14-hour driving window in § 395.3(a)(2). Finally, FMCSA proposes to add a new option under § 395.3(a)(3)(iii) that would allow one off-duty break of at least 30 minutes, but not more than 3 hours, during the course of a driver's 14-hour driving window to extend that period for the length of the break, provided drivers take at least 10 consecutive hours off duty at the end of the work shift.

C. Costs and Benefits

The proposed rule would not result in any new costs for regulated entities. Instead, the proposed rule would result in increased flexibility for drivers and a quantified reduction in costs for motor carriers. The Federal Government would incur a one-time electronic Record of Duty Status (eRODS) software update cost of approximately $20,000. The proposed change to the 30-minute break requirement would result in a reduction in opportunity cost, or a cost savings, for motor carriers. FMCSA estimates that the 10-year motor carrier cost savings attributable to the proposed changes to the 30-minute break provision, net of the Federal Government costs, would total $2,348.9 million discounted at 3 percent, and $1,931 million discounted at 7 percent. These cost savings are $275.4 million annualized at a 3 percent discount rate and $274.9 million annualized at a 7 percent discount rate. All values are in 2017 dollars. There are a number of other potential cost savings of this proposed rule that FMCSA considered but, due to uncertainty about driver behavior, could not quantify on an industry level. These non-quantified cost savings include increased flexibility resulting from the extension of the duty day and the air-mile radius for those operating under the short-haul exception; the increased options for drivers to respond to adverse driving conditions during the course of their duty period; reducing the need to apply for exemptions from the 30-minute break requirement; and increased flexibility afforded to drivers, such as increased options with regard to on-duty and off-duty time resulting from changes to the 30-minute break requirement, the sleeper-berth provisions, and the new split duty period provision.

None of the proposals in today's NPRM would increase the maximum allowable driving time, but may change the number of hours driven, or hours worked during a given work shift. The flexibilities in this proposal are intended to allow drivers to shift their drive and work time to mitigate the impacts of certain variables (*e.g.,* weather, traffic, detention times) and to take breaks without penalty when they need rest; FMCSA does not anticipate that any of these time shifts would negatively impact drivers' health. As discussed later in this document,

[1] On August 21, 2018, FMCSA posted the ANPRM at *https://www.fmcsa.dot.gov/regulations/hours-service-advanced-notice-proposed-rulemaking.*

[2] These are available in the public docket for this rulemaking at: *https://www.regulations.gov/document?D=FMCSA-2018-0248-1210* and *https://www.regulations.gov/document?D=FMCSA-2018-0248-0003,* respectively.

FMCSA anticipates that individual drivers may see a change in their work hours (both driving and non-driving) or vehicle miles traveled (VMT), but that the proposed changes would not result in an increase in freight movement or aggregate VMT. Aggregate VMT is determined by many factors, including market demand for transportation. FMCSA does not anticipate that the changes proposed in this rule would stimulate demand in the freight market, but acknowledges that freight loads may shift from one carrier or driver to another. However, FMCSA also acknowledges that if drivers and motor carriers cannot meet the current freight demands, the proposed rule may enable them to rearrange their daily schedules such that additional loads could be moved, resulting in an increase in aggregate VMT. FMCSA considers this an unlikely outcome of the proposed rule, and after consideration of the potential impacts, has determined that this proposal would not adversely affect driver fatigue levels or safety.

TABLE 1—TODAY'S PROPOSAL

HOS provision	Existing requirement	Proposed changes	Potential impacts
Short Haul	Drivers using the short haul exception applicable to drivers requiring CDL may not be on duty more than 12 hours. Drivers using the short haul exception applicable to drivers requiring CDL may not drive beyond a 100 air-mile radius.	Would extend the maximum duty period allowed under the short-haul exception available to certain CMV drivers from 12 hours to 14 hours. Would also extend, from a 100 to a 150 air-mile radius, the maximum distance in which drivers qualifying for the short-haul exception may operate.	Increase the number of drivers able to take advantage of the short-haul exception. Shift work and drive time from long-haul to short-haul, or from driver to driver. No increase in freight movement or aggregate VMT.
Adverse Driving Conditions	A driver may drive and be permitted or required to drive a commercial motor vehicle for not more than 2 additional hours beyond the maximum time allowed. However, this does not currently extend the maximum "driving windows".	Would allow a driver to use the adverse driving conditions exception to extend the maximum "driving windows" by up to 2 hours. This proposed change would apply for both property-carrying (14-hour "driving window") and passenger-carrying (15-hour "driving window") operators.	Increase the use of the adverse driving condition provision. Allow driving later in the work day, potentially shifting forward the hours driven and VMT travelled Allow drivers time to park and wait out the adverse condition or driving slowly through it. This has the potential to decrease crash risk relative to current requirements, assuming drivers now drive through adverse conditions No increase in freight volume or aggregate VMT, as adverse conditions cannot be planned for in advance.
30 Minute Break	If more than 8 consecutive hours have passed since the last off-duty (or sleeper berth) period of at least half an hour, a driver must take an off-duty break of at least 30 minutes before driving.	Would make the 30-minute break requirement for property-carrying CMV drivers applicable only in situations where a driver has driven for a period of 8 hours without at least a 30-minute interruption. If required, a 30-minute break could be satisfied with a non-driving period, either off duty, in the sleeper berth, or on-duty not-driving.	Increase the on-duty/non-driving time by up-to 30 minutes, or allow drivers to reach their destination earlier. No anticipated fatigue effect because drivers continue to be constrained by the 11-hour driving limit and would continue to receive on-duty/non-driving breaks from the driving task. Additionally, drivers are enabled to take off-duty breaks when needed via the split-duty day provision. Minimal or no change to hours driven or VMT, as the current off-duty break only impacts these factors if the schedule required driving late within the 14-hour driving window.
Split-Sleeper Berth	A driver can use the sleeper berth to get the "equivalent of at least 10 consecutive hours off duty." To do this, the driver must spend at least 8 consecutive hours (but less than 10 consecutive hours) in the sleeper berth. This rest period does not count as part of the 14-hour limit. A second, separate rest period must be at least 2 (but less than 10) consecutive hours long. This period may be spent in the sleeper berth, off duty, or sleeper berth and off duty combined. It does count as part of the maximum 14-hour driving window.	Would modify the sleeper-berth requirements to allow drivers to take their required 10 hours off-duty in two periods, provided one off-duty period (whether in or out of the sleeper berth) is at least 2 hours long and the other involves at least 7 consecutive hours spent in the sleeper berth. Neither time period would count against the maximum 14-hour driving window.	Allow one hour to be shifted from the longer rest period to the shorter rest period. Potentially increase the use of sleeper berths because drivers using a berth have two additional hours to complete 11 hours of driving (by virtue of excluding the shorter rest period from the calculation of the 14-hour driving window). No anticipated effect on fatigue because aggregate drive limits and off-duty time remains unchanged. Hours driven or VMT may change for an individual driver on a given work shift (by increased use of the sleeper berth). Total hours driven or aggregate VMT would remain the same.

TABLE 1—TODAY'S PROPOSAL—Continued

HOS provision	Existing requirement	Proposed changes	Potential impacts
Split-Duty Provision	Once the duty period starts, it runs for 14 consecutive hours, after which the driver may not drive a commercial motor vehicle (CMV) again until having another 10 or more consecutive hours off duty. Nothing stops the running of the "14-hour clock" except a minimum 8-hour period in a sleeper berth.	Would add a new option for one off duty break of at least 30 minutes, but not more than 3 hours, during the course of a driver's 14-hour "driving window" to extend that period for the length of the break, provided that drivers take at least 10 consecutive hours off duty at the end of the work shift.	Allow up to 3 hours in an off-duty status to be excluded from the 14-hour driving window. Drivers could use this time to: Rest without the penalty of losing time in their driving window, avoid traffic via waiting in a parking lot and increase their VMT efficiency, or mitigate the effect on the 14-hour rule of long detention times by allowing driving later in the work shift. Minimizing the effect on fatigue because drivers could use the voluntary pause to rest, off-setting any potential effect of driving later in the work shift. Depending on the situation, hours driven and VMT on a given work shift could: Remain the same but shift within the driving window; decrease the hours driven by increasing VMT per hour; allow the driver to finish more work during the current work shift instead of postponing it to the next one.

III. Abbreviations and Acronyms

ANPRM Advance notice of proposed rulemaking
CAA Clean Air Act
CBI Confidential Business Information
CE Categorical Exclusion
CFR Code of Federal Regulations
CMV Commercial motor vehicle
DOT Department of Transportation
ELD Electronic logging device
E.O. Executive Order
eRODS Electronic record of duty status
FAST Act Fixing America's Surface Transportation Act
FMCSA Federal Motor Carrier Safety Administration
FMCSRs Federal Motor Carrier Safety Regulations
FR Federal Register
HOS Hours of service
NEPA National Environmental Policy Act
NPRM Notice of proposed rulemaking
OMB Office of Management and Budget
OOIDA Owner-Operator Independent Drivers Association
RODS Record of duty status
RFA Regulatory Flexibility Act
SCE Safety critical event
§ Section
Secretary Secretary of Transportation
SBREFA Small Business Regulatory Enforcement Fairness Act of 1996
TruckerNation TruckerNation.org
UDA United Drivers Association
U.S.C. United States Code
USTA United States Transportation Alliance

IV. Legal Basis for the Rulemaking

This NPRM is based on the authority derived from the Motor Carrier Act of 1935 (1935 Act) and the Motor Carrier Safety Act of 1984 (1984 Act). The 1935 Act, as amended, provides that "The Secretary of Transportation may prescribe requirements for—(1) qualifications and maximum hours of service of employees of, and safety of operation and equipment of, a motor carrier; and (2) qualifications and maximum hours of service of employees of, and standards of equipment of, a motor private carrier, when needed to promote safety of operation." (49 U.S.C. 31502(b)(1), (2)).

The HOS regulations proposed below concern the "maximum hours of service of employees" of both motor carriers and motor private carriers, as authorized by the 1935 Act.

This NPRM also is based on the authority of the 1984 Act, as amended, which provides broad concurrent authority to regulate drivers, motor carriers, and vehicle equipment. It requires the Secretary of Transportation to "prescribe regulations on commercial motor vehicle safety. The regulations shall prescribe minimum safety standards for commercial motor vehicles." The 1984 Act also requires that: "At a minimum, the regulations shall ensure that—(1) commercial motor vehicles are maintained, equipped, loaded, and operated safely; (2) the responsibilities imposed on operators of commercial motor vehicles do not impair their ability to operate the vehicles safely; (3) the physical condition of operators of commercial motor vehicles is adequate to enable them to operate the vehicles safely . . . ; (4) the operation of commercial motor vehicles does not have a deleterious effect on the physical condition of the operators; and (5) an operator of a commercial motor vehicle is not coerced by a motor carrier, shipper, receiver, or transportation intermediary to operate a commercial motor vehicle in violation of a regulation promulgated under this section. . ." (49 U.S.C. 31136(a)(1)–(5)).

This NPRM is based specifically on section 31136(a)(2) and, less directly, sections 31136(a)(3) and (4). To the extent section 31136(a)(1) focuses on the mechanical condition of CMVs, that subject is not included in this rulemaking. However, as the phrase "operated safely" in paragraph (a)(1) encompasses safe driving practices, this proposed rule also addresses that mandate. To the extent section 31136(a)(4) focuses on the health of the driver, the Agency addresses that issue under the section *Driver Health Comments,* below. As for section 31136(a)(5), FMCSA anticipates the added flexibility of the NPRM would not increase the risk of coercion related to HOS rules.

Before prescribing regulations under these authorities, FMCSA must consider their "costs and benefits" (49 U.S.C. 31136(c)(2)(A) and 31502(d)). Those factors are addressed below.

V. Background

The HOS regulations in effect until 2003 were promulgated pursuant to the Motor Carrier Act of 1935 and then reissued under the Motor Carrier Safety Act of 1984, along with the rest of the Federal Motor Carrier Safety Regulations (53 FR 18042, May 19, 1988). The HOS rules are codified at Part 395 of Title 49 CFR. These regulations were originally promulgated in 1937, revised several times before 1940, and then left largely unchanged until 1962. They required 8 hours off between tours of duty work shifts that could be of indeterminate length, lasting until the driver accumulated a total of 15 hours on duty. Concerns that these regulations were outdated and contributed to driver fatigue led to an effort to incorporate new knowledge about fatigue and rest, and their effects on safety.

Revisions to the HOS regulations were proposed in an NPRM published in the May 2, 2000, **Federal Register** (65 FR 25540). Following reviews of the comments to the docket and additional study, FMCSA developed a revised set of HOS regulations. The final rule (the

''2003 HOS rule'') was promulgated on April 28, 2003 (68 FR 22456), and took effect on January 4, 2004. A regulatory impact analysis (RIA) comparing the costs, benefits, and impacts of this rule relative to the previous rule and several alternatives was prepared in accordance with the requirements of Executive Order 12866. That RIA, which is available in the HOS rule docket, showed that full compliance with the 2003 HOS rule could both save lives and increase productivity compared to full compliance with the rule then in existence. Much of the safety advantage of the 2003 HOS rule was shown to come from the mandate for at least 10 hours off after each tour of duty, and from helping to keep drivers on a regular 24-hour cycle.

After the 2003 HOS rule had been in effect for several months, it was vacated by a Federal appellate court. On July 16, 2004, the United States Court of Appeals for the D.C. Circuit held that FMCSA had not considered effects of the changes in the HOS rule on drivers' health, as required by 49 U.S.C. 31136(a)(4). *Public Citizen et al.* v. *FMCSA,* 374 F.3d 1209 (D.C. Cir. 2004). Additionally, the court expressed concerns about several areas of the rule, including:

▪ Permission to drive 11 hours in a tour of duty, rather than 10;

▪ Allowing more hours on duty in a given week, as a result of the restart provisions;

▪ Allowing drivers to split their off-duty periods into two parts through the use of sleeper berths; and

▪ Lack of consideration of the use of electronic on-board recorders.

In response to the court's action, Congress reinstated the 2003 HOS rule for a year, to give FMCSA a chance to revisit the issues cited by the court. A new HOS rule was published on August 25, 2005, retaining most of the provisions of the 2003 rule but requiring drivers using sleeper berths to spend 8 consecutive hours in the berth and take an additional 2 hours either off duty or in the sleeper berth; this 2 hour period must be counted against the 14 hour driving window (70 FR 49978). This established one ''core'' 8-hour period of sleep, as called for by various scientific research studies, yet provided the driver flexibility in use of the shorter off-duty period. Drivers, however, objected to 8 hours in the sleeper berth, and, in general, to the lack of flexibility provided by the sleeper-berth provisions and 14-hour rule. The 2005 HOS rule also provided relief to some short-haul operations using lighter trucks.

Public Citizen and others challenged the August 2005 rule on several grounds. On July 24, 2007, the D.C. Circuit ruled in favor of Public Citizen and vacated the 11-hour driving time and 34-hour restart provisions (*Owner-Operator Independent Drivers Association. Inc.* v. *FMCSA,* 494 F.3d 188 (D.C. Cir. 2007)). The court concluded that FMCSA had violated the Administrative Procedure Act's requirements by failing to provide an opportunity for public comment on the methodology of the Agency's operator-fatigue model, which FMCSA had used to assess the costs and benefits of alternative changes to the 2005 HOS rule. In particular, the court found that the Agency had not adequately disclosed and made available for review the modifications it had made to the 2003 operator-fatigue model to account for time-on-task (TOT) effects in the 2005 analysis. The court concluded that FMCSA's methodology had not remained constant from 2003 to 2005 because the TOT element in the model was new and constituted the Agency's response to a defect in its previous methodology. The court concluded that the Agency violated the Administrative Procedure Act because it failed to give interested parties an opportunity to comment on the methodology of the crash risk model that the Agency used to justify an increase in the maximum number of daily and weekly hours that CMV drivers may drive and work. The court listed several elements of the way FMCSA calculated the impact of TOT that it held could not have been anticipated and that were not disclosed in time for public comment upon them. Turning to Public Citizen's second argument, the court also found that FMCSA had failed to provide an adequate explanation for certain critical elements in the model's methodology. In vacating the increase in the daily driving limit from 10 to 11 hours, the court found arbitrary and capricious what it described as FMCSA's ''complete lack of explanation for an important step in the Agency's analysis,'' the manner in which it had plotted crash risk as a function of TOT per hours of driving. The court also found that FMCSA had failed to provide an explanation for its method for calculating risk relative to average driving hours in determining its estimate of the increased risk of driving in the 11th hour. In vacating the 34-hour restart provision, the court found that FMCSA also had provided no explanation for the failure of its operator-fatigue model to account for cumulative fatigue due to the increased weekly driving and working hours permitted by the 34-hour restart provision.

In an order filed on September 28, 2007, the court granted in part FMCSA's motion for a stay of the mandate. The court directed that issuance of the mandate be withheld until December 27, 2007.

On December 17, 2007, FMCSA published an Interim Final Rule (IFR) amending the Federal Motor Carrier Safety Regulations, effective December 27, 2007, to allow CMV drivers up to 11 hours of driving time within a 14-hour, non-extendable window from the start of the workday, following 10 consecutive hours off duty (72 FR 71247). The IFR also allowed motor carriers and drivers to restart calculations of the weekly on-duty time limits after the driver has at least 34 consecutive hours off duty. FMCSA explained that the IFR reinstating the 11-hour limit and the 34-hour restart was necessary to prevent disruption to enforcement and compliance with the HOS rule when the court's stay expired, and would ensure that a familiar and uniform set of national rules governed motor carrier transportation. Public Citizen immediately requested the D.C. Circuit to invalidate the IFR. However, on January 23, 2008, the court issued a per curiam order denying Public Citizen's request. On November 19, 2008, FMCSA adopted the provisions of the IFR as a final rule (73 FR 69567).

On December 18, 2008, Advocates for Highway and Automotive Safety, Public Citizen, the International Brotherhood of Teamsters, and the Truck Safety Coalition (hereafter referred to as ''HOS petitioners'') petitioned FMCSA to reconsider the research and crash data justifying the 11-hour driving rule and the 34-hour restart provision. FMCSA denied the petition on January 16, 2009. On March 9, 2009, the HOS petitioners filed a petition for judicial review of the 2008 rule in the D.C. Circuit and, on August 27, 2009, filed their opening brief. However, in October 2009, DOT, FMCSA, and the HOS petitioners reached a settlement agreement. DOT and FMCSA agreed to submit a new HOS NPRM to the Office of Management and Budget (OMB) by July 26, 2010, and to publish a final rule by July 26, 2011. Subsequently, FMCSA, DOT and the HOS petitioners agreed to publish the final rule on October 28, 2011. The parties filed a joint motion to hold the 2009 lawsuit in abeyance pending publication of the NPRM; the court later accepted that motion.

In 2011, after presenting various alternatives, FMCSA revised some aspects of the HOS regulations and maintained other provisions. The 2011

Final Rule could be divided into ''daily'' and ''multi-day'' provisions, which can be expressed as follows:

▪ Drivers of property-carrying CMVs must take at least 30 minutes off-duty no later than 8 hours after coming on duty if they wish to continue driving after the 8th hour.

▪ Drivers of property-carrying CMVs may drive up to 11 hours following an off-duty period of at least 10 consecutive hours.

▪ Drivers of property-carrying CMVs may not drive after the end of the 14th hour after coming on duty following an off-duty period of at least 10 consecutive hours.

▪ Drivers of property-carrying CMVs may obtain the equivalent of 10 consecutive hours off duty if they have a period of at least 8 hours in the sleeper berth and a second period of at least 2 hours either off duty or in the sleeper berth. Compliance is calculated from the end of the first two periods.

▪ For Drivers of property-carrying CMVs, any period of 7 or 8 consecutive days can begin following a period of at least 34 consecutive hours off duty provided it included 2 periods between 1:00 a.m. and 5:00 a.m.

Several categories of motor carriers and drivers are exempt from parts of the HOS regulations or from the entire HOS regulation under the National Highway System (NHS) Designation Act of 1995 (referred to as the NHS Act) and other statutes.

Public Citizen, the American Trucking Associations, and others challenged the 2011 final rule on several grounds. On August 2, 2013, the D.C. Circuit vacated the requirement for short-haul drivers to take a 30-minute break, but upheld the 2011 rule in all other respects. *American Trucking Associations, Inc.,* v. *Federal Motor Carrier Safety Administration,* 724 F.3d 243 (2013).

The 2015 and 2016 DOT Appropriations Acts and the Further Continuing and Security Assistance Appropriations Act, 2017

Sec. 133 of the Consolidated and Further Continuing Appropriations Act, 2015, Public Law 113–235, Div. K, Title I, sec. 133, 128 Stat. 2130, 2711–2713 (Dec. 16, 2014) suspended the 2011 restart provisions, which required 2 consecutive off-duty periods between 1:00 and 5:00 a.m. and allowed only one restart per week; temporarily reinstated the pre-2011 restart rule; and required a study of the effectiveness of the new rule. Sec. 133 of the Consolidated Appropriations Act, 2016, Public Law 114–113, Div. L., Title I, sec. 133, 129 Stat. 2242, 2850 (Dec. 18, 2015) made it clear that the 2011 restart provisions would have no effect unless the study required by the 2015 DOT Appropriations Act showed that those provisions had statistically significant benefits compared to the pre-2011 restart rule; this Act also expanded the factors that the Agency was required to evaluate by including driver health and longevity. The Further Continuing and Security Assistance Appropriations Act, 2017, Public Law 114–254, Div. A, sec. 180, 130 Stat. 1005, 1016 (Dec. 10, 2016), replaced Sec. 133 of the 2016 DOT Appropriations Act in its entirety to correct an error and ensure that the pre-2011 restart rule would be reinstated by operation of law [3] unless the study required by the 2015 DOT Appropriations Act showed that the 2011 restart rule had statistically significant benefits compared to the pre-2011 restart rule. DOT concluded that the study failed to find statistically significant benefits, and the Office of Inspector General confirmed that conclusion in a report to Congress. The pre-2011 restart rule was therefore reinstated by operation of law.

