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A cumulative list of the parts affected this month can be found in the Reader Aids section at the end of this issue.

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Presidential Documents

Title 3—

The President

Proclamation 9978 of January 21, 2020

National Sanctity of Human Life Day, 2020

By the President of the United States of America

A Proclamation

Every person—the born and unborn, the poor, the downcast, the disabled, the infirm, and the elderly—has inherent value. Although each journey is different, no life is without worth or is inconsequential; the rights of all people must be defended. On National Sanctity of Human Life Day, our Nation proudly and strongly reaffirms our commitment to protect the precious gift of life at every stage, from conception to natural death.

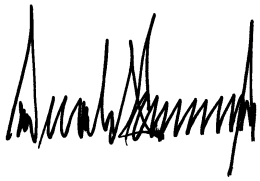
Recently, we have seen decreases in the total number and rate of abortions in our country. From 2007–2016, the most recent period of analysis, the number and rate of abortions decreased by 24 percent and 26 percent, respectively. The rate of teen pregnancies—the vast majority of which are unplanned—has almost continuously decreased over the last quarter century, contributing to the lowest rate of abortions among adolescents since the legalization of abortion in 1973. All Americans should celebrate this decline in the number and rate of abortions, which represents lives saved. Still, there is more to be done, and, as President, I will continue to fight to protect the lives of the unborn. I signed into law legislation under the Congressional Review Act that allows States and other grantees to exclude organizations that perform abortions from their Title X projects. My Administration has also issued regulations to ensure Title X family planning projects are clearly separated from those that perform, promote, or refer for abortion as a method of family planning; to protect the conscience rights of healthcare workers and organizations, including with respect to abortion; and to ensure the Federal Government does not force employers that object, based on religious belief or moral conviction, to provide insurance for contraceptives, including those they believe cause early abortions. Additionally, I have called on the Congress to act to prohibit abortions of later-term babies who can feel pain.

My Administration is also building an international coalition to dispel the concept of abortion as a fundamental human right. So far, 24 nations representing more than a billion people have joined this important cause. We oppose any projects that attempt to assert a global right to taxpayer-funded abortion on demand, up to the moment of delivery. And we will never tire of defending innocent life—at home or abroad.

As a Nation, we must remain steadfastly dedicated to the profound truth that all life is a gift from God, who endows every person with immeasurable worth and potential. Countless Americans are tireless defenders of life and champions for the vulnerable among us. We are grateful for those who support women experiencing unexpected pregnancies, those who provide healing to women who have had abortions, and those who welcome children into their homes through foster care and adoption. On National Sanctity of Human Life Day, we celebrate the wonderful gift of life and renew our resolve to build a culture where life is always revered.

NOW, THEREFORE, I, DONALD J. TRUMP, President of the United States of America, by virtue of the authority vested in me by the Constitution and the laws of the United States, do hereby proclaim January 22, 2020, as National Sanctity of Human Life Day. Today, I call on the Congress to join me in protecting and defending the dignity of every human life, including those not yet born. I call on the American people to continue to care for women in unexpected pregnancies and to support adoption and foster care in a more meaningful way, so every child can have a loving home. And finally, I ask every citizen of this great Nation to listen to the sound of silence caused by a generation lost to us, and then to raise their voices for all affected by abortion, both seen and unseen.

IN WITNESS WHEREOF, I have hereunto set my hand this twenty-first day of January, in the year of our Lord two thousand twenty, and of the Independence of the United States of America the two hundred and forty-fourth.



[FR Doc. 2020–01343
Filed 1–23–20; 8:45 am]
Billing code 3295–F0–P

Rules and Regulations

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DEPARTMENT OF AGRICULTURE

Agricultural Marketing Service

7 CFR Part 1260

[No. AMS–LP–19–0054]

Beef Promotion and Research Rules and Regulations

Correction

In rule document 2019–28058 beginning on page 825 in the issue of Wednesday, January 8, 2020, make the following correction:

§ 1260.172 [Corrected]

On page 826, table 2, should appear as follows:

TABLE 2 TO PARAGRAPH (b)(2)—IMPORTED BEEF AND BEEF PRODUCTS

HTS code	Assessment rate per kg
0201.10.0510	.01431558
0201.10.0590	.00379102
0201.10.1010	.01431558
0201.10.1090	.00379102
0201.10.5010	.01431558
0201.10.5090	.00511787
0201.20.0200	.00530743
0201.20.0400	.00511787
0201.20.0600	.00379102
0201.20.1000	.00530743
0201.20.3000	.00511787
0201.20.5015	.01431558
0201.20.5025	.00379102
0201.20.5035	.00379102
0201.20.5045	.00379102
0201.20.5055	.00379102
0201.20.5065	.00379102
0201.20.5075	.00379102
0201.20.5085	.00379102
0201.20.8090	.00379102
0201.30.0200	.00530743
0201.30.0400	.00511787
0201.30.0600	.00379102
0201.30.1000	.00530743
0201.30.3000	.00511787
0201.30.5015	.02090075
0201.30.5025	.00511787
0201.30.5035	.00511787
0201.30.5045	.00511787
0201.30.5055	.00511787

TABLE 2 TO PARAGRAPH (b)(2)—IMPORTED BEEF AND BEEF PRODUCTS—Continued

HTS code	Assessment rate per kg
0201.30.5065	.00511787
0201.30.5075	.00511787
0201.30.5085	.00511787
0201.30.8090	.00511787
0202.10.0510	.01431558
0202.10.0590	.00379102
0202.10.1010	.01431558
0202.10.1090	.00370102
0202.10.5010	.01431558
0202.10.5090	.00379102
0202.20.0200	.00530743
0202.20.0400	.00511787
0202.20.0600	.00379102
0202.20.1000	.00530743
0202.20.3000	.00511787
0202.20.5025	.00379102
0202.20.5035	.00379102
0202.20.5045	.00379102
0202.20.5055	.00379102
0202.20.5065	.00379102
0202.20.5075	.00379102
0202.20.5085	.00379102
0202.20.8000	.00379102
0202.30.0200	.00530743
0202.30.0400	.00511787
0202.30.0600	.00527837
0202.30.1000	.00530743
0202.30.3000	.00511787
0202.30.5015	.02090075
0202.30.5025	.00511787
0202.30.5035	.00511787
0202.30.5045	.00511787
0202.30.5055	.00511787
0202.30.5065	.00511787
0202.30.5075	.00511787
0202.30.5085	.00511787
0202.30.8000	.00379102
0206.10.0000	.00379102
0206.21.0000	.00379102
0206.22.0000	.00379102
0206.29.0000	.00379102
0210.20.0000	.00615701
1601.00.4010	.00473877
1601.00.4090	.00473877
1601.00.6020	.00473877
1602.50.0500	.00771610
1602.50.0720	.00663428
1602.50.0740	.00663428
1602.50.0800	.00663428
1602.50.2120	.00701388
1602.50.2140	.00701388
1602.50.6000	.00720293

[FR Doc. C1–2019–28058 Filed 1–23–20; 8:45 am]

BILLING CODE 1301–00–D

DEPARTMENT OF AGRICULTURE

Commodity Credit Corporation

7 CFR Part 1468

[Docket ID NRCS–2019–0006]

RIN 0578–AA66

Agricultural Conservation Easement Program

AGENCY: Natural Resources Conservation Service (NRCS) and the Commodity Credit Corporation (CCC), U.S. Department of Agriculture (USDA).

ACTION: Interim rule; correction and extension of comment period.

SUMMARY: On January 6, 2020, CCC and NRCS published an interim rule in the **Federal Register** that made changes to the Agricultural Conservation Easement Program (ACEP) regulations. This correction is being published to address minor errors in the preamble portion of the ACEP interim rule published on January 6, 2020. There are no changes to the ACEP regulations as published on January 6, 2020. CCC and NRCS are also extending the comment period and asking for public input on additional specific questions.

DATES: *Effective*: January 24, 2020.

Comments Date: The comment period for the Interim rule published January 6, 2020, at 85 FR 558, is extended. We will consider comments that we receive by March 20, 2020.

ADDRESSES: We invite you to submit comments on the ACEP interim rule as amended by this correction, the EA, and FONSI. In your comment, please specify RIN 0578–AA66 and include the date, volume, and page number of this issue of the **Federal Register**, and the title of the rule. You may submit comments through the:

- *Federal eRulemaking Portal:* Go to *http://www.regulations.gov* and search for Docket ID NRCS–2019–0006. Follow the online instructions for submitting comments.

All written comments received will be publicly available on *www.regulations.gov*.

A copy of the related Environmental Analysis (EA) and Finding of No Significant Impact (FONSI) may be obtained at *https://www.nrcs.usda.gov/wps/portal/nrcs/detailfull/national/programs/farmbill/?cid=stelprdb1263599*.

A hard copy may also be requested in one of the following ways:

• *Via mail: karen.fullen@usda.gov* with ''Request for EA'' in the subject line; or

• *A written request:* Karen Fullen, Environmental Compliance Specialist, Natural Resources Conservation Service, 9173 W Barnes Dr., Suite C, Boise, ID 83709.

FOR FURTHER INFORMATION CONTACT: Jeffrey White, 202–720–1882; email: *Jeffrey.White2@usda.gov*. Persons with disabilities who require alternative means for communication should contact the USDA Target Center at (202) 720–2600 (voice).

SUPPLEMENTARY INFORMATION: The ACEP interim rule was published in the **Federal Register** on January 6, 2020, (85 FR 558–590) to make changes to the ACEP policies and procedures in the ACEP regulations in 7 CFR part 1468. This correction is being published to address minor errors in the preamble portion of the ACEP interim rule. There are no changes to the ACEP regulations as published on January 6, 2020.

The Docket ID provided in the **ADDRESSES** section in the interim rule was incorrect as it should have matched the number provided in the document heading. The correct Docket ID is NRCS–2019–0006 and is correct throughout this document.

Additionally, in the ACEP wetland reserve easements (ACEP–WRE) Key-Changes preamble section on ACEP–WRE Wetland Restoration, on page 564 of the January 6, 2020, interim rule, the definition of ''wetland restoration'' from the previous ACEP regulation had been included for reference. NRCS recognizes that including the former definition may cause confusion. The interim rule revised the definition, and the new definition for the term ''wetland restoration'' can be found in § 1468.3 as revised.

Request for Public Input

At the time the interim rule was published, NRCS intended to request comment with respect to two additional matters.

In the discussion of § 1468.20(d) under the preamble heading ''Summary of Changes to Subpart B, Agricultural Land Easements (ACEP–ALE)'', on page 565 of the interim rule, NRCS discussed the criteria by which land can be determined eligible and explains the reasons why land enrolled in ACEP–ALE cannot include forest land greater than two-thirds of the ACEP–ALE easement area. NRCS is requesting public comment about whether other NRCS conservation programs with an easement component, such as the Healthy Forest Reserve Program or the Regional Conservation Partnership Program, should be used to assist in the protection of agricultural lands on which nonindustrial private forest is the predominate use at levels beyond the scope of ACEP–ALE.

Additionally, NRCS requests public comment on recommendations to streamline access to ACEP and input on new or existing ranking criteria that would assist NRCS in selecting projects that best further ACEP purposes. Specifically, NRCS is considering whether there is anything that would fit under the language 'other related conservation benefits' identified in § 1468.22(c)(3)(iv) that would not fit within the other criteria listed in § 1468.22(c)(3), in consideration of whether the criteria of 'other related conservation benefits' should be kept (see page 580 of the interim rule). All comments received on or before the closing date for comments, March 20, 2020, will be considered. NRCS will review and respond to the public comments in the ACEP final rule.

The comment period for the ACEP interim rule was initially scheduled to close on March 6, 2020. This correction extends the comment period, which will now close on March 20, 2020. The public comment period for the EA and FONSI has also been extended until March 20, 2020. In addition, the URL in the January 6, 2020, interim rule for the EA and FONSI was in error. There have been no changes to either the EA or FONSI, the correction is that the URL was not going to the web page that contains the EA and FONSI. A copy of the EA and FONSI may be obtained at *https://www.nrcs.usda.gov/wps/portal/nrcs/detailfull/national/programs/farmbill/?cid=stelprdb1263599*.

Kevin Norton,

Associate Chief, Natural Resources Conservation Service.

Robert Stephenson,

Executive Vice President, Commodity Credit Corporation.

[FR Doc. 2020–01066 Filed 1–22–20; 4:15 pm]

BILLING CODE 3410–16–P

DEPARTMENT OF AGRICULTURE

Animal and Plant Health Inspection Service

9 CFR Parts 71, 75, 80, and 93

[Docket No. APHIS–2016–0054]

RIN 0579–AE46

Approval of Laboratories To Conduct Official Testing; Consolidation of Regulations

AGENCY: Animal and Plant Health Inspection Service, USDA.

ACTION: Final rule.

SUMMARY: We are consolidating the regulations governing diagnostic laboratory approval authorities for select animal diseases into a single regulation and establishing a set of standard procedures that we will use to conduct future diagnostic laboratory approvals. These consolidated regulations will provide for consistent inspection protocols, proficiency testing methods, quality system guidelines, and definitions and will facilitate the approval of additional laboratories in emergency situations. The consolidated regulations will serve to simplify regulatory oversight and compliance.

DATES: February 24, 2020.

FOR FURTHER INFORMATION CONTACT: Dr. Randall L. Levings, Scientific Advisor, Diagnostics and Biologics, VS, APHIS, 1920 Dayton Ave., Ames, IA 50010–9602; (515) 337–7601.

SUPPLEMENTARY INFORMATION:

Background

The regulations in 9 CFR subchapters B, C, and D pertain to the cooperative control and eradication of livestock or poultry diseases (subchapter B), the interstate transportation of animals (including poultry) and animal products (subchapter C), and the exportation and importation of animals (including poultry) and animal products (subchapter D).

In a proposed rule [1] published in the **Federal Register** on May 30, 2019 (84 FR 25013–25018, Docket No. APHIS–2016–0054), we proposed to consolidate the regulations governing diagnostic laboratory approval authorities for animal diseases covered by 9 CFR subchapters B through D into a single regulation and establish a set of standard procedures that we would use to conduct future diagnostic laboratory

[1] To view the proposed rule, supporting documents, and the comments we received, go to *https://www.regulations.gov/docket?D=APHIS-2016-0054*.

approvals. The consolidated regulations are intended to provide for consistent inspection protocols, proficiency testing methods, quality system guidelines, and definitions; facilitate the approval of additional laboratories in emergency situations; and simplify regulatory oversight and compliance.

We solicited comments for 60 days ending on July 29, 2019. We received six comments by that date, from private citizens and a State animal health commission. All the commenters generally supported the proposed rule. One commenter did raise a few questions, which are discussed below.

As part of the proposed rule, we proposed to remove the specific laboratory approval provisions found in our regulations regarding equine infectious anemia, Johne's disease, and contagious equine metritis. One commenter noted that the scope of the proposed regulations could appear to be limited to those three diseases, but stated they favored a more expansive interpretation that would include all the diseases cited in 9 CFR subchapters B, C, and D.

The commenter's more expansive interpretation is correct. As stated in proposed § 71.22(a), State, university, and private laboratories must obtain Animal and Plant Health Inspection Service (APHIS) approval to conduct official testing for those diseases covered by subchapters B, C, and D and must meet the requirements of § 71.22 in order to obtain and maintain that approval.

The same commenter stated that it should be clear that regulations also apply to laboratories that test for other communicable diseases of livestock or poultry that the Secretary may determine constitute an emergency and pose a threat to animal health. In that vein, the commenter also encouraged APHIS to continue to develop regulations for a national list of reportable animal diseases.

As anticipated by the commenter, the regulations will serve as the framework for the approval of laboratories that test for new or emerging communicable diseases of livestock or poultry for which tests are available should there be a need for those laboratories. We continue our work on developing regulations for a national list of reportable animal diseases.

Finally, the commenter asked for clarity as to whether or not there are any potential user fees for laboratory approvals and inspections by APHIS personnel.

User fees currently do apply with respect to some inspections conducted in connection with new or continuing approvals of laboratories, and those existing fees are not affected by this rule. Any new fees or adjustments to existing fees would be the subject of a separate regulatory action.

Revision to the Proposed Definition of National Animal Health Laboratory Network

In the proposed rule, we proposed to define the term *National Animal Health Laboratory Network (NAHLN)* as ''a nationally coordinated network and partnership of Federal, State, and university-associated animal health laboratories that provide animal health diagnostic testing, methods research and development, and expertise for education and extension to detect biological threats to the nation's animal agriculture, thus protecting animal health, public health, and the nation's food supply.'' In this final rule, we are revising this proposed definition to indicate that the NAHLN is primarily composed of Federal, State, and university-associated animal health laboratories. This is because, on a case-by-case basis, private laboratories may be used in the NAHLN based on needed capabilities.

Clarification Regarding Laboratory Facility Approval

In the proposed rule, proposed paragraph (b) of § 71.22 provided that official testing would have to be performed in laboratory facilities with controlled conditions, instrumentation appropriate for the testing being conducted, and biosecurity measures commensurate with the disease of diagnostic concern, but neglected to specify that each of these facility requirements must be acceptable to APHIS. In this final rule, we are clarifying that the determinations that the requirements have been met must be made by APHIS, rather than the facility itself.

Therefore, for the reasons given in the proposed rule and in this document, we are adopting the proposed rule as a final rule, with the changes discussed in this document. Executive Orders 12866 and 13771 and Regulatory Flexibility Act.

This rule has been determined to be not significant for the purposes of Executive Order 12866 and, therefore, has not been reviewed by the Office of Management and Budget. This rule is not an Executive Order 13771 regulatory action because it is not significant under Executive Order 12866.

In accordance with the Regulatory Flexibility Act, we have analyzed the potential economic effects of this action on small entities. The analysis is summarized below. Copies of the full analysis are available by contacting the person listed under **FOR FURTHER INFORMATION CONTACT** or on the *Regulations.gov* website (see footnote 1 above for a link to *Regulations.gov*).

This rule consolidates existing diagnostic laboratory approval authorities for certain animal diseases into a single regulation and establishes a framework that we will use to conduct future diagnostic laboratory approvals. The consolidated regulations will serve to simplify regulatory oversight and compliance, saving time and resources. For both the laboratories and APHIS, consolidating and standardizing the process will create an easier-to-understand and more user-friendly approval process; improve efficiency in obtaining approvals to conduct testing for single or multiple diseases; reduce the administrative burden associated with obtaining and tracking laboratory approvals; and simplify the steps required to renew an existing approval.

There are over 400 APHIS-approved laboratories. The laboratories range widely in size, from one-person practices to large, State-wide systems. They are classified within the Veterinary Services industry, for which the Small Business Administration's small-entity standard is annual receipts of not more than $7.5 million. For the industry overall in 2012, there were 27,939 establishments that operated throughout the year. Ninety-nine percent (27,605 establishments) had receipts of less than $5 million. Thus, most of these entities are small.

Cost savings because of this rule would be realized mainly by approximately 50 larger laboratories due to the multiple tests they perform. In accordance with guidance on complying with Executive Order 13771, the single primary estimate of the yearly savings that would be provided by this proposed rule is $1.1 million, the mid-point estimate annualized in perpetuity using a 7 percent discount rate.

This rule will lessen the administrative burden for affected laboratories, benefiting rather than having any negative impact on them. Under these circumstances, the Administrator of the Animal and Plant Health Inspection Service has determined that this action will not have a significant economic impact on a substantial number of small entities.

Executive Order 12372

This program/activity is listed in the Catalog of Federal Domestic Assistance under No. 10.025 and is subject to Executive Order 12372, which requires intergovernmental consultation with

State and local officials. (See 2 CFR chapter IV.)

Executive Order 12988

This final rule has been reviewed under Executive Order 12988, Civil Justice Reform. This rule: (1) Preempts all State and local laws and regulations that are in conflict with this rule; (2) has no retroactive effect; and (3) does not require administrative proceedings before parties may file suit in court challenging this rule.

Congressional Review Act

Pursuant to the Congressional Review Act (5 U.S.C. 801 *et seq.*), the Office of Information and Regulatory Affairs designated this rule as not a major rule, as defined by 5 U.S.C. 804(2).

Paperwork Reduction Act

In accordance with section 3507(d) of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*), the reporting and recordkeeping requirements included in this final rule, which were filed under 0579–0472, have been submitted for approval to the Office of Management and Budget (OMB). When OMB notifies us of its decision, if approval is denied, we will publish a document in the **Federal Register** providing notice of what action we plan to take.

E-Government Act Compliance

The Animal and Plant Health Inspection Service is committed to compliance with the E-Government Act to promote the use of the internet and other information technologies, to provide increased opportunities for citizen access to Government information and services, and for other purposes. For information pertinent to E-Government Act compliance related to this rule, please contact Mr. Joseph Moxey, APHIS' Information Collection Coordinator, at (301) 851–2483.

List of Subjects

9 CFR Part 71

Animal diseases, Livestock, Poultry and poultry products, Quarantine, Reporting and recordkeeping requirements, Transportation.

9 CFR Part 75

Animal diseases, Horses, Quarantine, Reporting and recordkeeping requirements, Transportation.

9 CFR Part 80

Animal diseases, Livestock, Transportation.

9 CFR Part 93

Animal diseases, Imports, Livestock, Poultry and poultry products, Reporting and recordkeeping requirements.

Accordingly, we are amending 9 CFR parts 71, 75, 80, and 93 as follows:

PART 71—GENERAL PROVISIONS

■ 1. The authority citation for part 71 continues to read as follows:

Authority: 7 U.S.C. 8301–8317; 7 CFR 2.22, 2.80, and 371.4.

■ 2. Section 71.1 is amended by adding in alphabetical order definitions for ''Approved laboratory'', ''National Animal Health Laboratory Network (NAHLN)'', and ''Official testing'' to read as follows:

§ 71.1 Definitions.

* * * * *

Approved laboratory. A laboratory approved by the Administrator to conduct official testing in accordance with the regulations in § 71.22.

* * * * *

National Animal Health Laboratory Network (NAHLN). The NAHLN is a nationally coordinated network and partnership of primarily Federal, State, and university-associated animal health laboratories that provide animal health diagnostic testing, methods research and development, and expertise for education and extension to detect biological threats to the nation's animal agriculture, thus protecting animal health, public health, and the nation's food supply.

* * * * *

Official testing. Testing to determine the disease status of animals for use in State-Federal programs. Tests are approved by the Administrator and conducted by qualified analysts in an approved laboratory.

* * * * *

§ 71.20 [Amended]

■ 3. Section 71.20 is amended by redesignating footnote 7 as footnote 1.

§ 71.21 [Amended]

■ 4. Section 71.21 is amended by redesignating footnotes 8 and 9 as footnotes 2 and 3, respectively.

■ 5. Section 71.22 is added to read as follows:

§ 71.22 Approval of laboratories to conduct official testing.

(a) *Approvals.* State, university, and private laboratories must obtain APHIS approval to conduct official testing for those diseases covered by subchapters B, C, and D of this chapter. Laboratories seeking approval must meet the requirements of this section.

(b) *Facilities.* Official testing must be performed in laboratory facilities with controlled conditions, instrumentation appropriate for the testing being conducted, and biosecurity measures commensurate with the disease of diagnostic concern; each of these facility requirements must be acceptable to APHIS. Approved laboratories must agree to periodic, unannounced inspection by APHIS personnel or other APHIS-approved inspectors following an APHIS-approved checklist.

(c) *Quality system.* Laboratories must operate under a quality system acceptable to APHIS. Components of such systems include acceptable documentation of procedures, recordkeeping, training, reporting, and corrective actions taken if standards and procedures are not reached or maintained. Adherence to certain nationally or internationally established quality systems recognized by APHIS may be used to meet all or part of this requirement.[4] Quality system records are subject to review during facility inspections.

(d) *Procedures.* All official testing must be conducted using APHIS-approved assay methods,[5] which may include standard operating procedures recognized by the National Veterinary Services Laboratories (NVSL) or National Animal Health Laboratory Network, and/or diagnostic test kits licensed by the USDA.

(e) *Training.* Official testing must be conducted only by those individuals who have completed APHIS-approved training and have passed proficiency tests administered by APHIS or its official designee. These tests will be administered annually or as necessary at an interval stipulated by APHIS. Supervisory oversight of official testing must be performed by qualified individuals, as determined by APHIS.

(f) *Reporting.* Approved laboratories must report test results to APHIS and State animal health officials using an individualized (by disease) timeline established by APHIS at the time of laboratory approval.

(g) *Applications for approval.* (1) Laboratories must use APHIS application forms, including an agreement to meet the obligations to APHIS listed in this section, and submit

[4] A list of established quality systems recognized by APHIS is available on the internet at *https://www.nahln.org.*

[5] A list of approved assay methods is available on the APHIS Laboratory Portal website at *https://www.nahln.org* and at *https://www.aphis.usda.gov/aphis/ourfocus/animalhealth/animal-disease-information.*

completed forms to the NVSL Director. The Director will make a preliminary determination of the application's acceptability, based on initial review of submitted materials and, when appropriate, a needs assessment for diagnostic capacity. These determinations are made on an annual basis, or as needed based on the number of applications received.

(2) Applicants will be informed of the preliminary determination. If positive, applicants will then be able to request a facility inspection and personnel training, conducted in accordance with this section. If negative, APHIS will provide a rationale for the denial. Denied applicants may appeal any denials in accordance with the regulations in paragraph (j) of this section;

(3) When all requirements in this section have been met, the NVSL Director will issue a final approval. Approvals are specific to those lab personnel working at the inspected, approved laboratory who have met the eligibility and proficiency requirements. Denied applicants may appeal any denials in accordance with the regulations in paragraph (j) of this section.

(h) *Maintenance of approved status.* (1) Previously approved laboratories that wish to maintain their approved status must reapply for APHIS approval at least 1 month before their approval term expires, or at least every 2 years, whichever comes first. Laboratories wishing to maintain approved status must submit a renewal application form, as supplied by APHIS, to the NVSL Director.

(2) Approved laboratories must have at least one individual with the required training and unexpired proficiency certification in their employ at all times.

(3) Approved laboratories must perform the minimum number of tests to maintain proficiency, as stipulated by APHIS in the guidance documents developed for individual test types.

(i) *Probation, suspension, and rescission of laboratory approval.* (1) Laboratories not conducting the minimum number of tests as required by paragraph (h)(3) of this section during a single reporting period will be assigned probationary status. A reporting period is less than or equal to the time for which the laboratory has been approved to conduct testing by APHIS. Laboratories on probation may continue to conduct official testing. If the minimum required number of tests are not performed during two consecutive reporting periods, the laboratory will not be eligible for renewal of APHIS approval. Exceptions to this requirement may be granted by the NVSL Director upon request.

(2) Approval to conduct official testing will be suspended in the event that a laboratory experiences changes that may impact its ability to provide quality testing services. These changes include: No longer employing an individual approved to conduct official testing, a move to different facilities, or a natural disaster that impacts power or water systems. Laboratories with suspended status will not be approved to conduct official testing. Laboratories will be restored to approved status upon training and/or testing new personnel, successful inspection of new facilities, and/or correction of noncompliance issues. Reapproval will involve resubmitting those sections of the application materials required by the NVSL Director.

(3) Approval may be rescinded at any time, at the discretion of the NVSL Director, if a laboratory fails to meet its obligations to APHIS, as listed in the agreement signed by the laboratory during the application process. The NVSL Director will issue a notice to the laboratory, providing the justification for the proposed removal. Laboratories will have 30 days to respond in writing to the concerns provided before the NVSL Director finalizes the removal decision.

(j) *Appeals.* Appeal of any denial, probation, suspension, or rescission of laboratory approval must be made in writing to the APHIS Administrator or the Administrator's official designee within 30 days of the laboratory's receipt of the NVSL Director's decision. Responses to these appeals will be provided within 60 days of receipt by APHIS.

(Approved by the Office of Management and Budget under control number 0579–0472)

PART 75—COMMUNICABLE DISEASES IN HORSES, ASSES, PONIES, MULES, AND ZEBRAS

■ 6. The authority citation for part 75 continues to read as follows:

Authority: 7 U.S.C. 8301–8317; 7 CFR 2.22, 2.80, and 371.4.

■ 7. Section 75.4 is amended as follows:
■ a. By revising the section heading;
■ b. In paragraph (a), by removing the definition of *Official test* and by revising the definition of *Reactor;* and
■ c. By removing paragraphs (c) and (d).

The revisions read as follows:

§ 75.4 Interstate movement of equine infectious anemia reactors.

(a) * * *

Reactor. Any horse, ass, mule, pony or zebra which is subjected to an official test in accordance with the regulations in § 71.22 of this subchapter and found positive.

* * * * *

PART 80—JOHNE'S DISEASE IN DOMESTIC ANIMALS

■ 8. The authority citation for part 80 continues to read as follows:

Authority: 7 U.S.C. 8301–8317; 7 CFR 2.22, 2.80, and 371.4.

■ 9. In § 80.1, the definition of ''Official Johne's disease test'' is revised to read as follows:

§ 80.1 Definitions.

* * * * *

Official Johne's disease test. An organism detection test approved by the Administrator and conducted in a laboratory approved by the Administrator.[1]

* * * * *

[1] The list of approved laboratories is available on the internet at *https://www.nahln.org* or upon request from the Animal and Plant Health Inspection Service, Veterinary Services, National Veterinary Services Laboratories, P.O. Box 844, Ames, IA 50010–0844.