Executive Order (E.O.) 13771, Reducing Regulation and Controlling Regulatory Costs, issued on January 30, 2017, directs executive agencies of the Federal government to ''manage the costs associated with the governmental imposition of private expenditures required to comply with Federal regulations'' (82 FR 9339, Feb. 3, 2017). The E.O. 13777, Enforcing the Regulatory Reform Agenda, issued on February 24, 2017, sets forth regulatory reform initiatives and policies to ''alleviate unnecessary regulatory burdens placed on the American people'' (82 FR 12285, Mar. 1, 2017). In accordance with those Presidential directives and based upon its experience and expertise, FMCSA reviewed the driver HOS regulations to determine if revisions might alleviate unnecessary regulatory burdens while maintaining CMV driver safety and health and motor carrier safety, as well as the safety of the public. On May 17, 2018, 5 months after the implementation of the ELD mandate mentioned above, Administrator Martinez received a letter signed by 30 Senators (available in the docket for this rulemaking) expressing support for greater flexibility in the HOS regulations.

The DOT has longstanding processes to periodically review regulations and other agency actions.[4] If appropriate, FMCSA will revise regulations to ensure that they continue to meet the needs for which they were originally designed and that they remain justified, in accordance with applicable executive orders.[5] On October 2, 2017, DOT published a Notification of Regulatory Review, stating that it was reviewing its ''existing regulations and other agency actions to evaluate their continued necessity, determine whether they are crafted effectively to solve current problems, and evaluate whether they potentially burden the development or use of domestically produced energy resources'' (82 FR 45750). As part of these reviews, DOT sought public comment on existing rules that are good candidates for repeal, replacement, suspension, or modification. The HOS regulations and ELDs were the most common substantive topics discussed in response to the DOT Notification of Regulatory Review. The HOS regulations were identified as an area for potential modifications both as a result of the public comments received and due to changes in tracking HOS compliance through implementation of the ELD rulemaking. The accuracy of the electronic data provided to enforcement is much higher than the information that was previously provided on paper. While the ELD rule did not change the HOS rules, the accurate recording of driving time by ELDs highlighted the rigidity of HOS provisions and the practical ramifications drivers faced.

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[3] Because this study failed to establish a statistically significant improvement in the initial factors required by Congress, evaluation of the additional factors added by Congress became moot.

[4] Section 610 of the Regulatory Flexibility Act requires Federal Agencies to periodically conduct reviews of rules that: (1) Have been published within the last 10 years; and (2) have a ''significant economic impact on a substantial number of small entities.'' Agencies publish in the **Federal Register** the results of any such rules they reviewed during the past year, as well as a list of rules to be reviewed the next year.

[5] *See* Exec. Order No. 13777, sec. 1, (Mar. 1, 2017, 82 FR 12285) (''It is the policy of the United States to alleviate unnecessary regulatory burdens placed on the American people or . . .''); E.O. 13610 (May 14, 2012, 77 FR 28469) (requiring agencies to conduct retrospective analyses of existing rules to determine whether they remain justified); E.O. 13563, sec. 6(b) (Jan. 21, 2011, 76 FR 3821) (requiring agencies to submit a 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''); E.O. 12866, sec. 5, (Sept. 30, 1993, pub. 58 FR 51735) (requiring each agency to ''review its existing significant regulations to determine whether any such regulations should be modified or eliminated so as to make the agency's regulatory program more effective in achieving the regulatory objectives, less burdensome, or in greater alignment with the President's priorities and the principles set forth in this Executive order'').

The August 23, 2018, ANPRM (83 FR 42631) requested public comment on four areas pertaining to the HOS rules: Short-haul operations, the adverse driving conditions exception, the 30-minute break requirement, and the sleeper-berth provision. The ANPRM also sought public comment on two petitions for rulemaking relating to the HOS rules, one from OOIDA and one from TruckerNation.

OOIDA Petition for Rulemaking

On February 13, 2018, OOIDA petitioned FMCSA to amend the HOS rules to allow drivers to take an off-duty rest break for up to 3 consecutive hours once per 14-hour driving window. OOIDA requested that the rest break stop the 14-hour clock and extend the latest time a driver could drive after coming on duty. However, drivers would still be limited to 11 hours of driving time and required to have at least 10 consecutive hours off duty before the start of the next work shift.

OOIDA's petition also included a request that the Agency eliminate the 30-minute break requirement. The organization explained that there are many operational situations where the 30-minute break requires drivers to stop when they do not feel tired.

TruckerNation Petition for Rulemaking

On May 10, 2018, TruckerNation petitioned the Agency to revise the prohibition against driving after the 14th hour following the beginning of the work shift. As an alternative, the organization requested that the Agency prohibit driving after the driver has accumulated 14-hours of on-duty time.

In addition, TruckerNation requested that FMCSA allow drivers to use multiple off-duty periods of 3 hours or longer in lieu of having 10 consecutive hours off-duty and eliminate the 30-minute break requirement.

Additional Petitions for Rulemaking

Two additional petitions for rulemaking were received; one from the United States Transportation Alliance (USTA) and one from the United Drivers Association (UDA).[6] The petitions were not discussed in the ANPRM due to the timing of receipt; however, they were reviewed and considered in the development of this NPRM.

The USTA petition proposed an HOS rule that would prohibit driving after 80 hours on duty in a 7-day period (instead of the 60-hour limit in §§ 395.3(b)(1) and 395.1(b)(1), and allow a 14-hour day for driving or other work duties. The drivers' remaining 10 hours would include 2 hours of off-duty time, and 8 hours of sleeper-berth time could be split into two segments, with a minimum of 2 hours per segment. The 80-hour clock would be reset by 24 hours off duty. The petition is included in the docket referenced at the beginning of this notice.

The UDA proposal maintained the 14/10 HOS rule; however, the 10 hours off duty could be split into two 5-hour sleeper-berth periods. The weekly on-duty time, after which driving would be prohibited, would be 80 hours in an 8-day period, with a 24-hour restart, similar to that proposed by USTA. The petition is included in the docket referenced at the beginning of this notice.

Public Listening Sessions

FMCSA held a series of public listening sessions following the release of the ANPRM. These were held in Dallas, Texas, on August 24, 2018; Reno, Nevada, on September 24, 2018; Joplin, Missouri, on September 28, 2018; Orlando, Florida, on October 2, 2018; and Washington, DC, on October 10, 2018.[7] Transcripts of those listening sessions are available in the public docket for the rulemaking, and the sessions are available to stream at *https://www.fmcsa.dot.gov/mission/policy/public-listening-sessions-hours-service.*

VI. Overview of Comments to the ANPRM

The ANPRM asked a series of questions about the four topics and the two petitions for rulemaking mentioned above, but did not propose any regulatory changes. FMCSA appreciates the comments submitted. The Agency requests that individuals responding to the ANPRM comment again in the context of today's NPRM.

As noted above, FMCSA held a series of listening sessions. Comments provided at those sessions have been considered in the development of section VII of this preamble, ''Discussion of the Proposed Rulemaking.''

In addition, the Agency received more than 5,200 comments on the ANPRM, including over 1,000 from CMV drivers. Commenters also included trade associations and industry groups, law enforcement agencies, safety advocacy groups, motor carriers, and governmental entities. The majority of ANPRM commenters supported changes to the HOS rules. Of the issues addressed in the ANPRM, most comments were addressed to the 30-minute break and the sleeper-berth issues. Drivers and individuals supported other issues raised in the ANPRM or petitions, especially extending the short-haul duty period from 12 hours to 14 hours. Many drivers and individual commenters were in favor of extending the maximum driving window by 2 hours in the event of adverse driving conditions. A few driver and individual commenters requested that the definition of ''adverse driving conditions'' be changed or clarified, to make understanding and compliance easier for users and enforcement personnel. A large number of CMV drivers, trade associations, and industry groups supported the elimination of the 30-minute break rule. However, safety advocacy groups opposed changes to the rule due to the lack of research on its safety impacts.

Many commenters favored expanding the sleeper-berth options to 5/5, 6/4, or 7/3. In addition, they would like to see both qualifying sleeper-berth periods stop the 14-hour driving window. Most of the trade associations that commented on short-haul operations approved of an expansion of the 12-hour driving window to 14 hours. Trade associations, and other commenters were also in favor of expanding the adverse driving condition provision to extend the duty period during which driving is allowed.

Generally, law enforcement and safety advocacy organizations opposed changes to the current HOS rules. These comments often referenced safety research identified in prior HOS rulemakings. The relevant studies are discussed in the sections below.

Most motor carriers that responded were in favor of all the suggested changes in the ANPRM. Most of the elected officials supported flexibility for drivers.

Other Comments to the ANPRM

In addition to the four central topics covered by the ANPRM and the two petitions, FMCSA received comments and suggestions related to other aspects of the HOS rules.

Driver Health Comments. A number of commenters critiqued the current HOS rules, stating that the rules negatively impact their health. However, safety advocacy groups stated that changes to existing HOS would negatively impact health. The driver

[6] These petitions are available at *https://www.regulations.gov/document?D=FMCSA-2018-0248-2550* and *https://www.regulations.gov/document?D=FMCSA-2018-0248-0342.*

[7] Listening sessions were announced in the **Federal Register** at 83 FR 42631, August 23, 2018; 83 FR 45204, September 6, 2018; 83 FR 47589, September 20, 2018; 83 FR 48787, September 27, 2018, and 83 FR 50055, October 4, 2018. The listening session scheduled for September 14, 2018 in Washington, DC was canceled and rescheduled.

sleep apnea group, Truckers for a Cause provided research by Dr. Mona Shattell (3 studies cited in comments) on CMV driver mental health issues that showed stress caused by the ''14-hour clock'' to be a large cause and potential health issues. HOS changes which reduce this documented stress inducer would reduce driver stress and resulting health issues. They go on to add that fatigue research (Williamson 2001) has clearly shown that there is a fatigue impairment which greatly increases with being awake more than 14 hours. This impairment is equivalent to blood alcohol content (BAC) of .02% at 15 hours and .04% at 16 hours. With .04% being legally intoxicated for a CMV driver it is reasonable that HOS regulations should restrict driving beyond a 14 hour work day limit unless there has been reasonable restorative rest. The American Academy of Sleep Medicine focuses almost exclusively on the issue of fatigue—as it relates to driver health and some of the proposed changes. According to AASM, ''these proposed changes would occur in the setting of other common sleep disorders, such as sleep apnea, shift work sleep disorder, or insufficient sleep, which increase the risk of drowsy driving . . . . Given the large body of evidence that sleepiness plays a significant role in crashes, we recommend against the proposed relaxation of the present rules, in the best interest of not only commercial drivers' health and safety, but also public safety as a whole.'' The International Brotherhood of Teamsters commented on the 12-hour short haul provision, stating that several studies show that the majority of work-related injuries occurring among truck drivers result from non-driving work activities. When researchers further investigated these findings, they found that the types of injuries experienced by truck drivers varied by industry sector but were generally associated with falling from heights, trips, slips, falls, and overexertion due to manual materials handling. Drivers who are involved in short haul operations experienced occupational injuries primarily while performing three activities: (1) Operating the truck; (2) lifting/cranking; and (3) maneuvering into/out of truck cab . . . . Short-haul drivers will experience increased fatigue as a result of having to work an expanded number of hours and concurrently experience more fatigue-related occupational injuries and crashes . . . .'' In addition, researcher collected data on the driver's heart rates to estimate metabolic output and determined that such drivers worked in a job that required a high level of energy.'' FMCSA has considered these comments, and, as discussed in the Health Impacts section later in this document, proposes to find that the provisions of this NPRM would not adversely affect driver health.

Economic and Research Data, Surveys, and Studies Submitted to the Docket. A number of research papers, surveys, and studies, along with related data, were submitted to the docket. The relevant submissions, including those made by OOIDA, the American Transportation Research Institute (ATRI), and the Insurance Institute for Highway Safety (IIHS), have been considered and are discussed in the draft RIA for this NPRM, available in the docket. Other studies had been considered in previous rulemakings, were out of scope for this rule, or had data limitations.

Scope of Rulemaking. A number of the commenters raised HOS issues beyond the topics identified in the ANPRM. Many commenters believe driver pay is too low for the responsibilities they hold and stated that if drivers were paid more or compensated by the hour, there would be less of a need for HOS regulations. Other commenters stated that third parties such as shippers and receivers, who are not generally subject to FMCSA regulations, pressure drivers to violate HOS rules or create an environment where drivers are unable to take advantage of the work time allowed.

A number of commenters requested that FMCSA consider adopting the Canadian HOS standards.[8] These comments were either general or focused on specific limits, rest breaks, and sleeper-berth provisions.

VII. Discussion of the Proposed Rulemaking

A. Short-Haul Operations

Current Regulation

Currently, under 49 CFR 395.1(e)(1), certain CMV drivers do not have to prepare RODS, use an ELD, maintain supporting documents, or take a 30-minute break after 8 hours of duty if they meet certain conditions, including a return to their normal work reporting location and release from work within 12 consecutive hours after their starting time. Truck drivers operating under this provision are permitted a 12-hour work day in which to drive up to 11 total hours. Passenger-carrier drivers are allowed 10 hours of driving in a 12-hour workday. Under this short-haul exception, drivers also must operate within a 100 air-mile radius of their work reporting location. The motor carrier must maintain time records reflecting certain information. Specifically, the motor carrier that employs the driver and utilizes this exception must maintain and retain for a period of 6 months accurate and true time records showing: The time the driver reports for duty each day; the total number of hours the driver is on duty each day; the time the driver is released from duty each day; and the total time for the preceding 7 days in accordance with 49 CFR 395.8(j)(2) for drivers used for the first time or intermittently.

Under 49 CFR 395.3(a)(2)–(3), other property-carrying CMV drivers not utilizing the short-haul exception have a 14-hour window in which to drive up to 11 hours. Unless otherwise excepted, however, these drivers must maintain RODS, generally using an ELD. Drivers qualifying for the 49 CFR 395.1(e)(1) exception have the option to use the 14- or 15-hour driving window applicable to property and passenger carriers, respectively, under §§ 395.3 or 395.5, to fulfill the needs of the employer on a given day. However, drivers doing so would lose the benefits of the short-haul exception and be required to prepare RODS for those days.

Current Exemptions to the Short-Haul Operation Provision

Among other things, section 5521 of the FAST Act requires that the Agency allow drivers of ready-mixed concrete delivery trucks to return to the normal work reporting location within 14 hours of coming on duty rather than 12-hours of coming on duty. FMCSA implemented this provision on July 22, 2016 (81 FR 47714). FMCSA also has granted applications for exemptions, allowing an extension of the duty period in the short-haul provision from 12 to 14 hours, to the following entities: Waste Management Holdings, Inc., October 25, 2018 (83 FR 53940); American Concrete Pumping Association, November 1, 2018 (83 FR 54975); and National Asphalt Pavement Association, Inc., January 26, 2018 (83 FR 3864). Several additional groups have requested similar exemptions, but FMCSA has not yet published final decisions.

Comments to the ANPRM

A majority of commenters asserted that FMCSA should extend the duty

[8] A copy of the Canadian Commercial Vehicle Drivers Hours of Service rules is available at *https://laws-lois.justice.gc.ca/eng/regulations/SOR-2005-313/page-2.html#docCont (Accessed December 31, 2018).* A single-page summary is available at *https://www.cvse.ca/national_safety_code/pdf/HOS_Service_Rules.pdf (Accessed December 31, 2018).*

period for short-haul operations from 12 to 14 hours. However, other commenters, including drivers, disagreed. Some commenters suggested extending the air-mile radius of this provision to match the requirements of the 150 air-mile exceptions in §§ 395.1(e)(2) (Operators of property-carrying CMVs not requiring a CDL) and 395.1(k) (Agricultural operations).

A number of commenters said that they use the short-haul exception or would like to utilize it.[9] They gave specific operational examples under which drivers exceeded one or both of the limits infrequently, and most described driving as a secondary job function for their drivers. These commenters stated that operational complexity increased due to drivers using different statuses. If the overall short-haul provision were modified, many commenters who supported changing the short-haul provisions believed they might not need other exemptions and exceptions.

Today's Proposal

This NPRM proposes extending the maximum allowable work day for property-and passenger-carrying CMV drivers under the § 395.1(e)(1) short-haul exception from 12 to 14 hours to correspond with the 14-hour period requirement for property drivers in § 395.3(a)(2). Today's proposal would also extend the existing distance restriction under this provision from 100 air miles to 150 air miles to be consistent with the radius requirement for the other short-haul exception under § 395.1(e)(2). Truck drivers would continue to be limited to 11 hours of driving time, and passenger carrier drivers to 10 hours of driving time. All CMV drivers using the § 395.1(e)(1) exception would need to complete their work day within 14 hours of the beginning of the work shift.[10]

Safety Rationale

Using data from the FMCSA Motor Carrier Management Information System (MCMIS),[11] the Agency analyzed concrete mixer crashes before and after the FAST Act allowed ready-mix concrete operators up to 14 hours to return to their work reporting location under the short-haul provision. A review of the MCMIS crash data found that extending the short-haul exemption from 12 to 14 hours did not statistically increase the share of concrete mixers involved in crashes. This evaluation is discussed further in the draft RIA. Furthermore, the Agency emphasizes that the changes to the short-haul exception proposed in today's notice would allow neither additional drive time during the work day nor driving after the 14th hour from the beginning of the work day.

The extension of the air-mile radius by 50 air miles would allow carriers to reach customers farther from the work reporting location while maintaining eligibility for the short-haul exception. FMCSA believes that extending the air-mile radius would not increase market demand for services, and thus would not result in increased vehicle miles traveled (VMT). FMCSA anticipates that if these drivers change their routes resulting in an increase in VMT (*e.g.,* an increase in deliveries made per shift), that VMT would be shifted from other drivers or from the next day. On any given day, a driver may see an increase or decrease in VMT, but total VMT would not change. It could also be the case that on days that required driving past the 12th work hour, the driver was previously operating as a long-haul driver. Under this rule, the same driver could work the same day (*i.e.,* no change in work hours or VMT for any driver), with the only change being eligibility for the short-haul exception. Thus, more drivers or more trips would now be eligible for the short-haul exception, and thus excluded from the requirement to take a 30-minute break or prepare daily RODS, potentially with an ELD. Carriers would have the flexibility to meet existing and future market demands within the area that could be serviced within a 14-hour duty day more efficiently (*i.e.,* not incurring the costs of preparing RODS and retaining supporting documents for the days drivers did not satisfy the short-haul limits) while maintaining eligibility for the short-haul exception. Extending the air-mile radius and the work day would not extend the maximum allowable driving time. Therefore, the Agency does not anticipate any adverse impact on safety.

The IIHS provided data it believes indicates interstate truck drivers operating under the short-haul exception had a significantly higher crash risk than those not using the exception. FMCSA reviewed this study and found that it was based on a very small sample size, which prevented the authors from estimating a matched-pair odds ratio restricted to drivers operating under a short-haul exception, and was not nationally representative. Further, the authors noted that other related factors unobserved in the study may have led to this result. For example, it is possible that older or more poorly maintained trucks are used in local operations. The Agency relied on its own data and analysis discussed earlier in this section, which shows that increasing the duty day from 12 to 14 hours did not statistically increase the share of concrete mixers involved in crashes. The Agency's analysis is discussed in more detail in the RIA. The Agency invites comments on this determination.

In addressing today's proposed changes to the HOS rules, the agency encourages motor carriers and other stakeholders to submit driver record data supporting their comments in a manner that does not reveal the identity of an individual driver.

Additional Questions

FMCSA seeks additional information and data on the impacts of expanding short-haul exemption provision, in part to assess its potential costs and benefits. Specifically:

- How will this change impact motor carrier's ability to enforce HOS rules? What enforcement difficulties may arise from expanding both the time and distance requirements?
- Will drivers drive further or longer in the driving window under the short haul exception? Would this be different then these loads being hauled by drivers complying with the ELD requirements?
- Will the elimination of the 30-minute break requirement for drivers that are potentially driving later in their duty period impact safety?
- What cost savings are expected from not having to comply with the ELD requirements?

Additionally, some commenters to the ANPRM requested that drivers using the short-haul exception be allowed to end the work shift at a different location than the one from which they were dispatched. FMCSA requests public comment about this request, including which segments of the motor carrier industry would be impacted by this

[9] The Association of General Contractors of America commented: "Since many construction operations are local in nature, the short-haul exemption has been helpful but limited. Expansion of the short haul to 150 miles would significantly reduce the impact of HOS on the construction industry. The short-haul exemption should allow for an additional 2 hours of on-duty time. These additional 2 hours are absolutely crucial due to the seasonal nature of construction, and the fact that drivers in this industry are so frequently waiting at a jobsite—which we classify as "on duty not driving"." (*https://www.regulations.gov/document?D=FMCSA-2018-0248-4947*).

[10] Currently, short-haul drivers can use the adverse driving conditions provision under § 395.1(b), and this provision would continue to be available to drivers using the short-haul exception.

[11] MCMIS is an information system that captures data from field offices and through various sources. It is a source for FMCSA inspection, crash, compliance review, safety audit, and registration data.

potential change and whether this change would have an adverse effect on safety, or lead to operational changes such as increased driving time per trip or driving in the 12th and 13th hour after coming on-duty.

B. Adverse Driving Conditions

Current Regulation

Section 395.1(b)(1) allows 2 additional hours of driving time for ''adverse driving conditions,'' which is defined in § 395.2 as ''snow, sleet, fog, other adverse weather conditions, a highway covered with snow or ice, or unusual road and traffic conditions, none of which were apparent on the basis of information known to the person dispatching the run at the time it was begun.'' Although the rule allows truck drivers up to 13 hours of driving time under adverse conditions, instead of the normal 11 hours, it does not provide a corresponding extension of the 14-hour driving window. Similarly, the current rule allows drivers of passenger-carrying CMVs up to 12 hours of driving time under adverse conditions without a corresponding extension of the applicable duty period.

Comments to the ANPRM

Most commenters generally supported extending the adverse driving conditions provision to allow for a longer duty period. Some of these commenters noted that the additional time could be used to enable drivers to find a safe place to park. However, some commenters objected to a change to the exception. One commenter stated that due to the advancements of technology, there is no reason to replace proper trip planning with a 2-hour extension of the 14-hour driving window. Another commenter said that extending the 14-hour driving window would allow operators to be driving at a time in the drivers' work days when crash risks increase dramatically.

Frequency of Use. Some commenters said that they never used the adverse driving conditions exception, while others reported wide variances in the frequency of their use. A trade group provided survey results indicating an average use of the exception of 1.5 times a month.[12] A commenter said drivers should not be allowed to use this exception more than twice in a 7-day period.

Clarify Definition. Many commenters were confused by the current definition and requested clarification, including how often the provision may be used. Several specifically asked about the definition's use of the word ''apparent.'' Some commenters asked that provisions be expanded to include ''foreseen'' conditions or requested that ''unforeseen'' be stricken from the definition. Some commenters pointed out that weather conditions would be known by the dispatcher before the start of a trip, given today's technology. However, these commenters still believed the provision should exist. Many commenters stated that detainment by a third party, such as a shipper or receiver, during loading and unloading should be considered an adverse condition.

Commenters also requested that the definition be changed to require ''proof'' or that the use of this status be ''verifiable.'' Commenters asked for a clear definition that would eliminate inconsistent enforcement practices. Commenters also stated that training drivers in the use of the regulations should be based on a clarified definition. Some commenters requested that specific weather conditions be mentioned in the definition, while others wanted it to also apply to a variety of road-work conditions.

Some commenters requested that determination of adverse driving conditions should be a decision of the driver rather than the dispatcher.

Passenger Carriers. Some commenters requested that ''adverse passenger conditions'' be taken into consideration in the definition, and requested that passenger carriers be allowed an extension of the 10-hour drive time due to ''adverse passenger conditions.''

Today's Proposal

Today's proposal would allow a driver up to a 16-hour driving window (for property carriers) within which to complete up to 13 hours of driving, or a 17-hour duty period (for passenger carriers) within which to complete up to 12 hours of driving, if the driver encounters adverse driving conditions.

Safety Rationale

While the Agency is not aware of any research that is specific to the impact of adverse conditions on crash risk, the flexibility provided in the proposal would give drivers greater latitude to respond to adverse driving conditions by removing the existing penalty that ''shortens'' the driver's duty day if he or she responds cautiously to an adverse condition in a manner that takes up more duty time. FMCSA expects the proposed increase to duty time during adverse driving conditions to incentivize drivers facing these conditions to either travel at a reduced speed due to road conditions, which is likely to minimize the risk of crashes, or to suspend CMV operations in order to wait for the adverse conditions to abate. Further, the Agency stresses that this proposal would not increase available driving time beyond what is currently allowed by the exception. FMCSA does not anticipate that changes to the adverse weather condition provision would lead to increased VMT in most situations, but might shift when the miles are driven. This provision is intended to allow you to drive your anticipated trip within 1 shift (instead of extending it to 2) when adverse weather would decrease your VMT efficiency, or make road travel unsafe for a period of up to 2 hours. It is not intended to allow for additional trips or increased freight movement. FMCSA does not anticipate that motor carriers would be able to schedule additional freight movement because adverse conditions can't be planned for in advance.

FMCSA notes that the Federal Aviation Administration (FAA) and the Federal Railroad Administration (FRA) both allow duty period extensions in similar circumstances. FAA allows a 2-hour flight duty period extension for unforeseen operational circumstances (14 CFR 117.19(a)(1)) and FRA allows a 4-hour duty period extension for emergencies or work related to emergencies (49 CFR 228.405(c)). FRA's hours of service laws also do not apply to circumstances involving ''Acts of God'' (49 U.S.C. 21102(a)(3)).

The ''adverse passenger conditions'' mentioned by commenters from the bus industry do not involve driving conditions external to the vehicle, such as snow, sleet, fog, and the other conditions listed in the definition in § 395.2. Adverse passenger conditions are not within the scope of this rulemaking.

In addressing today's proposed changes to the HOS rules, the agency encourages motor carriers and other stakeholders to submit driver record data supporting their comments in a manner that does not reveal the identity of an individual driver.

Additional Questions

FMCSA seeks additional information and data on the impacts of changing the adverse conditions provision, in part to assess its potential costs and benefits. Specifically:

- Will this change cause drivers to travel further in adverse conditions?
- Will this change drivers' behavior when encountering adverse conditions? How so?

[12] Comment from OOIDA with this survey is available at: *https://www.regulations.gov/document?D=FMCSA-2018-0248-3347.*

- Understanding adverse conditions cannot be predicted, will drivers utilize this provision more often after this change?

Additionally, FMCSA requests public comment about potential modifications to the definition of ''adverse driving conditions.'' Specifically, the Agency requests input on the suggestion that knowledge of the existence of adverse conditions should rest with the driver rather than the dispatcher. Alternatively, should the requirement for lack of advance knowledge at the time of dispatch be eliminated? Should the current definition of ''adverse driving conditions'' be modified to address other circumstances?

C. 30-Minute Break

Current Regulation

Under 49 CFR 395.3(a)(3)(ii), except for drivers who qualify for either short-haul exception under § 395.1(e)(1) or (2), driving is not permitted if more than 8 hours have passed since the end of the driver's last off-duty or sleeper-berth period of at least 30 minutes.[13]

Comments to the ANPRM

Most commenters (including many drivers) supported removing the 30-minute break, citing a number of reasons, including stress on the driver and a perceived increase in crash risk. Many commenters stated that drivers already take sufficient breaks from driving, and that the additional break requirement is unsafe or unnecessary. Some commenters, including safety organizations, expressed support for the 30-minute break requirement, stating that rest breaks are necessary and should remain as currently required. Others stated that no other viable alternative could match the safety benefits achieved by an off-duty, 30-minute break.

Logistics/Time Taken. Some commenters recommended replacing the 30-minute provision with a rule requiring two breaks or similar expansions of break time. Drivers liked this idea if they felt it was more in-line with their existing operations, or if they thought it would be more advantageous. There was no data provided to show it increased safety. Commenters were discussing the current requirement, which mandates a 30-minute off-duty break that does not pause the duty clock. A commenter asked that the rule be revised to provide that the break may be taken any time during the duty period and that a second break would not be required if the first one is taken early in the duty period. Some commenters suggested allowing breaks to be split into smaller segments, such as 10 minutes. Others stated that the break should be tied to changes to the sleeper-berth provision.

Total On-Duty Time. Many commenters requested that on-duty non-driving time, *e.g.,* fueling or loading and unloading, be counted towards the break time. A number of commenters also requested that breaks stop the 14-hour on-duty clock. Others said that only breaks over a certain length and spent in a sleeper berth should stop the 14-hour on-duty clock.

In Combination with the Split Sleeper-Berth Provisions. Several commenters recommended that modifications to the break be tied to sleeper-berth changes. Others suggested that breaks be reviewed in conjunction with the proposed Split Sleeper-Berth Pilot Program.[14]

Removal of the 30-Minute Break for All Drivers. Since short-haul drivers are exempt from the 30-minute break requirement, several commenters believed that it ought to be eliminated for all drivers.

Incidental Drivers. Multiple commenters represented industries or operations for which driving is incidental to the principal job of the driver. A number suggested that their operations be exempt from the 30-minute break requirement.

Today's Proposal

FMCSA proposes to modify the existing 30-minute break requirement with a prohibition on driving for more than 8 hours without at least one 30-minute change in duty status. This would allow 30 minutes of on-duty, not driving time, off-duty time, or sleeper berth time to qualify as a break. Many drivers have interruptions of their driving time during normal business operations, such as loading or unloading a truck, completing paperwork, or stopping for fuel. Under the current rules, the break is required to be off-duty time during which no work, including paperwork, may be performed and is triggered after 8 hours, regardless of driving time. The flexibility provided in this proposal would allow these normal breaks from driving (*i.e.,* ''time on task'' in the research literature) to count as an interruption of the 8 hours of driving status, provided the break lasts at least 30 minutes. Additionally, these proposed changes to the 30-minute break provision proposed by today's rule would not allow an increase in maximum driving time during the work shift or driving after the 14th hour from the beginning of the work shift.

Safety Rationale

In today's NPRM, the Agency is reconsidering the value of off-duty breaks relative to on-duty breaks. Based on comments received, the Agency has taken another look at the Blanco, et al. (2011),[15] study to determine the applicability of its findings to the 30-minute break requirement.

While Blanco found that off-duty breaks resulted in a greater decrease in subsequent safety critical events (SCE) than on-duty breaks, many of the breaks were between 30 and 59 minutes in length, casting doubt on the findings' applicability to a strict 30-minute break.[16] Furthermore, the off-duty breaks in the Blanco study were voluntary and many were taken in the sleeper berth. Both of these elements deviate from the current environment where a rigid 30-minute rest break requirement forces drivers to go off-duty regardless of whether they feel fatigued or have space to rest. Thus, the study participants could have experienced off-duty breaks that were more beneficial in nature than the off-duty breaks taken as a result of the 2011 final rule, as the study participants likely opted to take off-duty breaks as a countermeasure to fatigue.

Lastly, Blanco categorized breaks from driving into four groups; Rest During Duty Period (Type 1), Work During Duty Period (Type 2), Rest During Duty Period/Off Duty (Type 3), and Off-Duty (Type 4). Break Type 1 and Type 4 include resting activities such as eating and sleeping, and break Type 3 is a combination of Type 1 and Type 4 breaks such that it also includes rest activities. The Blanco study collected data from November 2005 to March 2007, when the regulatory guidance required that any time spent in the vehicle cab (with the exception of the sleeper berth) was considered on-duty

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[13] The 30-minute rule does not apply to drivers who operate CMVs within a 100 air-mile radius of their normal work reporting location and return to that location within 12 hours, as authorized by § 395.1(e)(1), or to drivers who do not need a CDL, operate within a 150 air-mile radius of their work reporting location, and meet certain other requirements, as authorized by § 395.1(e)(2).

[14] The Split Sleeper-Berth Pilot Program mentioned in comments has been canceled. See the discussion below.

[15] Blanco, M., Hanowski, R., Olson, R., Morgan, J., Soccolich, S., Wu, S.C., & Guo, F. (2011) ''The Impact of Driving, Non-Driving Work, and Rest Breaks on Driving Performance in Commercial Motor Vehicle Operations.'' Available in this rulemaking docket.

[16] In reviewing the Blanco study, it was determined that there were 3,171 breaks of 30 minutes or longer used in the analysis. It should be noted that there were relatively few off-duty breaks—only 211 off-duty breaks, which was less than 6.7 percent of the total number of breaks.

time. This would include in-cab activities that after 2011 could be considered off-duty, such as eating or taking naps. As such, while the Blanco study analyzes the reduction in SCEs for Type 1 and Type 4 breaks separately, under the present regulatory structure they would likely both be considered off-duty breaks and thus would fit into Type 4; Off-Duty Break. Using the published data in the Blanco study, FMCSA recalculated the magnitude of SCE reduction for an off-duty break using the break frequency published in the study for break Type 1, Type 3, and Type 4. This calculation resulted in a 33 percent SCE reduction, which is lower than the 51 percent for Type 4 breaks alone, and very close to the 30 percent reduction for Break Type 2.[17] FMCSA acknowledges that this result is not precise due to the limitations of the available data. Multiple break types could make up a single break, such that the summation of the break frequency by type can be more than the total number of breaks, and the magnitude of SCE reduction would likely be slightly different than what was calculated above. What is clear is that the magnitude of SCE reduction that Blanco attributed to off-duty breaks is larger than the SCE reduction that would be attributable to the off-duty 30-minute breaks required under the 2011 HOS rule (those that would be made up of Type 1, Type 3, Type 4 breaks as defined by Blanco). In light of this recent review, it appears that FMCSA placed too great a value on off-duty breaks, compared to other types of breaks described above. What seems to be consistent in the Blanco study was that breaks of any type reduced SCEs. Therefore, the Agency proposes to change the break provision to allow the driver to take a break while on duty but not driving, rather than requiring the time to be off duty.

Further, the Agency is proposing to tie the break requirement to eight hours of driving time rather than eight consecutive hours since the driver's last off-duty or sleeper berth period of at least 30 minutes. Based on the discussion above, FMCSA believes that on-duty breaks can have essentially the same SCE reduction as off-duty breaks. Tying the break requirement to driving time is in line with this finding. Many commenters to the ANPRM stated that the current 30-minute break provision requires them to go off duty after eight hours of on-duty time, even though they may not have driven for a long period of time when the rule requires a stop. FMCSA required the 30-minute break in the 2011 HOS rule based on literature that found a break from the driving task would lead to a reduction in SCEs in the hour after a break was taken. If drivers' schedules include time periods of at least 30-minutes in an on-duty/non-driving status, they are receiving the intended benefits of the current requirement. FMCSA continues to believe that a break from driving is important for safety, but acknowledges that the changes in today's proposed rule would be less burdensome for carriers and drivers while achieving the same goal—a break from the driving task. These proposed changes may result in a decrease in off-duty breaks, but FMCSA anticipates that any potential effect on fatigue from fewer off-duty breaks will be offset or minimized by continuing to require a break from the driving task. Further, as explained below, this proposal would allow drivers to take an off-duty break when they believe it would be most helpful at preventing them from driving while fatigued, as opposed to requiring a break regardless of the warning signs of fatigue, without impacting their 14-hour driving window. As an example, consider a driver who under the current requirements spends two hours in on-duty/not driving status to start his or her duty period subsequently drives for six hours, takes the required 30-minute break, and then drives for five more hours before reaching the 11-hour limit. All other things equal, the proposed changes would allow this driver to take the break up to two hours later than under the current requirements, such that the driver's duty period could consist of an initial two hours in on-duty/not driving status followed by eight hours of driving, a 30-minute break, and three hours of driving before reaching the 11-hour limit. Both under the current requirements and under the proposed rule, this hypothetical driver receives the benefits of a break from the driving task. However, deferral of the break results in the driver driving later into the day before taking a required break, but driving fewer hours after it is taken. The Agency cannot say how this temporal shift in the break would alter the frequency of SCEs before the required break is taken as compared to driving fewer hours after the break. The agency requests comments on how to estimate the change in SCEs from this temporal shift in the 30 minute break.

Further, the Agency notes that for a driver who immediately begins driving at the start of his or her duty period, he or she may drive eight continuous hours before a break is required; this is true under the current requirements and would remain so under the proposed rule.

FMCSA anticipates that the same level of safety can be achieved by (1) allowing the driver to take a break while on-duty but not driving, rather than requiring the time to be off-duty, and (2) starting the 8-hour period when the CMV operator begins driving. The changes to the 30-minute break provision proposed by today's rule do not involve any increase to the 11-hour driving limit in place today.

Those drivers that work more than 8 hours but do not drive more than 8 hours may increase their VMT efficiency. These drivers are currently required to take a 30-minute off-duty break. Under the proposal, their on-duty/non-driving time would be considered a break from driving. They would be able to increase their efficiency by a reduction in off-duty time of up-to 30 minutes, but this would only be the case if off-duty breaks are not part of their regular operating schedule, and taken solely as a result of the 30-minute break requirement.

Drivers that drive for 8 consecutive hours may see an increase in VMT efficiency. This would occur if their day already has a 30-minute on-duty period (*e.g.,* waiting at a loading dock) that would occur regardless of this rule. This on-duty period would meet the break requirements of the proposed rule. These drivers may also see their VMT unchanged. This would occur if their day does not contain a 30-minute on-duty period that could count towards the proposed break requirement. In this instance, they would need to find a spot to park and take a break from driving under both today's requirements and the proposed requirements.

Furthermore, the Agency has reviewed several requests for exemption from the current 30-minute break requirement. In certain cases, the Agency has granted limited exemptions after determining, following notice and comment in the **Federal Register**, that the exemption would not result in any decrease in safety.[18] For example, in

[17] It is FMCSA's position that the calculated 3% difference in SCE reduction should not be considered to correspond directly to a difference in crash rates. This is because SCEs are a much more common event than crashes, which results in the likelihood that a 30% reduction and a 33% reduction in SCEs may have the same impact on overall crash rates.

[18] For more information about each of the exemptions, and the specific conditions under which they were granted, please review the following notices: the American Trucking Associations, granted August 21, 2015 (80 FR 50912); the Department of Energy, granted June 22, 2015 (80 FR 35703); the National Asphalt Pavement Association, granted January 26, 2018 (83 FR 3864);

Continued

certain cases the Agency has allowed the break requirement to be satisfied with on-duty not-driving time. All exemptions require a carrier to report recordable crashes related to the exemption to the Agency. However, crashes may involve multiple factors, and might not be directly attributable to the exemption.

FMCSA was able to analyze some MCMIS crash data to provide insight into the relationship between crash risk and one exemption in particular. FMCSA granted an exemption on August 21, 2015 (80 FR 50912), allowing operators of vehicles transporting certain hazardous materials (HM) to satisfy the 30-minute break requirement using attending time. This exemption was necessary because FMCSA regulations prohibit operators of vehicles transporting certain HM from leaving their vehicles unattended (49 CFR 397.5), and thus, they could not satisfy the off-duty break requirement while maintaining compliance with the requirement to attend the vehicle.

MCMIS contains counts of crashes where a vehicle with an HM placard was present, as well as crash counts of all large truck crashes. Using these data points, FMCSA examined the total number of crashes where a vehicle with an HM placard was present for the 2 years before and after the exemption went into effect. From August 22, 2013, through August 21, 2015, there were 7,217 crashes where vehicles with an HM placard were present, or 2.616 percent of the total crashes involving large trucks (7,217 HM placard present/275,915 large truck crashes). From August 22, 2015 through August 21, 2017 there were 7,277 crashes where vehicles with an HM placard were present, or 2.419 percent of the total crashes involving large trucks (7,277 HM placard present/300,775 large truck crashes). This analysis has some limitations in that not all vehicles transporting HM are large trucks and that crashes cannot be attributed to the exemption. However, the slight decrease in the HM placard share of total large truck crashes may suggest that the exemption allowing attending time to satisfy the break requirement did not increase crash risk for operators of vehicles transporting certain HM.

In the years that FMCSA has spent administering these exemptions, FMCSA has not discovered evidence of adverse safety impacts that would require withdrawal of any 30-minute exemption. However, in other cases, FMCSA has denied requests for blanket exemptions because the applicants were unable to provide an adequate alternative to, or sufficient information to support relief from, the 30-minute break that meets the statutory criteria and demonstrates an equivalent level of safety.[19]

FMCSA anticipates that an on-duty break from driving would not adversely affect safety relative to the current requirements as discussed in connection with the Blanco study, above, but requests additional data on the safety impacts of this proposal.

In addressing today's proposed changes to the HOS rules, the agency encourages motor carriers and other stakeholders to submit driver record data supporting their comments in a manner that does not reveal the identity of an individual driver.

Additional Questions

FMCSA seeks additional information and data on the impacts of changing the 30 minute break provision, in part to better assess its potential costs and benefits. Specifically:

- Will you take fewer total breaks from driving with this change? How many and when would those breaks have occurred during your route?
- Do you expect to still take a 30 minute break if you have less than 8 hours of drive time? If so, would you take that break on-duty or off-duty?
- If you no longer need to take a 30 minute break, how do you expect to spend this additional time?
- How will this provision change your scheduling and planning?
- Do you expect to drive more miles or hours based on this change? Do you expect to be able to complete additional ''runs''?

Additionally, the Agency acknowledges that many commenters specifically asked that the 30-minute break requirement be eliminated, and has considered that as an alternative under E.O. 12866. However, without the benefit of further information in this regard, it would not be appropriate to entirely eliminate the rule. Given that the flexibility allowed in today's proposal would alleviate many of the concerns expressed by commenters, FMCSA seeks further information on the effect of eliminating the break requirement altogether. Specifically—

(1) What would be the safety impact of eliminating the required break, potentially allowing up to 11 consecutive hours of driving?

(2) What has been the cost to your company of complying with the 30-minute break rule since the compliance date for that rule, July 1, 2013?

(3) How often do work shifts require an individual to drive more than 8 hours without at least a 30-minute change in duty status?

(4) Would eliminating the break requirement result in greater cost savings than the current proposal? If so, what would be the amount of these cost savings?

D. Sleeper Berth

History

The 2003 HOS rule (68 FR 22456, Apr. 28, 2003, amended by 68 FR 56208, Sept. 30, 2003), introduced the concept of a fixed 14-hour driving window to help limit potential overly-long periods of wakefulness and duty hours that could lead to fatigue-related crashes.

The 2005 HOS final rule (70 FR 49978, Aug. 25, 2005) changed the sleeper-berth provisions to require the equivalent of 10 hours off duty to be taken in one 8-hour sleeper-berth period, combined with another 2-hour period, either in the sleeper berth, off duty, or a combination of the two. This established one 8-hour period in which to obtain restorative rest, yet provided the driver flexibility in use of the shorter period. Although comments were closely divided on the issue and research related to the length of the longer rest period was not definitive, the Agency limited drivers to an 8/2 spilt option. Drivers, however, have often objected to 8 hours in the sleeper berth, the lack of flexibility allowed by the sleeper-berth provisions, and 14-hour rule in general.

Current Regulation

Current HOS rules allow a sleeper-berth user to divide the minimum 10 hours off duty, which are otherwise required to be consecutive, into two separate periods. Drivers who use

the National Tank Truck Carriers, granted April 9, 2018 (83 FR 15221); R&R Transportation, granted October 2, 2015 (80 FR 59848); the Specialized Carriers & Rigging Association, granted November 1, 2016 (81 FR 75727); the Department of Defense (DOD) Surface Deployment & Distribution Command (SDDC), granted October 28, 2013 (78 FR 64265); the American Concrete Pumping Association, granted March 21, 2017 (82 FR 14595); the National Pork Producers Council, granted June 11, 2014 (79 FR 33634); the California Farm Bureau Federation for bee transporters, granted June 19, 2015 (80 FR 35425); and the American Concrete Pavement Association, granted February 6, 2019 (84 FR 2307).

[19] For more information about these denials, please review the following information: the Payne & Dolan/Zenith Tech/Northeast Asphalt application, denied June 24, 2015 (80 FR 36397); the Commercial Vehicle Safety Alliance petition, denied August 9, 2016 (T.F. Scott Darling, Administrator, FMCSA, in a letter denying a petition for rulemaking dated October 28, 2015, to Colin Mooney, Executive Director, Commercial Vehicle Safety Alliance, August 8, 2016. Available at: *https://www.fmcsa.dot.gov/petitions*); and the Transco/McLane application, denied July 18, 2017 (82 FR 32918).

sleeper berths may take at least 8 consecutive hours of the required 10-hour off-duty period in the sleeper berth. In addition, the driver using the sleeper-berth exception must take a separate (earlier or later) period of at least 2 hours off duty, which may be in the sleeper berth if desired. It does not matter which rest period is taken first.