PART 93—IMPORTATION OF CERTAIN ANIMALS, BIRDS, FISH, AND POULTRY, AND CERTAIN ANIMAL, BIRD, AND POULTRY PRODUCTS; REQUIREMENTS FOR MEANS OF CONVEYANCE AND SHIPPING CONTAINERS

■ 10. The authority citation for part 93 continues to read as follows:

Authority: 7 U.S.C. 1622 and 8301–8317; 21 U.S.C. 136 and 136a; 31 U.S.C. 9701; 7 CFR 2.22, 2.80, and 371.4.

§ 93.301 [Amended]

■ 11. Section 93.301 is amended as follows:

■ a. In paragraphs (e)(2)(iii) and (e)(5)(i), by removing the words ''paragraph (i) of this section'' and adding the words ''§ 71.22 of this chapter'' in their place; and

■ b. By removing and reserving paragraph (i).

§ 93.303 [Amended]

■ 12. Section 93.303 is amended by redesignating footnote 12 as footnote 10.

§ 93.308 [Amended]

■ 13. Section 93.308 is amended by redesignating footnotes 13, 14, and 15 as footnotes 11, 12, and 13, respectively.

Done in Washington, DC, this 17th day of January 2020.

Kevin Shea,

Administrator, Animal and Plant Health Inspection Service.

[FR Doc. 2020–01114 Filed 1–23–20; 8:45 am]

BILLING CODE 3410–34–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. FAA–2019–0581; Product Identifier 2019–NM–067–AD; Amendment 39–21019; AD 2019–25–20]

RIN 2120–AA64

Airworthiness Directives; Lockheed Martin Corporation/Lockheed Martin Aeronautics Company Airplanes

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Final rule.

SUMMARY: The FAA is adopting a new airworthiness directive (AD) for all Lockheed Martin Corporation/Lockheed Martin Aeronautics Company Model 382, 382B, 382E, 382F, and 382G airplanes, type certificated in any category; and Model C–130A, C–130B, C–130BL, C–130E, C–130H, C–130H–30, C–130J, C–130J–30, EC–130Q, HC–130H, KC–130H, NC–130B, NC–130, and WC–130H airplanes, type certificated in the restricted or amateur category. This AD was prompted by a report indicating that two elevator booster assemblies experienced significant hydraulic fluid leaks, caused by fatigue cracks in the actuator cylinder. This AD requires an inspection to determine the part number of the elevator booster actuator, repetitive ultrasonic inspections of the actuator to detect cracking, and replacement of cracked elevator booster assemblies. The FAA is issuing this AD to address the unsafe condition on these products.

DATES: This AD is effective February 28, 2020.

The Director of the Federal Register approved the incorporation by reference of a certain publication listed in this AD as of February 28, 2020.

ADDRESSES: For service information identified in this final rule, contact Lockheed Martin Corporation/Lockheed Martin Aeronautics Company, Customer Support Center, Dept. 3E1M, Zone 0591, 86 S Cobb Drive, Marietta, GA 30063; telephone 770–494–9131; email *hercules.support@lmco.com;* internet *https://www.Lockheedmartin.com.* You may view this service information 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 on the internet at *https://www.regulations.gov* by searching for and locating Docket No. FAA–2019–0581.

Examining the AD Docket

You may examine the AD docket on the internet at *https://www.regulations.gov* by searching for and locating Docket No. FAA–2019–0581; 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: Hector Hernandez, Aerospace Engineer, Systems and Equipment Section, FAA, Atlanta ACO Branch, 1701 Columbia Avenue, College Park, GA 30337; phone: 404–474–5587; fax: 404–474–5606; email: *hector.hernandez@faa.gov.*

SUPPLEMENTARY INFORMATION:

Discussion

The FAA issued a notice of proposed rulemaking (NPRM) to amend 14 CFR part 39 by adding an AD that would apply to all Lockheed Martin Corporation/Lockheed Martin Aeronautics Company Model 382, 382B, 382E, 382F, and 382G airplanes, type certificated in any category; and Model C–130A, C–130B, C–130BL, C–130E, C–130H, C–130H–30, C–130J, C–130J–30, EC–130Q, HC–130H, KC–130H, NC–130B, NC–130, and WC–130H airplanes, type certificated in the restricted or amateur category. The NPRM published in the **Federal Register** on July 31, 2019 (84 FR 37165). The NPRM was prompted by a report indicating that two elevator booster assemblies experienced significant hydraulic fluid leaks, caused by fatigue cracks in the actuator cylinder. The NPRM proposed to require an inspection to determine the part number of the elevator booster actuator, repetitive ultrasonic inspections of the actuator to detect cracking, and replacement of cracked elevator booster assemblies.

The FAA is issuing this AD to address the possibility of a dual failure of the left and right actuator cylinders in the elevator booster assembly, which could lead to a significant reduction in controllability of the airplane.

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.

Lynden Air Cargo, LLC stated that it concurred in concept and that the proposed AD would enhance safety.

Request To Clarify Actions for Spare Parts

Lynden Air Cargo, LLC requested clarification whether the ultrasonic inspection procedures in the proposed AD can also be accomplished for off-airplane spare elevator booster actuators. The commenter noted that the Accomplishment Instructions of Lockheed Martin Aeronautics Company Service Bulletin 382–27–51, Revision 1, dated January 17, 2018, state to do the inspection while the elevator booster actuators are installed on the airplane. The commenter asked that, if the inspection cannot be done off-airplane, alternative inspection procedures be provided.

The FAA agrees to clarify. Lockheed has issued Lockheed Martin Aeronautics Company Service Bulletin 382–27–51, Revision 2, dated October 3, 2019. This service information has been revised to clarify that the same inspection procedures can be accomplished with the elevator booster actuators either on or off the airplane. The FAA has revised this AD to refer to the latest service information and to provide credit for actions that were accomplished using Lockheed Martin Aeronautics Company Service Bulletin 382–27–51, Revision 1, dated January 17, 2018.

Request To Correct Exception Language

Lynden Air Cargo, LLC requested that paragraph (h) of the proposed AD be revised to refer to flight hours, rather than flight cycles. The commenter noted that all other references for compliance time in the proposed AD and the service information refer to flight hours.

The FAA agrees with the commenter's request. The NPRM inadvertently referred to flight cycles rather than flight hours in the location noted. Since paragraph (h) of this AD is a compliance time exception for certain airplanes, revising the language will not adversely affect safety, but will allow operators to use this exception. This final rule has been revised accordingly.

Additional Changes Made to This Final Rule

The affected airplane models were originally manufactured by Lockheed Martin Corporation/Lockheed Martin Aeronautics Company, but are currently operating as type certificated airplanes in any category, including restricted and amateur category airplanes with a variety of type certificate holders. The FAA has revised the **SUMMARY**, the Discussion section, and paragraph (c) of this AD to clarify that the affected airplanes are certificated in different categories. The FAA has also revised paragraph (c) of this AD to refer to the current type certificate holders.

The FAA has also revised the manufacturer contact information in the **ADDRESSES** section and paragraph (m)(3) of this AD. The website provided in the NPRM is no longer valid.

The proposed AD inadvertently referred to Lockheed Martin Aeronautics Company Service Bulletin 82–833, Revision 1, dated January 17, 2018. That service information is only applicable for airplanes operated by the U.S. military, and is not applicable for the airplanes identified in this AD. The FAA revised this AD to remove all references to Lockheed Martin Aeronautics Company Service Bulletin 82–833, Revision 1, dated January 17, 2018.

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

Related Service Information Under 1 CFR Part 51

The FAA reviewed Lockheed Martin Aeronautics Company Service Bulletin 382–27–51, Revision 2, dated October 3, 2019. This service information describes procedures for an inspection to determine the part number of the elevator booster actuator, repetitive ultrasonic inspections of the elevator booster actuator at the forward-most end to detect cracking along the fluid transfer bore, left and right cylinders, and replacement of cracked elevator booster assemblies. This service information 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 7 airplanes of U.S. registry. The FAA estimates the following costs to comply with this AD:

ESTIMATED COSTS

Action	Labor cost	Parts cost	Cost per product	Cost on U.S. operators
Part number inspection	1 work-hour × $85 per hour = $85	$0	$85	$595.
Ultrasonic inspections	5 work-hours × $85 per hour = $425 per inspection cycle.	0	$425 per inspection cycle.	$2,975 per inspection cycle.

The FAA estimates the following costs to do any necessary replacements that would be required based on the results of the inspections. The FAA has no way of determining the number of aircraft that might need these replacements:

ON-CONDITION COSTS

Action	Labor cost	Parts cost	Cost per product
Replacement	10 work-hours × $85 per hour = $850	$43,000	$43,850

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

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 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):

2019–25–20 Lockheed Martin Corporation/Lockheed Martin Aeronautics Company: Amendment 39–21019; Docket No. FAA–2019–0581; Product Identifier 2019–NM–067–AD.

(a) Effective Date

This AD is effective February 28, 2020.

(b) Affected ADs

None.

(c) Applicability

This AD applies to all Lockheed Martin Corporation/Lockheed Martin Aeronautics Company Model 382, 382B, 382E, 382F, and 382G airplanes, type certificated in any category; and Model C–130A, C–130B, C–130BL, C–130E, C–130H, C–130H–30, C–130J, C–130J–30, EC–130Q, HC–130H, KC–130H, NC–130B, NC–130, and WC–130H airplanes, type certificated in the restricted or amateur category. The restricted and amateur category airplanes were originally manufactured by Lockheed Martin Corporation/Lockheed Martin Aeronautics Company; current type certificate holders include, but are not limited to, those specified in paragraphs (c)(1) through (9) of this AD.

(1) LeSEA Model C–130A airplanes, Type Certificate Data Sheet (TCDS) A34SO, Revision 1.

(2) T.B.M, Inc., (transferred from Central Air Services, Inc.) Model C–130A airplanes, TCDS A39CE, Revision 3.

(3) Western International Aviation, Inc., Model C–130A airplanes, TCDS A33NM.

(4) USDA Forest Service Model C–130A airplanes, TCDS A15NM, Revision 4.

(5) Snow Aviation International, Inc., Model C–130A, TCDS TQ3CH, Revision 1.

(6) Heavylift Helicopter, Inc. (transferred from Hemet Valley Flying Service), Model C–130A, TCDS A31NM, Revision 1.

(7) Heavylift Helicopters, Inc., Model C–130B, TCDS A35NM, Revision 1.

(8) Hawkins & Powers Aviation, Inc., Model HP–C–130A, TCDS A30NM, Revision 1.

(9) Coulson Aviation (USA), Inc., Model EC–130Q, TCDS T00019LA, Revision 2.

(d) Subject

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

(e) Unsafe Condition

This AD was prompted by a report indicating that two elevator booster assemblies experienced significant hydraulic fluid leaks, caused by fatigue cracks in the actuator cylinder. The FAA is issuing this AD to address the possibility of a dual failure of the left and right actuator cylinders in the elevator booster assembly, which could lead to a significant reduction in controllability of the airplane.

(f) Compliance

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

(g) Part Number Inspection, Repetitive Ultrasonic Inspections, and Replacement

(1) On any elevator booster assembly having a part number 374461–5, 374461–7, or 374461–11, before the accumulation of 4,000 total flight hours on the elevator booster assembly, or within 180 days after the effective date of this AD, whichever occurs later, except as required by paragraph (h) of this AD: Do an inspection of the elevator booster assembly to determine the part number of the elevator booster actuator. If the elevator booster actuator has a part number other than 5C5803, no further action is required by this AD.

(2) If, during the inspection required by paragraph (g)(1) of this AD, any elevator booster actuator having part number 5C5803 is found, before the accumulation of 4,000 total flight hours on the elevator booster assembly, or within 180 days after the effective date of this AD, whichever occurs later, except as required by paragraph (h) of this AD: Do an ultrasonic inspection of the elevator booster actuator at the forward-most end to detect cracking along the fluid transfer bore, left and right cylinders, in accordance with the Accomplishment Instructions of Lockheed Martin Aeronautics Company Service Bulletin 382–27–51, Revision 2, dated October 3, 2019. Repeat the inspection thereafter at intervals not to exceed 1,400 flight hours.

(3) If, during any inspection required by paragraph (g)(2) of this AD, any cracking is found, before further flight: Replace the elevator booster assembly, in accordance with the Accomplishment Instructions of Lockheed Martin Aeronautics Company Service Bulletin 382–27–51, Revision 2, dated October 3, 2019.

(h) Compliance Time Exception

For any elevator booster assembly having part number 374461–5, 374461–7, or 374461–11 on which the total flight hours are unknown, do the inspections required by paragraphs (g)(1) and (2) of this AD, as applicable, within 180 days after the effective date of this AD.

(i) No Reporting and No Return of Parts

(1) Although Lockheed Martin Aeronautics Company Service Bulletin 382–27–51, Revision 2, dated October 3, 2019, specifies to submit certain information to the manufacturer, this AD does not include that requirement.

(2) Although Lockheed Martin Aeronautics Company Service Bulletin 382–27–51, Revision 2, dated October 3, 2019, specifies to return parts to the manufacturer, this AD does not require the return of the parts to the manufacturer.

(j) Credit for Previous Actions

This paragraph provides credit for the actions specified in paragraph (g) of this AD, if those actions were performed before the effective date of this AD using Lockheed Martin Aeronautics Company Service Bulletin 382–27–51, dated July 17, 2017; or Lockheed Martin Aeronautics Company Service Bulletin 382–27–51, Revision 1, dated January 17, 2018.

(k) Alternative Methods of Compliance (AMOCs)

(1) The Manager, Atlanta ACO 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 manager of the certification office, send it to the attention of the person identified in paragraph (l)(1) of this AD.

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

(3) An AMOC that provides an acceptable level of safety may be used for any repair, modification, or alteration required by this AD if it is approved by a Lockheed Martin Corporation/Lockheed Martin Aeronautics Company Designated Engineering Representative (DER) that has been authorized by the Manager, Atlanta ACO Branch, FAA, to make those findings. To be approved, the repair, modification deviation, or alteration deviation must meet the certification basis of the airplane, and the approval must specifically refer to this AD.

(l) Related Information

(1) For more information about this AD, contact Hector Hernandez, Aerospace Engineer, Systems and Equipment Section, FAA, Atlanta ACO Branch, 1701 Columbia Avenue, College Park, GA 30337; phone: 404–474–5587; fax: 404–474–5606; email: *hector.hernandez@faa.gov*.

(2) Service information identified in this AD that is not incorporated by reference is available at the addresses specified in paragraphs (m)(3) and (4) of this AD.

(m) Material Incorporated by Reference

(1) The Director of the Federal Register approved the incorporation by reference (IBR) of the service information listed in this

paragraph under 5 U.S.C. 552(a) and 1 CFR part 51.

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

(i) Lockheed Martin Aeronautics Company Service Bulletin 382–27–51, Revision 2, dated October 3, 2019.

(ii) [Reserved]

(3) For service information identified in this AD, contact Lockheed Martin Corporation/Lockheed Martin Aeronautics Company, Customer Support Center, Dept. 3E1M, Zone 0591, 86 S Cobb Drive, Marietta, GA 30063; telephone 770–494–9131; email *hercules.support@lmco.com;* internet *https://www.Lockheedmartin.com.*

(4) You may view this service information 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.

(5) You may view this service information that is incorporated by reference at the National Archives and Records Administration (NARA). For information on the availability of this material at NARA, email *fedreg.legal@nara.gov,* or go to: *https://www.archives.gov/federal-register/cfr/ibr-locations.html.*

Issued on December 31, 2019.

Michael Kaszycki,

Acting Director, System Oversight Division, Aircraft Certification Service.

[FR Doc. 2020–01145 Filed 1–23–20; 8:45 am]

BILLING CODE 4910–13–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. FAA–2019–0723; Product Identifier 2019–NM–147–AD; Amendment 39–21023; AD 2019–26–01]

RIN 2120–AA64

Airworthiness Directives; Airbus SAS Airplanes

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

ACTION: Final rule.

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 reports of sealant bead damage caused by rotation of the attachment fitting bearing assembly of a trimmable horizontal stabilizer (THS). This AD requires repetitive detailed inspections, and applicable corrective action(s) if necessary, as specified in a European Union Aviation Safety Agency (EASA) AD, which is incorporated by reference. In addition, as specified in the EASA AD, this AD provides an optional modification that would terminate the inspections. The FAA is issuing this AD to address the unsafe condition on these products.

DATES: This AD is effective February 28, 2020.

The Director of the Federal Register approved the incorporation by reference of a certain publication listed in this AD as of February 28, 2020.

ADDRESSES: For the material incorporated by reference (IBR) in this AD, contact the EASA, 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 *https://www.regulations.gov* by searching for and locating Docket No. FAA–2019–0723.

Examining the AD Docket

You may examine the AD docket on the internet at *https://www.regulations.gov* by searching for and locating Docket No. FAA–2019–0723; 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: Kathleen Arrigotti, Aerospace Engineer, International Section, Transport Standards Branch, FAA, 2200 South 216th St., Des Moines, WA 98198; telephone and fax 206–231–3218; email *kathleen.arrigotti@faa.gov.*

SUPPLEMENTARY INFORMATION:

Discussion

The EASA, which is the Technical Agent for the Member States of the European Union, has issued EASA AD 2019–0206, dated August 20, 2019 (''EASA AD 2019–0206'') (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 FAA issued a notice of proposed rulemaking (NPRM) to amend 14 CFR part 39 by adding an AD that would apply to certain Airbus SAS Model A350–941 and –1041 airplanes. The NPRM published in the **Federal Register** on October 28, 2019 (84 FR 57655). The NPRM was prompted by reports of sealant bead damage caused by rotation of the attachment fitting bearing assembly of a THS. The NPRM proposed to require repetitive detailed inspections, and applicable corrective action(s) if necessary. In addition, as specified in the EASA AD, the NPRM provided an optional modification that would terminate the inspections.

The FAA is issuing this AD to address possible water ingress due to sealant bead damage, which could result in corrosion damage in the aluminum corner fitting. This condition, if not addressed, could lead to detachment and loss of the THS, possibly resulting in loss of control of the airplane and injury to persons on the ground. See the MCAI for additional background information.

Comments

The FAA gave the public the opportunity to participate in developing this final rule and has considered the comment received. Air Line Pilots Association, International (ALPA), indicated its support for the NPRM.

Conclusion

The FAA reviewed the relevant data, considered the comment received, and determined that air safety and the public interest require adopting this final rule as proposed, except for minor editorial changes. The FAA has 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.

Related IBR Material Under 1 CFR Part 51

EASA AD 2019–0206 describes procedures for repetitive detailed inspections for damage of the fillet sealant and corrosion on aluminum in the lower and upper corner fittings and bearing assembly attachment interface at frame (FR) 102, left-hand and right-hand sides. EASA AD 2019–0206 also describes procedures for an optional modification (application of new corrosion protection in the THS upper and lower attachment fitting bearing assembly) that would eliminate the need for the repetitive inspections. 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 11 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
30 work-hours × $85 per hour = $2,550	$0	$2,550	$28,050

The FAA estimates the following costs to do any necessary on-condition actions that would be required based on the results of any required actions. The FAA has no way of determining the number of aircraft that might need these on-condition actions:

ESTIMATED COSTS OF OPTIONAL ACTIONS

Labor cost	Parts cost	Cost per product
34 work-hours × $85 per hour = $2,890	$0	$2,890

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

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

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):

2019–26–01 Airbus SAS: Amendment 39–21023; Docket No. FAA–2019–0723; Product Identifier 2019–NM–147–AD.

(a) Effective Date

This AD is effective February 28, 2020.

(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 2019–0206, dated August 20, 2019 (''EASA AD 2019–0206'').

(d) Subject

Air Transport Association (ATA) of America Code 53, Fuselage.

(e) Reason

This AD was prompted by reports of sealant bead damage caused by rotation of the attachment fitting bearing assembly of a trimmable horizontal stabilizer (THS). The FAA is issuing this AD to address possible water ingress due to sealant bead damage, which could result in corrosion damage in the aluminum corner fitting. This condition, if not addressed, could lead to detachment and loss of the THS, possibly resulting in loss of control of the airplane and injury to persons on the ground.

(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 2019–0206.

(h) Exceptions to EASA AD 2019–0206

For purposes of determining compliance with the requirements of this AD:

(1) Where EASA AD 2019–0206 refers to February 21, 2018, this AD requires using the effective date of this AD.

(2) The ''Remarks'' section of EASA AD 2019–0206 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 2019–0206 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 Kathleen Arrigotti, Aerospace Engineer, International Section, Transport Standards Branch, FAA, 2200 South 216th St., Des Moines, WA 98198; telephone and fax 206–231–3218; email *kathleen.arrigotti@faa.gov.*

(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 2019–0206, dated August 20, 2019.

(ii) [Reserved]

(3) For information about EASA AD 2019–0206, 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 this EASA AD on the EASA website at *https://ad.easa.europa.eu.*

(4) You may view this 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. This material may be found in the AD docket on the internet at *https://www.regulations.gov* by searching for and locating Docket No. FAA–2019–0723.

(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, email *fedreg.legal@nara.gov,* or go to: *https://www.archives.gov/federal-register/cfr/ibr-locations.html.*

Issued on January 10, 2020.

Dionne Palermo,

Acting Director, System Oversight Division, Aircraft Certification Service.

[FR Doc. 2020–01044 Filed 1–23–20; 8:45 am]

BILLING CODE 4910–13–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. FAA–2019–0722; Product Identifier 2019–NM–141–AD; Amendment 39–19820; AD 2020–01–14]

RIN 2120–AA64

Airworthiness Directives; Airbus SAS Airplanes

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

ACTION: Final rule.

SUMMARY: The FAA is adopting a new airworthiness directive (AD) for all Airbus SAS Model A300 series airplanes. This AD was prompted by a report that indicated that bleed and air conditioning systems were contaminated by hydraulic fluid, and by an investigation that revealed that hydraulic fluid contaminations caused the failure of check valves installed on the hydraulic reservoir air pressurization system. This AD requires repetitive functional tests of the hydraulic reservoir air pressurization lines, and repair or replacement 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 is effective February 28, 2020.

The Director of the Federal Register approved the incorporation by reference of a certain publication listed in this AD as of February 28, 2020.

ADDRESSES: For the material incorporated by reference (IBR) in this AD, contact the EASA, 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 *https://www.regulations.gov* by searching for and locating Docket No. FAA–2019–0722.

Examining the AD Docket

You may examine the AD docket on the internet at *https://www.regulations.gov* by searching for and locating Docket No. FAA–2019–0722; 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: Dan Rodina, Aerospace Engineer, International Section, Transport Standards Branch, FAA, 2200 South 216th St., Des Moines, WA 98198; telephone and fax 206–231–3225; email *Dan.Rodina@faa.gov.*

SUPPLEMENTARY INFORMATION:

Discussion

The EASA, which is the Technical Agent for the Member States of the European Union, has issued EASA AD 2019–0190, dated July 31, 2019 (''EASA AD 2019–0190'') (also referred to as the Mandatory Continuing Airworthiness Information, or ''the MCAI''), to correct an unsafe condition for all Airbus SAS Model A300 series airplanes.

The FAA issued a notice of proposed rulemaking (NPRM) to amend 14 CFR part 39 by adding an AD that would apply to all Airbus SAS Model A300 series airplanes. The NPRM published in the **Federal Register** on October 28,

2019 (84 FR 57663). The NPRM was prompted by a report that indicated that bleed and air conditioning systems were contaminated by hydraulic fluid, and by an investigation that revealed that hydraulic fluid contaminations caused the failure of check valves installed on the hydraulic reservoir air pressurization system. The NPRM proposed to require repetitive functional tests of the hydraulic reservoir air pressurization lines, and repair or replacement if necessary.

The FAA is issuing this AD to address bleed and air conditioning systems contaminated by hydraulic fluid, which, if not detected and corrected, could lead to leakage of pressurization check valves, and, in case of pressurization line rupture, to loss of a hydraulic system, possibly resulting in reduced control of the airplane. See the MCAI for additional background information.

Comments

The FAA gave the public the opportunity to participate in developing this final rule. We have considered the comment received. The Air Line Pilots Association, International (ALPA) stated that it supports NPRM.

Conclusion

The FAA reviewed the relevant data, considered the comment received, and determined that air safety and the public interest require adopting this final rule as proposed, except for minor editorial changes. The FAA has 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.

Related IBR Material Under 1 CFR Part 51

EASA AD 2019–0190 describes procedures for repetitive functional tests of the hydraulic reservoir air pressurization lines, and repair or replacement if necessary. 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 1 airplane 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
2 work-hours × $85 per hour = $170	$0	$170	$170

* Table does not include estimated costs for reporting.

The FAA estimates 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, the FAA estimates the cost of reporting the inspection results on U.S. operators to be $85.

The FAA estimates the following costs to do any necessary on-condition actions that would be required based on the results of any required actions. The FAA has no way of determining the number of aircraft that might need these on-condition actions:

ESTIMATED COSTS OF ON-CONDITION ACTIONS

Labor cost	Parts cost	Cost per product
3 work-hours × $85 per hour = $255	$10,000	$10,255

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 Information Collection Clearance Officer, Federal Aviation Administration, 10101 Hillwood Parkway, Fort Worth, TX 76177–1524.

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

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):

2020–01–14 Airbus SAS: Amendment 39–19820; Docket No. FAA–2019–0722; Product Identifier 2019–NM–141–AD.

(a) Effective Date

This AD is effective February 28, 2020.

(b) Affected ADs

None.

(c) Applicability

This AD applies to Airbus SAS Model A300 B2–1A, B2–1C, B2K–3C, B2–203, B4–2C, B4–103, and B4–203 airplanes, certificated in any category, all manufacturer serial numbers.

(d) Subject

Air Transport Association (ATA) of America Code 29, Hydraulic power.

(e) Reason

This AD was prompted by a report that bleed and air conditioning systems were contaminated by hydraulic fluid, and an investigation revealed that hydraulic fluid contaminations caused the failure of check valves installed on the hydraulic reservoir air pressurization system. The FAA is issuing this AD to address this condition, which, if not detected and corrected, could lead to leakage of the pressurization check valves, and, in case of pressurization line rupture, to loss of a hydraulic system, possibly resulting 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 2019–0190, dated July 31, 2019 (''EASA AD 2019–0190'').

(h) Exceptions to EASA AD 2019–0190

(1) Where EASA AD 2019–0190 refers to its effective date, this AD requires using the effective date of this AD.

(2) The ''Remarks'' section of EASA AD 2019–0190 does not apply to this AD.

(3) Paragraph (4) of EASA AD 2019–0190 specifies to report accomplishment of each test and any repair or replacement to Airbus within a certain compliance time. For this AD, report that action at the applicable time specified in paragraph (h)(3)(i) or (ii) of this AD.

(i) If the action was done on or after the effective date of this AD: Submit the report within 30 days after the inspection.

(ii) If the action was done before the effective date of this AD: Submit the report within 30 days after the effective date of 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 2019–0190 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, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. All responses to this collection of information are mandatory as required by this AD; the nature and extent of confidentiality to be provided, if any. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden to Information Collection Clearance Officer, Federal Aviation Administration, 10101 Hillwood Parkway, Fort Worth, TX 76177–1524.

(j) Related Information

For more information about this AD, contact Dan Rodina, Aerospace Engineer, International Section, Transport Standards Branch, FAA, 2200 South 216th St., Des Moines, WA 98198; telephone and fax 206–231–3225; email *Dan.Rodina@faa.gov*.

(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 2019–0190, dated July 31, 2019.

(ii) [Reserved]

(3) For information about EASA AD 2019–0190, 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 this EASA AD on the EASA website at *https://ad.easa.europa.eu*.

(4) You may view this 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. This material may be found in the AD docket on the internet at *https://www.regulations.gov* by searching for and locating Docket No. FAA–2019–0722.

(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, email *fedreg.legal@nara.gov,* or go to: *https://www.archives.gov/federal-register/cfr/ibr-locations.html.*

Issued on January 14, 2020.

Dionne Palermo,

Acting Director, System Oversight Division, Aircraft Certification Service.

[FR Doc. 2020–01043 Filed 1–23–20; 8:45 am]

BILLING CODE 4910–13–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration

21 CFR Parts 510, 520, 522, 524, 529, 556, and 558

[Docket No. FDA–2019–N–0002]

New Animal Drugs; Approval of New Animal Drug Applications; Withdrawal of Approval of New Animal Drug Applications; Changes of Sponsor; Change of Sponsor's Address

AGENCY: Food and Drug Administration, HHS.

ACTION: Final rule; technical amendments.

SUMMARY: The Food and Drug Administration (FDA or we) is amending the animal drug regulations to reflect application-related actions for new animal drug applications (NADAs) and abbreviated new animal drug applications (ANADAs) during July, August, and September 2019. FDA is informing the public of the availability of summaries of the basis of approval and of environmental review documents, where applicable. The animal drug regulations are also being amended to make technical amendments to improve the accuracy of the regulations.

DATES: This rule is effective January 24, 2020, except for amendatory instruction number 3 to 21 CFR 510.600, number 8 to 21 CFR 520.1807, number 21 to 21 CFR 529.1115, and number 24 to 21 CFR 556.513, which are effective February 3, 2020.