Comments to the ANPRM

Many commenters to the ANPRM requested increased flexibility in the sleeper-berth provisions. Some suggested reverting to the pre-2005 split sleeper-berth provisions, which allowed qualifying hourly splits of 7/3, 6/4, or 5/5.[20] Some drivers suggested that the longer period be not less than 7 hours, because they suspected that motor carriers might require them to take the shortest rest period, regardless of how the drivers felt. However, several commenters stated that team drivers should be allowed to take advantage of additional flexibility, such as a 5/5 split. Safety advocates did not believe the data supported any changes to the existing sleeper-berth provisions.

One of the most common concerns raised by CMV drivers has been that, under the current HOS rules, they do not have the flexibility to rest when they are tired. Some commenters suggested that sleeper-berth time splits be allowed to vary from day to day, so long as drivers accumulated a total of at least 8 hours a day in the berth. Other commenters suggested that at least 8 hours in the berth should be logged for every 24-hour period, and once 10 hours are accumulated, the on-duty clock should be restarted. One commenter recommended eliminating the split sleeper-berth provision and just allowing ''off-duty'' time to stop the 14-hour clock. Some drivers stated that increased flexibility in split options would allow carriers to coerce drivers to operate when they would prefer not to do so. The perception from these commenters was that the dispatcher would manipulate the hours to maximize productivity.

Commenters from multiple segments of the motor carrier industry stated that sleeper-berth options currently do not suit their specific needs, and that expanded options would assist their operations. Commenters stated that parking would be easier if drivers had more staggered sleeping times and used rest stops at different times. However, some commenters suggested retaining the current standard, a sleeper-berth period of at least 8 hours.

Safety Rationale

There is an extensive body of research suggesting that split-sleep schedules may improve safety and productivity as compared to consolidated daytime sleep. Mollicone, et al. (2007)[21] conducted a laboratory study of 93 healthy adult subjects to investigate physiological sleep obtained in a range of restricted sleep schedules. Eighteen different conditions with restricted nocturnal anchor sleep, with and without diurnal naps, were examined. The study found that ''split sleep schedules are feasible and can be used to enhance the flexibility of sleep/work schedules involving restricted nocturnal sleep due to scheduling.'' The researchers concluded that the results are generally applicable to any continuous industrial operation that involves sleep restriction, night operations, and shift work.

Belenky, et al. (2012)[22] conducted a laboratory study on 53 healthy participants, making a between-group comparison of nighttime, 5 hour/5 hour split, or daytime sleep across a 5-day simulated workweek. The effect of the three sleep conditions was measured by polysomnography, Psychomotor Vigilance Task, high fidelity driving simulator, Digit Symbol Substitution Test, and subjective state, as well as the long-term health-related biomedical measurements of blood glucose, IL–6, leptin, testosterone, and blood pressure. In comparison to consolidated nighttime sleep or split sleep, participants in the daytime sleep condition slept less and reported (on a subjective sleepiness scale) that they felt sleepier. With respect to total sleep time and sleepiness, the findings of this 2012 study suggest that split sleep is preferable to consolidated daytime sleep which is allowed under the current regulations.

Short, et al. (2015)[23] conducted a systematic review of the sleep, sleepiness, and performance implications of limited wake shift work schedules. They identified 20 independent studies, including 5 laboratory and 17 field-based studies focused on maritime watch keepers, ship bridge officers, and long-haul train drivers. Findings indicate that limited wake shift work schedules were associated with better sleep and lower sleepiness in the case of (1) shorter time-at-work, (2) more frequent rest breaks, (3) shifts that start and end at the same clock time every 24 hours, and (4) work shifts commencing in the daytime (as opposed to night).

Soccolich, et al. (2015)[24] analyzed data that had been naturalistically collected during a separate study to compare driver usage of three separate restart methods under the 2005 HOS regulations: 10 consecutive hours off duty, 34 consecutive hours off duty, or the split sleeper berth provision, which requires a single sleeper berth period of at least 8 hours. The study also examined the relationship between the driver's choice of restart method and that driver's safety performance. The drivers chose which restart method worked best for their schedule and their preference, and they were free to use any restart period at any time, as long as they complied with the current HOS regulations. Safety performance was determined by comparing safety critical events with baseline data for each driver during the shift following their chosen restart method. After controlling for individual driver differences, Soccolich, et al. found that safety performance was comparable (*i.e.,* not significantly different) between drivers who used the sleeper berth provision and drivers who chose either the 10- or 34-hour restart method.

The above research highlights the value of split-sleep scenarios in combating driver fatigue, but does not directly speak to the changes proposed in this rule—allowing a 7/3 ''split'' option, and not counting either rest period in the calculation of the 14-hour ''driving window.'' Under the 2003 HOS rule, which initially established the concept of the 14-hour driving window, drivers were permitted to accumulate the minimum off-duty period of 10 consecutive hours in four separate ways: (1) A minimum of 10 consecutive hours off duty; (2) a minimum of 10

[20] Before the August 25, 2005 revisions of § 395.1(g), drivers of property-carrying CMVs were allowed to split sleeper-berth time into any two periods, as long as neither one was less than 2 hours, subject to certain restrictions.

[21] Mollicone, D.J., Van Dongen, H.P.A., Dinges, D.F. (2007) ''Optimizing Sleep/Wake Schedules in Space: Sleep During Chronic Nocturnal Sleep Restriction With and Without Diurnal Naps,'' *Acta Astronautica,* 60 (2007) 354–361. Available in this rulemaking docket.

[22] Belenky, G., Jackson, M.L., Tompkins, L., Satterfield, B., & Bender, A. (2012) ''Investigation of the Effects of Split Sleep Schedules on Commercial Vehicle Driver Safety and Health,'' Washington, DC: FMCSA. Available in the docket for this rulemaking.

[23] Short, M.A., Agostini, A., Lushington, K., & Dorrian, J. (2015) ''A Systematic Review of the Sleep, Sleepiness, and Performance Implications of Limited Wake Shift Work Schedules,'' *Scandinavian Journal of Work, Environment and Health,* 41(5):425440. Available at: *https://www.ncbi.nlm.nih.gov/pubmed/26103467.* (Accessed January 4, 2019).

[24] Soccolich, S., Hanowski, R., & Blanco M. (2015). Evaluating the Sleeper Berth Provision: Investigating Usage Characteristics and Safety-Critical Event Involvement. (Report No. 17–UI–046). Available at: *https://vtechworks.lib.vt.edu/handle/10919/73954* (accessed June 20, 2019).

consecutive hours in a sleeper berth; (3) by combining consecutive hours in the sleeper berth and off-duty time that total 10 hours; and (4) by combining two separate sleeper-berth rest periods totaling at least 10 hours, provided that neither period is less than 2 hours. The fourth option was the split sleeper-berth option at the time, which allowed drivers to split their sleeper berth time in any combination (such as 4/6; 5/5) as long as each period was at least 2 hours, and totaling a minimum of 10 hours. The rule allowed these periods to be excluded from the calculation of allowable on-duty and driving time. This approach resulted in concerns that the 2005 HOS rule intended to alleviate. The primary issue was the ability of drivers to split their rest periods into segments that did not provide for an adequate rest period, such as the 5/5 split. The 2005 rule resulted in more clarity by relying on the fixed 14-hour ''driving window'' under which only a rest period of at least 8 hours in the sleeper berth would not count against the 14-hour driving window. Although comments were closely divided on the issue and research related to the length of the longer rest period was not definitive, the Agency limited drivers to an 8/2 spilt option. In developing today's proposal, the Agency reviewed available research regarding the sleeper berth exception that has been in place since 2005 to determine if the intention of the regulation—an adequate longer rest period—can be achieved while providing additional flexibility.

Research conducted prior to 2003 found that commercial drivers were getting 5.18 hours of sleep per night, on average (Mitler, et al. (1997)).[25] In 2003, FMCSA revised the HOS regulations to provide drivers with more opportunities for sleep. Research completed after 2003 found an increase in sleep for drivers following the implementation of the 2003 HOS regulations. Hanowski, et al. (2007),[26] conducted a naturalistic driving study with 73 drivers, collecting and analyzing sleep actigraphy data to determine overall sleep quantity. The study found that commercial drivers were getting more sleep under the revised HOS regulations, with an average of 6.15 hours of sleep per 24-hour period (compared to the average of 5.18 hours per night reported by Mitler, et al. in 1997).

Van Dongen and Mollicone (2013)[27] conducted a naturalistic driving study of 106 CMV drivers whose schedules included the HOS restart provision. The study found that drivers obtained between 6.0 and 6.2 hours of sleep (on average) per 24 hours during duty cycles, as measured by wrist-worn actigraphy devices.

Dinges, et al. (2017),[28] conducted a naturalistic driving study to evaluate the operational, safety, fatigue, and health impacts of the HOS restart provisions. A total of 235 CMV drivers, representative of the industry, contributed data while working their normal schedules, with 181 drivers completing all 5 months of the study. Drivers' sleep times were monitored with wrist-worn actigraphy devices. The study found that drivers obtained, on average, approximately 6.5 hours of sleep per day during duty periods.

Finally, Sieber, et al. (2014),[29] conducted a survey of 1,670 long-haul truck drivers at 32 truck stops across the 48 contiguous United States. The research team used the responses to compute prevalence estimates for self-reported health conditions and risk factors. Drivers were asked to report how many hours they slept per night, on average; researchers compared drivers' self-reported sleep durations to those reported by sampled working adults in the 2010 National Health Interview Survey (NHIS).[30] The National Institute of Occupational Safety and Health study found that:

- 26.5 percent of long-haul truck drivers reported that they slept 6 hours or less per night, compared to 30.0 percent of the general working population;
- 51.4 percent of long-haul truck drivers reported that they slept 6–8 hours per night, compared to 63.9 percent of the general working population; and
- 22.1 percent of long-haul truck drivers reported that they slept more than 8 hours per night, compared to 5.0 percent of the general working population.

These studies show that long-haul truck drivers are, on average, getting more sleep than they did prior to the HOS rule change in 2003. Further, it shows that drivers are likely getting more sleep than other working adults in the United States.

Maislin, et al. (2001),[31] showed that it is possible for a person to avoid physiological sleepiness or performance deficits on less than 7 hours of sleep; the subjects in this study were supplementing their sleep with longer naps later in the day. Maislin found that a shorter restricted anchor sleep combined with longer naps can reduce sleepiness and performance deficits similar to longer duration anchor sleep alone. This study confirmed that total sleep time per 24-hour period is an important factor in reducing fatigue and improving performance. Rest breaks, and especially naps, are an important tool in combating fatigue, and FMCSA encourages their use. As noted in Wylie (1998),[32] ''[n]aps in trips with judged drowsiness appeared to result in recovery effect, compared to the relatively high levels of drowsiness seen in the hour prior to napping.'' Research on napping indicates it does refresh a driver and improves performance in the near term. Caldwell, et al. (1997),[33] found that their subjects performed better after napping compared to after only resting without sleep. Garbarino (2004)[34] found that, in addition to working as a short-term countermeasure to fatigue experienced during normal working hours, napping ''before night work can be an effective countermeasure to alertness and performance deterioration.'' Naps do not have to be long to improve performance.

[25] Mitler, M.M., Miller, J.C., Lipsitz, J.J., Walsh, J.K., Wylie, C.D. (1997) ''The Sleep of Long-Haul Truck Drivers,'' *New England Journal of Medicine,* 337, 755–761. Available in the docket for this rulemaking.

[26] Hanowski, R.J., Hickman, J., Fumero, M.C., Olson, R.L., Dingus, T.A. (2007) ''The Sleep of Commercial Vehicle Drivers Under the 2003 Hours-of-Service Regulations,'' *Accident; Analysis and Prevention,* 39(6), 1140–5. Available in the docket for this rulemaking.

[27] Van Dongen, H.P.A. & Mollicone, D.J. (2013) ''Field Study on the Efficacy of the New Restart Provision for Hours of Service,'' (FMCSA–RRR–13–058). Washington, DC: FMCSA. Available in the docket for this rulemaking.

[28] Dinges, D.F., Maislin, G., Hanowski, R.J., Mollicone, D.J., Hickman, J.S., Maislin, D., Kan, K., Hammond, R.L., Soccolich, S.A., Moeller, D.D., & Trentalange, M. (2017) ''Commercial Motor Vehicle (CMV) Driver Restart Study: Final Report,'' (FMCSA–RRR–15–011). Washington, DC: FMCSA. Available in the docket for this rulemaking.

[29] Sieber, K.W., Robinson, C.F., Birdsey, J., Chen, G.X., Hitchcock, E.M., Lincoln, J.E., Akinori, N., & Sweeney, M.H. (2014) ''Obesity and Other Risk Factors: The National Survey of U.S. Long-Haul Truck Driver Health and Injury,'' *American Journal of Industrial Medicine,* 57, 615–626. Available at: *https://www.ncbi.nlm.nih.gov/pubmed/24390804.* (Accessed January 4, 2019).

[30] Available at: *https://www.ncbi.nlm.nih.gov/pubmed/22624451* (accessed May 6, 2019).

[31] Maislin, G., Rogers, N.L., Price, N.J., Mullington, J.M., Szuba, M.P., Van Dongen, H.P.A., and Dinges, D., (2001) ''Response Surface Modeling of the Effects of Chronic Sleep Restriction With and Without Diurnal Naps,''—Report. Available in the docket for this rulemaking.

[32] Wylie, D. (1998) ''Commercial Motor Vehicle Driver Drowsiness, Length of Prior Principal Sleep Periods, and Naps,''—Report. Available in the docket for this rulemaking.

[33] Caldwell, J.S., et al. (1997) ''The Efficacy of Hypnotic-Induced Prophylactic Naps for the Maintenance of Alertness and Performance in Sustained Operations,''—Report. Available in the docket for this rulemaking.

[34] Garbarino, S., et al. (2004) ''Professional Shift-Work Drivers Who Adopt Prophylactic Naps Can Reduce the Risk of Car Accidents During Night Work,''—Report Abstract. Available in the docket for this rulemaking.

Sallinen, et al. (1997),[35] found that naps of less than 1 hour most influenced performance, and a survey of train engineers found that 20-minute napping was effective for enhancing alertness (Moore-Ede, et al. (1996)).[36]

The research discussed above demonstrates that drivers are getting adequate sleep, and that allowing a 7/3 split option would continue to provide the opportunity for a a longer sleep period commensurate with current levels of sleep for truck drivers. Further, by excluding the shorter rest period from the calculation of the 14-hour driving window, a driver has the ability to obtain needed rest without using available work time.

The Agency had planned to conduct a pilot program to collect data on the safety of drivers who split their sleeper-berth time in a variety of ways. However, as a result of a literature review, and subsequent comments to the ANPRM and listening sessions, FMCSA concluded that there was sufficient basis to support limited changes to the sleeper-berth provision without conducting a pilot program. Today's proposal would allow drivers additional flexibility in the use of the sleeper-berth provision.

Today's Proposal

Over the years FMCSA has received comments from motor carriers and industry associations that the current sleeper-berth provisions are too rigid and that drivers do not have enough opportunities to stop driving and take breaks when they are fatigued. The Agency recognizes that approximately 26 percent of drivers sleep less than 6 consecutive hours per night and about 51 percent sleep between 6 and 8 consecutive hours per night based on the NHIS study cited above; some may actually find it difficult to sleep more than 7 consecutive hours.[37] However, the current sleeper-berth provision requires them to be in the berth for 8 consecutive hours thus confining them to the berth for more time than many of them need for sleeping.

Today, FMCSA proposes a modification of the sleeper berth exception to allow drivers to satisfy the required 10 hours off duty by taking two off-duty periods, provided that neither period is less than 2 consecutive hours and one period consists of at least 7 consecutive hours in the berth. This sleeper-berth exception would provide drivers greater operational flexibility, while affording the opportunity for the driver to obtain the necessary amount of restorative sleep. Drivers using this option would be required to obtain one single rest period of at least 7 consecutive hours, paired with another period of at least 2 hours, provided that a total of 10 hours of off-duty time is achieved. When paired, neither qualifying period would count against the 14-hour driving window.

This proposal would ensure that drivers using the sleeper berth to obtain the minimum off-duty time have at least one rest period of a sufficient length to have restorative benefits to counter fatigue. This proposal would also provide for a second rest period that would allow a driver to have time for a nap or rest break, or provide an opportunity to attend to personal matters or other activities. A break later in the day, in which a driver could take a nap, could have a positive impact on driver performance, especially considering that drivers could be on an irregular or rotating schedule, getting out of phase with their natural circadian rhythm. Consistent with the current HOS rules, the order of the qualifying rest periods does not matter.

Each time an individual takes one of these two rest breaks, he or she would need to recalculate the on-duty period and driving hours available. Drivers must be in compliance with the 11-hour driving time and 14-hour driving window requirements on both sides of the qualifying rest period. Driving time in the period immediately before and after each rest period, when added together, must not exceed 11 hours under § 395.3(a)(3) and must not violate the 14-hour driving window under § 395.3(a)(2). The time in the period immediately before and after each rest period, when added together, establish the 14-hour window within which all driving must be completed. Thus, a CMV driver's activities between the qualifying split breaks, count towards the driver's next available 11-hour and 14-hour limits.

An example showing the 11-hour and 14-hour limitations in which the driver uses the sleeper berth provision might prove helpful. Assume the driver starts work on day 1 at 7:30 a.m., spends half an hour on duty (not driving), and then starts driving at 8:00 a.m. She drives for a continuous 7 hours but then takes a 3-hour off duty break, beginning at 3:00 p.m. She then starts driving again at 6:00 p.m. and drives for 4 hours. At 10:00 p.m., the driver enters the sleeper berth for 7 hours when she exhausted her 11 hours of driving time clock. She remains in the sleeper berth until 5:00 a.m. on day 2. (Alternatively, she could have limited her 3:00 p.m. break to as little as 2 hours and then restarted driving, but her second break in the sleeper berth would need to be longer so that combined time equals at least 10 hours.) Under either scenario, combining the two break periods under the sleeper berth provision, would allow her to avoid the required 10 consecutive hours off-duty, which would apply had she relied on the proposed split duty day provision rather than the sleeper berth exception. She can now drive again until noon that second day, at which point she runs up against the 11-hour clock governing driving time (her available hours are calculated from the end of the initial break period). Suppose instead of beginning to drive at 5:00 a.m., the driver spent 4 hours on duty (not driving) and then resumed driving at 9:00 a.m. She would then need to stop driving at 3:00 p.m. because she exhausted her 14-hour driving window, even though she drove for only 10 hours. However, note that a driver could not claim use of both the split duty day provision and the sleeper berth exception in a single duty day, without violating the 10 consecutive hour rule.

In addressing today's proposed changes to the HOS rules, the agency encourages motor carriers and other stakeholders to submit driver record data supporting their comments in a manner that does not reveal the identity of an individual driver.

Additional Questions

In today's NPRM, the Agency requests comments on the split rest periods under the sleeper berth proposal, including not counting either period toward the 14-hour driving window.

Given the previous discussion of the research showing many drivers typically sleep a little more than 6 consecutive hours, FMCSA also requests comments and any supporting data on the possibility of a 6- and 4-hour split break. Drivers using this option would be required to obtain one rest period of at least 6 consecutive hours in the sleeper berth, paired with another period off duty or in the sleeper berth, for a total of 10 hours of off-duty time.

Specifically FMCSA requests comments on:

- How often do you use the sleeper berth provision under the current regulations? Will you use the sleeper berth provision more or less if the proposed changes are finalized? How much more or less?

[35] Sallinen, Harma, M., Åkerstedt, T., Rosa, R., Lillqvist, O. (1997) ''Can a Short Napbreak Improve Alertness in a Night Shift?''—Report. Available in the docket for this rulemaking.

[37] Moore-Ede, M., Mitchell, R.E., Heitmann, A., Trutschel, U., Aguirre, A., Hajamavis, H. (1996) ''Canalert '95—Alertness Assurance in the Canadian Railways,''—Report. Available in the docket for this rulemaking.

• How will this provision change your scheduling and planning?
• How often would you utilize the 7–3 hour split during an average week?
• Would you expect to get the same amount of sleep in the 7 hour period as in the current 8 hour period?
• Do you expect to drive more miles or hours based on this change? Do you expect to be able to complete additional ''runs''?

E. Split-Duty Period

Current Rule

After being off duty for 10 or more consecutive hours, a driver of a property-carrying CMV is allowed a period of 14 consecutive hours in which to drive up to 11 hours. The 14-consecutive-hour driving window begins when an individual starts any kind of work. The individual may not drive again after the end of the 14-hour window until he or she has been off duty for another 10 consecutive hours, or the equivalent of at least 10 consecutive hours using the sleeper berth option. This 14-hour window currently may not be extended by off-duty breaks that may occur during the duty period.

Request

OOIDA petitioned FMCSA to allow property-carrying CMV drivers to take a single off-duty rest break for up to 3 consecutive hours once per 14-hour driving window. That rest break would pause the 14-hour clock for the duration of the break. However, drivers would still be limited to 11 hours of driving time and required to have at least 10 consecutive hours off duty before starting a new duty period. OOIDA also requested that the Agency eliminate the 30-minute break.

Comments Related to the Petition

Consistent with the OOIDA petition, a number of commenters addressed the 14-hour rule, saying that it should be extended by a break period of up to 3 hours. Many commenters to the ANPRM have stated that the 14-hour driving window does not comport with the inconsistent and sometimes unpredictable working conditions encountered during a duty period. Thus, the current rule leads to unintended consequences of added stress and potential speeding that result from the need to finish a run prior to the end of the 14-hour window.

Relevant Research

The Blanco study showed that the SCE rate increased modestly with increasing work and driving hours. Blanco also found that

''. . . breaks can be used to counteract the negative effects of time-on-task. The results from the break analyses indicated that significant safety benefits can be afforded when drivers take breaks from driving. This was a key finding in the current study and clearly shows that breaks can ameliorate the negative impacts associated with time-on-task. The benefits from breaks from driving ranged from a 30- to 50-percent reduction in the rate of SCE in the hour following a break, depending on the type of break from driving, with the most benefit occurring for off-duty (non-working) breaks.''

Today's Proposal

Today's proposal would allow a single break of off-duty time, ranging from 30 minutes to no more than 3 consecutive hours, to be excluded from the 14-hour driving window, provided the driver has at least 10 consecutive hours off duty before the start of his or her next duty period. A single pause up to 3 hours to the 14-hour clock would provide significantly more flexibility than allowed under the current rules. It would allow drivers to take an off-duty break without fear of exhausting their available hours under the 14-hour clock, which would also allow them to take additional rest or to avoid traffic congestion.[38]

An example under which a driver uses the split duty period might prove helpful. Assume a driver starts a new workday on duty at 7:30 a.m. and begins driving at 8:00 a.m. At 9:00 a.m., she arrives at a warehouse and experiences a 3-hour wait. The driver elects to use the split duty period, recording this time as ''off-duty,'' given she isn't performing any type of work. At noon, the driver begins to load, a process that takes 1 hour which she records as on duty, not-driving time. At 1:00 p.m., the driver starts driving for a consecutive 8 hours (1:00 p.m.–9:00 p.m.), at which point she must take a 30-minute break under today's proposal. At 9:30 p.m., however, she may still drive an additional 2 hours under today's split duty day proposal. She would need to stop driving at 11:30 p.m. because she would run up against her maximum driving time—11 hours (even though she would have another hour available on her maximum driving window). At 11:30 p.m., she starts a 10-consecutive hour off-duty period. She may then resume driving at 9:30 a.m. the following day. Absent the split duty pause, the driver would have had to stop driving at 9:30 p.m. when she exhausted her 14-hour driving window.

At 9:30 a.m., assume the driver spends 30 minutes on duty (not driving), then drives from 10:00 a.m. to 2:00 p.m. She then spends 2½ hours at a receiver, unloading part of her load. From 4:30 p.m. to 6:30 p.m., she drives to her next stop where she spends an additional 2 hours unloading (until 8:30 p.m.). She then drives for an hour to a rest area (9:30 p.m.) where she rests for 3 hours under the proposed split duty period. At 12:30 a.m. she starts driving. However, at 2:30 a.m. she has exhausted the 14-hour window (adjusted for her 3-hour pause) and must now take 10 hours off duty before driving, even though she never exhausted her 11-hour driving limit.

Safety Rationale

Except under the sleeper berth option, current regulations do not allow drivers to pause the 14-hour clock to take a prolonged break regardless of how they feel. By not providing credit for a break taken during a duty period, the existing rules may disincentivize drivers from voluntarily taking any additional rest breaks beyond those required by regulation. For drivers who voluntarily take additional rest breaks, the existing rules may incentivize these drivers to speed in order to complete their driving prior to the end of the 14-hour driving window, resulting in increasing crash risk. The split-duty provision would alleviate these unintended consequences by allowing drivers to take a break if they feel fatigued, or if their work day straddles a time period that doesn't provide for meaningful work to be accomplished (*e.g.,* long detention times). The intent is to give drivers the flexibility to shift their work and drive time commensurate with the length of a voluntary off-duty period. FMCSA is aware that this provision would allow driving up to 17 hours after the last longer rest period. Some research[39] has found a higher risk of an SCE when driving later in the driving window. However, that research did not examine a prolonged break within the driving window. Nor did that research consider how driver behavior might change to meet a delivery time. FMCSA is proposing to allow a voluntary break of up to 3 hours to mitigate the safety impacts that could result from unpredictable working conditions, and anticipates that due to the voluntary nature of the break, drivers would be able to obtain rest that would mitigate

[38] OOIDA also petitioned for elimination of the current 30-minute break requirement. The agency's analysis of this issue is discussed earlier in this document.

[39] Blanco, M., Hanowski, R., Olson, R., Morgan, J., Soccolich, S., Wu, S.C., & Guo, F. (2011) ''The Impact of Driving, Non-Driving Work, and Rest Breaks on Driving Performance in Commercial Motor Vehicle Operations.'' Available in this rulemaking docket.

the potential effect on fatigue of driving later in the work shift. FMCSA is not aware of research findings pointing to the optimal length of a pause, but considers 3 hours to be the right balance of flexibility and safety. FMCSA bases this proposal on the same logic which allows the 10-hour off-duty period to be split for drivers using sleeper berths. Research, as described in section VII. D., indicates benefits of mitigating time on task fatigue through a shorter rest period combined with a required sleeper berth period. Both provisions are based on a shorter break paired with a longer rest period. FMCSA requests comments, research, and data on the optimal length of a pause that would allow drivers reasonable flexibility to manage operational variables while ensuring that driving does not occur after too much time has elapsed since the last longer rest period.

It should be noted that the proposed off-duty break of up to 3 hours is not a unique exception to the 24-hour circadian cycle implicit in the current 14-hour driving window plus 10 consecutive hours off duty. Under current rules, drivers are not required to go off duty at the end of the 14-hour period. They must stop driving, but may remain on duty to perform other tasks. Post-driving work is most likely if the driver arrives at a terminal near the end of the 14-hour period and is required to perform additional work for the motor carrier at that location. Only when the driver goes off duty does the 10-hour rest period begin. The work day may thus be longer than 24 hours. On the other hand, drivers wishing to maximize their driving time may drive up to 11 hours, take a minimum of 10 hours off duty, and repeat the cycle. Based on FMCSA experience, this schedule is rare and mostly limited to drivers making rapid cross-country trips. The result is a 21-hour day, called a backward rotating cycle. That is a considerable improvement over the 18-hour day allowed by the FMCSRs until 2003, when a 10-hour driving limit could be combined with only 8 hours off duty. But in those two cases, drivers are likely to reach their 60- or 70-hour ''weekly'' on-duty limit more quickly, requiring them to stop driving, at least for a 34-hour restart. Neither of the current alternatives to a 24-hour cycle—post-driving work and compressed schedules—requires the driver to take compensatory off-duty time, yet that is precisely the added value provided by the proposed split duty day. The off-duty time required by this provision would enable drivers to take restorative rest that would counteract, if not eliminate, the effects of a longer duty day. The preamble to the 2003 final rule included the following: ''The FMCSA believes that the strict 24-hour work/rest cycle would be ideal from a scientific viewpoint, but it is simply not practical and too inflexible to require of the industry. A strict 24-hour work/rest cycle would cause unavoidable impacts to motor carrier operations that the agency cannot justify from a safety or economic standpoint'' (81 FR 22456, 22468, April 28, 2003). That conclusion remains true today.

When designating a qualifying off-duty period during the course of a duty day, a driver is not required to document the provision she or he is employing. However, a driver could not extend the duty period by employing both the sleeper berth option and split-duty day provision within the course of a duty period. A driver relying on the split-duty day provision can extend a duty day up to 17 hours by taking a qualifying off-duty break (ranging between 30 minutes and 3 hours), but then must take 10 consecutive hours off-duty before resuming driving. However, a driver could decide after taking a 3-hour break (or any off-duty or sleeper berth break of at least 2 consecutive hours) to instead pair it with a sleeper berth break of 7 hours, (thus totaling 10 hours off duty) and neither break period would count against the 14-hour clock. By using the sleeper berth approach, the driver could avoid the 10 consecutive hours off-duty under the split-duty day provision, provided that she or he satisfies the provisions of the sleeper berth rule. While the driver would have the option of using either the split-duty day provision or the sleeper berth option (provided the vehicle has a sleeper berth), a driver could not take more than a single 3-hour break, claiming time under both the sleeper berth provision and split-duty day provision without running afoul of the required 10 consecutive hours off duty under the split-duty day provision. Additionally, the split-duty day provision would be available to drivers who cannot rely on the sleeper berth exception because they are driving vehicles lacking a sleeper berth.

In addressing today's proposed changes to the HOS rules, the agency encourages motor carriers and other stakeholders to submit driver record data supporting their comments in a manner that does not reveal the identity of an individual driver.

Additional Questions on the Proposal

FMCSA seeks additional information and data on the impacts of the split-duty period provision, in part to assess its potential costs and benefits. Specifically:

- How will this provision impact the number of driving hours during a single driving window? How will this provision impact your total driving hours during a given week or year?
- How would this provision impact your regular schedule? How often would you expect to take advantage of this provision in a given work week? Why?
- What are the expected benefits from utilizing the 3 hour pause?
- Do you expect to use this provision to account for uncertainty such that trips could be finished on their scheduled completion day? How often do uncertain factors impact your schedule such that you are unable to complete a trip during the expected driving window and must delay delivery until after a 10 hour off-duty period?
- Do you expect to be able to complete more trips due to this provision (*i.e.,* schedule additional freight movement)? How many additional trips would you expect to plan during a given week or year?
- Would you expect to be able to utilize more of the 11 hours of drive time currently available due to the 3 hour pause?
- Do you expect this provision to impact drivers' sleep schedule? How so?
- Will this provision allow for drivers to shift off their circadian rhythm more easily than under current rules?
- In a full year, would this provision lead to additional driving miles and/or driving time?
- How often would you take advantage of the full 3 hour pause as compared to shorter amount of times? Why?
- How would you plan to utilize the off-duty time spent during the 3 hour pause? Would you utilize the time sleeping in a truck cab more often or other leisure activities more often?
- Do you anticipate any fatigue impacts on driving up to the 17th hour of a duty day? How would the up to 3 hour break impact that fatigue level?

Additional Questions on Allowing Multiple Pauses

FMCSA seeks additional information on whether the pause should be allowed to be divided and total up to 3 hours. Specifically:

- What operations would benefit from multiple off-duty periods totaling 3 hours?
- Are there data and research available to support breaking up the 3-hour pause into smaller increments?

• Would this flexibility cause drivers to alter their daily behavior or increase productivity? If so, how?
• What would be the impact on fatigue with several smaller breaks compared to a single period of up to 3 hours?
• If the 3-hour break were divided up into smaller increments, what would be the impact on enforcement when determining compliance?
• Would the added complexity of multiple pauses substantially add to the time needed for ELD vendors to re-program ELD software? If so, how much additional time would be needed?

F. TruckerNation Petition

TruckerNation petitioned the Agency to prohibit driving after the driver has accumulated 14 hours of on-duty time, rather than 14 hours after the beginning of the work shift. In addition, it petitioned the Agency to allow drivers to use multiple off-duty periods of 3 hours or longer in lieu of having 10 consecutive hours off duty. TruckerNation also requested elimination of the 30-minute break requirement.

Comments Related to the Petition

Commenters voiced both agreement with and opposition to the petition. Some stated that other changes to HOS rules might yield better results. Others objected to it on the grounds of safety concerns.

FMCSA Response

FMCSA has reviewed the TruckerNation petition and notes that it did not include data or research that would support the request. The TruckerNation petition would allow use of multiple off-duty periods of 3 hours or longer in lieu of having 10 consecutive hours off-duty or a split-sleeper rest period of at least 7 hours. This petition has the potential to allow drivers to operate for long periods of time without a sufficient longer sleep period. FMCSA believes it is important that CMV drivers have an opportunity for a longer sleep period. For these reasons, the Agency is not adopting the TruckerNation petition as proposed; however, aspects of the TruckerNation petition may be addressed in alternate ways.

G. Other Petitions

Similar to TruckerNation, the USTA petition provides an alternate means for splitting up the 10 hours of off-duty time into three separate periods, some as short as 2 hours, including, *e.g.,* a 2/3/5 split of the 10-hour period. The UDA petition provides for splitting the 10-hour period into two 5-hour periods. In both proposals, the 34-hour restart is shortened to 24 hours.

FMCSA Response

FMCSA has reviewed both the USTA and UDA petitions. As discussed above, no data was provided by the petitioners or available from other sources to support a proposal to eliminate the opportunity for a CMV driver to have a longer sleep period. Both petitions would result in the potential of drivers operating for long periods of time without a sufficient sleep period. For example, both petitions would allow a driver to operate for an entire week without a rest period longer than 5 hours. For these reasons, the Agency is not adopting the USTA or UDA petitions as proposed; however, aspects of both petitions may be addressed in alternate ways.

H. Compliance Date for the Rulemaking

To determine an appropriate compliance date for any final HOS rule, FMCSA asks for comments on the time needed for vendors to reprogram ELDs to conform to the proposed changes as well as time required by other areas of the motor carrier industry. While today's proposed changes, if adopted, should not require reprogramming of the basic requirements of an ELD, the Agency recognizes that many ELDs are set up to provide information and warnings to the driver or carrier relating to HOS compliance beyond what the technical specifications governing ELDs require, thus necessitating modifications in ELD software. Several ELD manufacturers requested time to implement HOS changes into their technology and the Agency requests additional information on how long this might take. Specifically, the Agency seeks comment on whether a 6- month or 12-month timeframe would provide sufficient time for ELD manufacturers and the motor carrier industry to conform to the proposed changes.

VIII. International Impacts

The FMCSRs, and any exceptions to the FMCSRs, apply only within the United States (and, in some cases, United States Territories). Motor carriers and drivers are subject to the laws and regulations of the countries in which they operate, unless an international agreement states otherwise. Drivers and carriers should be aware of the regulatory differences among nations in which they operate.

IX. Section-by-Section Analysis

This section includes a summary of the proposed regulatory changes in 49 CFR part 395, organized by section number and paragraph number.

A. Section 395.1 Scope of Rules in This Part

§ 395.1(b)(1): Adverse Driving Conditions

Today's NPRM proposes to modify the exception for drivers of property- and passenger-carrying CMVs encountering adverse driving conditions. Specifically, it would allow drivers of property- or passenger-carrying CMVs to extend their respective driving windows by up to an additional 2 hours, consistent with the current rules governing an extension of driving time.

In proposed § 395.1(b)(1), the reference to paragraph (h)(2) would be corrected to ''paragraph (h)(3),'' to reflect the provision addressing adverse driving conditions in the State of Alaska. The phrase ''or duty time during which driving is permitted'' would be added to reflect the expanded coverage of the adverse driving condition exception.

Other proposed changes to § 395.1 are editorial in nature to improve the clarity of the rule.

§ 395.1(e)(1): Short-Haul Operations

Today's NPRM proposes to modify the HOS short-haul exception under which an eligible driver of a CMV is not required to maintain RODS, and thus does not require an ELD for that day, and is not required to maintain supporting documents. Specifically, today's proposal would extend the current ''100 air-mile radius'' under § 395.1(e)(1)(i) to a ''150 air-mile radius'' and extend the work day period during which driving and work is allowed under § 395.1 (e)(1)(iii)(A) to a maximum of 14 hours. The driving time limits and off-duty periods required before restarting driving would remain unchanged.

References throughout paragraph (e)(1) under which drivers of ''ready-mixed concrete delivery vehicle[s]'' have a 14-hour driving window would be removed because the proposed change would allow a 14-hour driving window for all drivers operating under this exception.

Existing paragraph (e)(1)(iii)(C) (proposed paragraph (e)(1)(iii)(B)) would be modified to extend the 12-hour driving window applicable to drivers of passenger-carrying CMVs using the short-haul exception to a 14-hour driving window for consistency with the rule governing other drivers operating under this exception.

Existing paragraphs (e)(1)(iv)(A), (B), and (C) would be removed as these provisions are duplicative of provisions under §§ 395.3 and 395.5. Existing (e)(1)(v) would be redesignated as (e)(1)(iv).

The proposed changes would not alter the current exception referenced in § 395.1(e)(1)(ii)(A) to a ''driver-salesperson'' or affect drivers of property-carrying CMVs not requiring a commercial driver's license who operate under § 395.1(e)(2).

Other proposed changes are stylistic.

§ 395.1(g)(1): Sleeper Berths

Today's NPRM proposes to modify the sleeper berth rule applicable to drivers of property-carrying CMVs who elect to use this exception, provided that the CMV is equipped with a sleeper berth as defined in § 393.76. Generally, rather than the current 8- and 2-hour sleeper berth provision, today's proposal would allow a driver to satisfy the required 10 hours off duty by taking two off-duty periods, provided that neither period is less than 2 consecutive hours and one period consists of at least 7 consecutive hours in the sleeper berth. The two breaks would need to total 10 hours. Furthermore, under today's proposal, neither period of time would count against the driver's 14-hour driving window.

Paragraph (g)(1)(i) would be modified to clarify that this provision reflects the options available to a driver to satisfy the 10-hour hour off-duty period required under

Proposed new paragraph (g)(1)(i)(D) would describe an option for a team driver to take a combination of sleeper-berth time and time in the passenger seat—an option currently addressed in § 395.1(g)(1)(ii)(C). However, the current provision would be modified to require at least 7 hours in the sleeper berth rather than the current 8 hours, and would allow up to 3 hours, rather than the current 2 hours, spent riding in the passenger seat of a CMV.

Proposed paragraph (g)(1)(iii), captioned ''*Calculation,*'' would exclude both qualifying rest periods in applying the 14-hour rule.

Existing paragraphs (g)(1)(i)(B) through (g)(1)(i)(C) would be removed because these requirements are covered elsewhere in part 395. Specific requirements that pertain to the State of Alaska would be moved to § 395.1(h).

Proposed paragraphs (g)(1)(ii)(A) and (B) would require that a rest period consist of no less than 2 hours and that one rest period consist of at least 7 consecutive hours in the sleeper berth. As stated in proposed new paragraph (g)(1)(ii)(C), the two breaks would need to total 10 hours.

Existing paragraph (g)(1)(ii)(C), as it relates to the calculation point for compliance with the ''equivalent . . . 10 consecutive hours off duty,'' is deleted as unnecessary in light of the proposed language making clear that driving time in the period ''immediately before and after each rest period, when added together'' not violate either the 11- or 14-hour rules. This deletion does not modify how compliance with the sleeper berth provision is calculated. Other proposed changes are stylistic.

§ 395.1(h): State of Alaska

Today's NPRM would revise the HOS exception applicable to drivers of property-carrying CMVs in the State of Alaska to clarify the provision. Specifically, existing paragraph (h)(1) would be redesignated as new paragraph (h)(1)(i) and proposed paragraphs (h)(1)(ii)–(iv) would be added to address the required off-duty periods and use of the proposed sleeper-berth option. These proposed additions are derived from existing provisions applicable to Alaska under § 395.1(g) and are moved to paragraph (h) for clarity and based upon the provisions implicit under existing paragraph (h)(1). For example, the maximum 20-hour duty period under paragraph (h)(1)(ii) need not be consecutive hours and may be interrupted by any off-duty or sleeper-berth period. The reference to a 30-minute break under existing § 395.1(g)(1)(i)(B) was inadvertently added as part of a technical amendment rule (78 FR 58470, Sept. 24, 2015). That change was intended to address the hour limitations applicable in Alaska, but erroneously included the reference to a 30-minute break provision—a provision that was never intended to apply to drivers operating in Alaska, given the specific rules applicable to such drivers. Today's proposal would eliminate that reference.

Other proposed changes are editorial in nature to improve the clarity of the rule.

B. Section 395.3 Maximum Driving Time for Property-Carrying Vehicles

Today's NPRM would allow drivers to pause their 14-hour driving window and would modify the 30-minute break requirement applicable to drivers of property-carrying CMVs.

Specifically, proposed § 395.3(a)(3)(ii) (Interruption of driving time) would modify the requirement that a driver (other than a driver operating under the short-haul exceptions) may not drive if more than 8 hours have passed since the last period in which the driver took a minimum 30-minute off-duty or sleeper-berth break. Instead, the proposal would provide that a driver may not drive more than 8 hours without at least a 30-minute interruption in time behind the wheel whether on duty, off duty, or a combination of both.

Proposed paragraph (a)(3)(iii) (*Split-duty period*) would be added to allow drivers the option to break up their 14-hour driving window by taking a single off-duty break of at least 30 consecutive minutes, but not more than 3 consecutive hours, extending the driver's 14-hour limit by the length of the off-duty break. This proposal would make clear that a break under this provision would not impact the requirement for a driver to take 10 consecutive hours off under § 395.3(a)(1).

Other proposed changes are editorial in nature and intended to improve the clarity of the rule.

X. Regulatory Analyses

A. E.O. 12866 (Regulatory Planning and Review and DOT Regulatory Policies and Procedures as Supplemented by E.O. 13563), and DOT Regulatory Policies and Procedures

FMCSA has determined that this rulemaking is an economically significant regulatory action under E.O. 12866 [40] Regulatory Planning and Review, as supplemented by E.O. 13563.[41] It also is significant under Department of Transportation regulatory policies and procedures because the economic costs and benefits of the rule exceed the $100 million annual threshold and because of the substantial Congressional and public interest concerning the HOS requirements (DOT Order 2100.6 dated December 20, 2018).

An RIA is available in the docket. That document:

- Identifies the problem targeted by this rulemaking, including a statement of the need for the action.
- Defines the scope and parameters of the analysis.
- Defines the baseline.
- Defines and evaluates the costs and benefits of the action.

The RIA is the synthesis of research conducted specific to current HOS practices, stakeholder comments, and analysis of the impacts resulting from changes to the HOS provisions proposed by this NPRM.

Affected Entities

The changes proposed in this NPRM would affect CMV drivers, motor

[40] Executive Order 12866 of September 30, 1993. Regulatory Planning and Review. (58 FR 51735, October 4, 1993).

[41] Executive Order 13563 of January 18, 2011. Improving Regulation and Regulatory Review. (76 FR 3821, January 21, 2011).

carriers, and, except as otherwise exempt under 49 CFR 390.3T(f)(2), the Federal government. The HOS regulations apply to CMV drivers. FMCSA obtained driver count information, by carrier operation, from the Motor Carrier Management Information System (MCMIS), which includes information submitted to FMCSA by motor carriers the first time the carrier applies for a DOT number, and then biennially thereafter. Table 2 below displays the 2017 estimate of CMV drivers from MCMIS. With the current baseline annual number of 6,317,068 CMV drivers (473,617 passenger carrier CMV drivers and 5,843,451 property carrier CMV drivers), FMCSA then estimated the future baseline number of CMV drivers who would be affected by the proposed rule annually during the analysis period of 2020 to 2029. These future baseline projections were developed by increasing the current baseline 2017 values consistent with occupation-specific employment growth projections obtained from the BLS Employment Projections program. As explained in the RIA, FMCSA computed a weighted average annual compound growth rate of 0.613 percent for passenger vehicle driver employees and 0.588 percent for truck driver employees. The table below provides the total annual population of CMV drivers. More detail on these driver counts can be found in the RIA.