FOR FURTHER INFORMATION CONTACT: George K. Haibel, Center for Veterinary Medicine (HFV–6), Food and Drug Administration, 7500 Standish Pl., Rockville, MD 20855, 240–402–5689, *george.haibel@fda.hhs.gov.*

SUPPLEMENTARY INFORMATION:

I. Approval Actions

FDA is amending the animal drug regulations to reflect approval actions for NADAs and ANADAs during July, August, and September 2019, as listed in table 1. In addition, FDA is informing the public of the availability, where applicable, of documentation of environmental review required under the National Environmental Policy Act (NEPA) and, for actions requiring review of safety or effectiveness data, summaries of the basis of approval (FOI Summaries) under the Freedom of Information Act (FOIA). These public documents may be seen in the office of the Dockets Management Staff (HFA–305), Food and Drug Administration, 5630 Fishers Lane, Rm. 1061, Rockville, MD 20852, between 9 a.m. and 4 p.m., Monday through Friday. Persons with access to the internet may obtain these documents at the CVM FOIA Electronic Reading Room: *https://www.fda.gov/AboutFDA/CentersOffices/OfficeofFoods/CVM/CVMFOIAElectronicReadingRoom/default.htm.* Marketing exclusivity and patent information may be accessed in FDA's publication, Approved Animal Drug Products Online (Green Book) at: *https://www.fda.gov/AnimalVeterinary/Products/ApprovedAnimalDrugProducts/default.htm.*

TABLE 1—ORIGINAL AND SUPPLEMENTAL NADAS AND ANADAS APPROVED DURING JULY, AUGUST, AND SEPTEMBER 2019

Approval date	File No.	Sponsor	Product name	Species	Effect of the action	Public documents
July 1, 2019	200–639	Huvepharma EOOD, 5th Floor, 3A Nikolay Haytov Str., 1113 Sophia, Bulgaria.	MONOVET (monensin) Type A Medicated Article.	Cattle and goats.	Original approval as a generic copy of NADA 095–735.	FOI Summary.
July 2, 2019	141–519	Zoetis Inc., 333 Portage St., Kalamazoo, MI 49007.	PROHEART 12 (moxidectin) for Extended-Release Injectable Suspension.	Dogs	Original approval for prevention of heartworm disease caused by *Dirofilaria immitis* for 12 months in dogs 12 months of age and older; and for treatment of existing larval and adult hookworm (*Ancylostoma caninum* and *Uncinaria stenocephala*) infections.	FOI Summary.
July 5, 2019	113–645	Intervet, Inc., 2 Giralda Farms, Madison, NJ 07940.	ESTRUMATE (cloprostenol injection)	Cattle	Supplemental approval for synchronization of estrous cycles to allow for fixed time artificial insemination (FTAI) in lactating dairy cows.	FOI Summary.
July 26, 2019	141–255	Syndel USA, 1441 W. Smith Rd., Ferndale, WA 98248.	35% PEROX-AID (hydrogen peroxide) Concentrated Immersion Solution.	Finfish	Supplemental approval for the control of mortality in freshwater-reared coldwater finfish, fingerling and adult freshwater-reared coolwater finfish, and fingerling and adult freshwater-reared warmwater finfish due to saprolegniasis associated with fungi in the family Saprolegniaceae; for the treatment and control of *Gyrodactylus spp.* in freshwater-reared salmonids; and for the control of mortality in freshwater-reared warmwater finfish due to external columnaris associated with *Flavobacterium columnare.*	FOI Summary.
August 27, 2019.	141–465	Elanco US Inc., 2500 Innovation Way, Greenfield, IN 46140.	Avilamycin and monensin Type C medicated feeds.	Chickens	Supplemental approval of a revised age restriction caution statement for broiler feeds.	FOI Summary.
August 27, 2019.	141–467	Do.	Avilamycin and narasin Type C medicated feeds.	Chickens	Supplemental approval of a revised age restriction caution statement for broiler feeds.	FOI Summary.

TABLE 1—ORIGINAL AND SUPPLEMENTAL NADAS AND ANADAS APPROVED DURING JULY, AUGUST, AND SEPTEMBER 2019—Continued

Approval date	File No.	Sponsor	Product name	Species	Effect of the action	Public documents
August 27, 2019.	141–495	Do.	Avilamycin and salinomycin Type C medicated feeds.	Chickens	Supplemental approval of a revised age restriction caution statement for broiler feeds.	FOI Summary.
September 3, 2019.	141–494	Do.	CREDELIO (lotilaner) Chewable Tablet.	Dogs	Supplemental approval for prevention of flea infestations for 1 month in dogs and puppies.	FOI Summary.
September 20, 2019.	200–642	Huvepharma EOOD, 5th Floor, 3A Nikolay Haytov Str., 1113 Sophia, Bulgaria.	Monensin and tylosin phosphate Type B and Type C medicated feeds.	Cattle	Original approval for use of MONOVET 90 (monensin Type A medicated article) with TYLOVET (tylosin phosphate) Type A medicated articles in the manufacture of Type B and Type C medicated feeds as a generic copy of NADA 104–646.	FOI Summary.
September 20, 2019.	200–643	Do.	Monensin and tylosin phosphate Type B and Type C medicated feeds.	Cattle	Original approval for use of MONOVET 90 (monensin Type A medicated article) with TYLAN (tylosin phosphate) Type A medicated articles in the manufacture of Type B and Type C medicated feeds as a generic copy of NADA 104–646.	FOI Summary.
September 20, 2019.	200–644	Do.	Monensin, ractopamine hydrochloride, and tylosin phosphate Type B and Type C medicated feeds.	Cattle	Original approval for use of MONOVET 90 (monensin Type A medicated article) with OPTAFLEXX (ractopamine hydrochloride Type A medicated article) and TYLOVET (tylosin phosphate) Type A medicated article in the manufacture of Type B and Type C medicated feeds as a generic copy of NADA 141–224.	FOI Summary.
September 20, 2019.	200–645	Do.	Monensin, ractopamine hydrochloride, and tylosin phosphate Type B and Type C medicated feeds.	Cattle	Original approval for use of MONOVET 90 (monensin Type A medicated article) with ACTOGAIN (ractopamine hydrochloride Type A medicated article) and TYLOVET (tylosin phosphate) Type A medicated article in the manufacture of Type B and Type C medicated feeds as a generic copy of NADA 141–224.	FOI Summary.
September 20, 2019.	200–646	Do.	Monensin, ractopamine hydrochloride, and tylosin phosphate Type B and Type C medicated feeds.	Cattle	Original approval for use of MONOVET 90 (monensin Type A medicated article) with OPTAFLEXX (ractopamine hydrochloride Type A medicated article) and TYLAN (tylosin phosphate) Type A medicated article in the manufacture of Type B and Type C medicated feeds as a generic copy of NADA 141–224.	FOI Summary.
September 20, 2019.	200–647	Do.	Monensin, ractopamine hydrochloride, and tylosin phosphate Type B and Type C medicated feeds.	Cattle	Original approval for use of MONOVET 90 (monensin Type A medicated article) with ACTOGAIN (ractopamine hydrochloride Type A medicated article) and TYLAN (tylosin phosphate) Type A medicated article in the manufacture of Type B and Type C medicated feeds as a generic copy of NADA 141–224.	FOI Summary.
September 20, 2019.	200–648	Do.	Monensin, ractopamine hydrochloride, tylosin phosphate, and melengestrol acetate Type C medicated feeds.	Cattle	Original approval for use of MONOVET 90 (monensin Type A medicated article) with OPTAFLEXX (ractopamine hydrochloride Type A medicated article), TYLOVET (tylosin phosphate) Type A medicated article, and MGA (melengestrol acetate Type A medicated article) in the manufacture of Type C medicated feeds as a generic copy of NADA 141–233.	FOI Summary.
September 20, 2019.	200–649	Do.	Monensin, ractopamine hydrochloride, tylosin phosphate, and melengestrol acetate Type C medicated feeds.	Cattle	Original approval for use of MONOVET 90 (monensin Type A medicated article) with ACTOGAIN (ractopamine hydrochloride Type A medicated article), TYLOVET (tylosin phosphate) Type A medicated article, and MGA (melengestrol acetate Type A medicated article) in the manufacture of Type C medicated feeds as a generic copy of NADA 141–233.	FOI Summary.
September 20, 2019.	200–650	Do.	Monensin, ractopamine hydrochloride, tylosin phosphate, and melengestrol acetate Type C medicated feeds.	Cattle	Original approval for use of MONOVET 90 (monensin Type A medicated article) with OPTAFLEXX (ractopamine hydrochloride Type A medicated article), TYLOVET (tylosin phosphate) Type A medicated article, and MGA (melengestrol acetate Type A medicated article) in the manufacture of Type C medicated feeds as a generic copy of NADA 141–233.	FOI Summary.

TABLE 1—ORIGINAL AND SUPPLEMENTAL NADAS AND ANADAS APPROVED DURING JULY, AUGUST, AND SEPTEMBER 2019—Continued

Approval date	File No.	Sponsor	Product name	Species	Effect of the action	Public documents
September 20, 2019.	200–651	Do.	Monensin, ractopamine hydrochloride, tylosin phosphate, and melengestrol acetate Type C medicated feeds.	Cattle	Original approval for use of MONOVET 90 (monensin Type A medicated article) with ACTOGAIN (ractopamine hydrochloride Type A medicated article), TYLAN (tylosin phosphate) Type A medicated article, and MGA (melengestrol acetate Type A medicated article) in the manufacture of Type C medicated feeds as a generic copy of NADA 141–233.	FOI Summary.

II. Changes of Sponsor

The sponsors of the following approved applications have informed FDA that they have transferred ownership of, and all rights and interest in, these applications to another sponsor:

File No.	Product name	Transferring sponsor	New sponsor	21 CFR section
140–872	POSILAC (sometribove zinc) Injectable Suspension.	Elanco US Inc., 2500 Innovation Way, Greenfield, IN 46140.	Union Agener, Inc., 1788 Lovers Ln., Augusta, GA 30901.	522.2112
141–457	ENTYCE (capromorelin) Oral Solution.	Aratana Therapeutics, Inc., 11400 Tomahawk Creek Pkwy., Leawood, KS 66211.	Elanco US Inc., 2500 Innovation Way, Greenfield, IN 46140.	520.292
141–461	NOCITA (bupivacaine liposome injectable suspension).	Aratana Therapeutics, Inc., 11400 Tomahawk Creek Pkwy., Leawood, KS 66211.	Do.	522.224
200–180	Ampicillin Trihydrate (ampicillin trihydrate) Powder for Injection.	G. C. Hanford Mfg. Co., P.O. Box 1017, Syracuse, NY 13201.	HQ Specialty Pharma Corp., 120 Rte. 17 North, Suite 130, Paramus, NJ 07652.	522.90b
200–273	VETRO–GEN (gentamicin sulfate) Veterinary Ophthalmic Ointment.	Dechra, Ltd., Snaygill Industrial Estate, Keighley Rd., Skipton, North Yorkshire, BD23 2RW, United Kingdom.	Putney, Inc., One Monument Sq., Suite 400, Portland, ME 04101.	524.1044c
200–388	GB (gentamicin sulfate and betamethasone valerate) Topical Spray.	American Pharmaceuticals and Cosmetics. Inc., 1401 Joel East Rd., Fort Worth, TX 76140.	Do.	524.1044f
200–490	Carprofen (carprofen) Chewable Tablets.	Dragon Fire Holding Co., Inc., 2619 Skyway Dr., Grand Prairie, TX 75052.	Do.	520.490

Following these changes of sponsorship, American Pharmaceuticals and Cosmetics, Inc.; Aratana Therapeutics, Inc.; and Dragon Fire Holding Co., Inc. are no longer the sponsor of an approved application. Accordingly, the regulations in parts 510, 520, 522, and 524 are being amended to reflect these changes.

III. Change of Sponsor's Address

Halocarbon Products Corp., 887 Kinderkamack Rd., River Edge, NJ 07661 has informed FDA that it has changed its address to 6525 The Corners Pkwy., Suite 200, Peachtree Corners, GA 30092. Accordingly, we are amending § 510.600(c) to reflect this change.

IV. Withdrawals of Approval

Fleming Laboratories, Inc., P.O. Box 34384, Charlotte, NC 28234, has requested that FDA withdraw approval of NADA 010–005 for use of WAZINE (dipiperazine sulfate and piperazine hydrochloride) Soluble Powders because the product is no longer manufactured or marketed. Following this withdrawal of approval, Fleming Laboratories, Inc., is no longer the sponsor of an approved application. Accordingly, it will be removed from the list of sponsors of approved applications in § 510.600(c). In addition, Fleming Laboratories, Inc.'s product was the only piperazine product approved for use in food-producing animals. Accordingly, tolerances for piperazine will be removed from part 556.

Also, Halocarbon Products Corp., 6525 The Corners Pkwy., Suite 200, Peachtree Corners, GA 30092, has requested that FDA withdraw approval of ANADA 200–200 for use of Halothane USP (halothane) because the product is no longer manufactured or marketed.

Lastly, Mylan Institutional LLC, 4901 Hiawatha Dr., Rockford, IL 61103, has requested that FDA withdraw approval of ANADA 200–472 for use of Fomepizole Injection because the product is no longer manufactured or marketed.

Elsewhere in this issue of the **Federal Register**, FDA gave notice that approval of NADA 010–005 and ANADAs 200–200 and 200–472, and all supplements and amendments thereto, is withdrawn effective February 3, 2020. As provided in the regulatory text of this document, the animal drug regulations in parts 510, 520, 556, and 529 are amended to reflect these actions.

V. Technical Amendments

FDA is revising the regulations at 21 CFR 520.2520d to reflect the approved conditions of use of trichlorfon, phenothiazine, and piperazine soluble powder for oral administration to horses as an anthelmintic. This information was deleted in error during redesignation (79 FR 28833, May 20, 2014). FDA is also revising the regulations at 21 CFR 520.2612 to reflect the currently approved dosage for trimethoprim and sulfadiazine

suspension for oral administration to horses as an antimicrobial. Lastly, FDA is revising the assay limits for nicarbazin medicated feeds at 21 CFR 558.4(d) in the ''Category II'' table. These actions are being taken to improve the accuracy of the regulations.

VI. Legal Authority

This final rule is issued under section 512(i) of the Federal Food, Drug, and Cosmetic Act (the FD&C Act) (21 U.S.C.360b(i)), which requires **Federal Register** publication of ''notice[s] . . . effective as a regulation,'' of the conditions of use of approved new animal drugs. This rule sets forth technical amendments to the regulations to codify recent actions on approved new animal drug applications and corrections to improve the accuracy of the regulations, and as such does not impose any burden on regulated entities.

Although denominated a rule pursuant to the FD&C Act, this document does not meet the definition of ''rule'' in 5 U.S.C. 804(3)(A) because it is a ''rule of particular applicability.'' Therefore, it is not subject to the congressional review requirements in 5 U.S.C. 801–808. Likewise, this is not a rule subject to Executive Order 12866, which defines a rule as ''an agency statement of general applicability and future effect, which the agency intends to have the force and effect of law, that is designed to implement, interpret, or prescribe law or policy or to describe the procedure or practice requirements of an agency.''

List of Subjects

21 CFR Part 510

Administrative practice and procedure, Animal drugs, Labeling, Reporting and recordkeeping requirements.

21 CFR Parts 520, 522, 524, and 529

Animal drugs.

21 CFR Part 556

Animal drugs, Food.

21 CFR Part 558

Animal drugs, Animal feeds.

Therefore, under the Federal Food, Drug, and Cosmetic Act and under authority delegated to the Commissioner of Food and Drugs, 21 CFR parts 510, 520, 522, 524, 529, 556, and 558 are amended as follows:

PART 510—NEW ANIMAL DRUGS

■ 1. The authority citation for part 510 continues to read as follows:

Authority: 21 U.S.C. 321, 331, 351, 352, 353, 360b, 371, 379e.

■ 2. In § 510.600:
■ a. In the table in paragraph (c)(1):
■ i. Remove the entries for ''American Pharmaceuticals and Cosmetics. Inc.'', ''Aratana Therapeutics, Inc.'', and ''Dragon Fire Holding Co., Inc.'';
■ ii. Revise the entry for ''Halocarbon Products Corp.''; and
■ iii. Add an entry in alphabetical order for ''Union Agener, Inc.'';
■ b. In the table in paragraph (c)(2):
■ i. Revise the entry for ''012164'';
■ ii. Remove the entries for ''065531'', ''076033'', and ''086026''; and
■ iii. Add an entry in numerical order for ''086106''.
■ The revisions and additions read as follows:

§ 510.600 Names, addresses, and drug labeler codes of sponsors of approved applications.

* * * * *

(c) * * *

(1) * * *

Firm name and address	Drug labeler code
* * * * * * *	
Halocarbon Products Corp., 6525 The Corners Pkwy., Suite 200, Peachtree Corners, GA 30092	012164
* * * * * * *	
Union Agener, Inc., 1788 Lovers Ln., Augusta, GA 30901	086106
* * * * * * *	

(2) * * *

Drug labeler code	Firm name and address
* * * * * * *	
012164	Halocarbon Products Corp., 6525 The Corners Pkwy., Suite 200, Peachtree Corners, GA 30092
* * * * * * *	
086106	Union Agener, Inc., 1788 Lovers Ln., Augusta, GA 30901
* * * * * * *	

§ 510.600 [Amended]

■ 3. Effective February 3, 2020, § 510.600 is further amended, in the table in paragraph (c)(1), remove the entry for ''Fleming Laboratories, Inc.''; and in the table in paragraph (c)(2), remove the entry for ''015565''.

PART 520—ORAL DOSAGE FORM NEW ANIMAL DRUGS

■ 4. The authority citation for part 520 continues to read as follows:

Authority: 21 U.S.C. 360b.

§ 520.292 [Amended]

■ 5. In § 520.292, in paragraph (b), remove ''086026'' and in its place add ''058198''.

§ 520.304 [Amended]

■ 6. In § 520.304, in paragraph (b)(1), remove ''062250, and 076033'' and in its place add ''and 062250''.

§ 520.1286 [Amended]

■ 7. In § 520.1286, in paragraph (c)(2), remove ''for the treatment of flea infestations'' and in its place add ''for the treatment and prevention of flea infestations''.

§ 520.1807 [Removed]

■ 8. Effective February 3, 2020, § 520.1807 is removed.

■ 9. In § 520.2520d, revise the section heading and add paragraph (c) to read as follows:

§ 520.2520d Trichlorfon, phenothiazine, and piperazine.

* * * * *

(c) *Conditions of use in horses*—(1) *Amount.* 18.2 milligrams (mg) of trichlorfon, 12.5 mg of phenothiazine, and 40 mg of piperazine base per pound of body weight.

(2) *Indications for use.* For removal of bots (*Gastrophilus nasalis, Gastrophilus intestinalis*), large strongyles (*Strongylus vulgaris*), small strongyles, large roundworms (ascarids, *Parascaris equorum*), and pinworms (*Oxyuris equi*).

(3) *Limitations.* Do not use in horses intended for human consumption. Federal law restricts this drug to use by or on the order of a licensed veterinarian.

■ 10. In § 520.2612, revise paragraph (c)(2)(i) to read as follows:

§ 520.2612 Trimethoprim and sulfadiazine suspension.

* * * * *

(c) * * *

(2) * * *

(i) *Amount.* Administer orally at a dosage of 24 mg combined active ingredients per kilogram body weight (10.9 mg/lb) twice daily for 10 days. Administered by volume at 2.7 mL per 45.4 kilograms of body weight (2.7 mL/100 lb).

* * * * *

PART 522—IMPLANTATION OR INJECTABLE DOSAGE FORM NEW ANIMAL DRUGS

■ 11. The authority citation for part 522 continues to read as follows:

Authority: 21 U.S.C. 360b.

§ 522.90b [Amended]

■ 12. In § 522.90b, in paragraph (b), remove ''010515'' and in its place add ''042791''.

§ 522.224 [Amended]

■ 13. In § 522.224, in paragraph (b), remove ''086026'' and in its place add ''058198''.

■ 14. In § 522.460, add paragraph (b)(3), revise paragraphs (c)(1)(ii) and (iii), add paragraph (c)(1)(iv), and revise paragraph (c)(2) to read as follows:

§ 522.460 Cloprostenol.

* * * * *

(b) * * *

(3) No. 000061 for use of product described in paragraph (a)(2) as in paragraphs (c)(1)(iv) and (c)(2) of this section.

(c) * * *

(1) * * *

(ii) Administer 500 µg by intramuscular injection for abortion of unwanted pregnancies from mismatings from 1 week after mating until 5 months after conception; for unobserved (non-detected) estrus; for treatment of mummified fetus, luteal cysts, and pyometra or chronic endometritis in beef cows, lactating dairy cows, and replacement beef and dairy heifers.

(iii) Administer 500 µg by intramuscular injection as a single injection regimen or double injection regimen with a second injection 11 days after the first, for estrus synchronization in beef cows, lactating dairy cows, and replacement beef and dairy heifers.

(iv) For use with gonadorelin acetate to synchronize estrous cycles to allow for fixed time artificial insemination (FTAI) in lactating dairy cows: Administer to each cow 86 µg gonadorelin by intramuscular injection, followed 6 to 8 days later by 500 µg cloprostenol by intramuscular injection, followed 30 to 72 hours later by 86 µg gonadorelin by intramuscular injection.

(2) *Limitations.* Gonadorelin acetate for use in paragraph (c)(1)(iv) of this section as provided by No. 000061 in § 510.600(c) of this chapter.

■ 15. Revise § 522.1451 to read as follows:

§ 522.1451 Moxidectin microspheres for injection.

(a) Specifications. The drug product consists of two separate vials. One vial contains 10 percent moxidectin microspheres and the second vial contains a vehicle for constitution of the moxidectin microspheres.

(1) Each milliliter (mL) of constituted suspension contains 3.4 milligrams (mg) moxidectin.

(2) Each mL of constituted suspension contains 10 mg moxidectin.

(b) *Sponsor.* See No. 54771 in § 510.600(c) of this chapter.

(c) *Conditions of use in dogs*—(1) *Amount.* (i) Using the suspension described in paragraph (a)(1) of this section, administer 0.05 mL of the constituted suspension per kilogram (kg) of body weight (0.023 mL per pound (lb)) as a single subcutaneous injection to provide 0.17 mg/kg body weight (0.0773 mg/lb).

(ii) Using the suspension described in paragraph (a)(2) of this section, administer 0.05 mL of the constituted suspension/kg of body weight (0.023 mL/lb) as a single subcutaneous injection to provide 0.5 mg/kg body weight (0.23 mg/lb).

(2) *Indications for use*—(i) *Suspension described in paragraph (a)(1) of this section.* For prevention of heartworm disease caused by *Dirofilaria immitis* in dogs 6 months of age and older; and for treatment of existing larval and adult hookworm (*Ancylostoma caninum* and *Uncinaria stenocephala*) infections.

(ii) *Suspension described in paragraph (a)(2) of this section.* For prevention of heartworm disease caused by *Dirofilaria immitis* for 12 months in dogs 12 months of age and older; and for treatment of existing larval and adult hookworm (*Ancylostoma caninum* and *Uncinaria stenocephala*) infections.

(3) *Limitations.* Federal law restricts this drug to use by or on the order of a licensed veterinarian.

§ 522.2112 [Amended]

■ 16. In § 522.2112, in paragraph (b), remove ''058198'' and in its place add ''086106''.

PART 524—OPHTHALMIC AND TOPICAL DOSAGE FORM NEW ANIMAL DRUGS

■ 17. The authority citation for part 524 continues to read as follows:

Authority: 21 U.S.C. 360b.

§ 524.1044c [Amended]

■ 18. In § 524.1044c, in paragraph (b), remove ''043264'' and in its place add ''026637''.

§ 524.1044f [Amended]

■ 19. In § 524.1044f, in paragraph (b), remove ''058829, and 065531'' and in its place add ''and 058829''.

PART 529—CERTAIN OTHER DOSAGE FORM NEW ANIMAL DRUGS

■ 20. The authority citation for part 529 continues to read as follows:

Authority: 21 U.S.C. 360b.

§ 529.1115 [Amended]

■ 21. Effective February 3, 2020, in § 529.1115, in paragraph (b), remove ''Nos. 012164 and 054771'' and in its place add ''No. 054771''.

■ 22. In § 529.1150, revise paragraph (c) to read as follows:

§ 529.1150 Hydrogen peroxide.

* * * * *

(c) *Conditions of use*—(1) *Indications and amount.* (i) Freshwater-reared finfish eggs for the control of mortality in due to saprolegniasis associated with fungi in the family Saprolegniaceae:

(A) For all coldwater and coolwater species of freshwater-reared finfish eggs: 500 to 1,000 mg per liter (/L) of culture water for 15 minutes in a continuous flow system once per day on consecutive or alternate days until hatch, or

(B) For all freshwater-reared warmwater finfish eggs: 750 to 1,000 mg/L for 15 minutes in a continuous flow system once per day on consecutive or alternate days until hatch.

(ii) Freshwater-reared finfish for the control of mortality due to saprolegniasis associated with the fungi in the family Saprolegniaceae: For freshwater-reared coldwater finfish including salmonids (all life stages), freshwater-reared coolwater finfish fingerlings and adults, and freshwater-reared warmwater finfish fingerlings and adults: 75 mg/L for 60 minutes in continuous flow water supply or as a static bath once per day on alternate days for three treatments.

(iii) Freshwater-reared salmonids for the control of mortality due to bacterial gill disease associated with *Flavobacterium branchiophilum:* 100 mg/L for 30 minutes, or 50 to 100 mg/L for 60 minutes, in a continuous flow water supply or as a static bath once per day on alternate days for three treatments.

(iv) Freshwater-reared salmonids for the treatment and control of *Gyrodactylus spp:* 100 mg/L for 30 minutes, or 50 to 100 mg/L for 60 minutes, in a continuous flow water supply or as a static bath once per day on alternate days for three treatments.

(v) Freshwater-reared coolwater and warmwater finfish fingerlings and adults for the control of mortality due to external columnaris disease associated with *Flavobacterium columnare:* 50 to 75 mg/L for 60 minutes in continuous flow water supply or as a static bath once per day on alternate days for three treatments.

(vi) Freshwater-reared coolwater finfish fry and warmwater finfish fry for the control of mortality due to external columnaris disease associated with *Flavobacterium columnare:* 50 mg/L for 60 minutes in continuous flow water supply or as a static bath once per day on alternate days for three treatments.

(2) *Limitations.* (i) Initial bioassay on a small number is recommended before treating the entire group.

(ii) Eggs: Some strains of rainbow trout eggs are sensitive to hydrogen peroxide treatment at a time during incubation concurrent with blastopore formation through closure, about 70 to 140 Daily Temperature Units, °C. Consider withholding treatment or using an alternate therapeutant during that sensitive time to reduce egg mortalities due to drug toxicity.

(iii) Finfish: Because finfish sensitivity to 35% PEROX–AID® increases with increasing water temperature, consider administering initial treatments at the lower end of the treatment regimen or reducing water temperature before treatment. Do not use this product to treat northern pike (*Esox lucius*) or paddlefish (*Polyodon spathula*) of any age. Do not use this product to treat pallid sturgeon fry. Use with caution on walleye (*Sander vitreus*) and ornamental finfish.

(iv) Preharvest withdrawal time: Zero days.

PART 556—TOLERANCES FOR RESIDUES OF NEW ANIMAL DRUGS IN FOOD

■ 23. The authority citation for part 556 continues to read as follows:

Authority: 21 U.S.C. 342, 360b, 371.

§ 556.513 [Removed]

■ 24. Effective February 3, 2020, § 556.513 is removed.

PART 558—NEW ANIMAL DRUGS FOR USE IN ANIMAL FEEDS

■ 25. The authority citation for part 558 continues to read as follows:

Authority: 21 U.S.C. 354, 360b, 360ccc, 360ccc–1, 371.

■ 26. In § 558.4, in paragraph (d), revise the entry for ''Nicarbazin (powder)'' to read as follows:

§ 558.4 Requirement of a medicated feed mill license.

* * * * *

(d) * * *

CATEGORY II

Drug	Assay limits percent [1] Type A	Type B maximum (100x)	Assay limits percent [1] Type B/C [2]
*	*	*	*
Nicarbazin (powder)	96–104	9.08 g/lb (2.00%)	85–115/75–125
*	*	*	*

* * * * *

■ 27. In § 558.68, revise paragraphs (e)(1)(ii), (iii), and (v) to read as follows:

§ 558.68 Avilamycin.

* * * * *

(e) * * *

(1) * * *

Avilamycin in grams/ton	Indications for use	Limitations	Sponsor
*	*	* * * * *	
(ii) 13.6 to 40.9	Monensin, 90 to 110	Feed as the sole ration for 21 consecutive days. Feed to chickens that are at risk of developing, but not yet showing clinical signs of, necrotic enteritis associated with *Clostridium perfringens* in broiler chickens. Avilamycin has not been demonstrated to be effective in broiler chickens showing clinical signs of necrotic enteritis prior to the start of medication. To assure responsible antimicrobial drug use in broiler chickens, treatment administration must begin on or before 18 days of age. Do not feed to chickens over 16 weeks of age. The safety of avilamycin has not been established in chickens intended for breeding purposes. Do not allow horses or other equines access to feed containing avilamycin and monensin. Ingestion of monensin by horses has been fatal. Do not feed to chickens producing eggs for human consumption. Monensin as provided by No. 058198 in § 510.600(c) of this chapter.	058198
(iii) 13.6 to 40.9	Narasin, 54 to 90	Feed as the sole ration for 21 consecutive days. Feed to chickens that are at risk of developing, but not yet showing clinical signs of, necrotic enteritis associated with *Clostridium perfringens.* Avilamycin has not been demonstrated to be effective in broiler chickens showing clinical signs of necrotic enteritis prior to the start of medication. To assure responsible antimicrobial drug use in broiler chickens, treatment administration must begin on or before 18 days of age. The safety of avilamycin has not been established in chickens intended for breeding purposes. Do not allow adult turkeys, horses, or other equines access to narasin formulations. Ingestion of narasin by these species has been fatal. Do not feed to chickens producing eggs for human consumption. Narasin as provided by No. 058198 in § 510.600(c) of this chapter.	058198
*	*	* * * * *	
(v) 13.6 to 40.9	Salinomycin sodium, 40 to 60	Feed as the sole ration for 21 consecutive days. Feed to chickens that are at risk of developing, but not yet showing clinical signs of, necrotic enteritis associated with *Clostridium perfringens.* Avilamycin has not been demonstrated to be effective in broiler chickens showing clinical signs of necrotic enteritis prior to the start of medication. To assure responsible antimicrobial drug use in broiler chickens, treatment administration must begin on or before 18 days of age. The safety of avilamycin has not been established in chickens intended for breeding purposes. May be fatal if fed to adult turkeys or to horses. Not approved for use with pellet binders. Do not feed to laying hens producing eggs for human consumption. Salinomycin as provided by No. 016592 in § 510.600(c) of this chapter.	058198

* * * * *

■ 28. In § 558.355, revise paragraphs (b) and (f)(6)(i) to read as follows:

§ 558.355 Monensin.

* * * * *

(b) *Sponsors.* See sponsors in § 510.600(c) of this chapter for use as in paragraph (f) of this section.

(1) No. 058198 for use as in paragraph (f) of this section.

(2) No. 016592 for use of a Type A medicated article containing 90.7 grams monensin, USP, per pound as in paragraphs (f)(3), (f)(4)(vi), and (f)(6) of this section.

* * * * *

(f) * * *

(6) * * *

Monensin in grams/ton	Indications for use	Limitations	Sponsor
(i) 20	For the prevention of coccidiosis caused by *Eimeria crandallis, E. christenseni,* and *E. ninakohlyakimovae.*	Feed only to goats being fed in confinement. Do not feed to lactating goats. See paragraph (d)(11) of this section for provisions for monensin liquid Type C goat feeds.	058198
*	*	* * * * *	

* * * * *

§ 558.625 [Amended]

■ 29. Amend § 558.625:

■ a. By removing ''monensin as provided by No. 058198'' and adding in its place ''monensin as provided by Nos. 016592 or 058198'' in the ''Limitations'' column, in:

■ 1. Paragraph (e)(2)(iv),

■ 2. Paragraph (e)(2)(v),

■ 3. Paragraph (e)(2)(x),

■ 4. Paragraph (e)(2)(xi),

■ 5. Paragraph (e)(2)(xii), and

■ 6. Paragraph (e)(2)(xiii); and

■ b. By adding ''016592'' in numerical order in the ''Sponsors'' column in:

■ 1. Paragraph (e)(2)(x),

■ 2. Paragraph (e)(2)(xi),

■ 3. Paragraph (e)(2)(xii), and

■ 4. Paragraph (e)(2)(xiii).

Dated: January 9, 2020.

Lowell J. Schiller,

Principal Associate Commissioner for Policy.

[FR Doc. 2020–00421 Filed 1–23–20; 8:45 am]

BILLING CODE 4164–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration

21 CFR Parts 520, 522, and 529

[Docket No. FDA–2019–N–0002]

New Animal Drugs; Withdrawal of Approval of a New Animal Drug Application; Withdrawal of Approval of Abbreviated New Animal Drug Applications

AGENCY: Food and Drug Administration, HHS.

ACTION: Notification of withdrawal.

SUMMARY: The Food and Drug Administration (FDA) is withdrawing approval of a new animal drug application (NADA) and two abbreviated new animal drug applications (ANADAs) at the sponsors' request because the products are no longer manufactured or marketed.

DATES: Withdrawal of approval is applicable February 3, 2020.

FOR FURTHER INFORMATION CONTACT: Sujaya Dessai, Center for Veterinary Medicine (HFV–212), Food and Drug Administration, 7519 Standish Pl., Rockville, MD 20855, 240–402–5761, *sujaya.dessai@fda.hhs.gov*.

SUPPLEMENTARY INFORMATION: Fleming Laboratories, Inc., P.O. Box 34384, Charlotte, NC 28234, has requested that FDA withdraw approval of NADA 010–005 for use of WAZINE (dipiperazine sulfate and piperazine hydrochloride) Soluble Powders because the product is no longer manufactured or marketed.

Also, Halocarbon Products Corp., 6525 The Corners Pkwy., Suite 200, Peachtree Corners, GA 30092, has requested that FDA withdraw approval of ANADA 200–200 for use of Halothane USP (halothane) because the product is no longer manufactured or marketed.

Lastly, Mylan Institutional LLC, 4901 Hiawatha Dr., Rockford, IL 61103, has requested that FDA withdraw approval of ANADA 200–472 for use of Fomepizole Injection because the product is no longer manufactured or marketed.

Therefore, under authority delegated to the Commissioner of Food and Drugs and in accordance with § 514.116 *Notice of withdrawal of approval of application* (21 CFR 514.116), notice is given that approval of NADA 010–005 and ANADAs 200–200 and 200–472, and all supplements and amendments thereto, is hereby withdrawn, effective February 3, 2020.

Elsewhere in this issue of the **Federal Register**, FDA is amending the animal drug regulations to reflect the voluntary withdrawal of approval of these applications.

Dated: January 9, 2020.

Lowell J. Schiller,

Principal Associate Commissioner for Policy.

[FR Doc. 2020–00422 Filed 1–23–20; 8:45 am]

BILLING CODE 4164–01–P

DEPARTMENT OF JUSTICE

Drug Enforcement Administration

21 CFR Part 1308

[Docket No. DEA–446]

Schedules of Controlled Substances: Placement of 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA and MDMB-FUBINACA in Schedule I

AGENCY: Drug Enforcement Administration, Department of Justice.

ACTION: Final rule.

SUMMARY: The Drug Enforcement Administration places methyl 2-(1-(5-fluoropentyl)-1*H*-indazole-3-carboxamido)-3,3-dimethylbutanoate [5F-ADB; 5F-MDMB-PINACA]; methyl 2-(1-(5-fluoropentyl)-1*H*-indazole-3-carboxamido)-3-methylbutanoate [5F-AMB]; *N*-(adamantan-1-yl)-1-(5-fluoropentyl)-1*H*-indazole-3-carboxamide [5F-APINACA, 5F-AKB48]; *N*-(1-amino-3,3-dimethyl-1-oxobutan-2-yl)-1-(4-fluorobenzyl)-1*H*-indazole-3-carboxamide [ADB-FUBINACA]; methyl 2-(1-(cyclohexylmethyl)-1*H*-indole-3-carboxamido)-3,3-dimethylbutanoate [MDMB-CHMICA, MMB-CHMINACA]; and methyl 2-(1-(4-fluorobenzyl)-1*H*-indazole-3-carboxamido)-3,3-dimethylbutanoate [MDMB-FUBINACA], including their salts, isomers, and salts of isomers whenever the existence of such salts, isomers, and salts of isomers is possible, in schedule I of the Controlled Substances Act. This action continues the imposition of the regulatory controls and administrative, civil, and criminal sanctions applicable to schedule I controlled substances on persons who handle (manufacture, distribute, import, export, engage in research, conduct instructional activities or chemical analysis, or possess), or propose to handle 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, and MDMB-FUBINACA.

DATES: Effective: January 24, 2020.

FOR FURTHER INFORMATION CONTACT: Scott A. Brinks, Regulatory Drafting and Policy Support Section, Diversion Control Division, Drug Enforcement Administration; Mailing Address: 8701 Morrissette Drive, Springfield, Virginia 22152; Telephone: (202) 598–6812.

SUPPLEMENTARY INFORMATION:

Legal Authority

The Controlled Substances Act (CSA) provides that proceedings for the issuance, amendment, or repeal of the scheduling of any drug or other substance may be initiated by the Attorney General (1) on his own motion; (2) at the request of the Secretary of the Department of Health and Human Services (HHS);[1] or (3) on the petition of any interested party. 21 U.S.C. 811(a). This action was initiated on the Attorney General's own motion, as delegated to the Administrator of the DEA, and is supported by, *inter alia,* a recommendation from the Assistant Secretary for Health of HHS and an evaluation of all relevant data by the DEA. This action continues the imposition of the regulatory controls and administrative, civil, and criminal sanctions of schedule I controlled substances on any person who handles or proposes to handle 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA and MDMB-FUBINACA.

Background

On April 10, 2017, DEA published an order in the **Federal Register** amending 21 CFR 1308.11(h) to temporarily place the six synthetic cannabinoids (SCs) methyl 2-(1-(5-fluoropentyl)-1*H*-indazole-3-carboxamido)-3,3-dimethylbutanoate [5F-ADB; 5F-MDMB-PINACA]; methyl 2-(1-(5-fluoropentyl)-1*H*-indazole-3-carboxamido)-3-methylbutanoate [5F-AMB]; *N*-(adamantan-1-yl)-1-(5-fluoropentyl)-1*H*-indazole-3-carboxamide [5F-APINACA, 5F-AKB48]; *N*-(1-amino-3,3-dimethyl-1-oxobutan-2-yl)-1-(4-fluorobenzyl)-1*H*-indazole-3-carboxamide [ADB-FUBINACA]; methyl 2-(1-(cyclohexylmethyl)-1*H*-indole-3-carboxamido)-3,3-dimethylbutanoate [MDMB-CHMICA, MMB-CHMINACA]; and methyl 2-(1-(4-fluorobenzyl)-1*H*-indazole-3-carboxamido)-3,3-dimethylbutanoate [MDMB-FUBINACA] in schedule I of the CSA pursuant to the temporary scheduling provisions of 21 U.S.C. 811(h). 82 FR 17119. That temporary scheduling order was effective on the date of publication, and was based on findings by the former Acting Administrator of the DEA (Acting Administrator) that the temporary scheduling of these six SCs was necessary to avoid an imminent hazard to the public safety pursuant to 21 U.S.C. 811(h)(1). Section 201(h)(2) of

[1] As set forth in a memorandum of understanding entered into by the Food and Drug Administration (FDA) and the National Institute on Drug Abuse (NIDA), the FDA acts as the lead agency within the Department of Health and Human Services (HHS) in carrying out the Secretary's scheduling responsibilities under the CSA, with the concurrence of NIDA. 50 FR 9518, Mar. 8, 1985. The Secretary of the HHS has delegated to the Assistant Secretary for Health of the HHS the authority to make domestic drug scheduling recommendations. 58 FR 35460, July 1, 1993.

the CSA, 21 U.S.C. 811(h)(2), requires that the temporary control of these substances expire two years from the issuance date of the scheduling order, on or before April 9, 2019. However, the CSA also provides that during the pendency of proceedings under 21 U.S.C. 811(a)(1) with respect to the substance, the temporary scheduling of that substance could be extended for up to one year. Accordingly, on April 8, 2019, DEA extended the temporary scheduling of 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, and MDMB-FUBINACA by one year, or until April 9, 2020. 84 FR 13796. Also, on April 8, 2019, DEA published a notice of proposed rulemaking (NPRM) to permanently control 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, and MDMB-FUBINACA in schedule I of the CSA. 84 FR 13848. Specifically, DEA proposed to add these six SCs to the hallucinogenic substances list under 21 CFR 1308.11(d).

DEA and HHS Eight Factor Analyses

On March 21, 2019, HHS provided DEA with a scientific and medical evaluation document prepared by the Food and Drug Administration (FDA) entitled ''Basis for the Recommendation to Place Methyl 2-(1-(5-fluoropentyl)-1H-indazole-3-carboxamido)-3,3-dimethylbutanoate [5F-ADB; 5F-MDMB-PINACA]; Methyl 2-(1-(5-fluoropentyl)-1H-indazole-3-carboxamido)-3-methylbutanoate [5F-AMB]; N-(adamantan-1-yl)-1-(5-fluoropentyl)-1H-indazole-3-carboxamide [5F-APINACA, 5F-AKB48]; N-(1-amino-3,3-dimethyl-1-oxobutan-2-yl)-1-(4-fluorobenzyl)-1H-indazole-3-carboxamide [ADB-FUBINACA]; Methyl 2-(1-(cyclohexylmethyl)-1H-indole-3-carboxamido)-3,3-dimethylbutanoate [MDMB-CHMICA, MMB-CHMINACA], Methyl 2-(1-(4-fluorobenzyl)-1H-indazole-3-carboxamido)-3,3-dimethylbutanoate [MDMB-FUBINACA] and their Salts in Schedule I of the Controlled Substances Act.'' After considering the eight factors in 21 U.S.C. 811(c), each substance's abuse potential, lack of legitimate medical use in the United States, and lack of accepted safety for use under medical supervision pursuant to 21 U.S.C. 812(b), the Assistant Secretary of HHS recommended that 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA and MDMB-FUBINACA be controlled in schedule I of the CSA. In response, DEA conducted its own eight factor analysis of 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, and MDMB-FUBINACA. The DEA and HHS analyses are available in their entirety in the public docket for this rule (Docket Number DEA–446) at *http://www.regulations.gov* under ''Supporting Documents.''

Determination to Schedule 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA and MDMB-FUBINACA

After a review of the available data, including the scientific and medical evaluation and the scheduling recommendations from HHS, DEA published a NPRM entitled ''Schedules of Controlled Substances: Placement of 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, and MDMB-FUBINACA in Schedule I.'' This NPRM proposed to control 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, and MDMB-FUBINACA, and their salts, isomers, and salts of isomers in schedule I of the CSA. 84 FR 13848, April 8, 2019. The proposed rule provided an opportunity for interested persons to file a request for hearing in accordance with DEA regulations on or before May 8, 2019. No requests for such a hearing were received by DEA. The NPRM also provided an opportunity for interested persons to submit comments on the proposed rule on or before May 8, 2019.

Comments Received

The DEA received three comments on the proposed rule to control 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, and MDMB-FUBINACA in schedule I of the CSA.

Support for rulemaking: Two commenters recognized the dangers and public health risks, and supported the rulemaking to permanently place these substances in schedule I.

DEA Response: The DEA appreciates the comments in support of this rulemaking.

Dissent for rulemaking: One commenter stated that while SCs, in general, could pose a public health risk, are more harmful than ''traditional cannabis,'' and have no known legitimate medical use, this individual disagreed with the permanent control of these specific six substances. This commenter also questioned the appropriateness and effectiveness of current drug control policy and mentioned use of alternative approaches such as investing in treatment of current SC users, education about harmful effects of SCs, removal of cannabis from schedule I, and additional research into the substances at issue in this rulemaking. In addition, the commenter discussed the increased cost associated with regulatory, administrative, and enforcement activities involving scheduled drugs and concern over potential tribal implications.

DEA response: DEA's mission is to enforce the controlled substance laws and regulations of the United States. The CSA contains specific mandates pertaining to the scheduling of controlled substances. DEA has followed all of those mandates regarding the scheduling of 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, and MDMB-FUBINACA, including receiving from the Secretary of HHS a scientific and medical evaluation, and recommendation, regarding control (21 U.S.C. 811(b)); considering the factors enumerated in 21 U.S.C. 811(c); determining, based on the above, appropriate scheduling for these SCs (21 U.S.C. 812(b)); and conducting a formal rulemaking to schedule these SCs (21 U.S.C. 811(a)). These SCs satisfy the CSA's criteria for placement in schedule I by virtue of their high potential for abuse, the fact that these substances have no currently accepted medical use in treatment in the United States, and their lack of accepted safety for use of the substance under medical supervision. 21 U.S.C. 812(b)(1).

As per the commenter's views regarding the appropriateness and effectiveness of current drug control policy, use of alternative approaches such as investing in treatment, education about harmful effects of SCs, and removal of cannabis from schedule I, these are outside the scope of the current scheduling action.

Regarding the increased costs associated with regulatory, administrative, and enforcement activities involving scheduled drugs, these issues are not unique to the substances that are currently being controlled by this final rule.

Regarding the commenter's concern that the scheduling of these SCs will have tribal implications, DEA has analyzed the expected impact of this final rule, and has determined that it will not have substantial direct effects 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. As evidence, the commenter cites the incarceration rates of Native Americans and native youths relative to the national average; however, does not explain how this data is relevant to the substances being permanently scheduled in this final rule.

As per the comment related to additional research into the substances at issue in this rulemaking, DEA has utilized funding of its own to conduct pharmacological research studies into all these six substances. The data generated from these studies have been utilized in evaluating these substances for control under the CSA. HHS, upon conducting scientific and medical evaluation of these and all available data, recommended schedule I controls for these substances. DEA conducted its own review of HHS scientific and medical evaluation and all other relevant data and determined that these substances warrant control as schedule I substances under the CSA. Additional information about these substances can be viewed in the public docket for this rule (Docket Number DEA–446) at *http://www.regulations.gov* under ''Supporting Documents.''

Scheduling Conclusion

After consideration of the relevant matter presented as a result of public comments, the scientific and medical evaluations and accompanying recommendation of HHS, and after its own eight-factor evaluation, DEA finds that these facts and all other relevant data constitute substantial evidence of potential for abuse of 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, and MDMB-FUBINACA. As such, DEA is permanently scheduling 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, and MDMB-FUBINACA as controlled substances under the CSA.

Determination of Appropriate Schedule

The CSA establishes five schedules of controlled substances known as schedules I, II, III, IV, and V. The CSA also outlines the findings required to place a drug or other substance in any particular schedule. 21 U.S.C. 812(b). After consideration of the analysis and recommendation of the Assistant Secretary for HHS and review of all other available data, the Acting Administrator of DEA, pursuant to 21 U.S.C. 811(a) and 21 U.S.C. 812(b)(1), finds that:

(1) Methyl 2-(1-(5-fluoropentyl)-1*H*-indazole-3-carboxamido)-3,3-dimethylbutanoate [5F-ADB; 5F-MDMB-PINACA]; methyl 2-(1-(5-fluoropentyl)-1*H*-indazole-3-carboxamido)-3-methylbutanoate [5F-AMB]; *N*-(adamantan-1-yl)-1-(5-fluoropentyl)-1*H*-indazole-3-carboxamide [5F-APINACA, 5F-AKB48]; *N*-(1-amino-3,3-dimethyl-1-oxobutan-2-yl)-1-(4-fluorobenzyl)-1*H*-indazole-3-carboxamide [ADB-FUBINACA]; methyl 2-(1-(cyclohexylmethyl)-1*H*-indole-3-carboxamido)-3,3-dimethylbutanoate [MDMB-CHMICA, MMB-CHMINACA]; and methyl 2-(1-(4-fluorobenzyl)-1*H*-indazole-3-carboxamido)-3,3-dimethylbutanoate [MDMB-FUBINACA] have a high potential for abuse that is comparable to other schedule I substances such as delta-9-tetrahydrocannabinol (Δ^9-THC) and JWH-018;

(2) Methyl 2-(1-(5-fluoropentyl)-1*H*-indazole-3-carboxamido)-3,3-dimethylbutanoate [5F-ADB; 5F-MDMB-PINACA]; methyl 2-(1-(5-fluoropentyl)-1*H*-indazole-3-carboxamido)-3-methylbutanoate [5F-AMB]; *N*-(adamantan-1-yl)-1-(5-fluoropentyl)-1*H*-indazole-3-carboxamide [5F-APINACA, 5F-AKB48]; *N*-(1-amino-3,3-dimethyl-1-oxobutan-2-yl)-1-(4-fluorobenzyl)-1*H*-indazole-3-carboxamide [ADB-FUBINACA]; methyl 2-(1-(cyclohexylmethyl)-1*H*-indole-3-carboxamido)-3,3-dimethylbutanoate [MDMB-CHMICA, MMB-CHMINACA]; and methyl 2-(1-(4-fluorobenzyl)-1*H*-indazole-3-carboxamido)-3,3-dimethylbutanoate [MDMB-FUBINACA] have no currently accepted medical use in treatment in the United States; and

(3) There is a lack of accepted safety for use of methyl 2-(1-(5-fluoropentyl)-1*H*-indazole-3-carboxamido)-3,3-dimethylbutanoate [5F-ADB; 5F-MDMB-PINACA]; methyl 2-(1-(5-fluoropentyl)-1*H*-indazole-3-carboxamido)-3-methylbutanoate [5F-AMB]; *N*-(adamantan-1-yl)-1-(5-fluoropentyl)-1*H*-indazole-3-carboxamide [5F-APINACA, 5F-AKB48]; *N*-(1-amino-3,3-dimethyl-1-oxobutan-2-yl)-1-(4-fluorobenzyl)-1*H*-indazole-3-carboxamide [ADB-FUBINACA]; methyl 2-(1-(cyclohexylmethyl)-1*H*-indole-3-carboxamido)-3,3-dimethylbutanoate [MDMB-CHMICA, MMB-CHMINACA]; and methyl 2-(1-(4-fluorobenzyl)-1*H*-indazole-3-carboxamido)-3,3-dimethylbutanoate [MDMB-FUBINACA] under medical supervision.

Based on these findings, the Acting Administrator of DEA concludes that methyl 2-(1-(5-fluoropentyl)-1*H*-indazole-3-carboxamido)-3,3-dimethylbutanoate [5F-ADB; 5F-MDMB-PINACA]; methyl 2-(1-(5-fluoropentyl)-1*H*-indazole-3-carboxamido)-3-methylbutanoate [5F-AMB]; *N*-(adamantan-1-yl)-1-(5-fluoropentyl)-1*H*-indazole-3-carboxamide [5F-APINACA, 5F-AKB48]; *N*-(1-amino-3,3-dimethyl-1-oxobutan-2-yl)-1-(4-fluorobenzyl)-1*H*-indazole-3-carboxamide [ADB-FUBINACA]; methyl 2-(1-(cyclohexylmethyl)-1*H*-indole-3-carboxamido)-3,3-dimethylbutanoate [MDMB-CHMICA, MMB-CHMINACA]; and methyl 2-(1-(4-fluorobenzyl)-1*H*-indazole-3-carboxamido)-3,3-dimethylbutanoate [MDMB-FUBINACA], including their salts, isomers and salts of isomers, whenever the existence of such salts, isomers, and salts of isomers is possible, warrant control in schedule I of the CSA. 21 U.S.C. 812(b)(1).

Requirements for Handling 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, and MDMB-FUBINACA

5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, and MDMB-FUBINACA will continue [2] to be subject to the CSA's schedule I regulatory controls and administrative, civil, and criminal sanctions applicable to the manufacture, distribution, dispensing, importing, exporting, research, and conduct of instructional activities, including the following:

1. *Registration.* Any person who handles (manufactures, distributes, imports, exports, engages in research, or conducts instructional activities or chemical analysis with, or possesses), or who desires to handle, 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, or MDMB-FUBINACA must be registered with DEA to conduct such activities pursuant to 21 U.S.C. 822, 823, 957, and 958 and in accordance with 21 CFR parts 1301 and 1312.

2. *Security.* 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, and MDMB-FUBINACA are subject to schedule I security requirements and must be handled in accordance with 21 CFR 1301.71–1301.93.

3. *Labeling and Packaging.* All labels and labeling for commercial containers of 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, and MDMB-FUBINACA must be in compliance with 21 U.S.C. 825 and 958(e), and be in accordance with 21 CFR part 1302.

4. *Quota.* Only registered manufacturers are permitted to manufacture 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, or MDMB-FUBINACA in accordance with a quota assigned pursuant to 21 U.S.C. 826 and in accordance with 21 CFR part 1303.

5. *Inventory.* Every DEA registrant who possesses any quantity of 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, and MDMB-FUBINACA was required to

[2] 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, and MDMB-FUBINACA are currently subject to schedule I controls on a temporary basis, pursuant to 21 U.S.C. 811(h). 82 FR 17119, April 10, 2017.

keep an inventory of all stocks of these substances on hand as of April 10, 2017, pursuant to 21 U.S.C. 827 and 958 and in accordance with 21 CFR 1304.03, 1304.04, and 1304.11.

6. *Records and Reports.* Every DEA registrant must maintain records and submit reports with respect to 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, and/or MDMB-FUBINACA, pursuant to 21 U.S.C. 827 and 958(e), and in accordance with 21 CFR parts 1304 and 1312.

7. *Order Forms.* Every DEA registrant who distributes 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, or MDMB-FUBINACA must continue to comply with the order form requirements, pursuant to 21 U.S.C. 828, and 21 CFR part 1305.

8. *Importation and Exportation.* All importation and exportation of 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, or MDMB-FUBINACA must continue to be in compliance with 21 U.S.C. 952, 953, 957, and 958, and in accordance with 21 CFR part 1312.

9. *Liability.* Any activity involving 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, or MDMB-FUBINACA not authorized by, or in violation of, the CSA or its implementing regulations is unlawful, and may subject the person to administrative, civil, and/or criminal sanctions.

Regulatory Analyses

Executive Orders 12866, 13563, and 13771, Regulatory Planning and Review, Improving Regulation and Regulatory Review, and Reducing Regulation and Controlling Regulatory Costs

In accordance with 21 U.S.C. 811(a), this final scheduling action is subject to formal rulemaking procedures performed ''on the record after opportunity for a hearing,'' which are conducted pursuant to the provisions of 5 U.S.C. 556 and 557. The CSA sets forth the criteria for scheduling a drug or other substance. Such actions are exempt from review by the Office of Management and Budget (OMB) pursuant to section 3(d)(1) of Executive Order 12866 and the principles reaffirmed in Executive Order 13563.

This final rule does not meet the definition of an Executive Order 13771 regulatory action. OMB has previously determined that formal rulemaking actions concerning the scheduling of controlled substances, such as this rule, are not significant regulatory actions under section 3(f) of Executive Order 12866.

Executive Order 12988

This regulation meets the applicable standards set forth in sections 3(a) and 3(b)(2) of Executive Order 12988 to eliminate drafting errors and ambiguity, minimize litigation, provide a clear legal standard for affected conduct, and promote simplification and burden reduction.

Executive Order 13132

This rulemaking does not have federalism implications warranting the application of Executive Order 13132. The rule does not have substantial direct effects on the States, on the relationship between the national government and the States, or the distribution of power and responsibilities among the various levels of government.

Executive Order 13175

This rule does not have tribal implications warranting the application of Executive Order 13175. It does not have substantial direct effects 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.

Regulatory Flexibility Act

The Acting Administrator, in accordance with the Regulatory Flexibility Act (RFA), 5 U.S.C. 601–602, has reviewed this final rule and by approving it certifies that it will not have a significant economic impact on a substantial number of small entities. On April 10, 2017, DEA published an order to temporarily place these six substances in schedule I of the CSA pursuant to the temporary scheduling provisions of 21 U.S.C. 811(h). DEA estimates that all entities handling or planning to handle these substances have already established and implemented the systems and processes required to handle 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, or MDMB-FUBINACA. There are currently 33 registrations authorized to handle 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, and/or MDMB-FUBINACA specifically, as well as a number of registered analytical labs that are authorized to handle schedule I controlled substances generally. These 33 registrations represent 28 entities, of which 22 are small entities. Therefore, DEA estimates 22 small entities are affected by this rule.

A review of the 33 registrations indicates that all entities that currently handle 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, or MDMB-FUBINACA also handle other schedule I controlled substances, and have established and implemented (or maintain) the systems and processes required to handle 5F-ADB, 5F-AMB, 5F-APINACA, ADB-FUBINACA, MDMB-CHMICA, or MDMB-FUBINACA. Therefore, DEA anticipates that this rule will impose minimal or no economic impact on any affected entities; and, thus, will not have a significant economic impact on any of the 22 affected small entities. Therefore, DEA has concluded that this rule will not have a significant effect on a substantial number of small entities.

Unfunded Mandates Reform Act of 1995

In accordance with the Unfunded Mandates Reform Act (UMRA) of 1995, 2 U.S.C. 1501 *et seq.,* DEA has determined and certifies that this action would not result in any Federal mandate that may result ''in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of $100,000,000 or more (adjusted annually for inflation) in any 1 year. . . .'' Therefore, neither a Small Government Agency Plan nor any other action is required under UMRA of 1995.

Paperwork Reduction Act of 1995

This action does not impose a new collection of information under the Paperwork Reduction Act of 1995. 44 U.S.C. 3501–3521. This action would not impose recordkeeping or reporting requirements on State or local governments, individuals, businesses, or organizations. 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.

Congressional Review Act

This rule is not a major rule as defined by the Congressional Review Act (CRA), 5 U.S.C. 804. This rule will not result in an annual effect on the economy of $100,000,000 or more; a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or 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. However, pursuant to the CRA, DEA has submitted a copy of this final rule to both Houses of Congress and to the Comptroller General.

List of Subjects in 21 CFR Part 1308

Administrative practice and procedure, Drug traffic control, Reporting and recordkeeping requirements.

For the reasons set out above, 21 CFR part 1308 is amended as follows:

PART 1308—SCHEDULES OF CONTROLLED SUBSTANCES

■ 1. The authority citation for 21 CFR part 1308 continues to read as follows:

Authority: 21 U.S.C. 811, 812, 871(b), 956(b), unless otherwise noted.