Due to exceptions and exemptions from the HOS regulations, the total CMV driver population must be broken down based on specific criteria in order to isolate the population that would be affected by each provision of today's proposal. With the exception of the adverse driving condition provision and maximum driving window under the short-haul exception, the changes proposed in this NPRM would affect only property-carrying CMV operations. Further, the quantified cost savings anticipated from the rule are largely a function of the estimated number of drivers who are affected by the 30-minute break requirement. In general, those CMV drivers subject to the 30-minute break requirement exclude the 474,000 passenger carrier drivers, the 3.0 million drivers estimated to operate under the short-haul exception, and the 19,000 drivers from Alaska (who are not subject to the 30-minute break requirement). This analysis will refer to drivers affected by the 30-minute break requirement as CMV truck drivers. The table below provides estimates of all CMV drivers, and the CMV truck drivers that are currently subject to the 30-minute break requirement.

TABLE 2—CMV TRUCK DRIVER POPULATION

Year (A)	Passenger carrier CMV drivers (B)	Property carrier CMV drivers (C)	Total CMV drivers (D) = (B) + (C)	CMV Drivers subject to the 30-minute break requirement (E)
2017	473,617	5,843,451	6,317,068	2,866,472
2018	476,522	5,877,791	6,354,312	2,883,317
2019	479,444	5,912,332	6,391,776	2,900,261
2020	482,385	5,947,077	6,429,461	2,917,305
2021	485,343	5,982,025	6,467,368	2,934,449
2022	488,320	6,017,179	6,505,499	2,951,693
2023	491,314	6,052,540	6,543,854	2,969,039
2024	494,328	6,088,108	6,582,436	2,986,487
2025	497,359	6,123,886	6,621,245	3,004,038
2026	500,409	6,159,874	6,660,283	3,021,691
2027	503,478	6,196,073	6,699,551	3,039,449
2028	506,566	6,232,485	6,739,051	3,057,310
2029	509,673	6,269,111	6,778,784	3,075,277

Summary of Costs

FMCSA evaluated the impacts expected to result from the changes proposed in the NPRM and anticipates that there would be no new regulatory costs or increases in existing regulatory costs for the regulated entities. The NPRM would, however, improve efficiency by allowing drivers to shift their drive and work time to mitigate the effect of uncertain variables, resulting in a reduction in costs, or cost savings, to drivers and motor carriers. The Agency anticipates that the change to each provision would result in cost savings, quantitatively estimates the motor carrier cost savings attributable to the 30-minute break proposal, and qualitatively assesses cost savings of the remaining impacts resulting from today's NPRM.

30-Minute Break

Today's NPRM proposes to allow on-duty, non-driving time to fulfill the 30-minute break requirement, as opposed to the current off-duty requirement. Also, the break would be required after 8 hours of driving rather than 8 hours of on-duty time. The NPRM would thus reduce the number of drivers required to take a break (*i.e.,* those drivers whose schedules include on-duty breaks from driving would not be required to also take an off-duty break) and it also allows for flexibility in how drivers spend their time as long as they are not driving. The proposed rule would result in cost savings to carriers in the form of avoided losses in driver productivity.

FMCSA values the reduction in driver time spent in nonproductive activity as the opportunity cost to the motor carrier, which is represented by the now attainable profit, using three variables: Driver hours available for labor (*i.e.,* those hours that are currently required to be off duty, but could be on-duty but not-driving under the NPRM), an estimate of a typical average motor carrier profit margin, and the marginal cost of operating a CMV. The estimation of driver hours stems from the populations of drivers who either (1) drive more than 8 hours in an average shift, (2) work more than 8 hours in an average shift but do not drive more than 8 hours, or (3) work less than 8 hours in an average shift. Drivers who fall into category (3) would be unaffected by the proposed changes. Drivers who fall into category (2) would receive regulatory relief from the proposal, estimated as regaining a full half hour per shift. Additionally, drivers who drive more than 8 hours (category 1), would also receive regulatory relief by the allowance of on-duty, non-driving time to meet the 30-minute break requirement, estimated as regaining half of the half hour break time (15 minutes) per shift. The Agency multiplied the time estimated to be regained by drivers per affected shift, the number of affected shifts, and the estimated driver population in each driver group to produce column (A) in Table 3.

As shown in Table 3, the estimate of cost savings is the product of the total hours saved by drivers (column A), and the estimated hourly profit for motor carriers (column B). FMCSA estimates the cost savings resulting from the changes to the 30-minute break provision to be $275.4 million on an annualized basis at a 3 percent discount rate, and $274.9 million on an annualized basis at a 7 percent discount rate.

TABLE 3—TOTAL AND ANNUALIZED MOTOR CARRIER COST SAVINGS DUE TO CHANGES IN BREAK PROVISION

Year	CMV Drivers currently subject to the 30-minute break requirement	Total hours saved (A)	Profit per hour (2017$) (B)	Total cost savings—undiscounted (millions of 2017$) (C = A × B)	Total cost savings—3% discount rate (millions of 2017$)	Total cost savings—7% discount rate (millions of 2017$)
2020	2,917,305	80,582,382	$3.33	($268.5)	($260.7)	($251.0)
2021	2,934,449	81,055,933	3.33	(270.1)	(254.6)	(235.9)
2022	2,951,693	81,532,267	3.33	(271.7)	(248.6)	(221.8)
2023	2,969,039	82,011,401	3.33	(273.3)	(242.8)	(208.5)
2024	2,986,487	82,493,350	3.33	(274.9)	(237.1)	(196.0)
2025	3,004,038	82,978,132	3.33	(276.5)	(231.6)	(184.3)
2026	3,021,691	83,465,762	3.33	(278.1)	(226.2)	(173.2)
2027	3,039,449	83,956,258	3.33	(279.8)	(220.9)	(162.8)
2028	3,057,310	84,449,636	3.33	(281.4)	(215.7)	(153.1)
2029	3,075,277	84,945,914	3.33	(283.1)	(210.6)	(143.9)
Total 10-Year Cost Savings					(2,348.9)	(1,930.5)
Total Annualized Cost Savings					(275.4)	(274.9)

Notes:
(a) Total cost values may not equal the sum of the components due to rounding. (The totals shown in this column are the rounded sum of unrounded components.)
(b) Values shown in parentheses are negative values (*i.e.,* less than zero) and represent a decrease in cost or a cost savings.

Time is a scarce resource, and FMCSA recognizes that forced off-duty time is not always the drivers' best alternative. Some commenters claimed that the rigid off-duty requirement forces drivers to rest when they are not tired and penalizes them for resting. Though the Agency does not necessarily agree with these commenters' characterization of the off-duty requirement, it is reasonable to assume that the current HOS regulations are imposing an opportunity cost on drivers that could be alleviated by providing drivers greater flexibility. In recent RIAs for non-HOS regulations, FMCSA has valued the opportunity cost of drivers' time using their wage rate. In other words, the increased flexibility provided by the proposal would result in a reduction in costs, or a cost savings, to drivers equal to the number of hours saved multiplied by the driver wage rate. The Agency did not account for the opportunity cost of the driver's time in the 2011 RIA, and thus hesitates to estimate cost savings resulting from today's proposed changes. The Agency requests comments on any additional impacts that have not been discussed above.

FMCSA considered eliminating the break requirement entirely. Drivers would still use off-duty time when needed or break-up the driving task using on-duty/non-driving time. Drivers in group 1 would likely regain 15 minutes of on-duty time, and drivers in group 2 would likely regain 30 minutes of on-duty time. As in the preferred alternative, FMCSA assumes that drivers in group 1 would only regain 15 minutes because they need personal time to eat, drink, etc. That time would continue to be off-duty regardless of eliminating the requirement. Elimination of the break requirement would seem to provide additional flexibility beyond the preferred alternative; however, it would not impact driver behavior relative to the preferred alternative, and thus would result in an equivalent motor carrier cost savings.

Split-Duty Period

Currently, after being off duty for 10 or more consecutive hours, a driver of a property-carrying CMV is allowed a period of 14 consecutive hours in which to drive up to 11 hours. The 14-consecutive hour driving window begins when an individual starts any kind of work. Subject to an exception involving use of a sleeper berth, the individual cannot drive again after the end of the 14-consecutive hour period until he or she has been off duty for another 10 consecutive hours, or the equivalent of at least 10 consecutive hours. This 14-hour window currently cannot be extended by off-duty breaks that may occur during the duty period. In effect, taking a break penalizes drivers because their available work hours were spent resting. The 14-hour window was intended to prohibit drivers from extending their work day by continuing to drive after taking repeated breaks. However, many commenters to the ANPRM have stated that the 14-hour driving window does not comport with the inconsistent and sometimes unpredictable working conditions encountered during a duty period. Thus, the current rule leads to unintended consequences of added stress and potential speeding that result from the need to finish a run prior to the end of the 14-hour window.

In an effort to provide more flexibility, but still maintain the safety achieved by the 14-hour window, today's proposal would allow a single break of off-duty time, ranging from a minimum of 30 consecutive minutes, up to 3 consecutive hours, to be excluded from the 14-hour window, provided that the driver has 10 consecutive hours off-duty before the start of his or her next duty period. A single pause would allow drivers desiring to rest to take an off-duty break without fear of exhausting their available hours under the 14-hour driving window.

This proposal would not result in new requirements or costs but would allow for additional flexibility by giving drivers the ability to make informed decisions about their work and driving time. The ATRI estimated time and cost savings of a scenario similar to the proposal.[42] For reasons discussed in the RIA, FMCSA cannot extrapolate the time savings to any particular driver or trip. However, the analysis is informative and insightful. In light of the ATRI analysis, FMCSA believes that allowing drivers to rest when they are tired or during peak rush-hour or detention times would result in cost savings to drivers. The Agency requests comments on any additional impacts that have not been discussed above.

Sleeper Berth

Drivers qualifying for the HOS sleeper-berth provision in 49 CFR 395.1(g)(1)(i)(A) and (ii)(A) must, before driving, accumulate the equivalent of at least 10 consecutive hours off duty. The equivalent refers to two periods that need not be consecutive: At least 8 but fewer than 10 consecutive hours in a sleeper berth, and a separate period of at least 2 hours either in the sleeper berth or off duty, or any combination thereof. Today's NPRM would continue to allow drivers using the sleeper berth to obtain their required off-duty time by taking fewer hours in the sleeper berth. However, drivers using this option would be required to obtain one rest period of at least 7 consecutive hours in the sleeper berth, paired with another period of at least 2 hours, such that 10 hours of off-duty time is achieved. Neither period would count against the 14-hour driving window.

The sleeper berth provision proposed in today's rule allows for additional flexibility in a driver's duty day by (1) providing for an optional 1-hour reduction in the amount of time that drivers are required to spend in the sleeper berth, and (2) excluding both rest periods when calculating the 14-hour driving window. The Agency expects that carriers and drivers could realize efficiency gains by the proposed reduction in time required to be in the sleeper berth and the exclusion of the shorter off-duty period in the calculation of the 14-hour driving window. A driver that uses the sleeper berth provision today must include the shorter rest period in the calculation of the 14-hour window, resulting in an available 12 hours to complete up to 11 hours of driving. Under the proposed rule, drivers would be provided the ability to choose between split-rest options that would not reduce their available work time because the shorter rest period would be excluded from the calculation of the 14-hour driving window. The Agency, however, lacks data on the use of the sleeper berth provision today, and the number of drivers that would use it under the proposed rule. FMCSA thus requests comment on the potential frequency of the use of the sleeper berth provision today, the change in the use of the provision that would result from the proposal, and the gains in efficiency that drivers would experience due to this change.

FMCSA also considered retaining the current split option of 8/2 but excluding the shorter rest period from the calculation of the 14-hour driving window. Excluding the shorter rest period from the calculation of the 14-hour driving window would result in the same per-trip cost savings estimated for the preferred alternative but would limit the driver's flexibility. The preferred alternative would allow drivers to use a 7/3 split option, which is consistent with the split-duty period proposal in this NPRM and provides flexibility for drivers to shift an additional hour of their off-duty time in the most optimal way for their current situation.

FMCSA also considered expanding the sleeper berth options to allow a 7/3 split, while continuing to count the shorter rest period in the calculation of the 14-hour driving window. Drivers making use of this alternative would then have an 11-hour window within which to drive 11 hours. This alternative provides a false sense of flexibility due to the impractically, and would limit the use of the option to those drivers that don't anticipate reaching the maximum driving or work time. Additionally, it would eliminate the cost savings resulting from increased productivity discussed in the preferred alternative. This alternative does not meet the Agency objective of providing drivers the ability to take needed rest breaks while ensuring opportunity for an adequate rest period.

Short-Haul Operations

Currently, under 49 CFR 395.1(e)(1), drivers do not have to prepare RODS or use an ELD if they meet certain conditions, including a return to their work reporting location and release from work within 12 consecutive hours. Drivers operating under this provision are permitted a 12-hour work day in which to drive up to 11 hours (for passenger carriers, up to 10 hours) and the motor carrier must maintain time records reflecting certain information. Specifically, the motor carrier that employs the driver and utilizes this exception must maintain and retain for a period of 6 months accurate and true time records showing: The time the driver reports for duty each day; the total number of hours the driver is on duty each day; the time the driver is released from duty each day; and the total time for the preceding 7 days in accordance with 49 CFR 395.8(j)(2) for drivers used for the first time or intermittently.

Under 49 CFR 395.3(a)(2)–(3), other property-carrying CMV drivers not utilizing the short-haul exception have a 14-hour driving window in which to drive up to 11 total hours. Under 49 CFR 395.5(a)(1)–(2), CMV drivers operating passenger-carrying CMVs can operate for up to 15 hours after coming on duty. However, unless otherwise excepted, these drivers must maintain RODs, generally through the use of an ELD. The drivers qualifying for the 49 CFR 395.1(e)(1) exception currently have the option to use the 14- or 15-hour duty day in §§ 395.3 or 395.5, but may choose not to use the option to avoid keeping RODS.

Additionally, drivers currently qualifying for this HOS short-haul exception must stay within 100 air-miles of their work reporting location. In today's NPRM, FMCSA proposes to extend the air-mile radius from 100 air miles to 150 air miles, consistent with the radius requirement for the other short-haul exceptions in § 395.1(e)(2).

In the ELD rule, FMCSA anticipated that all drivers employed by passenger and private non-passenger (*i.e.,* property) carriers qualifying for the

[42] American Transportation Research Institute, "Technical Memorandum: Hours-of-Service Flexibility". August 2018. Available at: *http://atri-online.org/2018/08/28/atri-hours-of-service-flexibility-technical-memo/* (Accessed on December 31, 2018).

short-haul exception would be able to take advantage of the exception. However, FMCSA received comments on the HOS ANPRM from carriers discussing their business practices and normal operating conditions, and how the lack of flexibility in the 12-hour workday limits their ability to take advantage of the short-haul exception. On many shifts, drivers return to their work reporting location within 12 hours, but there are some occasions when drivers need an additional 2 hours in their workday. This extra time beyond 12 hours could result from detention time, longer-than-expected customer service stops, traffic, or other unforeseen events. When this occurs more than 8 days in a 30-day period, the driver must prepare daily RODS using an ELD as required by 49 CFR 395.8 (a)(1)(iii)(A)(*1*). Due to the uncertainty surrounding the driver's eligibility at the beginning of the workday, the carrier may choose to have their driver operate as though he or she is not eligible for the short-haul exception. This results in unnecessary ELD expenses. One commenter estimated that the proposal would reduce the required ELDs for its heavy-duty service vehicles by 84 percent, resulting in annual cost savings of $1.5 million. While this comment is informative and suggests that the proposed rule would result in cost savings, FMCSA cannot extrapolate from one carrier's cost savings to determine the cost savings to all carriers. Thus, while FMCSA expects the proposal to result in cost savings for the affected entities, those impacts are not quantified.

The extension of the air-mile radius by 50 air miles would afford drivers additional flexibility and allow carriers to reach customers farther from the work reporting location while maintaining eligibility for the short-haul exception. Extending the air-mile radius would not extend the driving time. FMCSA does not anticipate that extending the air-mile radius would increase market demand or result in more VMT. Rather, more carriers might use the short-haul exception. Carriers would have the flexibility to meet market demands more efficiently while maintaining eligibility for the short-haul exception. One commenter explained that the increased flexibility in the air-mile radius would reduce the number of vehicles necessary for their operation, and thus would result in cost savings of approximately $1.7 million per year. Again, motor carriers are very diverse in their operating structures, and FMCSA cannot extrapolate from one carrier's cost savings to determine the cost savings to all carriers. While FMCSA expects the proposal to result in cost savings for the affected entities, those impacts are not quantified. The Agency requests comments on the impact of extending the air-mile radius and any additional impacts that have not been discussed above.

FMCSA also considered limiting the proposal to an extension of the time required for drivers to return to their work reporting location from 12 to 14 hours, without changing the air-mile radius requirements. This alternative would decrease the population eligible for the short-haul exception relative to the preferred alternative by removing eligibility for those drivers operating between 100 and 150 air miles. Decreasing the population affected by the NPRM would decrease any cost savings resulting from the proposal.

Adverse Driving Conditions

Under the current regulations, drivers qualifying for the HOS adverse driving conditions provision in 49 CFR 395.1(b)(1) may drive for no more than 2 additional hours beyond the maximum driving time allowed under 49 CFR 395.3(a) or 395.5(a) if they encounter adverse driving conditions after dispatch. The current provision does not allow for the extension of the 14-hour driving window (or 15 hours on duty for drivers of passenger-carrying CMVs), and thus cannot be used if the adverse condition is encountered towards the end of that period. In today's rule, FMCSA proposes to allow a 2-hour extension of the 14-hour driving window (or 15 hours on duty for drivers of passenger-carrying CMVs). This proposal aligns the regulations with the intent of the adverse driving condition provision, which is to allow drivers flexibility when faced with unexpected conditions. This proposal would not increase the available driving time.

The adverse driving conditions provision is intended to provide flexibility for drivers who encounter adverse conditions which were not apparent at the time of dispatch. However, it does not currently extend the driving window, limiting its use. Today's proposal would increase flexibility by allowing drivers encountering adverse conditions to extend their driving window by the same 2 hours that currently apply to driving time. The proposed changes would provide drivers with additional options to determine the best solution based on their situation.

The Agency anticipates that the increased options and flexibility would result in cost savings to drivers, but is unable to quantify them due to a lack of data regarding the use of the adverse driving exception. The Agency requests information on current usage of the adverse driving conditions exception as well as anticipated use under the proposed rule. The Agency also welcomes comments on possible cost savings, as well as any additional impacts that have not been discussed above.

Federal Government eRODS Cost

FMCSA would incur costs to update the existing eRODS software. The eRODS software is used by safety officials (Federal, State, and local safety partners) to locate, open, and review output files transferred from a compliant ELD. The eRODS software consists of two components: a database containing the HOS requirements and the software component that compares the compliant ELD output files to the HOS requirements. The proposed changes to the 30-minute break requirement, sleeper-berth requirements, and the split duty period would necessitate updates to the eRODS database that stores the HOS requirements and some minor programming changes to the compliance algorithm aspects of the software.

The Department's Volpe National Transportation Systems Center developed the eRODS software and continues to maintain and update it when needed. Volpe estimates that the proposed rule would result in one-time eRODS software update costs of $20,000. This would include updating the HOS requirements database and minor programing changes to the software component which consist of five steps: developing a requirements analysis, design, coding, testing, and deployment of the updates.

Non-Quantified Costs

There are a number of other potential cost savings of this proposed rule that FMCSA considered that, due to uncertainty around driver behavior, could not quantify on an industry level.

FMCSA has granted 5-year exemptions from the requirement to return to the driver's normal work reporting location within 12 hours of coming on duty (examples include: (1) Waste Management Holdings, Inc.; (2) American Concrete Pumping Association; and (3) National Asphalt Paving Association).[43] During the

[43] Available at: *https://www.regulations.gov/docket?D=FMCSA-2017-0197. https://www.regulations.gov/document?D=FMCSA-2018-0181-0057,* and *https://www.regulations.gov/docket?D=FMCSA-2018-0175,* respectively.

exemption period, all drivers operating under the exemption must carry a copy of the exemption; after that period, those entities seeking to maintain the exemption must reapply. This proposal, if adopted, would result in cost savings to these entities by alleviating the need to pursue the exemption process and eliminating compliance with exemption conditions such as carrying a copy of the exemption applicable to 49 CFR 395.1(e)(1), as well as reallocating the time and resources that would have been spent on the exemption reapplication. The Federal government would experience a cost savings equal to the reduction in time and resources necessary to review, comment on, and make final determinations on the exemptions. Additional non-quantified cost savings include increased efficiency afforded to drivers through the changes to the various HOS provisions, such as, efficiency gains due to the short-haul exception; the ability of drivers to make informed decisions due to the changes to the adverse driving conditions and sleeper berth provisions; and the reduction in opportunity cost to drivers from the changes to the 30-minute break provision. The Agency requests comment on how drivers would use the changes in these provisions to inform their decision-making process. This information could assist the Agency in quantifying additional cost savings that are anticipated to result from today's rule.

The Agency did not include the cost for ELD manufacturers to update ELD equipment. A compliant ELD would not need to be updated as a result of this proposed rule. FMCSA is aware that some ELD manufacturers have chosen to go beyond the ELD requirements and provide additional features such as alerts when a driver may be close to an HOS violation. Those additional features would need to be updated as a result of the rule, or risk being inaccurate. Because the additional features are not required by FMCSA, but were developed as a selling point for individual ELD products, updating the additional features would not be a cost to this rule and FMCSA is not estimating the cost of updating the additional ELD features.

The Agency did not quantify impacts resulting from any potential decreases in congestion that may result from the proposed rule. Allowing drivers to take breaks at their convenience, such as during times of heavy traffic congestion, could allow the driver to operate at a consistent speed without the starting and stopping that occurs in heavy traffic. The ATRI technical memorandum demonstrated that avoiding congestion could result in moving freight the same number of miles in fewer work hours. This could reduce fuel and vehicle costs for the motor carriers, congestion for the public by removing large vehicles from the road during peak travel times, and the incidence of crashes related to congestion. While these impacts could result from any individual trip, FMCSA cannot estimate the magnitude or likelihood of these potential impacts for many reasons. Most notably, these impacts hinge on the availability of CMV parking. FMCSA is aware that parking is not always available, especially in urban areas or heavily travelled truck routes.

Additional non-quantified cost savings include increased flexibility resulting from the extension of the duty day and the air-mile radius for those operating under the short-haul exception; the increased options for drivers to respond to adverse driving conditions during the course of their duty period; and increased flexibility afforded to drivers, such as increased options with regard to on-duty and off-duty time resulting from changes to the 30-minute break requirement, the sleeper-berth provisions, and the new split duty period provision. The Agency requests comment on how drivers would utilize the changes in these provisions to inform their decision-making process. This information could assist the Agency in quantifying additional cost savings that are anticipated to result from today's rule.