■ 2. In § 1308.11,

■ a. Add paragraphs (d)(73) through (78); and

■ b. Remove and reserve paragraphs (h)(6) through (11);

The additions read as follows:

§ 1308.11 Schedule I.

* * * * *

(d) * * *

(73) methyl 2-(1-(5-fluoropentyl)-1*H*-indazole-3-carboxamido)-3,3-dimethylbutanoate (Other names: 5F-ADB; 5F-MDMB-PINACA) 7034
(74) methyl 2-(1-(5-fluoropentyl)-1*H*-indazole-3-carboxamido)-3-methylbutanoate (Other names: 5F-AMB) 7033
(75) *N*-(adamantan-1-yl)-1-(5-fluoropentyl)-1*H*-indazole-3-carboxamide (Other names: 5F-APINACA, 5F-AKB48) 7049
(76) *N*-(1-amino-3,3-dimethyl-1-oxobutan-2-yl)-1-(4-fluorobenzyl)-1*H*-indazole-3-carboxamide (Other names: ADB-FUBINACA) 7010
(77) methyl 2-(1-(cyclohexylmethyl)-1*H*-indole-3-carboxamido)-3,3-dimethylbutanoate (Other names: MDMB-CHMICA, MMB-CHMINACA) 7042
(78) methyl 2-(1-(4-fluorobenzyl)-1*H*-indazole-3-carboxamido)-3,3-dimethylbutanoate (Other names: MDMB-FUBINACA) 7020

* * * * *

Dated: January 3, 2020.

Uttam Dhillon,

Acting Administrator.

[FR Doc. 2020–00665 Filed 1–23–20; 8:45 am]

BILLING CODE 4410–09–P

DEPARTMENT OF JUSTICE

Drug Enforcement Administration

21 CFR Part 1308

[Docket No. DEA–492]

Schedules of Controlled Substances: Removal of 6β-Naltrexol From Control

AGENCY: Drug Enforcement Administration, Department of Justice.

ACTION: Final rule.

SUMMARY: With the issuance of this final rule, the Acting Administrator of the Drug Enforcement Administration removes (5α,6β)-17-(cyclopropylmethyl)-4,5-epoxymorphinan-3,6,14-triol (6β-naltrexol) and its salts from the schedules of the Controlled Substances Act (CSA). This scheduling action is pursuant to the CSA which requires that such actions be made on the record after opportunity for a hearing through formal rulemaking. Prior to the effective date of this rule, 6β-naltrexol was a schedule II controlled substance because it can be derived from opium alkaloids. This action removes the regulatory controls and administrative, civil, and criminal sanctions applicable to controlled substances, including those specific to schedule II controlled substances, on persons who handle (manufacture, distribute, reverse distribute, dispense, conduct research, import, export, or conduct chemical analysis) or propose to handle 6β-naltrexol.

DATES: *Effective Date:* January 24, 2020.

FOR FURTHER INFORMATION CONTACT: Scott A. Brinks, Regulatory Drafting and Policy Support Section, Diversion Control Division, Drug Enforcement Administration; Mailing Address: 8701 Morrissette Drive, Springfield, Virginia 22152; Telephone: (571) 362–8209.

SUPPLEMENTARY INFORMATION:

Legal Authority

Under the Controlled Substances Act (CSA), each controlled substance is classified into one of five schedules based upon its potential for abuse, its currently accepted medical use in treatment in the United States, and the degree of dependence the drug or other substance may cause. 21 U.S.C. 812. The initial schedules of controlled substances established by Congress are found at 21 U.S.C. 812(c) and the current list of scheduled substances is published at 21 CFR part 1308.

Pursuant to 21 U.S.C. 811(a)(2), the Attorney General may, by rule, ''remove any drug or other substance from the schedules if he finds that the drug or other substance does not meet the requirements for inclusion in any schedule.'' The Attorney General has delegated scheduling authority under 21 U.S.C. 811 to the Acting Administrator of the Drug Enforcement Administration (DEA). 28 CFR 0.100.

The CSA provides that proceedings for the issuance, amendment, or repeal of the scheduling of any drug or other substance may be initiated by the Attorney General (1) on his own motion, (2) at the request of the Secretary of the Department of Health and Human Services (HHS),[1] or (3) on the petition of any interested party. 21 U.S.C. 811(a). This action was initiated by two citizen petitions to remove 6β-naltrexol from the list of scheduled controlled substances of the CSA, and is supported by, *inter alia,* a recommendation from the Assistant Secretary of the HHS and an evaluation of all relevant data by the DEA. This action removes the regulatory controls and administrative, civil, and criminal sanctions applicable to controlled substances, including those specific to schedule II controlled substances, on persons who handle or propose to handle 6β-naltrexol.

Background

6β-Naltrexol is the major metabolite of naltrexone. Naltrexone and 6β-naltrexol are reversible opioid receptor antagonists. Opioid receptor antagonists are commonly used in the treatment of opioid addiction and overdose. On December 24, 1974, naloxone, an opioid receptor antagonist that works similarly to naltrexone, was removed from all schedules for control under the CSA. Effective on March 6, 1975, title 21 of the Code of Federal Regulations was amended to remove naltrexone from all schedules for control under the CSA. The Administrator of the DEA found that both naltrexone and naloxone and their salts have an accepted medical use for treatment in the United States and that they do not have a potential for abuse to justify continued control in any schedule under the CSA. In June 2003 and April 2008, the DEA received two separate citizen petitions to initiate proceedings to amend 21 CFR 1308.12(b)(1) to decontrol 6β-naltrexol from schedule II of the CSA. These petitions complied with the requirements of 21 CFR 1308.44(b) and were accepted for filing. Both petitioners argue that 6β-naltrexol has been characterized as an opioid receptor

[1] As discussed in a memorandum of understanding entered into by the Food and Drug Administration (FDA) and the National Institute on Drug Abuse (NIDA), the FDA acts as the lead agency within the HHS in carrying out the Secretary's scheduling responsibilities under the CSA, with the concurrence of NIDA. 50 FR 9518, Mar. 8, 1985. The Secretary of the HHS has delegated to the Assistant Secretary for Health of the HHS the authority to make domestic drug scheduling recommendations. 58 FR 35460, July 1, 1993.

antagonist, a class of drugs with no abuse potential.

DEA and HHS Eight Factor Analyses

Pursuant to 21 U.S.C. 811(b), the DEA gathered the necessary data on 6β-naltrexol and forwarded the data, the sponsors' petitions, and a request for scheduling recommendation on 6β-naltrexol to HHS on August 11, 2009.

On July 21, 2017, HHS provided to DEA a scientific and medical evaluation entitled ''Basis for the Recommendation to Remove (5α,6β)-17-(cyclopro pylmethyl)-4,5-epoxymorphinan-3,6,14-triol (6β-naltrexol) and Its Salts from All Schedules of Control Under the Controlled Substances Act'' and a scheduling recommendation. Following consideration of the eight factors and findings related to the substance's abuse potential, legitimate medical use, and dependence liability, HHS recommended that 6β-naltrexol and its salts be removed from all schedules of control of the CSA.

In response, DEA conducted its own eight factor analysis of 6β-naltrexol pursuant to 21 U.S.C. 811(c). Both the DEA and HHS analyses are available in their entirety in the public docket of this rule (Docket Number DEA–492) at *http://www.regulations.gov* under ''Supporting and Related Material.''

Determination To Decontrol 6β-Naltrexol

After a review of the available data, including the scientific and medical evaluation and the recommendation to decontrol 6β-naltrexol from HHS, the Acting Administrator of DEA published in the **Federal Register** a notice of proposed rulemaking (NPRM) entitled ''Schedules of Controlled Substances: Removal of 6β-naltrexol from Control'' which proposed removal of 6β-naltrexol and its salts from the schedules of the CSA. 84 FR 43530, August 21, 2019. The proposed rule provided an opportunity for interested persons to file a request for a hearing in accordance with DEA regulations by September 20, 2019. No requests for such a hearing were received by DEA. The NPRM also provided an opportunity for interested persons to submit written comments on the proposal on or before September 20, 2019.

Comments Received

DEA received four comments on the proposed rule to remove 6β-naltrexol from control. Two commenters supported decontrol of 6β-naltrexol. Two commenters submitted comments not related to the proposed action.

Support

One commenter supported decontrolling 6β-naltrexol and expressed agreement with DEA's findings that 6β-naltrexol does not possess abuse or dependence potential. Another commenter was also in support of this decontrol action although the commenter mentioned the drug names as ''6-naltrexol'' and ''naltrexone'' and appears to have used these two names interchangeably. DEA assumes that the commenter's reference to ''naltrexone'' or ''6-naltrexol'' is actually in reference to 6β-naltrexol.

DEA Response: DEA appreciates the comments in support of this rulemaking.

Unrelated Comments

One commenter stated that DEA should spend more time in combating drugs that are readily available to public and are highly prescribed by physicians rather than putting efforts on drugs with no abuse potential and are limited to research labs.

DEA Response: DEA's mission is to enforce the controlled substance laws and regulations. The CSA contains specific mandates pertaining to the scheduling of controlled substances. Pursuant to 21 U.S.C. 811(a)(2), the Attorney General through formal rulemaking may remove any drug or other substance from the schedules if it is found that the drug or other substance does not meet the requirement for inclusion in any schedule under the CSA. Proceedings for the issuance, amendment, or repeal of such rules may be initiated by the Attorney General (1) on his own motion, (2) at the request of the Secretary, or (3) on the petition of any interested party. DEA, under authority delegated by the Attorney General, has initiated the current scheduling action in response to two petitions requesting decontrol of 6β-naltrexol. Pursuant to CSA, DEA has followed all of those mandates regarding the current decontrol of 6β-naltrexol, including receiving from the Secretary of HHS a scientific and medical evaluation, and recommendation, regarding control (21 U.S.C. 811(b)); considering the factors enumerated in 21 U.S.C. 811(c); determining, based on the above, appropriate scheduling for 6β-naltrexol (21 U.S.C. 812(b)); and conducting a formal rulemaking to decontrol 6β-naltrexol (21 U.S.C. 811(a)(2)). 6β-Naltrexol satisfies the CSA's criteria for removal from controls.

Another commenter mentioned that a majority of states have legalized the use of cannabis for medical and recreational purposes and there are reports of medical benefits for cannabis. This commenter further stated that ''removing cannabis from being Schedule I drug is long over due . . .''

DEA Response: Because the current rule involves 6β-naltrexol, but not cannabis, this comment is unrelated and is outside the scope of the current scheduling action.

Scheduling Conclusion

Based on the consideration of all comments, the scientific and medical evaluation and accompanying recommendation of HHS, and based on DEA's consideration of its own eight-factor analysis, the Acting Administrator finds that these facts and all relevant data demonstrate that 6β-naltrexol does not meet the requirements for inclusion in any schedule, and will be removed from control under the CSA.

Regulatory Analyses

Executive Orders 12866 and 13563

In accordance with 21 U.S.C. 811(a), this scheduling action is subject to formal rulemaking procedures done ''on the record after opportunity for a hearing,'' which are conducted pursuant to the provisions of 5 U.S.C. 556 and 557. The CSA sets forth the criteria for scheduling a drug or other substance. Such actions are exempt from review by the Office of Management and Budget (OMB) pursuant to section 3(d)(1) of Executive Order 12866 and the principles reaffirmed in Executive Order 13563.

Executive Order 12988

This regulation meets the applicable standards set forth in sections 3(a) and 3(b)(2) of Executive Order 12988 Civil Justice Reform to eliminate drafting errors and ambiguity, minimize litigation, provide a clear legal standard for affected conduct, and promote simplification and burden reduction.

Executive Order 13132

This rulemaking does not have federalism implications warranting the application of Executive Order 13132. The rule does not have substantial direct effects on the States, on the relationship between the Federal Government and the States, or the distribution of power and responsibilities among the various levels of government.

Executive Order 13175

This rule does not have tribal implications warranting the application of Executive Order 13175. This rule does not have substantial direct effects 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.

Regulatory Flexibility Act

The Acting Administrator, in accordance with the Regulatory Flexibility Act (5 U.S.C. 601–612) (RFA), has reviewed this rule and by approving it certifies that it will not have a significant economic impact on a substantial number of small entities. The purpose of this rule is to remove 6β-naltrexol from the list of schedules of the CSA. This action removes regulatory controls and administrative, civil, and criminal sanctions applicable to controlled substances for handlers and proposed handlers of 6β-naltrexol. Accordingly, it has the potential for some economic impact in the form of cost savings.

This rule will affect all persons who would handle, or propose to handle, 6β-naltrexol. 6β-Naltrexol is the major metabolite of naltrexone and is not currently available or marketed in any country. Due to the wide variety of unidentifiable and unquantifiable variables that potentially could influence the distribution and dispensing rates, if any, of 6β-naltrexol, DEA is unable to determine the number of entities and small entities which might handle 6β-naltrexol. In some instances where a controlled pharmaceutical drug is removed from the schedules of the CSA, DEA is able to quantify the estimated number of affected entities and small entities because the handling of the drug is expected to be limited to DEA registrants even after removal from the schedules. In such instances, DEA's knowledge of its registrant population forms the basis for estimating the number of affected entities and small entities. However, the DEA does not have a basis to estimate whether 6β-naltrexol is expected to be handled by persons who hold DEA registrations, by persons who are not currently registered with DEA to handle controlled substances, or both. Therefore, the DEA is unable to estimate the number of entities and small entities who plan to handle 6β-naltrexol.

Although DEA does not have a reliable basis to estimate the number of affected entities and quantify the economic impact of this final rule, a qualitative analysis indicates that this rule is likely to result in some cost savings. Any person planning to handle 6β-naltrexol will realize cost savings in the form of saved DEA registration fees, and the elimination of physical security, recordkeeping, and reporting requirements. Because of these factors, DEA projects that this rule will not result in a significant economic impact on a substantial number of small entities.

Unfunded Mandates Reform Act of 1995

On the basis of information contained in the ''Regulatory Flexibility Act'' section above, DEA has determined and certifies pursuant to the Unfunded Mandates Reform Act of 1995 (UMRA), 2 U.S.C. 1501 *et seq.,* that this action would not result in any Federal mandate that may result ''in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of $100,000,000 or more (adjusted for inflation) in any one year . . .'' Therefore, neither a Small Government Agency Plan nor any other action is required under provisions of UMRA.

Paperwork Reduction Act

This action does not impose a new collection of information requirement under the Paperwork Reduction Act, 44 U.S.C. 3501–3521. This action would not impose recordkeeping or reporting requirements on State or local governments, individuals, businesses, or organizations. 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.

Congressional Review Act

This rule is not a major rule as defined by section 804 of the Small Business Regulatory Enforcement Fairness Act of 1996 (Congressional Review Act (CRA)). This rule will not result in: An annual effect on the economy of $100,000,000 or more; a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based companies to compete with foreign-based companies in domestic and export markets. However, pursuant to the CRA, DEA has submitted a copy of this final rule to both Houses of Congress and to the Comptroller General.

List of Subjects in 21 CFR Part 1308

Administrative practice and procedure, Drug traffic control, Reporting and recordkeeping requirements.

For the reasons set out above, 21 CFR part 1308 is amended to read as follows:

PART 1308—SCHEDULES OF CONTROLLED SUBSTANCES

■ 1. The authority citation for 21 CFR part 1308 continues to read as follows:

Authority: 21 U.S.C. 811, 812, 871(b), 956(b) unless otherwise noted.

■ 2. In § 1308.12, revise the introductory text of paragraph (b)(1) to read as follows:

§ 1308.12 Schedule II.

* * * * *

(b) * * *

(1) Opium and opiate, and any salt, compound, derivative, or preparation of opium or opiate excluding apomorphine, thebaine-derived butorphanol, dextrorphan, nalbuphine, naldemedine, nalmefene, naloxegol, naloxone, 6β-naltrexol and naltrexone, and their respective salts, but including the following:

* * * * *

Dated: December 19, 2019.

Uttam Dhillon,

Acting Administrator.

[FR Doc. 2020–00664 Filed 1–23–20; 8:45 am]

BILLING CODE 4410–09–P

DEPARTMENT OF JUSTICE

Drug Enforcement Administration

21 CFR Part 1308

[Docket No. DEA–503]

Schedules of Controlled Substances: Placement of Brexanolone in Schedule IV

AGENCY: Drug Enforcement Administration, Department of Justice.

ACTION: Final rule.

SUMMARY: This final rule adopts without change an interim final rule with request for comments published in the **Federal Register** on June 17, 2019. That interim final rule placed the substance brexanolone (3α-hydroxy-5α-pregnan-20-one), including its salts, isomers, and salts of isomers whenever the existence of such salts, isomers, and salts of isomers is possible, in schedule IV of the Controlled Substances Act. With the issuance of this final rule, the Drug Enforcement Administration maintains brexanolone in schedule IV of the Controlled Substances Act.

DATES: Effective January 24, 2020.

FOR FURTHER INFORMATION CONTACT: Scott Brinks, Diversion Control Division, Drug Enforcement

Administration; Mailing Address: 8701 Morrissette Drive, Springfield, Virginia 22152; Telephone: (571) 362–3261.

SUPPLEMENTARY INFORMATION:

Background

On June 17, 2019, the Drug Enforcement Administration (DEA) published an interim final rule to make brexanolone (including its salts, isomers, and salts of isomers whenever the existence of such salts, isomers, and salts of isomers is possible) a schedule IV controlled substance. 84 FR 27938. The interim final rule provided an opportunity for interested persons to submit comments, as well as file a request for hearing or waiver of hearing, on or before July 17, 2019.

Comments Received

The DEA received three comments in response to the interim final rule to control brexanolone as a schedule IV substance of the Controlled Substances Act (CSA). Two of the three commenters were in support of the interim final rule to place brexanolone in schedule IV of the CSA, and one commenter was opposed to the placement of brexanolone in schedule IV of the CSA. The DEA did not receive any requests for hearing or waiver of hearing.

Support of the Interim Final Rule

Two commenters supported controlling brexanolone as a schedule IV controlled substance. These commenters indicated support for scheduling brexanolone under the CSA due to its similarity to other schedule IV sedatives including midazolam and alprazolam.

DEA Response. The DEA appreciates the support for this rulemaking.

Opposition to the Interim Final Rule

A commenter opposed the interim final rule to control brexanolone as a schedule IV substance. Although the commenter did not state if or where brexanolone should be scheduled, the commenter expressed concerns about brexanolone's adverse health effects such as exposure of an antidepressant to infants through breastmilk, potential for ''hidden side effects,'' and drug-associated dizziness and somnolence affecting the maternal care of the infant.

DEA Response. The commenter's concerns about adverse health effects of brexanolone are related to the Food and Drug Administration's (FDA) approval process (such as weighing the benefits versus risks) and outside of the scope of this rulemaking. The FDA approved a new drug application (NDA) for Zulresso (brexanolone)—a substance identified as having abuse potential pursuant to 21 U.S.C. 811(f)—and provided the DEA with a scheduling recommendation for control of brexanolone in schedule IV of the CSA. As provided in 21 U.S.C. 811(j), the scheduling recommendation by the Department of Health and Human Services (HHS) and the FDA approval of the NDA necessitated the DEA review and scheduling action. The DEA made the findings required under 21 U.S.C. 812(b)(4) for the placement of brexanolone in schedule IV. The scheduling determination was based on a comprehensive evaluation of all available data as related to the eight-factor analysis pursuant to 21 U.S.C. 811(c), but not by a single metric such as adverse health effects as expressed by this commenter. As stated in the interim final rule, after careful consideration of data from preclinical and clinical studies, the DEA concurred with the HHS recommendation that brexanolone has abuse potential comparable to other schedule IV benzodiazepines such as midazolam and alprazolam, and therefore, supported and continues to support through the promulgation of this final rule placement of brexanolone in schedule IV under the CSA. None of the commenter's concerns about brexanolone's potential health effects undermine any aspect of the interim final rule's analysis.

Based on the rationale set forth in the interim final rule, the DEA adopts the interim final rule without change.

Requirements for Handling Brexanolone

As indicated above, brexanolone has been a schedule IV substance by virtue of the interim final rule issued by DEA in June 2019. Therefore, this final rule does not alter the regulatory requirements applicable to handlers of brexanolone that have been in place since that time. Nonetheless, for informational purposes, we restate here those requirements. Brexanolone is subject to the CSA's schedule IV regulatory controls and administrative, civil, and criminal sanctions applicable to the manufacture, distribution, reverse distribution, dispensing, importing, exporting, research, and conduct of instructional activities and chemical analysis with, and possession involving schedule IV substances, including the following:

1. *Registration.* Any person who handles (manufactures, distributes, reverse distributes, dispenses, imports, exports, engages in research, or conducts instructional activities or chemical analysis with, or possesses) brexanolone, or who desires to handle brexanolone, must be registered with the DEA to conduct such activities pursuant to 21 U.S.C. 822, 823, 957, and 958 and in accordance with 21 CFR parts 1301 and 1312. Any person who intends to handle brexanolone and is not registered with the DEA must submit an application for registration and may not handle brexanolone, unless the DEA approves that application for registration, pursuant to 21 U.S.C. 822, 823, 957, and 958, and in accordance with 21 CFR parts 1301 and 1312.

2. *Disposal of stocks.* Any person who obtains a schedule IV registration to handle brexanolone, but who subsequently does not desire or is not able to maintain such registration, must surrender all quantities of brexanolone or may transfer all quantities of brexanolone to a person registered with the DEA in accordance with 21 CFR part 1317, in addition to all other applicable federal, state, local, and tribal laws.

3. *Security.* Brexanolone is subject to schedule III–V security requirements and must be handled and stored in accordance with 21 CFR 1301.71–1301.93.

4. *Labeling and Packaging.* All labels, labeling, and packaging for commercial containers of brexanolone must comply with 21 U.S.C. 825 and 958(e), and be in accordance with 21 CFR part 1302.

5. *Inventory.* Every DEA registrant who possesses any quantity of brexanolone was required to keep an inventory of all stocks of brexanolone on hand, as of June 17, 2019, pursuant to 21 U.S.C. 827 and 958(e), and in accordance with 21 CFR 1304.03, 1304.04, and 1304.11.

6. *Records and Reports.* DEA registrants must maintain records and submit reports for brexanolone, pursuant to 21 U.S.C. 827 and 958(e), and in accordance with 21 CFR parts 1304, 1312, and 1317.

7. *Prescriptions.* All prescriptions for brexanolone or products containing brexanolone must comply with 21 U.S.C. 829, and be issued in accordance with 21 CFR parts 1306 and 1311, subpart C.

8. *Manufacturing and Distributing.* In addition to the general requirements of the CSA and DEA regulations that are applicable to manufacturers and distributors of schedule IV controlled substances, such registrants should be advised that (consistent with the foregoing considerations) any manufacturing or distribution of brexanolone may only be for the legitimate purposes consistent with the drug's labeling, or for research activities authorized by the Federal Food, Drug, and Cosmetic Act and the CSA.

9. *Importation and Exportation.* All importation and exportation of

brexanolone must be in compliance with 21 U.S.C. 952, 953, 957, and 958, and in accordance with 21 CFR part 1312.

10. *Liability.* Any activity involving brexanolone not authorized by, or in violation of, the CSA or its implementing regulations, is unlawful, and may subject the person to administrative, civil, and/or criminal sanctions.

Regulatory Analyses

Administrative Procedure Act

This final rule, without change, affirms the amendment made by the interim final rule that is already in effect. Section 553 of the Administrative Procedure Act (APA) (5 U.S.C. 553) generally requires notice and comment for rulemakings. However, 21 U.S.C. 811 provides that in cases where a new drug is (1) approved by the HHS and (2) HHS recommends control in CSA schedule II–V, the DEA shall issue an interim final rule scheduling the drug within 90 days. Additionally, the law specifies that the rulemaking shall become immediately effective as an interim final rule without requiring the DEA to demonstrate good cause. The DEA issued an interim final rule on June 17, 2019 and solicited public comments on that rule. Section 811 further states that after giving interested persons the opportunity to comment and to request a hearing, ''the Attorney General shall issue a final rule in accordance with the scheduling criteria of subsections (b), (c), and (d) of this section and section 812 (b) of'' the CSA. 21 U.S.C. 811(j)(3). The DEA is now responding to the comments submitted by the public and issuing the final rule, in conformity with the APA and the procedure required by 21 U.S.C. 811.

Executive Orders 12866, 13563, and 13771, Regulatory Planning and Review, Improving Regulation and Regulatory Review, and Reducing Regulation and Controlling Regulatory Costs

In accordance with 21 U.S.C. 811(a) and (j), this scheduling action is subject to formal rulemaking procedures performed ''on the record after opportunity for a hearing,'' which are conducted pursuant to the provisions of 5 U.S.C. 556 and 557. The CSA sets forth the procedures and criteria for scheduling a drug or other substance. Such actions are exempt from review by the Office of Management and Budget (OMB) pursuant to section 3(d)(1) of Executive Order 12866 and the principles reaffirmed in Executive Order 13563.

This final rule is not an Executive Order 13771 regulatory action pursuant to Executive Order 12866 and OMB guidance.[1]

Executive Order 12988, Civil Justice Reform

This regulation meets the applicable standards set forth in sections 3(a) and 3(b)(2) of Executive Order 12988 to eliminate drafting errors and ambiguity, minimize litigation, provide a clear legal standard for affected conduct, and promote simplification and burden reduction.

Executive Order 13132, Federalism

This final rulemaking does not have federalism implications warranting the application of Executive Order 13132. The final rule does 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.

Executive Order 13175, Consultation and Coordination With Indian Tribal Governments

This final rule does not have tribal implications warranting the application of Executive Order 13175. It does not have substantial direct effects 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.

Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) (5 U.S.C. 601–612) applies to rules that are subject to notice and comment under section 553(b) of the APA. Under 21 U.S.C. 811(j), the DEA was not required to publish a general notice of proposed rulemaking prior to this final rule. Consequently, the RFA does not apply.

Unfunded Mandates Reform Act of 1995

In accordance with the Unfunded Mandates Reform Act (UMRA) of 1995, 2 U.S.C. 1501 *et seq.,* the DEA has determined that this action would not result in any Federal mandate that may result ''in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of $100,000,000 or more (adjusted for inflation) in any one year.'' Therefore, neither a Small Government Agency Plan nor any other action is required under UMRA of 1995.

Paperwork Reduction Act of 1995

This action does not impose a new collection of information requirement under the Paperwork Reduction Act of 1995. 44 U.S.C. 3501–3521. This action would not impose recordkeeping or reporting requirements on State or local governments, individuals, businesses, or organizations. 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.

Congressional Review Act

This final rule is not a major rule as defined by the Congressional Review Act (CRA), 5 U.S.C. 804. This rule will not result in: An annual effect on the economy of $100,000,000 or more; a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of U.S.-based companies to compete with foreign based companies in domestic and export markets. However, pursuant to the CRA, the DEA is submitting a copy of this final rule to both Houses of Congress and to the Comptroller General.

List of Subjects in 21 CFR Part 1308

Administrative practice and procedure, Drug traffic control, Reporting and recordkeeping requirements.

PART 1308—SCHEDULES OF CONTROLLED SUBSTANCES

■ Accordingly, the interim final rule amending 21 CFR part 1308, which published on June 17, 2019 (84 FR 27938), is adopted as a final rule without change.

Dated: January 3, 2020.

Uttam Dhillon,

Acting Administrator.

[FR Doc. 2020–00669 Filed 1–23–20; 8:45 am]

BILLING CODE 4410–09–P

[1] Office of Mgmt. & Budget, Exec. Office of The President, Interim Guidance Implementing Section 2 of the Executive Order of January 30, 2017 Titled ''Reducing Regulation and Controlling Regulatory Costs'' (Feb. 2, 2017).

DEPARTMENT OF STATE

22 CFR Part 41

[Public Notice: 10930]

RIN 1400–AE96

Visas: Temporary Visitors for Business or Pleasure

AGENCY: Department of State.

ACTION: Final rule.

SUMMARY: The Department of State, Bureau of Consular Affairs (''Department''), is amending its regulation governing the issuance of visas in the ''B'' nonimmigrant classification for temporary visitors for pleasure. This rule establishes that travel to the United States with the primary purpose of obtaining U.S. citizenship for a child by giving birth in the United States is an impermissible basis for the issuance of a B nonimmigrant visa. Consequently, a consular officer shall deny a B nonimmigrant visa to an alien who he or she has reason to believe intends to travel for this primary purpose. The Department does not believe that visiting the United States for the primary purpose of obtaining U.S. citizenship for a child, by giving birth in the United States—an activity commonly referred to as ''birth tourism''—is a legitimate activity for pleasure or of a recreational nature, for purposes of consular officers adjudicating applications for B nonimmigrant visas. The final rule addresses concerns about the attendant risks of this activity to national security and law enforcement, including criminal activity associated with the birth tourism industry, as reflected in federal prosecutions of individuals and entities involved in that industry. The final rule also codifies a requirement that B nonimmigrant visa applicants who seek medical treatment in the United States must demonstrate, to the satisfaction of the consular officer, their arrangements for such treatment and establish their ability to pay all costs associated with such treatment. The rule establishes a rebuttable presumption that a B nonimmigrant visa applicant who a consular officer has reason to believe will give birth during her stay in the United States is traveling for the primary purpose of obtaining U.S. citizenship for the child.

DATES: This rule is effective on January 24, 2020.

FOR FURTHER INFORMATION CONTACT: Megan Herndon, Deputy Director for Legal Affairs, Office of Visa Services, Bureau of Consular Affairs, Department of State, 600 19th St. NW, Washington, DC 20006, (202) 485–7586.

SUPPLEMENTARY INFORMATION:

I. What changes to 22 CFR 41.31 does this rule make?

This rule makes certain changes to the Department's regulation on B nonimmigrant visas, but does not change Department of Homeland Security regulations regarding the admissibility of aliens, including Visa Waiver Program travelers, or otherwise modify the standards enforced by officials of the Department of Homeland Security. The Department is revising the definition of ''pleasure'' and subdividing 22 CFR 41.31(b)(2) into three paragraph levels. The Department is retaining its existing, and longstanding, general rule that pleasure, as referred to in Immigration and Nationality Act (INA) section 101(a)(15)(B), 8 U.S.C. 1101(a)(15)(B), for purposes of visa issuance, refers to legitimate activities of a recreational character, including tourism, amusement, visits with friends or relatives, rest, medical treatment, and activities of a fraternal, social, or services nature. The Department is also adding a provision that provides, for purposes of visa issuance, that the term pleasure, as used in INA 101(a)(15)(B), 8 U.S.C. 1101(a)(15)(B), does not include travel for the primary purpose of obtaining United States citizenship for a child by giving birth in the United States. The Department is renumbering this provision as paragraph (i).

The Department is adding a provision that provides that a nonimmigrant B visa applicant seeking medical treatment in the United States shall be denied a visa under INA section 214(b), 8 U.S.C. 1184, if unable to establish, to the satisfaction of a consular officer, a legitimate reason why he or she wishes to travel to the United States for medical treatment, and that a medical practitioner or facility in the United States has agreed to provide treatment. Additionally, the applicant must provide the projected duration and cost of treatment and any incidental expenses. The applicant must also establish to the satisfaction of the consular officer that he or she has the means and intent to pay for the medical treatment and all incidental expenses, including transportation and living expenses, either independently or with the pre-arranged assistance of others. If an applicant's responses to this line of questions are not credible, that may give consular officers reason to question whether the applicant qualifies for a visa in the B nonimmigrant classification, and could lead to additional questions as to whether the applicant intends to timely depart the United States, or intends to engage in other impermissible activity. The Department is renumbering this provision as paragraph (ii).

The Department is adding a new paragraph (iii), which establishes a rebuttable presumption that any B nonimmigrant visa applicant who a consular officer has reason to believe will give birth during her stay in the United States is traveling for the primary purpose of obtaining U.S. citizenship for a child.

II. Why is the Department promulgating this rule?

Section 101(a)(15)(B) of the INA, 8 U.S.C. 1101(a)(15)(B), is ambiguous as to the scope of activities covered by the phrase ''visiting the United States . . . temporarily for pleasure.'' Birth tourism is not explicitly mentioned in INA 101(a)(15)(B), 8 U.S.C. 1101(a)(15)(B). The Department is aware that many foreign nationals have sought B nonimmigrant visas for the purpose of obtaining U.S. citizenship for a child by giving birth in the United States. The Department has concluded that a more reasonable interpretation of the statutory provision and a better policy is that the statutory provision authorizing the issuance of visas to temporary visitors for pleasure does not extend to individuals whose primary purpose of travel is to obtain U.S. citizenship for a child by giving birth in the United States. The Department considers birth tourism an inappropriate basis for the issuance of temporary visitor visas for the policy reasons discussed herein.

As discussed below, this rule reflects a better policy, as birth tourism poses risks to national security. The birth tourism industry is also rife with criminal activity, including international criminal schemes, as reflected in federal prosecutions of individuals and entities involved in that industry.

The Department recognizes that some aliens may wish to rely on U.S. medical facilities for birth because of specialized medical needs that can be met in the United States. Thus, given the Department's longstanding practice of considering receipt of medical treatment as legitimate activity for purposes of B nonimmigrant visa issuance, this rule seeks to balance the United States' strong interest in curtailing birth tourism with its interests in facilitating legitimate medical travel and other legitimate travel on a B nonimmigrant visa. In order to clarify when visa issuance for the purpose of travel to the United States for medical treatment while pregnant (and likely to give birth) might be acceptable, the Department is codifying in regulation the standards regarding B nonimmigrant visa issuance for travel for medical treatment. Nothing in this rule purports to affect the acquisition of U.S. citizenship by individuals born in the United States, under the Fourteenth Amendment to the

U.S. Constitution or INA 301, 8 U.S.C. 1401.

A. Primary Purpose

This rule, which explicitly establishes that birth tourism is not a permissible purpose for issuance of a B visa, also reflects—for the first time in regulation—a longstanding Department doctrine of visa adjudication—namely, the primary purpose test. Under the primary purpose test, a consular officer must consider a visa applicant's primary (or principal) purpose of travel to evaluate the applicant's eligibility for the requested visa classification. All of a visa applicant's intended activities in the United States are considered in determining the applicant's eligibility for a visa under standards set out in INA 212 and 214(b), 8 U.S.C. 1182 and 1184, and other applicable visa eligibility standards. The Department's FAM guidance to consular officers on this point—that an ''alien desiring to come to the United States for one principal, and one or more incidental, purposes should be classified in accordance with the principal purpose''—has remained unchanged for well over 30 years. Compare 9 FAM 41.11 N3.1 (August 30, 1987) with current 9 FAM 402.1–3 (last revised May 21, 2018).[1] For B nonimmigrant visa applicants, the primary purpose of travel must be for permissible B–1 or B–2 activity for business or pleasure. Under the primary purpose test, in the context of a B–1/B–2 visa application, a consular officer may not issue a visa to an applicant who: (1) Primarily intends to engage in activity properly classified in another nonimmigrant visa classification; or (2) primarily intends to engage in any other activity not permissible in the B nonimmigrant visa classification. In addition, no visa may be issued to an alien who intends to engage in any unlawful activity. An alien's ''primary purpose'' of travel would be determined by the consular officer based on what the consular officer concludes is the alien's principal objective for traveling to the United States, following careful consideration of information submitted by the applicant and the consular officer's evaluation of the credibility of the applicant.

For example, consider a minor applying for a B nonimmigrant visa to accompany his legal guardian, but not parent, in the United States on another nonimmigrant visa classification (*e.g.,* H–1B). The minor would not qualify for a derivative visa (*e.g.,* H–4), because he is not a child of the guardian. In that case, the minor's primary purpose of travel would be to accompany his guardian, which is permissible activity in the B visa classification. The Department's FAM guidance has long acknowledged a tension that arises with minors who are legally required under state or local law in the United States to attend school while residing, even if temporarily, in the United States, but whose primary purpose of travel is to accompany an adult to whose household they belong. The Department's FAM guidance has long provided that ''when a family member's primary purpose to come to the United States is to accompany the principal, the classification of the accompanying [minor] family member is either of a derivative of the principal, if the classification provides, or as a B–2, if not.''

The burden is on the visa applicant to establish that he or she is entitled to nonimmigrant status under INA 101(a)(15) of the INA, 8 U.S.C. 1101(a)(15), based on his or her primary purpose of travel, to the satisfaction of the consular officer. See INA section 214(b), 291, 8 U.S.C. 1184(b), 1361.

B. National Security and Law Enforcement Concerns With Birth Tourism

The Department estimates that thousands of children are born in the United States to B–1/B–2 nonimmigrants annually. While the Department recognizes that precisely estimating the number of individuals who give birth in the United States, after traveling to the United States on a B1/B2 nonimmigrant visa, is challenging, reporting from U.S. embassies and consulates has documented trends showing an increasing number of B visa applicants whose stated primary purpose of travel is to give birth in the United States. Permitting short-term visitors with no demonstrable ties to the United States to obtain visas to travel to the United States primarily to obtain U.S. citizenship for a child creates a potential long-term vulnerability for national security. Foreign governments or entities, including entities of concern to the United States, may seek to benefit from birth tourism for purposes that would threaten the security of the United States. This rule would help close a potential vulnerability to national security that would be posed by any foreign government or entity that sought to exploit birth tourism to enhance access to the United States.

The Fourteenth Amendment to the U.S. Constitution provides that ''[a]ll persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the state wherein they reside.'' Section 301(a) of the INA, 8 U.S.C. 1401(a) states that ''a person born in the United States, and subject to the jurisdiction thereof'' shall be a national and citizen of the United States at birth. The INA provides a clear method for those who do not acquire U.S. citizenship at birth to acquire it later: Naturalization.

This is a stark difference between aliens using a temporary visitor visa for the purpose of obtaining U.S. citizenship for their children and the extensive requirements applicants must meet to naturalize to become U.S citizens. To naturalize, an alien must establish attachment to the principles of the Constitution of the United States and favorable disposition toward the ''good order and happiness'' of the United States, including a depth of conviction that would lead to active support of the Constitution, and not be hostile to the basic form of government of the United States, or disbelieve in the principles of the Constitution. *See* 8 U.S.C. 1427(a); 8 CFR 316.11(a). Adult citizens are entitled to numerous rights and benefits of citizenship, including the right to vote in federal elections, the ability to run for public office, the ability to serve on a jury, and the option to petition immediate family members to immigrate to the United States when they reach the age of twenty-one. Citizens have a right to enter the United States even without a U.S. passport. *See Worthy* v. *United States,* 328 F. 2d 386, 394 (5th Cir. 1964). The previous regulation failed to address the national security vulnerability that could allow foreign governments or entities to recruit or groom U.S. citizens who were born as the result of birth tourism and raised overseas, without attachment to the United States, in manners that threaten the security of the United States.

An entire ''birth tourism'' industry has evolved to assist pregnant women from other countries to come to the United States to obtain U.S. citizenship for their children by giving birth in the United States, and thereby entitle their children to the benefits of U.S.

[1] The Board of Immigration Appeals has also long evaluated an alien's primary purpose in various contexts. *See, e.g., Matter of Hoeft,* 12 I&N Dec. 182 (BIA 1967) (alien whose primary purpose of entry was to engage in full-time employment and did not have a labor certification ineligible for Adjustment of Status); *Matter of M–,* 3 I&N Dec. 218 (BIA 1948) (alien not subject to Excludability under section 3 of the Immigration Act of 1917, entry for immoral purpose, where her primary purpose of travel was to visit fiancée); *Matter of Healy and Goodchild,* 17 I. & N. Dec. 22, 26 (BIA 1979) (holding that an alien bound for the United States for the primary purpose of study is not admissible as a nonimmigrant visitor for pleasure).

citizenship.[2] Birth tourism companies advertise their businesses abroad by promoting the citizenship-related benefits of giving birth in the United States. Companies tout a broad range of benefits for the U.S. citizen child and eventually its family, including, but not limited to, access to free education, less pollution, retirement benefits, the ability to compete for jobs in the U.S. government, and the ability for the whole family to eventually immigrate to the United States.[3]

By obtaining a child's U.S. citizenship through birth tourism, foreign nationals are able to help that child avoid the scrutiny, standards, and procedures that he or she would normally undergo if he or she sought to become a U.S. citizen through naturalization. Under INA section 316, 8 U.S.C 1427, for example, such aliens generally are required to fulfill a residency requirement of at least five years, be a person of good moral character attached to the principles of the Constitution, and be well disposed to the ''good order and happiness'' of the United States. Additionally, they are required to take an Oath of Allegiance. *See* section 337(a) of the INA, 8 U.S.C. 1448(a). The steps for naturalization are rigorous and include national security-related inquiries, requiring applicants to meet stringent residency rules, complete multiple forms collecting detailed personal information, provide fingerprints, complete an in-person interview, and pass English and civics tests.

Foreign travelers have sought to gain the numerous benefits of U.S. citizenship for their children by obtaining visas to travel to the United States to give birth, while in some cases, passing along the costs to tax payers at the state and local level. Some of these benefits include ease of travel to countries that offer visa-free travel to U.S. citizens, the ability to study and work in the United States, and a legal path for the child's parents to immigrate to the United States once the child turns twenty-one. U.S. embassies and consulates have reported that visa applicants intending to give birth in the United States provide numerous reasons for their choice, including, but not limited to, obtaining a second citizenship for their child, the perceived low-cost medical services available to women in the United States, the lower cost of obtaining U.S. citizenship through birth tourism than through a U.S. investor visa, and the perceived guarantee of a better socioeconomic future for their child.

While this rule will not preclude visa issuance to all aliens who may give birth in the United States, it recognizes the risks posed by allowing the previous visa policy to continue; and addresses some of those national security threats that exist when aliens, who may have no ties to, or constructive interest in, the United States, easily are able to obtain U.S. citizenship for their children, through birth in the United States.

The birth tourism industry in the United States also is a source of fraud and other criminal activity, including international criminal schemes. A recent federal indictment of 19 individuals on immigration fraud charges shows that businesses in the lucrative birth tourism industry committed ''widespread immigration fraud and engaged in international money laundering,'' as well as defrauding ''property owners when leasing the apartments and houses used in their birth tourism schemes.''[4] According to the recent federal indictment, in exchange for their services, birth tourism operators charged as much as $100,000 and one of the largest operators is alleged to have used ''14 different bank accounts to receive more than $3.4 million in international wire transfers'' in a two year period alone.[5]

This rule explicitly establishes that birth tourism is not a permissible purpose of travel for issuance of a B visa. This rule will help eliminate the criminal activity associated with the birth tourism industry. The recent federal indictments describe birth tourism schemes in which foreign nationals applied for visitor visas to come to the United States and lied to consular officers about the duration of their trips, where they would stay, and their purpose of travel. According to the indictments that charge the operators of the birth tourism schemes, foreign women were coached on how to pass their U.S. visa interviews by lying on their visa application forms and providing false statements to consular officers. The applicants also provided false statements on their visa applications and in their interviews about the funds available to them to cover the costs of their proposed treatment and stay in the United States.[6] When foreign travelers lie about their true purpose of travel to the United States during their visa interviews, consular officers may not identify a true basis for visa ineligibility, including, for example, lack of intent or ability to pay for the costs of their stay. This rule, by limiting the circumstances in which an alien will be in a position to give birth in the United States on a ''tourist'' visa, will potentially decrease the number of birth tourism providers in the United States, thus discouraging aliens from applying for visas to travel to the United States for this purpose. By explicitly establishing that birth tourism is not a permissible purpose for issuance of a B visa, this rule will reduce the number of visa applicants who apply for B visas for the purpose of birth tourism.

This rule will help prevent operators in the birth tourism industry from profiting off treating U.S. citizenship as a commodity, sometimes through potentially criminal acts, as described above. The investigation into birth tourism operators in California uncovered a scheme where birth tourism operators enriched themselves ''using cash, fabricated financial documents, and nominee names for the transfer of money''[7] from overseas to the United States. In some cases, birth tourism operators leased apartments by providing false information about the true occupants of the residences, making false statements about occupants' monthly income, and furnishing altered bank statements in order to be approved for leases.[8] The federal indictments highlight accounts of birth tourism customers failing to pay all the costs of giving birth in the United States, including hospital, doctor, and other bills, which would then be referred to collection.[9] In one example, a couple ''paid only $4,600 of the $32,291 in hospital charges related to the birth of their baby.''[10] In another example, a couple paid a hospital the indigent rate of $4,080 for hospital bills that exceeded $28,000, despite having more than $225,000 in a U.S. bank account and making purchases at Rolex and Louis Vuitton stores during their

[2] *United States* v. *Li,* 19–cr–00016 (S.D. Cal., filed Jan 30, 2019), *United States* v. *Liang,* 15–cr–00061 (C.D. Cal., filed May 18, 2015).

[3] *Id.*

[4] *https://www.justice.gov/usao-cdca/pr/federal-prosecutors-unseal-indictments-naming-19-people-linked-chinese-birth-tourism.*

[5] *https://www.justice.gov/usao-cdca/pr/federal-prosecutors-unseal-indictments-naming-19-people-linked-chinese-birth-tourism.*

[6] *United States* v. *Li,* 19–cr–00016 (S.D. Cal., filed Jan 30, 2019). *See also https://www.justice.gov/usao-cdca/pr/chinese-national-pleads-guilty-running-birth-tourism-scheme-helped-aliens-give-birth-us.*

[7] *https://www.justice.gov/usao-cdca/pr/federal-prosecutors-unseal-indictments-naming-19-people-linked-chinese-birth-tourism.*

[8] *United States* v. *USA Happy Baby Inc.,* 19–cr–00027 (C.D. Cal., filed January 20, 2019); *United States* v. *Li,* 19–cr–00016 (S.D. Cal, filed Jan 30, 2019).

[9] *United States* v. *Li,* 19–cr–00016 (S.D. Cal., filed Jan 30, 2019).

[10] *https://www.justice.gov/usao-cdca/pr/federal-prosecutors-unseal-indictments-naming-19-people-linked-chinese-birth-tourism.*

time in the United States.[11] Meanwhile, birth tourism operators are earning millions of dollars through the scheme, evading taxes, money laundering, and engaging in fraud to enhance their profits.

C. Medical Treatment

Under previous Department guidance and under this rule, medical treatment, whether medically necessary or elective, generally continues to be permissible activity in the B nonimmigrant classification, subject to certain restrictions.

Under guidance to consular officers in the Department's Foreign Affairs Manual (FAM)[12] and this rule, an applicant who seeks a B nonimmigrant visa for medical treatment in the United States shall be denied a visa under INA section 214(b), 8 U.S.C. 1184(b), if unable to establish, to the satisfaction of a consular officer, a legitimate reason why he or she wishes to travel to the United States for medical treatment. Additionally, the applicant must satisfy the consular officer that a medical practitioner or facility in the United States has agreed to provide treatment. The applicant must also establish to the satisfaction of the consular officer that he or she has reasonably estimated the duration of the visit and has the means, derived from lawful sources, and intent to pay for the medical treatment and all incidental expenses. If an applicant's responses to this line of inquiry are not credible, that may give consular officers reason to question whether the applicant intends to timely depart the United States or intends to engage in other impermissible activity.

The two new sentences in § 41.31(b)(2)(ii) added by this rule track language about medical treatment and the B–2 nonimmigrant classification on the Department's public facing website. *See https://travel.state.gov/content/travel/en/us-visas/tourism-visit/visitor.html.*[13] The identified information often helps inform a consular officer's determination whether the applicant qualifies for a B visa, including whether the applicant overcomes the presumption in INA 214(b), 8 U.S.C. 1184(b), that he or she is an intending immigrant, and whether the applicant is ''entitled to a nonimmigrant status under section 101(a)(15).'' INA 214(b), 8 U.S.C. 1184(b).

The Department is adding this provision to § 41.31(b) now because application of these factors will have a direct bearing on implementation of this new policy that a primary purpose of obtaining United States citizenship for a child by giving birth in the United States (as opposed to travel for the primary purpose of obtaining medical treatment for reasons related to childbirth for maternal or infant health) is an impermissible basis for B visa issuance. For a B nonimmigrant visa applicant who seeks to travel to the United States to give birth, consular officers will evaluate whether the applicant has credibly articulated a permissible purpose of travel on a B visa, or whether the applicant's primary purpose of travel is birth tourism, *i.e.,* to obtain U.S. citizenship for the child.

The Department believes including the new provisions in § 41.31 clarify the requirements for all B nonimmigrant applicants who seek medical treatment in the United States, by including the factors that a consular officer will weigh when determining whether the applicant qualifies for a B nonimmigrant visa. These regulatory refinements should be particularly helpful for applicants who are likely to give birth in the United States, to help them determine whether they are eligible to apply for a B nonimmigrant visa.

D. Presumption of Intent

Under this rule, if a consular officer has reason to believe a B nonimmigrant visa applicant will give birth in the United States, the applicant is presumed to be seeking a visa for the primary purpose of obtaining U.S. citizenship for the child. To rebut this presumption, the visa applicant must establish, to the satisfaction of a consular officer, a legitimate primary purpose other than obtaining U.S. citizenship for a child by giving birth in the United States. The fact that an applicant has arranged an elective medical birth plan (as opposed to a birth requiring specialized medical treatment) in the United States is not, by itself, sufficient to establish that the primary purpose is not obtaining U.S. citizenship for the child. Take, for example, a visa applicant who identified several potential options in multiple countries that would satisfy her medical birth plan. If that visa applicant arranged a birth plan in the United States, instead of in another country, because the child would acquire U.S. citizenship, the presumption would likely not be rebutted, especially if she had ties to a geographically closer country that would meet her needs. But, for another example, consider an otherwise qualified B nonimmigrant visa applicant from a part of Mexico lacking appropriate medical facilities who arranged a birth plan in the United States based on proximity to her residence in Mexico. In that case, the presumption could be rebutted. A visa applicant who identified a birth plan in the United States based on specialized medical care for a complicated pregnancy could also potentially rebut the presumption. Medical care is not the only way the presumption can be rebutted. For example, if a consular officer determined an individual's primary purpose for travel to the United States is to visit her dying mother, and that during the visit she may give birth in the United States because her due date overlapped with her mother's last expected months of life, she could rebut the presumption. For another example, if a B nonimmigrant visa applicant satisfied the consular officer that her child would acquire U.S. citizenship if born outside the United States under section 301(g) of the INA, 8 U.S.C. 1401(g), based on the visa applicant's husband's U.S. citizenship and prior physical presence in the United States, the visa applicant would rebut the presumption that her primary purpose was to obtain U.S. citizenship for the child.

III. Regulatory Findings

A. Administrative Procedure Act

This rule is exempt from notice and comment under the foreign affairs exemption of the Administrative Procedure Act (APA), 5 U.S.C. 553(a).

Opening this pronouncement of foreign policy to public comment, including comment from foreign government entities themselves, and requiring the Department to respond publicly to pointed questions regarding foreign policy decisions would have definitely undesirable international consequences. *See Yassini* v. *Crosland,* 618 F.2d 1356, n.4 (9th Cir. 1980). The Department recognizes specifically that foreign governments or parts thereof may have interests in this rule as a matter of their foreign policy goals. The Department has concerns that birth tourism, and the birth tourism industry, pose a significant vulnerability for the security of the United States. Various public sources have identified specific countries that are the primary sources of birth tourists, some of which countries have very sensitive relationships with the United States. Some governments may support their citizens' desire to use U.S. temporary visitor visas as a mechanism to obtain U.S. citizenship for their children. Foreign governments or entities, including entities of concern to the United States, may seek to benefit

[11] *United States* v. *Li,* 19–cr–00016 (S.D. Cal., filed Jan 30, 2019).

[12] *See* 9 FAM 402.2–4(A)(2).

[13] *Id.*

directly or indirectly from birth tourism, including for purposes that would threaten the security of the United States. As a DOJ representative stated during hearings on the Administrative Procedure Act, ''[a] requirement of public participation in . . . promulgation of rules to govern our relationships with other nations . . . would encourage public demonstrations by extremist factions which might embarrass foreign officials and seriously prejudice our conduct of foreign affairs.'' Administrative Procedure Act: Hearings on S.1663 Before the Subcomm. on Admin. Practice & Procedure of the S. Comm. on the Judiciary, 88th Cong. at 363 (1964).

Recognizing that certain countries have been publicly identified as being principal sources of foreign nationals pursuing birth tourism, and certain of those countries raise particular national security concerns, this rule clearly and directly impacts foreign affairs functions of the United States and ''implicat[es] matters of diplomacy directly.'' *City of N.Y.* v. *Permanent Mission of India to the U.N.,* 618 F.3d 172, 202 (2d Cir. 2010). This regulatory change reflects changes to U.S. foreign policy, specifically in the context of U.S. visas, that significantly narrow the ability of foreign nationals residing abroad to easily obtain U.S. citizenship for their children without complying with any of the rigorous requirements for permanent residence or naturalization. Publicly identifying birth tourism as a threat to the security of the United States, in a context where specific countries have been identified as the primary source of birth tourists, inherently affects U.S. bilateral relations with those countries, and signals a significant shift in U.S. policy towards those foreign governments and their populations. This modification of U.S. visa policy may also lead to reciprocal actions on the part of foreign governments, including some countries in which there are a significant number of U.S. citizens residing.

B. Regulatory Flexibility Act/Executive Order 13272 (Small Business)

Because this final rule is exempt from notice and comment rulemaking under 5 U.S.C. 553, it is exempt from the regulatory flexibility analysis requirements set forth by the Regulatory Flexibility Act (5 U.S.C. 603 and 604).

C. Unfunded Mandates Reform Act of 1995

The Unfunded Mandates Reform Act of 1995 (UMRA) is intended, among other things, to curb the practice of imposing unfunded Federal mandates on State, local, and tribal governments. Title II of UMRA requires each Federal agency to prepare a written statement assessing the effects of any Federal mandate in a proposed or final agency rule that may directly result in a $100 million or more expenditure (adjusted annually for inflation) in any one year by State, local, and tribal governments, in the aggregate, or by the private sector. This rule governs B nonimmigrant visa classification and does not mandate any direct expenditure by State, local, or tribal governments.

D. Congressional Review Act

The Office of Information and Regulatory Affairs has determined that this rule is not a major rule as defined by 5 U.S.C. 804(2), for purposes of congressional review of agency rulemaking under the Small Business Regulatory Enforcement Fairness Act of 1996.

E. Executive Orders 12866 (Regulatory Planning and Review) and 13563 (Improving Regulation and Regulatory Review)

The Office of Information and Regulatory Affairs (OIRA) has determined that this rule is significant under Executive Order 12866, though not economically significant. Thus, it has been reviewed by OIRA. 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 (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). The Department has reviewed this rule to ensure consistency with those requirements.

The Department has also considered this rule in light of Executive Order 13563 and affirms that this regulation is consistent with the guidance therein.

In crafting this rule, the Department considered alternate ways to address the national security concerns associated with birth tourism. The Department seeks to balance the United States' strong interest in curtailing birth tourism, based on national security and law enforcement concerns, with its commitment to facilitating legitimate medical travel and other legitimate bases for issuing B nonimmigrant visas.

The Department recognizes this rule may result in indirect costs to state and local entities and the private sector associated with loss of business from foreign national customers who seek to travel to the United States for the primary purpose of obtaining United States citizenship for a child by giving birth in the United States.

As detailed above, the rule aims to end a threat to national security and to mitigate criminal activity associated with the birth tourism industry. Birth tourism companies highlight the benefits of eligibility and priority for jobs in U.S. government, public companies and large corporations.

This rule represents the most narrowly tailored regulation to mitigate the threat. The Department considered whether *all* B–1/B–2 visa applicants, and applicants for visas in other nonimmigrant classifications, might be denied, in accordance with the INA, in any case where a consular officer reasonably expects the applicant will give birth in the United States to a child who would become a U.S. citizen solely because of the place of birth. The Department decided not to adopt such an interpretation, instead limiting this policy to B–1/B–2 nonimmigrant visa applicants and limiting it to applicants who have a primary purpose of obtaining U.S. citizenship for a child expected to be born in the United States. Notably, the B visa classification constitutes the vast majority of nonimmigrant visa applications and the one that is typically used for birth tourism.

With the understanding that some foreign nationals have historically applied for and obtained B nonimmigrant visas for the primary purpose of giving birth in the United States to obtain U.S. citizenship for the child, the Department crafted this rule narrowly to address core national security-related concerns.

F. Executive Orders 12372 and 13132 (Federalism)

The objective of E.O. 13132 is to guarantee the Constitution's division of governmental responsibilities between the federal government and the states. It furthers the policies of the Unfunded Mandates Reform Act. This rule does not have federalism implications within the meaning of E.O. 13132, because it does not impose any substantial direct compliance costs on State, local, or tribal governments or preempt State, local, or tribal law. Furthermore, this rule does not involve grants, other forms of financial assistance, and direct development that implicate concerns under E.O. 12372.

G. Executive Order 12988 (Civil Justice Reform)

The Department has reviewed the regulation in light of sections 3(a) and 3(b)(2) of Executive Order 12988 to eliminate ambiguity, minimize

litigation, establish clear legal standards, and reduce burden.

H. Executive Order 13175 (Consultation and Coordination With Indian Tribal Governments)

The Department has determined that this rulemaking will not have a substantial direct effect on one or more Indian tribes, will not impose substantial direct compliance costs on Indian tribal governments, 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, and will not pre-empt tribal law. Accordingly, the requirements of Section 5 of Executive Order 13175 do not apply to this rulemaking.

I. Executive Order 13771 (Reducing Regulation and Controlling Regulatory Costs)

This rule is not subject to the requirements of E.O. 13771 (82 FR 9339, February 3, 2017), because it is expected to be *de minimis* under E.O. 13771.

J. Paperwork Reduction Act

This rule does not impose any new information collection requirements under the provisions of the Paperwork Reduction Act, 44 U.S.C. Chapter 35. The Online Nonimmigrant Visa Application, DS–160, already allows visa applicants to identify medical treatment as a subset of B visa travel purpose. Consular officers would evaluate the application using existing forms and would not need new approved information collections.

List of Subjects in 22 CFR Part 41

Administrative practice and procedure, Foreign Relations, Visas, Aliens, Foreign official, Employment, Students, Cultural Exchange Programs.