Summary of Benefits

The Agency does not anticipate that this proposed rule would result in any new regulatory benefits. Additionally, the Agency does not believe that the proposed changes would result in any reductions in safety benefits or other regulatory benefits.

30-Minute Break

The proposed changes to the 30-minute break provision are estimated to be safety-neutral because both the current rule and the proposed rule would prevent CMV operators from driving for more than 8 hours without at least a 30-minute change in duty status. The distinction is that the proposal would focus on actual driving time rather than on-duty time, some of which may not be spent behind the wheel. The Agency discussed the value of off-duty breaks as compared to on-duty breaks in previous rulemakings, but did not quantify the safety benefits attributable to the off-duty break when the break provision was added to the HOS rules in 2011 (76 FR 81134, Dec. 27, 2011). Further, FMCSA has determined that the value of off-duty breaks relative to on-duty breaks should be reconsidered.

As discussed above and in the RIA, The Agency has carefully considered the views of numerous commenters requesting exemptions or removal of the 30-minute break requirement. As a result of the feedback, and after reviewing available research, FMCSA anticipates that an on-duty break, which would maintain a break from driving, would not adversely affect safety relative to the current requirements. Based on comments received, the Agency has taken another look at the Blanco, et al. (2011), study to determine the applicability of the study findings to the 30-minute break requirement. Today's NPRM focuses on achieving a break from driving as opposed to a break after a certain amount of time on duty. For these reasons, the Agency believes that these changes would not have an impact on the safety benefits of the HOS rules and did not quantify changes in regulatory benefits for this proposed rule.

Alternative 1, which would eliminate the 30-minute break requirement, seems to be more flexible than the preferred alternative. However, eliminating the requirement would allow drivers the opportunity to operate a vehicle for 11 hours without stopping. In general, FMCSA does not anticipate that drivers would alter their schedules to such an extent, but would likely take breaks to eat, rest, etc. However rare of an occurrence 11 continuous hours of driving may be, FMCSA considers it to be detrimental to safety. As such, alternative 1 may be more flexible and would result in an equivalent level of motor carrier cost savings, but would lead to a reduction in safety benefits relative to the preferred alternative. Therefore, FMCSA is not proposing alternative 1, but requests comment on this determination.

Split-Duty Period

Today's 14-hour continuous driving window has been perceived as regulatory discouragement against taking long breaks. Drivers may feel compelled to operate while fatigued to avoid losing available driving time, or speed to make up time from traffic congestion. FMCSA anticipates that the NPRM would increase flexibility by allowing drivers to rest when they are tired or to avoid traffic congestion, without losing available work time, and would not reduce safety relative to the current HOS requirements. Additionally, drivers would still be constrained by the 11-hour driving limit in place today.

Sleeper Berth

As discussed in the RIA and elsewhere in this preamble, there is an extensive body of research suggesting that split-sleep schedules may be a good alternative to consolidated daytime sleep, as they may improve safety and productivity as compared to consolidated daytime sleep.

This proposal would ensure that drivers using the sleeper berth to obtain the minimum off-duty time have at least one rest period of a sufficient length to have restorative benefits to counter fatigue. Today's proposal intends to provide drivers with the flexibility to make decisions regarding their rest that best fits their individual needs, while continuing to prohibit potential overly-long periods of wakefulness and duty hours that could lead to fatigue-related crashes.

The proposed sleeper-berth exception would provide drivers greater operational flexibility, while affording the opportunity for the driver to obtain the necessary amount of restorative sleep. As such, the Agency anticipates that the increased flexibility proposed in today's NPRM would not affect the safety outcomes achieved by the current sleeper berth provision. FMCSA requests comments on the frequency of use of the proposed split-rest periods provision and the impacts of the provision on safety. Additionally, the Agency invites stakeholders to identify any additional safety impacts resulting from the changes to the split-rest periods provision in today's NPRM they believe have not been adequately considered.

Alternative 1, which would maintain an 8/2 split option but exclude the shorter rest period from the calculation of the 14-hour driving window, is more restrictive than the preferred alternative by allowing fewer options for a driver to split their 10 hours of off-duty time. Based on the research discussed above, a 7/3 split option would allow for an adequate rest period such that it would not impact safety relative to an 8/2 split option. As such, alternative 1 would be more restrictive, would reduce cost savings associated with the proposal, and would not provide any additional safety benefits relative to the preferred alternative. Therefore, FMCSA is not proposing alternative 1 but requests comment on this determination.

Alternative 2, which would allow a 7/3 split option but include the shorter rest period from the calculation of the 14-hour driving window, is more restrictive than the preferred alternative by continuing to count the shorter rest period in the calculation of the 14-hour driving window. Under this alternative, a driver would be required to stop driving 14 hours after coming on-duty, regardless of how much of that 14-hour period was spent resting. Based on results in the Blanco study (2011), FMCSA believes that excluding the shorter rest period from the calculation of the 14-hour driving window would not reduce safety relative to the preferred alternative. The Blanco study showed that the SCE rate increased modestly with increasing work and driving hours. Blanco also found that breaks can be used to counteract the negative effects of time-on-task. The results from the break analyses indicated that significant safety benefits can be afforded when drivers take breaks from driving. This was a key finding in the Blanco study and clearly shows that breaks can ameliorate the negative impacts associated with fatigue and time-on-task. As such, alternative 2 would be more restrictive, reduce cost savings associated with the proposal and would not provide any additional safety benefits relative to the preferred alternative. Therefore, FMCSA is not proposing alternative 2, but requests comment on this determination.

Short-Haul Operations

The IIHS conducted a study in North Carolina in 2017 and found that interstate truck drivers operating under the short-haul exception had a crash risk 383 percent higher than those not using the exception. They recommended that, due to this finding, the Agency should not propose an extension of the short-haul exception from 12 to 14 hours. FMCSA reviewed the study and noted that while the finding was statistically significant, it was based on a very small sample size, which prevented the author from estimating a matched-pair odds ratio restricted to drivers operating under a short-haul exception, and was not nationally representative. Further, the authors noted that other related factors unobserved in the study may have led to this result. For example, it is possible that older or more poorly maintained trucks are used in local operations. Regardless, because FMCSA's number one priority is safety, the Agency investigated the safety implications of the proposal using available data.

Congress passed the FAST Act on December 4, 2015, which, among other things, requires drivers of ready-mixed concrete delivery trucks be exempted from the requirement to return to their normal work-reporting location after 12 hours of coming on duty. Beginning on December 5, 2015, operators of concrete mixer trucks met the requirements for the short-haul exception if they returned to their normal work reporting location within 14 hours after coming on duty. MCMIS contains data on crashes based on vehicle type, allowing the Agency to isolate crashes involving concrete mixer trucks both before and after the congressionally mandated changes to the short-haul exception that mirror today's proposal to extend the 12-hour limit for all short-haul operators.

The Agency first focused on the time of day when crashes occurred. Assuming the majority of concrete mixer trucks are operated on a schedule with a workday that begins in the morning hours and ends in the evening hours, those crashes that occur in the later part of the day would occur towards the end of the 12- or 14-hour workday for the concrete mixer driver. FMCSA found that the percentage of concrete mixers in crashes at later hours of the day (5:00 p.m. to 11:59 p.m.—when drivers are more likely to be close to their maximum hours for the day) has been declining in recent years, falling from 7.6 percent in 2013 to 5.8 percent in 2017.

FMCSA also examined the total number of crashes that involved concrete mixer trucks for the 2 years before and after the congressionally mandated change went into effect. From December 4, 2013, through December 3, 2015, there were 2,723 concrete mixers involved in crashes, or 0.907 percent of the total large trucks involved in crashes (2,723 concrete mixers involved in crashes/300,324 large trucks, including concrete mixers, involved in crashes). From December 4, 2015, through December 2, 2017, there were 2,955 concrete mixers involved in crashes, or 0.919 percent of the total large trucks involved in crashes (2,955 concrete mixers involved in crashes/321,471 large trucks, including concrete mixers, involved in crashes). A Chi-square test suggests that this very minor increase in the concrete mixer share of the total is not statistically significant at the $p < 0.05$ level. Both analyses suggest that the implementation of the FAST Act on December 4, 2015, did not increase the share of concrete mixers involved in crashes when extending the short-haul exception requirement from 12 to 14 hours.

FMCSA does not anticipate that extending the air-mile radius would increase market demand for services, and thus would not result in increased VMT. While more drivers or more trips would now be eligible for the short-haul exception, and thus excluded from the requirement to take a 30-minute break or prepare daily RODS, the total costs of freight transportation would likely not change to such an extent that the quantity demanded of trucking services would increase. Because total VMT is not expected to increase, the Agency does not anticipate changes in exposure or crash risk. FMCSA requests comments on the operational changes, or changes to VMT, that might result from today's proposal to extend the air-mile radius. Additionally, the Agency emphasizes the changes to the short-haul exception proposed today would not allow any additional drive time, or allow driving after the 14th hour from the beginning of the duty day. Drivers also would still be subject to the ''weekly'' limits of 60 and 70 hours, and the employer must maintain accurate time records concerning the time the driver reports for work each day and the time the driver is released from duty each day. FMCSA therefore anticipates that this proposal would not affect the crash risk of drivers operating under the short-haul exception.

Alternative 1, which would extend the time required for drivers to return to their work reporting location from 12 to 14 hours but continue to maintain a 100 air-mile radius requirement, would be more restrictive than the preferred alternative by reducing the population of drivers eligible for the short-haul exception. As discussed above, FMCSA does not anticipate that changing the air-mile radius from 100 to 150 air-miles would impact safety. As such, alternative 1 would be more restrictive, reduce any cost savings associated with the proposal, and would not provide any additional safety benefits relative to the preferred alternative. As a result, FMCSA is not proposing alternative 1, but requests comment on this determination.

Adverse Driving Conditions

The Agency defines ''adverse driving conditions'' in 49 CFR 395.2 as ''snow, sleet, fog, other adverse weather conditions, a highway covered with snow or ice, or unusual road and traffic conditions, none of which were apparent on the basis of information known to the person dispatching the run at the time it was begun.'' The adverse driving condition provision was intended to provide drivers flexibility to avoid rushing to either stay ahead of adverse conditions, make up for lost time due to poor conditions, or allow drivers time to locate a safe place to stop and wait out the adverse conditions. The Agency anticipates that today's proposed rule would enhance this goal by allowing drivers to avail themselves of this flexibility when the adverse conditions occur later in the driving window. While the Agency is not aware of any research that is specific to the impact of adverse conditions on crash risk, the flexibility provided in the proposal would allow drivers to make decisions based on current conditions without penalizing them by ''shortening'' their driving window. Further, the Agency stresses that this proposal would not increase maximum available driving time beyond that allowed by the current rule, but may increase driving hours by allowing some drivers to use more of their available driving time.

The Agency is unable to quantitatively assess the impacts on safety from today's proposal due to a lack of data regarding the use of the adverse driving provision. The Agency also lacks data on the relationship between crash risk and adverse driving conditions, and potential reductions in crash risk that result from the avoidance of these conditions. FMCSA thus requests comment on the frequency of use of the adverse driving conditions provision and the impacts of the provision on safety. Additionally, the Agency invites stakeholders to identify any additional safety impacts resulting from the changes to the adverse driving conditions provision in today's proposed rule that have not been discussed above.

Health Impacts

The RIA for the 2011 HOS final rule estimated health benefits in the form of decreased mortality risk based on decreases in daily driving time, and possible increases in sleep. The changes were largely based on limiting the use of the 34-hour restart provision. That provision, however, was removed by operation of law when the study required by the 2015 DOT Appropriations Act failed to find statistically significant benefits of the 2011 limitations on the 34-hour restart.[44] Today's proposed rule does not affect the reinstated original 34-hour restart provision, and thus the health benefits estimated in the 2011 RIA would not be affected by today's rule.

As concerns this proposed rule, FMCSA anticipates that some drivers would experience a decrease in stress, which could lead to increases in health benefits. As discussed in the RIA, drivers have repeatedly provided comments relating to stress resulting from the 14-hour limit. Both the split-duty and sleeper berth proposal could alter drivers' schedules relative to the current requirements, by allowing drivers flexibility to rest, without penalty, when they are tired or in times of heavy traffic. However, these proposals would continue to allow for an adequate rest period. Today's proposal retains the current driving time and work time, but could allow for changes in the number of hours driven or worked on any given day. The flexibilities in this proposal are intended to allow drivers to shift their drive and work time under the HOS rules in an effort to mitigate the impacts of uncertain factors (*e.g.,* traffic, weather, and detention times). Total hours driven or worked could increase or decrease on a given day, but FMCSA does not anticipate that these time shifts would negatively impact drivers health. Instead, today's proposal would empower drivers to make informed decisions based on the current situation, and as a result the proposed rule could lead to a decrease in stress and subsequent health benefits. FMCSA requests comments on the health impacts of today's proposal.

Section 12.f of DOT Order 2100.6 dated December 20, 2018 provides additional requirements for retrospective reviews, specifically each economically significant rule or high-impact rule, the responsible OA or OST component shall publish a regulatory impact report in the **Federal Register** every 5 years after the effective date of the rule while the rule remains in effect.

In accordance with the DOT order, FMCSA would assess the impact of the proposed changes to the HOS requirements within five years of the effective date of a final rule.

B. E.O. 13771 (Reducing Regulation and Controlling Regulatory Costs)

E.O. 13771, Reducing Regulation and Controlling Regulatory Costs, was

[44] Sec. 133 of the 2015 DOT Appropriations Act (Pub. L. 113–235, Dec. 16, 2014, 128 Stat. 2130, 2711) suspended the 2011 restart provisions, temporarily reinstated the pre-2011 restart rule, and required a study of the effectiveness of the new rule. Sec. 133 of the 2016 DOT Appropriations Act (Pub. L. 114–113, Dec. 18, 2015, 129 Stat. 2242, 2850) made it clear that the 2011 restart provisions would have no effect unless the study required by the 2015 DOT Appropriations Act showed that those provisions had statistically significant benefits compared to the pre-2011 restart rule. Sec. 180 of the Further Continuing and Security Assistance Appropriations Act, 2017 (Pub. L. 114–254, Dec. 10, 2016, 130 Stat. 1005, 1016) replaced Sec. 133 of the 2016 DOT Appropriations Act in its entirety to correct an error and ensure that the pre-2011 restart rule would be reinstated by operation of law unless the study required by the 2015 DOT Appropriations Act showed that the 2011 restart rule had statistically significant improvements related to safety and operator fatigue compared to the pre-2011 restart rule. DOT concluded that the study failed to find these statistically significant improvements, and the Office of Inspector General confirmed that conclusion in a report to Congress.

issued on January 30, 2017 (82 FR 9339, Feb. 3, 2017). E.O. 13771 requires that, for every one new regulation issued by an Agency, at least two prior regulations be identified for elimination, and that the cost of planned regulations be prudently managed and controlled through a budgeting process. Final implementation guidance addressing the requirements of E.O. 13771 was issued by the OMB on April 5, 2017.[45] The OMB guidance defines what constitutes an E.O. 13771 regulatory action and an E.O. 13771 deregulatory action, provides procedures for how agencies should account for the costs and cost savings of such actions, and outlines various other details regarding implementation of E.O. 13771.

This proposed rule is expected to have total costs less than zero, and, if finalized, would therefore qualify as an E.O. 13771 deregulatory action. The present value of the cost savings of this proposed rule, measured on an infinite time horizon at a 7 percent discount rate, expressed in 2016 dollars, and discounted to 2020 (the year the proposed rule would go into effect and cost savings would first be realized), is $4,055 million. On an annualized basis, these cost savings are $284 million.

For the purpose of E.O. 13771 accounting, the April 5, 2017, OMB guidance requires that agencies also calculate the costs and cost savings discounted to year 2016. In accordance with this requirement, the present value of the cost savings of this rule, measured on an infinite time horizon at a 7 percent discount rate, expressed in 2016 dollars, and discounted to 2016, is $3,094 million. On an annualized basis, these cost savings are $217 million.

C. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) of 1980, Public Law 96–354, 94 Stat. 1164 (5 U.S.C. 601–612), as amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA) (Pub. L. 104–121, 110 Stat. 857, Mar. 29, 1996) and the Small Business Jobs Act of 2010 (Pub. L. 111–240, 124 Stat. 2504 Sept. 27, 2010), requires Federal agencies to consider the effects of the regulatory action on small business and other small entities and to minimize any significant economic impact. The term ''small entities'' comprises small businesses and not-for-profit organizations that are independently owned and operated and are not dominant in their fields, and governmental jurisdictions with populations of less than 50,000. Additionally, DOT policy requires an analysis of the impact of all regulations on small entities, and mandates that agencies strive to lessen any adverse effects on these businesses. FMCSA has not determined whether this proposed rule would have a significant economic impact on a substantial number of small entities. Therefore, FMCSA is publishing this Initial Regulatory Flexibility Analysis (IRFA) to aid the public in commenting on the potential small business impacts of the proposals in this NPRM. We invite all interested parties to submit data and information regarding the potential economic impact that would result from adoption of the proposals in this NPRM. We will consider all comments received in the public comment process when making a determination or when completing a Final Regulatory Flexibility Assessment.

An IRFA must contain the following:

(1) A description of the reasons why the action by the agency is being considered;

(2) A succinct statement of the objective of, and legal basis for, the proposed rule;

(3) A description of and, where feasible, an estimate of the number of small entities to which the proposed rule will apply;

(4) A description of the projected reporting, recordkeeping, and other compliance requirements of the proposed rule, including an estimate of the classes of small entities which will be subject to the requirement and the type of professional skills necessary for preparation of the report or record;

(5) An identification, to the extent practicable, of all relevant Federal rules that may duplicate, overlap, or conflict with the proposed rule; and

(6) A description of any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any significant economic impact of the proposed rule on small entities.

Why the Action by the Agency Is Being Considered

FMCSA has longstanding processes, which provide that regulations and other agency actions be periodically reviewed and, if appropriate, revised to ensure that they continue to meet the needs for which they were originally designed, and that they remain justified.[46] Further, on October 2, 2017, DOT published a Notification of Regulatory Review and stated that it was reviewing its ''existing regulations and other agency actions to evaluate their continued necessity, determine whether they are crafted effectively to solve current problems, and evaluate whether they potentially burden the development or use of domestically produced energy resources'' (82 FR 45750). As part of these reviews, DOT sought public comment on existing rules that are good candidates for repeal, replacement, suspension, or modification. The HOS regulations and ELDs were the most common substantive topics discussed in response to the DOT Notification of Regulatory Review. The HOS regulations were identified as an area for potential modifications in 2018, due to changes in tracking HOS brought about by the implementation of the ELD rulemaking (80 FR 78292, Dec. 16, 2015). Consistent with these processes and with the goal of improving regulatory efficiency, the Agency proposes to revise the HOS requirements applicable to CMV drivers.

The Objectives of and Legal Basis for the Proposed Rule

In response to public comments received on the ANPRM and to the listening sessions held by FMCSA, the proposed rule would (1) change the short-haul exception available to certain CMV drivers by lengthening the drivers' maximum on-duty period from 12 to 14 hours and extending from 100 air miles to 150 air miles within which the driver may operate; (2) modify the adverse driving conditions exception by extending by 2 hours the maximum window during which driving is permitted; (3) provide flexibility for the 30-minute break rule by tying the break requirement to 8 hours of driving time without an interruption of at least 30 minutes and allowing the break to be satisfied by a driver using on-duty, not-driving status, rather than off duty; (4) modify the sleeper-berth exception to allow drivers to split their required 10-hours off duty into two periods, one of at least 7 consecutive hours in the sleeper berth and the other of not less than 2 consecutive hours, either off duty or in the sleeper berth, with neither period counting against the driver's 14-hour driving window; and (5) allow one off-duty break of at least 30 minutes, but not more than 3 hours, that would pause a truck driver's 14-hour window, provided the driver takes 10 consecutive hours off-duty at the end of the work shift. This NPRM is based on authority derived from the Motor Carrier Act of 1935 and the Motor Carrier Safety Act of 1984. *See* heading IV, Legal Basis for Rulemaking, above.

[45] Executive Office of the President. Office of Management and Budget. *Memorandum M–17–21. Guidance Implementing Executive Order 13771.* April 5, 2017.

[46] See footnote 4, above.

A Description of, and Where Feasible an Estimate of, the Number of Small Entities To Which the Proposed Rule Will Apply

''Small entity'' is defined in 5 U.S.C. 601(3) as having the same meaning as ''small business concern'' under Section 3 of the Small Business Act (SBA). This includes any small business concern that is independently owned and operated, and is not dominant in its field of operation. Section 601(4), likewise, includes within the definition of ''small entities'' not-for-profit enterprises that are independently owned and operated, and are not dominant in their fields of operation. Additionally, Section 601(5) defines ''small entities'' as governments of cities, counties, towns, townships, villages, school districts, or special districts with populations less than 50,000. Small businesses are defined by the SBA Table of Size standards, which adopts the NAICS codes for industry sectors.

This proposed rule would affect drivers, motor carriers, and the Federal government. Drivers are not considered small entities because they do not meet the definition of a small entity in Section 601 of the RFA. Specifically, drivers are considered neither a small business under Section 601(3) of the RFA, nor are they considered a small organization under Section 601(4) of the RFA.

The SBA defines the size standards used to classify entities as small. SBA establishes separate standards for each industry, as defined by the North American Industry Classification System (NAICS). It is estimated that the motor carriers that would experience regulatory relief under the proposed rule would be in industries within Subsector 484 (Truck Transportation). These industries include General Freight Trucking (4841) and Specialized Freight Trucking (4842). Subsector 484 has an SBA size standard based on annual revenue of $27.5 million.

FMCSA examined data from the Statistics of U.S. Businesses (SUSB) annual data tables by Enterprise Receipt size and the 2012 Economic Census, the most recent Census for which data were available, to determine the percentage of firms that have revenue at or below SBA's thresholds. Although boundaries for the revenue categories used in the Economic Census do not exactly coincide with the SBA thresholds, FMCSA was able to make reasonable estimates using these data.

Motor carrier operations in the Truck Transportation industry primarily earn their revenue via the movement of goods. According to the 2012 Economic Census, 98,312 Truck Transportation firms operated for the entire year. As shown in Table 4, according to the Economic Census, at least 98 percent of trucking firms with employment had annual revenue less than $25 million; the Agency concluded that the percentage would be approximately the same using the SBA threshold of $27.5 million as the boundary.