Text of the Rule

Accordingly, for the reasons stated in the preamble, the Department is amending 22 CFR part 41 as follows:

PART 41—VISAS: DOCUMENTATION OF IMMIGRANTS UNDER THE IMMIGRATION AND NATIONALITY ACT, AS AMENDED

■ 1. The authority citation for part 41 is revised to read as follows:

Authority: 8 U.S.C. 1101; 1102; 1104; 1182; 1184; 1185 note (section 7209 of Pub. L. 108–458, as amended by section 546 of Pub. L. 109–295); 1323; 1361; 2651a.

■ 2. In § 41.31, revise paragraph (b)(2) to read as follows:

§ 41.31 Temporary visitors for business or pleasure.

(b) * * *

(2)(i) The term pleasure, as used in INA 101(a)(15)(B) for the purpose of visa issuance, refers to legitimate activities of a recreational character, including tourism, amusement, visits with friends or relatives, rest, medical treatment, and activities of a fraternal, social, or service nature, and does not include obtaining a visa for the primary purpose of obtaining U.S. citizenship for a child by giving birth in the United States.

(ii) Any visa applicant who seeks medical treatment in the United States under this provision shall be denied a visa under INA section 214(b) if unable to establish, to the satisfaction of a consular officer, a legitimate reason why he or she wishes to travel to the United States for medical treatment, that a medical practitioner or facility in the United States has agreed to provide treatment, and that the applicant has reasonably estimated the duration of the visit and all associated costs. The applicant also shall be denied a visa under INA section 214(b) if unable to establish to the satisfaction of the consular officer that he or she has the means derived from lawful sources and intent to pay for the medical treatment and all incidental expenses, including transportation and living expenses, either independently or with the pre-arranged assistance of others.

(iii) Any B nonimmigrant visa applicant who a consular officer has reason to believe will give birth during her stay in the United States is presumed to be traveling for the primary purpose of obtaining U.S. citizenship for the child.

* * * * *

Carl C. Risch,

Assistant Secretary for Consular Affairs, Department of State.

[FR Doc. 2020–01218 Filed 1–23–20; 8:45 am]

BILLING CODE 4710–06–P

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

24 CFR Part 51

[Docket No: FR–6054–F–02]

RIN 2506–AC45

Conforming the Acceptable Separation Distance (ASD) Standards for Residential Propane Tanks to Industry Standards

AGENCY: Office of the Assistant Secretary for Community Planning and Development, HUD.

ACTION: Final rule.

SUMMARY: This final rule reduces regulatory and cost burden on communities that may be restricted in their ability to site HUD-assisted projects, by allowing HUD-assisted projects near stationary aboveground propane storage tanks with a capacity of 1,000 gallons or less if the storage tanks comply with National Fire Protection Association (NFPA) 58 (2017). Based on consideration of public comments, HUD is adopting this 1,000-gallon limit in lieu of the 250-gallon limit contemplated in the proposed rule. This final rule incorporates by reference NFPA 58 (2017), a voluntary consensus standard for public safety that establishes safety standards used by the propane industry and operators regarding storage, handling, transportation, and use of propane.

DATES: *Effective Date:* February 24, 2020. The incorporation by reference of certain publications listed in the rule is approved by the Director of the Federal Register as of February 24, 2020.

FOR FURTHER INFORMATION CONTACT: Danielle Schopp, Director, Office of Environment and Energy, Office of Community Planning and Development, U.S. Department of Housing and Urban Development, 451 7th Street SW, Washington, DC 20410; telephone number 202–402–5226 (this is not a toll-free number). Persons with hearing or speech impairments may access this number through TTY by calling the Federal Relay Service at 800–877–8339 (this is a toll-free number).

SUPPLEMENTARY INFORMATION:

I. Background

On December 10, 2018, HUD published a rule in the **Federal Register,** at 83 FR 63457, which proposed expanding HUD's ability to approve assistance for projects sited near propane storage tanks (otherwise known as ''Liquified Petroleum Gas containers'' or ''LPG containers''). The rule proposed amending HUD regulations at 24 CFR part 51, subpart C, which establish the Acceptable Separation Distance (ASD) that must be kept between HUD-assisted projects and containers of hazardous substances, by creating an exception for aboveground propane storage tanks of a capacity of 250 gallons or less if the storage tank complies with NFPA 58 (2017), a voluntary consensus standard that establishes safety standards used by the propane industry and operators regarding storage, handling, transportation, and use of propane, as well as all underground storage tanks.

HUD's proposed rule was intended to modernize outdated codified safety

standards. HUD's current standards, codified at 24 CFR part 51, subpart C, are based on the findings of studies conducted by the Department, in 1975 and 1982.[1] The effect of these standards is to prescribe the ASD of HUD-assisted projects from specific hazardous operations, unless appropriate mitigating measures are implemented. Substances deemed hazardous include petrochemical products, such as propane. HUD-assisted projects include the development, construction, rehabilitation, modernization, or conversion with HUD subsidy, grant assistance, loan, loan guarantee, or mortgage insurance of any project intended for residential, institutional, recreational, commercial, or industrial use.

Mitigation measures can be costly and limit choices for siting a HUD-assisted project. HUD's experience has been that there are significant practical and economic difficulties in mitigating off-site residential propane tanks located on adjacent properties. HUD has recently provided waivers for approval of HUD-assisted sites that have propane tanks in compliance with NFPA 58 (2017) on the basis that such compliance mitigated any danger to HUD-assisted projects sited adjacent to the hazard.

Based on HUD's experience, HUD issued its proposed rule to streamline and update its current rule.

II. Changes and Clarifications Made in This Final Rule

This final rule follows publication of the December 10, 2018, proposed rule and takes into consideration the public comments received on the proposed rule. In response to public comment, a discussion of which is presented in the following section of this preamble, and in further consideration of issues addressed at the proposed rule stage, the Department is making changes, described below, in this final rule.

A. Propane Tanks of up to 1,000 Gallons Exempted From Hazard ASD Restrictions

HUD received several comments requesting reconsideration of the 250-gallon limit for aboveground propane tanks exempted from HUD's ASD requirements. After performing further analysis on common residential tank sizes and potential risks posed by larger tanks, HUD has determined that exempting tanks up to 1,000 gallons would increase the rule's effectiveness without posing additional risk. As such, the definition of ''hazard'' in § 51.201 has been revised to exempt tanks up to 1,000 gallons. The justification for this change is described below.

1. Common Residential Tank Sizes

Typical propane consumption and the range of typical tank sizes vary widely between warmer and cooler climates. An average-size modern home using high-efficiency propane heating equipment and other appliances in a warm climate region can expect to use 194 to 258 gallons per year, while the same home in a cold climate region would typically use 991 to 1,844 gallons per year.[2]

The same variables that impact propane consumption naturally also impact the choice of propane tank sizing. In addition, the average customer, especially in a cold climate prefers to minimize the frequency of refueling to ensure that they don't run out given the high heating loads they experience in the winter. Propane prices also fluctuate with the market throughout the year and tend to be on the higher side during the heating season and lower in the summer. Larger tanks allow customers to buy larger quantities of propane during periods of lower prices resulting in better savings. They also save on delivery related fees by having fewer fill ups. The tank size thus becomes a cost controlling factor for the customer, and tank sizes up to 1,000 gallons are regularly used for residential purposes.[3]

2. Safety of 1,000-Gallon Propane Tanks

The reliability of propane tanks has increased significantly over the past 30 years and studies suggest that the evolution of industry safety practices has reduced the probability of propane tank failure.[4] Studies by the NFPA, documented in the rule's Regulatory Impact Analysis, show that propane is not a leading cause of fires or listed as a source of residential structure fires in the United States. Propane tanks are extremely durable. In a study performed by the U.S. Department of Defense and the Energy Research and Development Administration, these tanks sustained very little damage even from the energy of a simulated nuclear blast.[5] This experiment and others conducted in the propane industry demonstrate that propane tank explosions are difficult and rare.

Furthermore, this rule does not remove all safe distance requirements for LPG containers sited near HUD-assisted projects. All tanks exempted from HUD's ASD requirements under this rule must be fully compliant with NFPA (2017) standards, including NFPA separation distance requirements. Tanks locations must meet a separation distance between the container and important buildings[6] or line of adjoining property that can be built upon, in accordance with the NFPA 58. Tanks between 125 and 500 gallons must be at least 10 feet apart from important buildings or property lines of adjoining property that can be built upon, while tanks between 501 and 1,000 gallons must be at least 25 feet apart. Under NFPA 58 and this rule's revision of 24 CFR part 51, tanks under 125 gallons would not require a separation distance.

For the reasons described above, HUD has determined that LPG containers with capacities of up to 1,000 gallons that comply with NFPA 58 (2017) will no longer be subject to the hazard restrictions posed by 24 CFR part 51. Since the separation distance imposed by NFPA 58 compliance is sufficient to ensure the safety of HUD-assisted projects, increasing the size of tank covered by this exception will reduce regulatory and cost burden on even more projects and communities without any significant additional risk.

B. Other Changes and Clarifications

One commenter stated that it was unclear whether the tank size referenced in § 51.201 definition of ''hazard'' was to be measured in water gallon capacity or propane gallon capacity. As a result, HUD has amended the language of § 51.201 to clarify that tanks are measured in water gallon capacity. This language was clarified in order to align the rule with language in NFPA 58 (which uses water capacity to determine ASD standards). The American Society of Mechanical Engineers, which certifies propane tanks, also rates tanks in terms of their water capacity.

Additionally, a commenter found the language used to describe propane tanks (''Containers which are designed to hold

[1] Safety Consideration in Siting Housing Projects, prepared by Arthur D. Little Inc., 1975; and Urban Development Siting with Respect to Hazardous Commercial/Industrial Facilities, by Rolf Jensen and Associates Inc., 1982.

[2] Energy and Environmental Analysis of Propane Energy Pod Homes, Prepared for the Propane Education & Research Council, 2011.

[3] See NFPA 58 LP-Gas Code Handbook (2017).

[4] See Ahrens, M. (2017), Ahrens, M. (2018), Flynn, J. (2010), and Hall. J.R. (2014).

[5] The Effects of Nuclear Weapons, Compiled and edited by Samuel Glasstone and Philip J. Dolan., 1977.

[6] According to the NFPA 58 LP-Gas Code Handbook, a building can be considered important for a number of reasons such as high replacement value, its human occupancy, or vital importance of contents to a business. A building with characteristics that hinder emergency responders' access and ability to safely apply water to a tank or act as an impediment to applying water should also be considered an important building.

liquefied propane gas . . .'') confusing. To increase clarity and accuracy, HUD is amending the phrase to read: ''Containers which are *used* to hold liquefied *petroleum* gas.'' First, replacing ''designed'' with ''used'' more accurately describes the scope of the definition, since some containers that are not designed to hold LPG are used to hold it nonetheless, while still complying with NFPA safety requirements. Second, HUD is replacing ''liquified propane gas'' with ''liquefied petroleum gas'' because the gas used in heating systems is sometimes comprised of not only propane, but butane as well. These changes will increase consistency between this final rule and NFPA 58 (2017).

III. Discussion of Public Comments Received on December 10, 2018, Proposed Rule

The public comment period for the proposed rule closed on February 8, 2019. HUD received six public comments in response to the proposed rule. These comments were submitted by a nationally recognized fire safety codes and standards organization, the national trade group for the propane industry, a nonprofit affordable housing developer, and private citizens.

None of the commenters opposed conforming the ASD standards for residential propane tanks to industry standards. Commenters were generally supportive of the proposed rule, but, as provided in the following section of this Preamble, they also recommended changes or clarifications, several of which are discussed above.

Comment: How will this rule impact HUD-assisted projects sited near multiple propane tanks, or propane tanks stored near other gases.

HUD Response: Under this final rule, LPG tanks of 1,000 gallons or less are not subject to ASD requirements, regardless of how many tanks are present, if they comply with NFPA code 58 (2017). The exclusion from the ASD requirement applies only to LPG tanks. If there are other gases stored in stationary aboveground containers, the ASD must be calculated for those nonpropane containers.

Comment: HUD should not exempt all underground propane containers from hazard restrictions, but only those which comply with applicable Federal, State, or local safety standards, because improperly spaced underground containers can leak gas into underground structures.

HUD Response: HUD is declining to implement this change in this final rule, as this rule is amending safety standards relating to fire and blast hazards, which do not take into consideration other issues such as vapor contamination. HUD performs environmental review of most projects, including multifamily housing and new construction, which captures information related to vapor contamination to document compliance with the standards at 24 CFR 50.3(i) and 58.5(i)(2), using investigative techniques including but not limited to ASTM Phase I and Phase II Environmental Site Assessment.[7] Furthermore, this rule is conforming the relevant regulation with HUD's longstanding policy of considering underground tanks exempt from the ASD restrictions listed in 24 CFR 51 subpart C because they are shielded by the topography from posing fire or blast risks to HUD-assisted projects and, therefore, do not meet the definition of ''hazard'' at § 51.201. This is also consistent with HUD's treatment of LPG pipelines in existing regulations, in which LPG pipelines are excluded from the definition of ''hazard'' so long as they are either underground or comply with Federal, State, and local safety standards.

Comment: HUD should update the FHA *Single Family Housing Policy Handbook* to indicate that FHA can assist in the purchase of properties with underground propane tanks.

HUD Response: This final rule focuses on updates to the regulation at 24 CFR 51 subpart C, and updates to subregulatory guidance are beyond the scope of this rulemaking. Nevertheless, HUD agrees that the referenced guidance should reflect these revisions.

Comment: The rule only incorporates NFPA 58 by reference for LPG containers 250 gallons or less which are exempt from hazard restrictions. HUD should incorporate NFPA 58 by reference for all LPG containers regardless of size in order to maintain a consistent approach to handling LPG as a hazard.

HUD Response: As discussed above, in this final rule HUD is incorporating NFPA 58 (2017) by reference for LPG containers 1,000 gallons or less that are exempt from hazard restrictions. Containers larger than 1,000 gallons will still be defined as ''hazards'' and will still need to comply with HUD's safety standards at 24 CFR part 51, subpart C. This rulemaking is intended to mitigate regulatory and cost burden related to residential propane tanks (which typically hold 1,000 gallons or less)[8] and is not intended to address commercial, industrial, or agricultural propane tanks (which typically hold more than 1,000 gallons).[9]

IV. Incorporation by Reference

This rule incorporates the following voluntary consensus standard for siting of HUD-assisted projects near aboveground propane storage tanks that hold up to 1000 gallons: NFPA 58 Liquefied Petroleum Gas Code (2017). The NFPA develops building, fire, and electrical safety codes and standards. Federal agencies frequently use these codes and standards as the basis for developing Federal regulations concerning safety. NFPA 58 (2017) provides industry benchmark and operational information and standards for safe propane storage, handling, transportation, and use. NFPA 58 (2017) mitigates risks and ensures safe installations, to prevent failures, leaks, and tampering that could lead to fires and explosions. The regulation cannot account for future editions of NFPA that do not yet exist. Therefore, if HUD wishes to revise the standard in the future to incorporate newer editions of NFPA 58 this would require further rulemaking.

NFPA 58 (2017) is available online, via read-only access, at *https://www.nfpa.org/codes-and-standards/all-codes-and-standards/list-of-codes-and-standards/detail?code=58.* Members of the public may visit the link and create a username and password to view the free-access edition. The standard may also be obtained from the National Fire Protection Association at 1 Batterymarch Park, Quincy, MA 02169, telephone number (800) 344–3555, fax number (800) 593–6372.

V. Findings and Certifications

Regulatory Review—Executive Orders 12866 and 13563

Under Executive Order 12866 (Regulatory Planning and Review), a determination must be made whether a regulatory action is significant and, therefore, subject to review by the Office of Management and Budget (OMB) in accordance with the requirements of the order. Executive Order 13563 (Improving Regulations and Regulatory Review) directs executive agencies to analyze regulations that are ''outmoded, ineffective, insufficient, or excessively burdensome, and to modify, streamline, expand, or repeal them in accordance with what has been learned.'' Executive Order 13563 also directs that, where relevant, feasible, and consistent with regulatory objectives, and to the extent permitted by law, agencies are to

[7] HUD's environmental review regulations can be found at 24 CFR parts 50, 51, 55, and 58.

[8] See NFPA 58 LP-Gas Code Handbook (2017).

[9] *Ibid.*

identify and consider regulatory approaches that reduce burdens and maintain flexibility and freedom of choice for the public. HUD has examined the economic, budgetary, legal, and policy implications of this action and has determined that this final rule is a significant regulatory action under section 3(f) of Executive Order 12866 (but not an economically significant action). HUD has prepared a regulatory impact analysis that addresses the costs and benefits of the final rule. The analysis is available at *Regulations.gov* and is part of the docket file for this rule.

Executive Order 13771

Executive Order 13771, entitled ''Reducing Regulation and Controlling Regulatory Costs,'' was issued on January 30, 2017. This final rule is an Executive Order 13771 deregulatory action. Details on the estimated cost savings of this rule can be found in the rule's economic analysis.

Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) (5 U.S.C. 601 *et seq.*) generally requires an agency to conduct a regulatory flexibility analysis of any rule subject to notice and comment rulemaking requirements, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. Small entities include small businesses, small nonprofit organizations, and small governmental jurisdictions.

This rule updates a codified regulation to reduce regulatory and cost burden on communities that may be restricted in their ability to site HUD-assisted projects because of the presence of stationary aboveground propane storage tanks that may be nearby. Specifically, the rule allows the siting of HUD-assisted projects near stationary aboveground propane storage tanks with a capacity of 1,000 gallons or less if the storage tank complies with NFPA Code 58 (2017). HUD has determined that the rule would result in the reduction of costly mitigation measures.

Small entities affected by the rule include owner-occupied single family, small public housing authorities, and a limited number of multifamily projects. Notwithstanding, HUD has determined that the rule's impact will be to reduce administrative burdens and generate cost savings estimated to be from $200,000–$18,000,000 per year. Due to economies of scale and the cost of compliance with the existing rule, these reductions of administrative burden will provide relatively greater benefit to entities that are small. This rule would have minimal impact on small firms because they would not be required to modify current operational procedures. The rule will eliminate the need for costly waiver processes and mitigation costs on the part of these small entities. For example, as described in the Regulatory Impact Analysis, of 1200 small rental properties in Mississippi applying for disaster recovery assistance after Hurricane Katrina, 750 required additional compliance measures or a waiver under current 24 CFR part 51 subpart C in order to be eligible for assistance. Removing such obstacles to assistance would have particularly beneficial impact for similarly situated small rental properties, and other small entities, that are assisted going forward. Similarly, as discussed in the Regulatory Impact Analysis, HUD's 2017 waiver for certain Community Development Block Grant and Home Investment Partnerships programs in Vermont included both residences and small businesses; specifically, restaurants. In waiving the requirements of the existing regulation as to these small businesses, HUD noted that in 2011 there were 1,346 restaurants in Vermont using propane. These restaurants were affected by the cost or practicability of compliance with the existing rule, and these costs will be saved in future projects under this rule. Accordingly, the undersigned certifies that this rule will not have a significant economic impact on a substantial number of small entities.

Environmental Impact

A Finding of No Significant Impact with respect to the environment for this rule has been made in accordance with HUD regulations at 24 CFR part 50, which implement section 102(2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4332(2)(C)). The Finding of No Significant Impact is available for public inspection between 8 a.m. and 5 p.m., weekdays in the Regulations Division, Office of General Counsel, U.S. Department of Housing and Urban Development, 451 7th Street SW, Room 10276, Washington, DC 20410–5000. Due to security measures at the HUD Headquarters building, please schedule an appointment to review the Finding by calling the Regulations Division at (202) 708–3055 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number via TTY by calling the Federal Relay Service at (800) 877–8339. The Finding of No Significant Impact will also be available for review in the docket for this rule on *Regulations.gov*.

Federalism Impact

Executive Order 13132 (entitled ''Federalism'') prohibits, to the extent practicable and permitted by law, an agency from promulgating a regulation that has federalism implications and either imposes substantial direct compliance costs on State and local governments and is not required by statute, or preempts State law, unless the relevant requirements of section 6 of the Executive order are met. This rule does not have federalism implications and does not impose substantial direct compliance costs on State and local governments or preempt State law within the meaning of the Executive order.

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531–1538) (UMRA) establishes requirements for Federal agencies to assess the effects of their regulatory actions on State, local, and tribal governments and on the private sector. This rule would not impose any Federal mandates on any State, local, or tribal governments, or on the private sector, within the meaning of UMRA.

List of Subjects in 24 CFR Part 51

Airports, Hazardous substances, Housing standards, Incorporation by reference, Noise control.

Accordingly, for the reasons stated in the foregoing preamble, HUD amends 24 CFR part 51 as follows:

PART 51—ENVIRONMENTAL CRITERIA AND STANDARDS

■ 1. The authority citation for 24 CFR part 51 subpart C continues to read as follows:

Authority: 42 U.S.C. 3535(d), unless otherwise noted.

■ 2. In § 51.201, revise the definition of ''hazard'' to read as follows:

§ 51.201 Definitions.

* * * * *

Hazard—means any stationary container which stores, handles, or processes hazardous substances of an explosive or fire prone nature. The term ''hazard'' does not include:

(1) Pipelines for the transmission of hazardous substances, if such pipelines are located underground, or comply with applicable Federal, State and local safety standards;

(2) Containers with a capacity of 100 gallons or less when they contain common liquid industrial fuels, such as gasoline, fuel oil, kerosene, and crude oil, since they generally would pose no

danger in terms of thermal radiation or blast overpressure to a project;

(3) Facilities that are shielded from a proposed HUD-assisted project by the topography, because these topographic features effectively provide a mitigating measure already in place;

(4) All underground containers; and

(5) Containers used to hold liquefied petroleum gas with a volumetric capacity not to exceed 1,000 gallons water capacity, if they comply with National Fire Protection Association (NFPA) 58. NFPA 58, Liquefied Petroleum Gas Code, 2017 Edition, copyright 2016 is incorporated by reference into this section with the approval of the Director of the **Federal Register,** under 5 U.S.C. 552(a) and 1 CFR part 51. All approved material is available for inspection at HUD's Office of Environment and Energy, 202–402–5226, and is available from National Fire Protection Association, 1 Batterymarch Park, Quincy, MA 02169, telephone number 800–344–3555, fax number 800–593–6372, *www.nfpa.org.* It is also available for inspection at the National Archives and Records Administration (NARA). For information on the availability of this material at NARA, *email fedreg.legal@nara.gov* or visit *www.archives.gov/federal-register/cfr/ibr-locations.html.* Persons with hearing or speech impairments may access the numbers above through TTY by calling the Federal Relay Service, toll-free, at 800–877–8339.

* * * * *

Dated: January 9, 2020.

David C. Woll, Jr.,

Principal Deputy Assistant Secretary for Community Planning and Development.

[FR Doc. 2020–00440 Filed 1–23–20; 8:45 am]

BILLING CODE 4210–67–P

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 52

[EPA–R07–OAR–2019–0656; FRL–10004–15–Region 7]

Air Plan Approval; Missouri; Sampling Methods for Air Pollution Sources

AGENCY: Environmental Protection Agency (EPA).

ACTION: Final rule.

SUMMARY: The Environmental Protection Agency (EPA) is taking final action to approve a revision to the State Implementation Plan (SIP) for the State of Missouri submitted by the State on October 25, 2019. The revisions will amend the SIP by providing a more efficient way to perform emissions sampling on air pollution sources throughout Missouri. The State requested approval of incorporating by reference the federally defined methods for stack testing. These revisions are administrative in nature and do not affect the stringency of the SIP. 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 February 24, 2020.

ADDRESSES: The EPA has established a docket for this action under Docket ID No. EPA–R07–OAR–2019–0656. 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: Jan Simpson, Environmental Protection Agency, Region 7 Office, Air Quality Planning Branch, 11201 Renner Boulevard, Lenexa, Kansas 66219; telephone number (913) 551–7089; email address *simpson.jan@epa.gov.*

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

Table of Contents

I. Background

On December 3, 2019, the EPA proposed in the **Federal Register** approval of the SIP submission. See 84 FR 66096. The proposed revisions would amend the SIP by providing a more efficient way to perform emissions sampling on air pollution sources throughout Missouri. The State requested approval of incorporating by reference the federally defined methods for stack testing. The EPA solicited comments on the proposed revisions to Missouri's SIP and received no comments.

II. What is being addressed in this document?

The EPA is approving revisions to the Missouri SIP submitted by the State of Missouri to the EPA on October 25, 2019. The revisions to the previously federally approved Missouri State rule 10 CSR 10–6.030 *Sampling Methods for Air Pollution Sources* are administrative in nature and do not affect the stringency of the SIP. The revisions will provide a more efficient way to perform emissions sampling by incorporating by reference federally promulgated methods.

A detailed discussion of the revision to Missouri's SIP and was provided in EPA's December 3, 2019, **Federal Register** document. *See* 84 FR 66096.

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 May 15, 2018 to August 2, 2018 and received eight comments. Based on the comments received the State made revisions to rule text in sections (21) (22) and (23) that incorporated by reference specific appendices and subparts. The State provided a second public notice on this SIP revision from April 15, 2019 to June 6, 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 EPA taking?

We are taking final action to approve revisions to Missouri's SIP by approving the State's request to revise 10 CSR 10–6.030, *Sampling Methods for Air Pollution Sources.*

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**. 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 March 24, 2020. 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: January 9, 2020.

James Gulliford,

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 ''10–6.030'' 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				

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

EPA-APPROVED MISSOURI REGULATIONS—Continued

Missouri citation	Title	State effective date	EPA approval date	Explanation
* *	*	*	*	* *
10–6.030	Sampling Methods for Air Pollution Sources.	11/30/2019	1/24/2020, [insert **Federal Register** citation].	
* *	*	*	*	* *

* * * * *

[FR Doc. 2020–00516 Filed 1–23–20; 8:45 am]

BILLING CODE 6560–50–P

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 52

[EPA–R05–OAR–2019–0311; FRL–10004–21–Region 5]

Air Plan Approval; Illinois; Emissions Statement Rule Certification for the 2015 Ozone Standard

AGENCY: Environmental Protection Agency (EPA).

ACTION: Direct final rule.

SUMMARY: The Environmental Protection Agency (EPA) is approving a State Implementation Plan (SIP) submission from the Illinois Environmental Protection Agency (IEPA) dated May 16, 2019. The submission provides IEPA's certification that its existing emissions statement program, titled ''Annual Emissions Report'', remains in effect and satisfies the Clean Air Act (CAA) emissions statement requirement for the Illinois portions of the Chicago, Illinois-Indiana-Wisconsin (IL–IN–WI) and St. Louis, Missouri-Illinois (MO–IL) nonattainment areas under the 2015 ozone National Ambient Air Quality Standard (NAAQS). Under the CAA, states' SIPs must require stationary sources in ozone nonattainment areas classified as marginal or above to annually report emissions of Volatile Organic Compounds (VOC) and Oxides of Nitrogen (NO_X).

DATES: This direct final rule will be effective March 24, 2020, unless EPA receives adverse comments by February 24, 2020. If adverse comments are received by EPA, EPA will publish a timely withdrawal of the direct final rule in the **Federal Register** informing the public that the rule will not take effect.

ADDRESSES: Submit your comments, identified by Docket ID No. EPA–R05–OAR–2019–0311 at *http://www.regulations.gov* or via email to *Arra.Sarah@epa.gov.* For comments submitted at *Regulations.gov*, follow the online instructions for submitting comments. Once submitted, comments cannot be edited or removed from *Regulations.gov*. For either manner of submission, 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. 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 *http://www2.epa.gov/dockets/commenting-epa-dockets.*

FOR FURTHER INFORMATION CONTACT: Kathleen D'Agostino, Attainment Planning and Maintenance Section, Air Programs Branch (AR–18J), Environmental Protection Agency, Region 5, 77 West Jackson Boulevard, Chicago, Illinois 60604, (312) 886–1767, *Dagostino.Kathleen@epa.gov.*

SUPPLEMENTARY INFORMATION: Throughout this document, whenever ''we,'' ''us,'' or ''our'' is used, we mean EPA. This supplementary information section is arranged as follows:

I. Background

On October 1, 2015, EPA promulgated a revised 8-hour ozone NAAQS of 0.070 parts per million (ppm). *See* 80 FR 65292 (October 26, 2015). Effective August 3, 2018, EPA designated nonattainment areas for the 2015 ozone NAAQS. *See* 83 FR 25776 (June 4, 2018). The Chicago, IL–IN–WI and St. Louis, MO–IL areas were designated as marginal nonattainment areas for the 2015 ozone NAAQS.

Section 182(a)(3)(B) of the CAA requires states with ozone nonattainment areas classified as marginal and above to submit revisions to their SIPs to require the owner or operator of each stationary source of NO_X or VOC to provide the state with an annual statement documenting the actual emissions of NO_X and VOC from their source. Under section 182(a)(3)(B)(ii), a state may waive the emissions statement requirement for any class or category of stationary sources which emits less than 25 tons per year of VOC or NO_X if the state, in its base year emissions inventory, provides an inventory of emissions from such class or category of sources. States and EPA have generally interpreted this waiver provision to apply to sources (without specification of a specific source class or source category) emitting less than 25 tons per year of VOC or NO_X.

Many states, including Illinois, adopted emissions statement rules for stationary sources in nonattainment areas under the 1-hour ozone NAAQS, which EPA approved as part of each state's SIP. In cases where an existing emissions statement requirement is still adequate to meet the requirements under the 2015 ozone NAAQS, states may provide the rationale for that determination to EPA in a written statement for approval in the SIP to meet the requirements of section 182(a)(3)(B). *See* 83 FR 62998, 63001, 63023 (December 6, 2018) and 80 FR 12264, 12291 (March 6, 2015).