TABLE 4—ESTIMATES OF NUMBERS OF SMALL ENTITIES WITH EMPLOYMENT

NAICS code	Description	Total number of firms	Number of small entities	Percent of all firms
484	Truck Transportation	98,312	96,539	98
484110	General Freight Trucking, Local	25,754	25,270	98
484121	General Freight Trucking, Long-Distance, Truckload	25,933	25,268	97
484122	General Freight Trucking, Long-Distance, Less Than Truckload	3,525	3,410	97
484210	Used Household and Office Goods Moving	6,945	6,860	99
484220	Specialized Freight (except Used Goods) Trucking, Local	29,048	28,588	98
484230	Specialized Freight (except Used Goods) Trucking, Long-Distance	7,623	7,285	96

Source: U.S. Census Bureau. 2012 SUSB Annual Data Tables by Establishment Industry. Available at: *https://www.census.gov/data/tables/2012/econ/susb/2012-susb-annual.html.*

The SUSB data includes information from most U.S. business establishments but does not include data on sole-proprietorship establishments, commonly referred to in the truck transportation industry as owner/operators. The U.S. Census Bureau also provides the Nonemployer Statistics, which is an annual series that provides subnational economic data for businesses that have no paid employees and are subject to federal income tax. This series includes the number of establishments by the total receipts (*i.e.,* revenue) by industry.[47] An establishment is a single physical location at which business is conducted. A firm, or business, may consist of multiple establishments. It is not clear if a sole-proprietorship would report a single or multiple establishments. The Nonemployer Statistics for 2016 reports a total or 587,038 establishments. This is slightly larger than expected because MCMIS contains information for a total of 493,730 active interstate freight motor carriers. The Nonemployer Statistics could include a large number of intrastate freight motor carriers that are not regulated by FMCSA. Regardless, FMCSA assumes that all owner/operator firms would be considered small under the SBA thresholds, and requests comment on the number of interstate freight motor carriers that are considered owner/operators.

FMCSA does not have exact estimates on the per-motor carrier impact of this proposal. The RIA for the NPRM estimated cost savings associated with the proposed changes to the 30-minute break requirement. For illustrative purposes within this IRFA, FMCSA developed a per-driver annual cost savings estimate. As shown below, a firm with one driver could expect a cost savings of approximately $127 in 2020, the first year of the analysis.

[47] U.S. Census Bureau. 2018 Nonemployer Statistics. Available at: *https://www.census.gov/programs-surveys/nonemployer-statistics.html.*

TABLE 5—WEIGHTED ANNUAL PER-DRIVER COST SAVINGS OF THE PROPOSED CHANGES TO THE 30-MINUTE BREAK REQUIREMENT

Driver group	Hours saved per shift [a]	Shifts per year [b]	Annual hours saved per driver [c]	Annual per-driver cost savings [d]	Percent of total hours [e]
Group 1	0.25	120	30	$99.98	19
Group 2	0.50	80	40	133.30	81
Group 3	0.00	60	0	0	0
Weighted Annual Per-Driver Cost Savings					$127.04

[a] See Table 5 in the RIA.
[b] See Table 6 in the RIA.
[c] Hours Saved per Shift × Annual Hours Saved per Driver.
[d] Annual Hours Saved per Driver × $3.33 Motor Carrier Profit Margin.
[e] See Table 7 in the RIA, Total Hours Saved per Year, by Group ÷ Total Hours Saved per Year for All Groups.

A Description of the Proposed Reporting, Recordkeeping and Other Compliance Requirements of the Proposed Rule, Including an Estimate of the Classes of Small Entities Which Will Be Subject to the Requirement and Type of Professional Skills Necessary for Preparation of the Report or Record

This proposed rule would not change recordkeeping requirements as compared to what is currently required by the HOS rules.

An Identification, to the Extent Practicable, of All Relevant Federal Rules That May Duplicate, Overlap, or Conflict With the Proposed Rule

FMCSA is not aware of any relevant Federal rules that may duplicate, overlap, or conflict with the proposed rule. The current HOS rules would be replaced by those in the NPRM.

A Description of Any Significant Alternatives to the Proposed Rule Which Accomplish the Stated Objectives of Applicable Statutes and Which Minimize Any Significant Economic Impact of the Proposed Rule on Small Entities

In developing this proposal, FMCSA considered alternatives that would involve: (1) Requiring an off-duty 30-minute break following 8 hours of driving, (2) eliminating the 30-minute break requirement entirely; (3) continuing to allow and 8/2 sleeper berth option, but excluding the shorter rest period from the calculation of the 14-hour driving window; (4) allowing both an 8/2 and a 7/3 sleeper berth option, but continuing to include the shorter rest period in the calculation of the 14-hour driving window; (5) allowing drivers to maintain eligibility for the short-haul exception if they return to their work reporting location within 14 hours, but maintaining the current air-mile radius; and (6) a ''no-action'' alternative for both the split-duty period and adverse driving condition proposals. These alternatives generally would be more restrictive, reduce or eliminate any cost savings associated with the proposal, and would not provide any additional safety benefits relative to the preferred alternative. FMCSA requests comments, with supporting data, on these and any other alternatives that would meet the intent of the statutes and prove cost beneficial for small entities.

Requests for Comment To Assist Regulatory Flexibility Analysis

FMCSA requests comments on all aspects of this IRFA and on the cost and benefit impacts that small business may experience as a result of this rule.

FMCSA is not a covered agency as defined in Section 609(d)(2) of the Regulatory Flexibility Act, and has taken no steps to minimize the additional cost of credit for small entities.

D. Assistance for Small Entities

In accordance with section 213(a) of the SBREFA, FMCSA wants to assist small entities in understanding this proposed rule so that they can better evaluate its effects on themselves and participate in the rulemaking initiative. If the proposed rule would affect your small business, organization, or governmental jurisdiction and you have questions concerning its provisions or options for compliance, please consult the FMCSA point of contact, Richard Clemente, listed in the **FOR FURTHER INFORMATION CONTACT** section of this proposed rule.

Small businesses may send comments on the actions of Federal employees who enforce or otherwise determine compliance with Federal regulations to the Small Business Administration's Small Business and Agriculture Regulatory Enforcement Ombudsman and the Regional Small Business Regulatory Fairness Boards. The Ombudsman evaluates these actions annually and rates each agency's responsiveness to small business. If you wish to comment on actions by employees of FMCSA, call 1–888–REG–FAIR (1–888–734–3247). DOT has a policy regarding the rights of small entities to regulatory enforcement fairness and an explicit policy against retaliation for exercising these rights.

E. Unfunded Mandates Reform Act of 1995

The Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531–1538) requires Federal agencies to assess the effects of their discretionary regulatory actions. In particular the Act addresses actions that may result in the expenditure by a State, local, or tribal government, in the aggregate, or by the private sector, of $161 million (which is the value equivalent of $100,000,000 in 1995, adjusted for inflation to 2017 levels) or more in any 1 year. Because this proposed rule would not result in such an expenditure, a written statement is not required. However, the Agency does discuss the costs and benefits of this proposed rule elsewhere in this preamble.

F. Paperwork Reduction Act

This proposed rule would not call for a new collection of information under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520). This proposed rule would not modify the existing approved collection of information (OMB Control Number 2126–0001, HOS of Drivers Regulations, approved Jun. 13, 2016, through Jun. 30, 2019).

G. E.O. 13132 (Federalism)

A rule has implications for federalism under section 1(a) of E.O. 13132 if it has ''substantial direct effects 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.'' FMCSA determined that this proposal would not have substantial direct costs on or for States, nor would it limit the policymaking discretion of States. Nothing in this document preempts any State law or regulation. Therefore, this rule does not have sufficient federalism implications to warrant the preparation of a Federalism Impact Statement.

H. E.O. 12988 (Civil Justice Reform)

This proposed rule meets applicable standards in sections 3(a) and 3(b)(2) of E.O. 12988, Civil Justice Reform, to minimize litigation, eliminate ambiguity, and reduce burden.

I. E.O. 13045 (Protection of Children)

E.O. 13045, Protection of Children from Environmental Health Risks and Safety Risks (62 FR 19885, April 23, 1997), requires agencies issuing ''economically significant'' rules, if the regulation also concerns an environmental health or safety risk that an agency has reason to believe may disproportionately affect children, to include an evaluation of the regulation's environmental health and safety effects on children. The Agency determined this proposed rule is economically significant, however it does not anticipate that this regulatory action could in any respect present an environmental or safety risk that could disproportionately affect children.

J. E.O. 12630 (Taking of Private Property)

FMCSA reviewed this proposed rule in accordance with E.O. 12630, Governmental Actions and Interference with Constitutionally Protected Property Rights, and has determined it would not effect a taking of private property or otherwise have taking implications.

K. Privacy

Section 522 of title I of division H of the Consolidated Appropriations Act, 2005, enacted December 8, 2004 (Pub. L. 108–447, 118 Stat. 2809, 3268, note following 5 U.S.C. 552a), requires the Agency to conduct a Privacy Impact Assessment of a regulation that will affect the privacy of individuals. The assessment considers impacts of the rule on the privacy of information in an identifiable form and related matters. The FMCSA Privacy Officer has evaluated the risks and effects the rulemaking might have on collecting, storing, and sharing personally identifiable information and has evaluated protections and alternative information handling processes in developing the rule to mitigate potential privacy risks. FMCSA determined that this rule does not require the collection of individual personally identifiable information.

Additionally, the Agency submitted a Privacy Threshold Assessment analyzing the rulemaking and the specific process for collection of personal information to the DOT, Office of the Secretary's Privacy Office. The DOT Privacy Office has determined that this rulemaking does not create privacy risk.

The E-Government Act of 2002, Public Law 107–347, sec. 208, 116 Stat. 2899, 2921 (Dec. 17, 2002), requires Federal agencies to conduct a Privacy Impact Assessment for new or substantially changed technology that collects, maintains, or disseminates information in an identifiable form. No new or substantially changed technology would collect, maintain, or disseminate information because of this proposed rule.

L. E.O. 12372 (Intergovernmental Review)

The regulations implementing E.O. 12372 regarding intergovernmental consultation on Federal programs and activities do not apply to this rulemaking.

M. E.O. 13211 (Energy Supply, Distribution, or Use)

FMCSA has analyzed this proposed rule under E.O. 13211, Actions Concerning Regulations That Significantly Affect Energy Supply, Distribution, or Use. The Agency has determined that it is not a ''significant energy action'' under that order because it is not a ''significant regulatory action'' likely to have a significant adverse effect on the supply, distribution, or use of energy. Therefore, it does not require a Statement of Energy Effects under E.O. 13211.

N. E.O. 13783 (Promoting Energy Independence and Economic Growth)

E.O. 13783 directs executive departments and agencies to review existing regulations that potentially burden the development or use of domestically produced energy resources, and to appropriately suspend, revise, or rescind those that unduly burden the development of domestic energy resources. In accordance with E.O. 13783, DOT prepared and submitted a report to the Director of OMB that provides specific recommendations that, to the extent permitted by law, could alleviate or eliminate aspects of agency action that burden domestic energy production. This proposed rule has not been identified by DOT under E.O. 13783 as potentially alleviating unnecessary burdens on domestic energy production.

O. E.O. 13175 (Indian Tribal Governments)

This proposed rule does not have tribal implications under E.O. 13175, Consultation and Coordination with Indian Tribal Governments, because it does not have a substantial direct effect on one or more Indian tribes, on the relationship between the Federal government and Indian tribes, or on the distribution of power and responsibilities between the Federal government and Indian tribes.

P. National Technology Transfer and Advancement Act (Technical Standards)

The National Technology Transfer and Advancement Act (note following 15 U.S.C. 272) directs agencies to use voluntary consensus standards in their regulatory activities unless the agency provides Congress, through OMB, with an explanation of why using these standards would be inconsistent with applicable law or otherwise impractical. Voluntary consensus standards (*e.g.,* specifications of materials, performance, design, or operation; test methods; sampling procedures; and related management systems practices) are standards that are developed or adopted by voluntary consensus standards bodies. This proposed rule does not use technical standards. Therefore, FMCSA did not consider the use of voluntary consensus standards.

Q. Environment (CAA, NEPA)

FMCSA completed an environmental assessment (EA) pursuant to the National Environmental Policy Act of 1969 (NEPA) (42 U.S.C. 4321 *et seq.*), 40 CFR parts 1500–1508, Council on Environmental Quality Regulations for Implementing NEPA, as amended, FMCSA Order 5610.1, *National Environmental Policy Act Implementing Procedures and Policy for Considering Environmental Impacts,* March 1, 2004, and DOT Order 5610.1C, *Procedures for Considering Environmental Impacts,* as amended on July 13, 1982 and July 30, 1985. The EA is in the docket pertaining to this rulemaking. As discussed in the EA, FMCSA also analyzed this proposed rule under the Clean Air Act, as amended, section 176(c), (42 U.S.C. 7401 *et seq.*) and implementing regulations promulgated by the Environmental Protection Agency. FMCSA concludes that the issuance of the proposed rule would not significantly affect the quality of the human environment. Therefore, an environmental impact statement process is unnecessary. FMCSA requests comments on this analysis.

List of Subjects in 49 CFR Part 395

Highway safety, Motor carriers, Reporting and recordkeeping requirements.

In consideration of the foregoing, FMCSA proposes to amend 49 CFR part 395.

PART 395—HOURS OF SERVICE OF DRIVERS

■ 1. The authority citation for part 395 continues to read as follows:

Authority: 49 U.S.C. 504, 31133, 31136, 31137, 31502; sec. 113, Pub. L. 103–311, 108 Stat. 1673, 1676; sec. 229, Pub. L. 106–159 (as added and transferred by sec. 4115 and amended by secs. 4130–4132, Pub. L. 109–59, 119 Stat. 1144, 1726, 1743, 1744); sec. 4133, Pub. L. 109–59, 119 Stat. 1144, 1744; sec. 108, Pub. L. 110–432, 122 Stat. 4860–4866; sec. 32934, Pub. L. 112–141, 126 Stat. 405, 830; sec. 5206(b), Pub. L. 114–94, 129 Stat. 1312, 1537; and 49 CFR 1.87.

■ 2. Amend § 395.1 by revising paragraphs (b)(1), (e)(1), (g)(1) and (h) to read as follows:

§ 395.1 Scope of rules in this part.

* * * * *

(b) * * * (1) *Adverse driving conditions.* Except as provided in paragraph (h)(3) of this section, a driver who encounters adverse driving conditions, as defined in § 395.2, and cannot, because of those conditions, safely complete the run within the maximum driving time or duty time during which driving is permitted under §§ 395.3(a) or 395.5(a) may drive and be permitted or required to drive a commercial motor vehicle for not more than 2 additional hours beyond the maximum allowable hours to complete that run or to reach a place offering safety for the occupants of the commercial motor vehicle and security for the commercial motor vehicle and its cargo.

* * * * *

(e) * * * (1) *150 air-mile radius.* A driver is exempt from the requirements of §§ 395.8 and 395.11 if:

(i) The driver operates within a 150 air-mile radius (172.6 miles) of the normal work reporting location;

(ii) The driver, except a driver-salesperson, returns to the work reporting location and is released from work within 14 consecutive hours;

(iii)(A) A property-carrying commercial motor vehicle driver has at least 10 consecutive hours off duty separating each 14 hours on duty;

(B) A passenger-carrying commercial motor vehicle driver has at least 8 consecutive hours off duty separating each 14 hours on duty; and

(iv) The motor carrier that employs the driver maintains and retains for a period of 6 months accurate and true time records showing:

(A) The time the driver reports for duty each day;

(B) The total number of hours the driver is on duty each day;

(C) The time the driver is released from duty each day; and

(D) The total time for the preceding 7 days in accordance with § 395.8(j)(2) for drivers used for the first time or intermittently.

* * * * *

(g) * * * (1) *Property-carrying commercial motor vehicle*—(i) *General.* A driver who operates a property-carrying commercial motor vehicle equipped with a sleeper berth, as defined in § 395.2, and uses the sleeper berth to obtain the required off duty time must accumulate:

(A) At least 10 consecutive hours off duty;

(B) At least 10 consecutive hours of sleeper-berth time;

(C) A combination of consecutive sleeper-berth and off-duty time amounting to at least 10 hours;

(D) A combination of sleeper-berth time of at least 7 consecutive hours and up to 3 hours riding in the passenger seat of the vehicle while the vehicle is moving on the highway, either immediately before or after the sleeper berth time, amounting to at least 10 consecutive hours; or

(E) The equivalent of at least 10 consecutive hours off duty calculated under paragraphs (g)(1)(ii) and (iii) of this section.

(ii) *Sleeper berth.* A driver may accumulate the equivalent of at least 10 consecutive hours off duty by taking not more than two periods of either sleeper-berth time or a combination of off-duty time and sleeper-berth time if:

(A) Neither rest period is shorter than 2 consecutive hours;

(B) One rest period is at least 7, but less than 10, consecutive hours in the sleeper berth;

(C) The total of the two periods is at least 10 hours; and

(D) Driving time in the period immediately before and after each rest period, when added together:

(*1*) Does not exceed 11 hours under § 395.3(a)(3); and

(*2*) Does not violate the 14-hour duty-period limit under § 395.3(a)(2).

(iii) *Calculation.* The 14-hour driving window for purposes of § 395.3(a)(2) does not include qualifying rest periods under paragraph (g)(1)(ii) of this section.

* * * * *

(h) *State of Alaska*—(1) *Property-carrying commercial motor vehicle.* (i) *In general.* The provisions of § 395.3(a) and (b) do not apply to any driver who is driving a commercial motor vehicle in the State of Alaska. A driver who is driving a property-carrying commercial motor vehicle in the State of Alaska must not drive or be required or permitted to drive:

(A) More than 15 hours following 10 consecutive hours off duty;

(B) After being on duty for 20 hours or more following 10 consecutive hours off duty;

(C) After having been on duty for 70 hours in any period of 7 consecutive days, if the motor carrier for which the driver drives does not operate every day in the week; or

(D) After having been on duty for 80 hours in any period of 8 consecutive days, if the motor carrier for which the driver drives operates every day in the week.

(ii) *Off-duty periods.* Before driving, a driver who operates a property-carrying commercial motor vehicle equipped with a sleeper berth, as defined in § 395.2, and uses the sleeper berth to obtain the required off-duty time in the State of Alaska must accumulate:

(A) At least 10 consecutive hours off duty;

(B) At least 10 consecutive hours of sleeper-berth time;

(C) A combination of consecutive sleeper-berth and off-duty time amounting to at least 10 hours;

(D) A combination of consecutive sleeper-berth time and up to 3 hours riding in the passenger seat of the vehicle while the vehicle is moving on a highway, either immediately before or after a period of at least 7, but less than 10, consecutive hours in the sleeper berth; or

(E) The equivalent of at least 10 consecutive hours off duty calculated under paragraph (h)(1)(iii) of this section.

(iii) *Sleeper berth.* A driver who uses a sleeper berth to comply with the Hours of Service regulations may accumulate the equivalent of at least 10 consecutive hours off duty by taking not more than two periods of either sleeper-berth time or a combination of off-duty time and sleeper-berth time if:

(A) Neither rest period is shorter than 2 consecutive hours;

(B) One rest period is at least 7 consecutive hours in the sleeper berth;

(C) The total of the two periods is at least 10 hours; and

(D) Driving time in the period immediately before and after each rest period, when added together:

(*1*) Does not exceed 15 hours; and

(*2*) Does not violate the 20-hour duty period under paragraph (h)(1)(i)(B) of this section.

(iv) *Calculation.* The 20-hour duty period under paragraph (h)(1)(i)(B) does not include off-duty or sleeper-berth time.

(2) *Passenger-carrying commercial motor vehicle.* The provisions of § 395.5 do not apply to any driver who is driving a passenger-carrying commercial motor vehicle in the State of Alaska. A driver who is driving a passenger-carrying commercial motor vehicle in the State of Alaska must not drive or be required or permitted to drive—

(i) More than 15 hours following 8 consecutive hours off duty;

(ii) After being on duty for 20 hours or more following 8 consecutive hours off duty;

(iii) After having been on duty for 70 hours in any period of 7 consecutive days, if the motor carrier for which the driver drives does not operate every day in the week; or

(iv) After having been on duty for 80 hours in any period of 8 consecutive days, if the motor carrier for which the driver drives operates every day in the week.

(3) *Adverse driving conditions.* (i) A driver who is driving a commercial motor vehicle in the State of Alaska and who encounters adverse driving conditions (as defined in § 395.2) may drive and be permitted or required to drive a commercial motor vehicle for the period of time needed to complete the run.

(ii) After a property-carrying commercial motor vehicle driver completes the run, that driver must be off duty for at least 10 consecutive hours before he/she drives again; and

(iii) After a passenger-carrying commercial motor vehicle driver completes the run, that driver must be off duty for at least 8 consecutive hours before he/she drives again.

* * * * *

■ 3. Amend § 395.3 by revising paragraphs (a)(2) and (3) to read as follows:

§ 395.3 Maximum driving time for property-carrying vehicles.

(a) * * *

(2) *14-hour period.* Except as provided in paragraph (a)(3)(iii) of this section, a driver may not drive after a period of 14 consecutive hours after coming on duty following 10 consecutive hours off duty.

(3) *Driving time and interruptions of driving periods.* (i) *Driving time.* A driver may drive a total of 11 hours during the period specified in paragraph (a)(2) of this section.

(ii) *Interruption of driving time.* Except for drivers who qualify for either of the short-haul exceptions in § 395.1(e)(1) or (2), driving is not permitted if more than 8 hours of driving time have passed without at least a 30-minute consecutive interruption in driving status, either off duty or on duty.

(iii) *Split duty period.* (A) A driver may take one off-duty break of at least 30 minutes, but not more than 3 hours, during the driver's 14-hour period specified in paragraph (a)(2) of this section and extend the 14-hour period for the length of the driver's off-duty break.

(B) An off-duty break under paragraph (a)(3)(iii)(A) of this section does not affect the requirement that a driver take 10 consecutive hours off duty under paragraph (a)(1) of this section.

* * * * *

Issued under authority delegated in 49 CFR 1.87 on: August 13, 2019.

Raymond P. Martinez,

Administrator.

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