II. IEPA's Emissions Statement Certification and EPA's Evaluation of the State's Submission

IEPA submitted a SIP revision on May 16, 2019 certifying that the previously SIP-approved emissions statement regulations meet the emissions statement requirement for areas

designated as nonattainment for the 2015 ozone standard pursuant to sections 110 and 182 of the CAA. In its submission, IEPA stated that it has information collection authority under Section 4 of the Illinois Environmental Protection Act, and that IEPA collects NO_X and VOC emissions statements under 35 IAC Part 254, titled ''Annual Emissions Report,'' which applies to any source located in an ozone nonattainment area that has the potential to emit 25 tons per year or more of VOC or NO_X from all emission units during the reporting year. IEPA further stated that these regulations also apply to permitted smaller sources which are required to submit and certify source-wide totals of actual emissions from all regulated air pollutants emitted. Finally, IEPA confirmed, that in general, facilities subject to Part 254 must submit actual emissions data for NO_X and VOC on an annual basis and must certify that the information provided is accurate to the best of the certifier's knowledge.

EPA approved the ''Annual Emissions Report'' rules into the Illinois SIP on May 15, 2002 (67 FR 34614). Based on this approval and IEPA's certification, the regulations at 35 IAC Part 254 are sufficient to meet the emissions statement requirements of CAA section 182(a)(3)(B) for the 2015 ozone NAAQS.

III. Final Action

EPA is approving, as a SIP revision, IEPA's certification that Illinois' ''Annual Emissions Report'' rules at 35 IAC Part 254 meet the requirements of CAA section 182(a)(3)(B) under the 2015 ozone standard for the Illinois portions of the Chicago, IL–IN–WI and St. Louis, MO–IL ozone nonattainment areas.

We are publishing this action without prior proposal because we view this as a noncontroversial amendment and anticipate no adverse comments. However, in the proposed rules section of this **Federal Register** publication, we are publishing a separate document that will serve as the proposal to approve the state plan if relevant adverse written comments are filed. This rule will be effective March 24, 2020 without further notice unless we receive relevant adverse written comments by February 24, 2020. If we receive such comments, we will withdraw this action before the effective date by publishing a subsequent document that will withdraw the final action. All public comments received will then be addressed in a subsequent final rule based on the proposed action. EPA will not institute a second comment period. Any parties interested in commenting on this action should do so at this time. Please note that, if EPA receives adverse comment on an amendment, paragraph, or section of this rule and if that provision may be severed from the remainder of the rule, EPA may adopt as final those provisions of the rule that are not the subject of an adverse comment. If we do not receive any comments, this action will be effective March 24, 2020.

IV. Statutory and Executive Order Reviews

Under the CAA, the Administrator is required to approve a SIP submission that complies with the provisions of the CAA 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 expected to be an Executive Order 13771 (82 FR 9339, February 2, 2017) regulatory action because this action is not significant 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).

In addition, 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).

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 March 24, 2020. 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. Parties with objections to this direct final rule are encouraged to file a comment in response to the parallel notice of proposed rulemaking for this action published in the proposed rules section of this issue of the **Federal Register**, rather than file an immediate petition for judicial review of this direct final rule, so that EPA can withdraw this direct final rule and address the comment in the proposed rulemaking. This action may not be challenged later in proceedings to enforce its requirements. (See section 307(b)(2) of the CAA.)

List of Subjects in 40 CFR Part 52

Environmental protection, Air pollution control, Incorporation by reference, Intergovernmental relations, Oxides of nitrogen, Ozone, Reporting and recordkeeping requirements, Volatile organic compounds.

Dated: December 30, 2019.

Cheryl L Newton,

Acting Regional Administrator, Region 5.

40 CFR part 52 is amended as follows:

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.*

■ 2. In § 52.720, the table in paragraph (e) is amended by adding an entry for ''Ozone (8-hour, 2015) certification of emissions statement regulations'' following the entry for ''Ozone (8-hour, 2008) Nonattainment New Source Review Requirements'' to read as follows:

§ 52.720 Identification of plan.

* * * * *

(e) * * *

EPA-APPROVED ILLINOIS NONREGULATORY AND QUASI-REGULATORY PROVISIONS

Name of SIP provision	Applicable geographic or nonattainment area	State submittal date	EPA approval date	Comments
*	*	*	*	*
Ozone (8-hour, 2015) certification of emissions statement regulations.	Chicago and St. Louis areas.	5/16/2019	1/24/2020, [insert **Federal Register** citation].	Certification that Illinois' previously approved regulations at 35 IAC Part 254 meet the emissions statement requirements for the 2015 ozone NAAQS.
*	*	*	*	*

[FR Doc. 2020–00541 Filed 1–23–20; 8:45 am]

BILLING CODE 6560–50–P

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 52

[EPA–R10–OAR–2019–0568; FRL–10003–85-Region 10]

Air Plan Approval; Washington; Update to the Adoption by Reference, Energy Facility Site Evaluation Council

AGENCY: Environmental Protection Agency (EPA).

ACTION: Final rule.

SUMMARY: The Environmental Protection Agency (EPA) is revising the Washington State Implementation Plan (SIP) to approve updates to the Energy Facility Site Evaluation Council (EFSEC) air quality regulations. The EFSEC regulations apply to major energy facilities in the State of Washington and establish permitting requirements and emissions standards for such facilities. The EFSEC regulations primarily adopt by reference the Washington Department of Ecology (Ecology) general air quality regulations for program implementation. We are approving EFSEC's updated adoption by reference to include certain changes to Ecology's general air quality regulations since EFSEC's last adoption by reference, consistent with prior approvals.

DATES: This final rule is effective February 24, 2020.

ADDRESSES: The EPA has established a docket for this action under Docket ID No. EPA–R10–OAR–2019–0568. 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, *e.g.,* Confidential Business Information or other information the disclosure of which 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 at *https://www.regulations.gov,* or please contact the person listed in the **FOR FURTHER INFORMATION CONTACT** section for additional availability information.

FOR FURTHER INFORMATION CONTACT: Jeff Hunt, EPA Region 10, 1200 Sixth Avenue—Suite 155, Seattle, WA 98101, at (206) 553–0256, or *hunt.jeff@epa.gov.*

SUPPLEMENTARY INFORMATION: Throughout this document, wherever ''we,'' ''us,'' or ''our'' is used, it means the EPA.

I. Background

By statute, EFSEC has jurisdiction for managing the air program with respect to major energy facilities in the State of Washington. See Chapter 80.50 of the Revised Code of Washington (RCW). The EFSEC air quality regulations are contained in Chapter 463–78 Washington Administrative Code (WAC) *General and Operating Permit Regulations for Air Pollution Sources.* These EFSEC regulations rely primarily on the adoption by reference of the corresponding Ecology general air quality regulations contained in Chapter 173–400 WAC *General Regulations for Air Pollution Sources.* Many of the provisions of Chapter 173–400 WAC adopted by reference remain unchanged since the EPA's last approval of EFSEC's regulations and were not resubmitted as part of Washington's September 30, 2019, SIP revision. Other revised Chapter 173–400 WAC provisions were not submitted for approval as part of this current SIP revision, including certain subsections of WAC 173–400–030 and 173–400–040. Specifically, subsections WAC 173–400–030(30) [subsequently renumbered to (32)], WAC 173–400–030(36) [subsequently renumbered to (38)], and WAC 173–400–040(2) were not submitted by Ecology and EFSEC as part of this action. For those sections, the versions previously approved by the EPA in the **Federal Register** at 82 FR 24533 (May 30, 2017) remain in the SIP.

On October 29, 2019, we proposed approving EFSEC's updated adoption by reference to include certain changes to Ecology's general air quality regulations since EFSEC's last adoption by reference (84 FR 57836). The reasons for our proposed approval were stated in the proposed rule and will not be re-stated here. The public comment period for our proposed action ended on November 29, 2019. We received no adverse comments.

II. Final Action

The EPA is approving and incorporating by reference into the Washington SIP the submitted changes to WAC 463–78–005, *Adoption by Reference,* State effective August 26, 2019, and the corresponding submitted updates to EFSEC's adoption by reference of the following sections of Chapter 173–400 WAC:

- 173–400–111, 173–400–116, 173–400–710, 173–400–720, 173–400–730, 173–400–810, 173–400–830, 173–400–840, 173–400–850, State effective July 01, 2016;
- 173–400–025, 173–400–030, 173–400–040, 173–400–050, 173–400–171, 173–400–740, State effective September 16, 2018; and
- 173–400–060 and 173–400–105, State effective November 25, 2018.

III. Incorporation by Reference

In this rule, the EPA is finalizing regulatory text that includes incorporation by reference. In accordance with requirements of 1 CFR 51.5, we are finalizing the incorporation by reference as described in the amendments set forth to 40 CFR part 52 below. The EPA has made, and will continue to make, these materials generally available through *https://www.regulations.gov* and at the EPA Region 10 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 SIP, have been incorporated by reference by the 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]

IV. Statutory and Executive Order Review

Under the CAA, the Administrator is required to approve a SIP submission that complies with the provisions of the CAA 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 section 12(d) of the National Technology Transfer and Advancement Act of 1995 (15 U.S.C. 272 note) because it does not address technical standards; and
- Does not provide the 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 in Washington except as specifically noted in this preamble and is also not approved to apply 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). Washington's SIP is approved to apply on non-trust land within the exterior boundaries of the Puyallup Indian Reservation, also known as the 1873 Survey Area. Under the *Puyallup Tribe of Indians Settlement Act of 1989,* 25 U.S.C. 1773, Congress explicitly provided state and local agencies in Washington authority over activities on non-trust lands within the 1873 Survey Area. Consistent with EPA policy, the EPA provided a consultation opportunity to the Puyallup Tribe in a letter dated May 16, 2019.

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. The 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 March 24, 2020. 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.

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

Dated: December 13, 2019.

Chris Hladick,

Regional Administrator, Region 10.

For the reasons set forth in the preamble, 40 CFR part 52 is amended as follows:

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.*

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

Subpart WW—Washington

■ 2. Amend § 52.2470(c), Table 3, by:
■ a. Revising the entry ''78–005''; and
■ b. Under the heading ''Washington Administrative Code, Chapter 173–400 Regulations Incorporated by Reference in WAC 463–78–005'':
■ i. Adding the entry ''173–400–025'' in numerical order;
■ ii. Revising the entry ''173–400–030'';
■ iii. Adding the entry ''173–400–030(30)&(36)'' in numerical order;
■ iv. Revising the entry ''173–400–040'';
■ v. Adding the entry ''173–400–040(2)'' in numerical order; and
■ vi. Revising the entries ''173–400–050'', ''173–400–060'', ''173–400–105'', ''173–400–111'', ''173–400–116'', ''173–400–171'', ''173–400–710'', ''173–400–720'', ''173–400–730'', ''173–400–740'', ''173–400–810'', ''173–400–830'', ''173–400–840'', and ''173–400–850''.

The revisions and additions read as follows:

§ 52.2470 Identification of plan.

* * * * *

(c) * * *

TABLE 3—ADDITIONAL REGULATIONS APPROVED FOR THE ENERGY FACILITIES SITE EVALUATION COUNCIL (EFSEC) JURISDICTION

[See the SIP-approved provisions of WAC 463–78–020 for jurisdictional applicability]

State citation	Title/subject	State effective date	EPA approval date	Explanations
Washington Administrative Code, Chapter 463–78—General and Operating Permit Regulations for Air Pollution Sources				
78–005	Adoption by Reference	8/26/19	1/20/2020, [Insert **Federal Register** citation].	Subsection (1) only. See below for the updated Chapter 173–400—WAC provisions adopted by reference and submitted to the EPA for approval.
*	*	*	*	*
Washington Administrative Code, Chapter 173–400—Regulations Incorporated by Reference in WAC 463–78–005				
173–400–025	Adoption of Federal Rules	9/16/18	1/20/2020, [Insert **Federal Register** citation].	
173–400–030	Definitions	9/16/18	1/20/2020, [Insert **Federal Register** citation].	Except: 173–400–030(6); 173–400–030(32); 173–400–030(38); 173–400–030(45); 173–400–030(83); 173–400–030(89); 173–400–030(96); 173–400–030(97); 173–400–030(100); 173–400–030(103); 173–400–030(104).
173–400–030(30) & (36).	Definitions	12/29/12	5/30/17, 82 FR 24533.	
*	*	*	*	*
173–400–040	General Standards for Maximum Emissions.	9/16/18	1/20/2020, [Insert **Federal Register** citation].	Except: 173–400–040(2); 173–400–040(3); 173–400–040(5).
173–400–040(2)	General Standards for Maximum Emissions.	4/1/11	5/30/17, 82 FR 24533	Except: 173–400–040(2)(c); 173–400–040(2)(d).
173–400–050	Emission Standards for Combustion and Incineration Units.	9/16/18	1/20/2020, [Insert **Federal Register** citation].	Except: 173–400–050(2); 173–400–050(4); 173–400–050(5); 173–400–050(6).
173–400–060	Emission Standards for General Process Units.	11/25/18	1/20/2020, [Insert **Federal Register** citation].	
*	*	*	*	*
173–400–105	Records, Monitoring, and Reporting.	11/25/18	1/24/2020, [Insert **Federal Register** citation].	
*	*	*	*	*
173–400–111	Processing Notice of Construction Applications for Sources, Stationary Sources and Portable Sources.	07/01/16	1/20/2020, [Insert **Federal Register** citation].	Except: 173–400–111(3)(h); The part of 173–400–111(8)(a)(v) that says, • ''and 173–460–040,''; 173–400–111(9).
*	*	*	*	*
173–400–116	Increment Protection	07/01/16	1/20/2020, [Insert **Federal Register** citation].	
*	*	*	*	*
173–400–171	Public Notice and Opportunity for Public Comment.	9/16/18	1/20/2020, [Insert **Federal Register** citation].	Except: The part of 173–400–171(3)(b) that says, • ''or any increase in emissions of a toxic air pollutant above the acceptable source impact level for that toxic air pollutant as regulated under chapter 173–460 WAC''; 173–400–171(3)(o); 173–400–171(12).

TABLE 3—ADDITIONAL REGULATIONS APPROVED FOR THE ENERGY FACILITIES SITE EVALUATION COUNCIL (EFSEC) JURISDICTION—Continued

[See the SIP-approved provisions of WAC 463–78–020 for jurisdictional applicability]

State citation	Title/subject	State effective date	EPA approval date	Explanations
*	* *		* *	* *
173–400–710	Definitions	07/01/16	1/24/2020, [Insert **Federal Register** citation].	
173–400–720	Prevention of Significant Deterioration (PSD).	07/01/16	1/24/2020, [Insert **Federal Register** citation].	Except: 173–400–720(4)(a)(i through iv) and 173–400–720(4)(b)(iii)(C).
173–400–730	Prevention of Significant Deterioration Application Processing Procedures.	07/01/16	1/24/2020, [Insert **Federal Register** citation].	
173–400–740	PSD Permitting Public Involvement Requirements.	9/16/18	1/24/2020, [Insert **Federal Register** citation].	
*	* *		* *	* *
173–400–810	Major Stationary Source and Major Modification Definitions.	07/01/16	1/24/2020, [Insert **Federal Register** citation].	
*	* *		* *	* *
173–400–830	Permitting Requirements	07/01/16	1/24/2020, [Insert **Federal Register** citation].	
173–400–840	Emission Offset Requirements.	07/01/16	1/24/2020, [Insert **Federal Register** citation].	
173–400–850	Actual Emissions Plantwide Applicability Limitation (PAL).	07/01/16	1/24/2020, [Insert **Federal Register** citation].	
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DEPARTMENT OF HEALTH AND HUMAN SERVICES

Office of the Secretary

45 CFR Part 162

[CMS–0055–F]

RIN 0938–AT52

Administrative Simplification: Modification of the Requirements for the Use of Health Insurance Portability and Accountability Act of 1996 (HIPAA) National Council for Prescription Drug Programs (NCPDP) D.0 Standard

AGENCY: Office of the Secretary, HHS.

ACTION: Final rule.

SUMMARY: This final rule adopts a modification of the requirements for the use of the Telecommunication Standard Implementation Guide, Version D, Release 0 (Version D.0), August 2007, National Council for Prescription Drug Programs, by requiring covered entities to use the Quantity Prescribed (460–ET) field for retail pharmacy transactions for Schedule II drugs. The modification enables covered entities to distinguish whether a prescription is a ''partial fill,'' where less than the full amount prescribed is dispensed, or a refill, where the full amount prescribed is dispensed, in the HIPAA retail pharmacy transactions. This modification is important to ensure the availability of a greater quantum of data that may help prevent impermissible refills of Schedule II drugs, which will help to address the public health concerns associated with prescription drug abuse in the United States.

DATES: *Effective Date:* This final rule is effective on March 24, 2020.

Incorporation by reference: The incorporation by reference of certain publications listed in the rule was approved by the Director of the Federal Register as of March 17, 2009.

Compliance Date: Compliance with these regulations is required by September 21, 2020.

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SUPPLEMENTARY INFORMATION:

I. Background

The Health Insurance Portability and Accountability Act of 1996 (HIPAA) requires the Secretary of Health and Human Services (HHS) to adopt standards for the electronic transmission of certain health care administrative transactions conducted between health care providers, health plans, health care clearinghouses, and others. In January 2009 (74 FR 3295), the Secretary adopted the National Council for Prescription Drug Programs (NCPDP) Telecommunication Standard Implementation Guide, Version D, Release 0, August 2007 (hereinafter referred to as Version D.0) for the following retail pharmacy transactions: Health care claims or equivalent encounter information, referral certification and authorization, and coordination of benefits.

A. Inappropriate Medicare Part D Payments for Schedule II Drugs Billed as Refills

Schedule II drugs are defined, in part, by the Controlled Substances Act (CSA) as those with a high potential for abuse which may lead to severe psychological or physical dependence (21 U.S.C. 812(b)(2)). Regulators take particular interest in Schedule II drugs because of public health concerns associated with their potential for misuse. The CSA prohibits the refilling of Schedule II drugs, but permits partial fills of

Schedule II drugs in limited circumstances where a pharmacist has less than the prescribed amount of a medication in stock, the prescription is for a patient in a long-term care (LTC) facility, or a patient has a terminal illness.[1]

In September 2012, the HHS Office of the Inspector General (OIG) issued a report titled ''Inappropriate Medicare Part D Payments for Schedule II Drugs Billed as Refills'' that analyzed all of the 2009 program year prescription drug event (PDE) records for refills of Schedule II drugs.[2] PDE records are claim summary records that contain data elements from prescription drug claims, submitted by prescription drug plan sponsors to the Centers for Medicare & Medicaid Services (CMS) for every prescription a provider fills for a Medicare Part D beneficiary. One of those data element fields is titled ''Fill Number (403–D3),'' [3] which identifies refills. The Version D.0 implementation specifications require that a ''0'' be entered in the Fill Number (403–D3) field for a new prescription and that the number be sequentially increased by ''1'' for each refill. The OIG analyzed 20.1 million records for Schedule II drugs and, focusing on the Fill Number (403–D3) field, identified what it concluded were refills. The OIG concluded that the Medicare Part D program had inappropriately paid $25 million for 397,203 Schedule II drug refills and that LTC facility pharmacies billed for 75 percent of such refills. The OIG stated that the Medicare Part D plan sponsors should not have paid for those drugs because Federal law prohibits Schedule II drug refills, and concluded that ''[p]aying for such drugs raises public health concerns and may contribute to the diverting of controlled substances and their being resold on the street.'' [4]

CMS took a different interpretation of the OIG's findings. In its written response to the OIG report,[5] CMS expressed concern that the OIG's strict interpretation of PDE data did not support the OIG's findings. CMS believed the OIG's findings were based, in part, on a misinterpretation of Schedule II drug partial fills dispensed to LTC facility residents as refills. This prompted CMS to make an inquiry to an NCPDP work group, the WG9 Government Programs Medicare Part D FAQ Task Group (''Task Group''), which is designed to guide Federal pharmacy programs on NCPDP standards. CMS noted to the Task Group that, while the OIG report appeared to misinterpret partial fills as refills dispensed to patients in LTC facility pharmacies, it was not aware of any means by which a pharmacy could distinguish partial fills of a controlled substance prescription for billing purposes without using the Fill Number (403–D3) field. The Task Group replied to CMS that the Version D.0 implementation specification did not support the OIG's findings regarding the use of the Fill Number (403–D3) field,[6] and that the industry used the Fill Number (403–D3) field to represent the fill number—the amount actually dispensed—and not necessarily the refill number.

As a result, the Task Group initiated Designated Standard Maintenance Organization (DSMO) change request #1182 [7] to update the pharmacy standard to effect a clarification and avoid further misinterpretation. The Task Group advised CMS that NCPDP would recommend changes to the standard to allow Version D.0 to specify the conditional use of a field not then used in the claim billing transaction, the Quantity Prescribed (460–ET) field, to indicate the actual quantity prescribed in the transmission of the claim, which would make data available to validate whether there are inappropriate fills in excess of the quantity prescribed. NCPDP noted this change in its November 2012 publication of Version D.0, which required the use of the Quantity Prescribed (460–ET) field when claims for Schedule II drugs are submitted to Medicare Part D. However, HHS has not adopted the November 2012 publication of Version D.0, thus HIPAA covered entities may not use it for HIPAA transactions.

B. National Committee on Vital and Health Statistics (NCVHS) Recommendation

On June 21, 2013, the NCVHS wrote to the Secretary that it agreed with NCPDP's recommendation to allow Version D.0 to specify the conditional use of the Quantity Prescribed (460–ET) field in a republished Version D.0 with an explanation in the Editorial Corrections section, and a change to the Version D.0 Editorial Document.[8] The NCVHS indicated that, with this change, ''data will be available to validate whether or not there are inappropriate fills in excess of the quantity prescribed, a concern raised in a September 2012 report from the HHS Office of the Inspector General.''

C. Congressional and Administration Actions in Response to the Opioid Crisis

During the last decade, the nation has experienced worsening issues with opioid addiction and overdose deaths, prompting various Congressional and Administration actions. For example, the Comprehensive Addiction and Recovery Act (CARA) (Pub. L. 114–198) was enacted on July 22, 2016. CARA amended the CSA to allow a pharmacist to partially fill a prescription for a Schedule II controlled substance if (1) such partial fills are not prohibited by state law; (2) a partial fill is requested by the patient or prescribing practitioner; and (3) the total quantity dispensed in a partial fill does not exceed the quantity prescribed. We believe CARA's implementation will yield an upsurge in partial fills. That view is echoed in a May 31, 2017 letter NCPDP sent to the DEA, which stated ''[w]ith implementation of the CARA partial Fill Provision, the potential exists for a significant increase in the number of occurrences of a prescription for a Schedule II controlled substance being partially filled.''

Pursuant to the President's direction to consider the declaration of the public health emergency, consistent with the requirements of the Public Health Service Act, the Acting Secretary declared a nationwide public health emergency to address the opioid crisis on October 26, 2017.[9] The President also directed the heads of executive departments and agencies to use all lawful means to exercise all appropriate emergency and other relevant authorities to reduce the number of deaths and minimize the devastation the

[1] The Drug Enforcement Agency (DEA) indicated in a July 2017 letter to NCPDP that it was currently promulgating proposed rulemaking to address the changes to 21 CFR 1306.13 (which concerns partial fills of prescriptions for Schedule II controlled substances) made by the Comprehensive Addiction and Recovery Act (CARA).

[2] Inappropriate Medicare Part D Payments for Schedule II Drugs Billed as Refills, *https://oig.hhs.gov/oei/reports/oei-02-09-00605.asp.*

[3] National Council for Prescription Drug Programs (NCPDP) Telecommunication Standard Implementation Guide, Version D, Release 0, August 2007, defines the Fill Number Field as ''403–D3.''

[4] Inappropriate Medicare Part D Payments for Schedule II Drugs Billed as Refills, page 13, *https://oig.hhs.gov/oei/reports/oei-02-09-00605.asp.*

[5] Inappropriate Medicare Part D Payments for Schedule II Drugs Billed as Refills, page 17, *https://oig.hhs.gov/oei/reports/oei-02-09-00605.asp.*

[6] *https://www.ncpdp.org/NCPDP/media/pdf/OESS_request_20121115.pdf.*

[7] *https://www.ncpdp.org/NCPDP/media/pdf/OESS_request_20121115.pdf.*

[8] To review the recommendation, see *http://www.ncvhs.hhs.gov/wp-content/uploads/2014/05/130621lt1.pdf.*

[9] *https://www.hhs.gov/sites/default/files/opioid%20PHE%20Declaration-no-sig.pdf.*

drug demand and opioid crisis inflicts upon American communities. Even prior to the President's direction, HHS had been responsive to the opioid crisis. In April 2017, the Secretary announced a 5-Point Strategy to—

- Improve access to prevention, treatment, and recovery support services;
- Target the availability and distribution of overdose-reversing drugs;
- Strengthen public health data reporting and collection;
- Support cutting-edge research on addiction and pain; and
- Advance the practice of pain management.[10]

The requirements finalized in this rule support one of our top opioid strategic priorities calling for better data, which may ultimately help in reducing the drug supply.

II. Provisions of the Proposed Rule and the Analysis of and Responses to Public Comments

In the January 31, 2019 **Federal Register** (84 FR 633), we published the proposed rule titled ''Administrative Simplification: Modification of the Requirements for the Use of Health Insurance Portability and Accountability Act of 1996 (HIPAA) National Council for Prescription Drug Programs (NCPDP) D.0 Standard'' (hereafter referred to as the January 2019 proposed rule). In response to the January 2019 proposed rule, we received 15 timely pieces of correspondence from a variety of commenters, including a pharmacy standards development organization, data content committees, health plans, health care companies, professional associations, technology companies, and individuals.

In this section of this final rule, we present our proposals, summation of the comments received, and our responses to the comments. Some of the public comments received in response to the January 2019 proposed rule were outside of the scope of the proposed rule, and are not addressed in this final rule.

A. Modification of the Requirements for Use of the Telecommunication Standard Implementation Guide Version D, Release 0 (Version D.0), August 2007, NCPDP

We proposed to adopt a modification of the requirements for the use of the Quantity Prescribed (460–ET) field of the August 2007 publication of Version D.0, which is the currently adopted version. We indicated that the modification would require that covered entities treat that field as required where a transmission uses Version D.0, August 2007, for a Schedule II drug for these transactions: (1) Health care claims or equivalent encounter information; (2) referral certification and authorization; and (3) coordination of benefits. HHS believes that, by modifying the requirements for the use of the NCPDP Telecommunication Standard Implementation Guide, Version D, Release 0 (Version D.0), August 2007, covered entities will be able to clearly distinguish whether a prescription is a ''partial fill,'' or a refill, in the HIPAA retail pharmacy transactions.

Comment: A number of commenters supported HHS's proposal, noting that its narrow approach would not increase administrative burden and would let all covered entities accurately reflect partial fills of Schedule II drugs. A commenter stated that, while the proposal would not itself solve the opioid crisis, it would represent a step in the right direction by yielding better data to allow researchers to understand opioid prescribing trends.

Response: We thank the commenters for their support.

Comment: Some commenters did not agree with the proposal and urged HHS to adopt the November 2012 publication of Version D.0, which commenters stated was balloted and approved by the NCPDP membership and subsequently approved by the American National Standards Institute. Some of these commenters noted that NCPDP's only modification in that November 2012 version was to alter use of the Quantity Prescribed (460–ET) field from ''not used'' to ''situational.''

Response: We note that, regardless of whether NCPDP's only change in its November 2012 version of D.0 was with respect to the Quantity Prescribed (460–ET) field, NCPDP had made other changes in previous D.0 releases before that time, and that all of the modifications NCPDP made to Version D.0 subsequent to the currently adopted 2007 version are included in its November 2012 publication. Thus, were we to adopt the November 2012 version here, covered entities would be required to implement a number of changes in addition to the one associated with the Quantity Prescribed (460–ET) field. Moreover, as we noted in the January 2019 proposed rule (84 FR 635), the alterations NCPDP made with respect to the Quantity Prescribed (460–ET) field in its November 2012 publication applied only to Medicare Part D claims, which would not cover a huge swath of HIPAA covered entities. We continue to believe that the narrow, targeted approach we proposed best addresses the immediate need to yield better data and information regarding partial fills of Schedule II drugs, and is the least burdensome to the industry.

Comment: Some commenters stated that HHS's proposal to modify the requirements for the use of the Quantity Prescribed (460–ET) field in Version D.0 failed to follow the process for adopting a modification to an existing HIPAA standard as established in the Transactions and Code Sets Rule and codified at § 162.910.

Response: As we explained in the January 2019 proposed rule (84 FR 635), the proposal would not modify the currently adopted Version D.0. Rather, it would require covered entities to treat a field in Version D.0 differently than is required by the Version D.0 implementation specifications. While commenters rightly note that modifications to HIPAA standards would require HHS to use the standards modification process established through rulemaking, because we are not modifying a HIPAA standard, we are not required to follow that process.

Specifically, our regulations at § 162.923(a) require covered entities to comply with the adopted HIPAA standards, except as otherwise provided. Here, we are providing that in a narrow instance, covered entities must use the adopted HIPAA standard Version D.0 in a way other than that specified by Version D.0. This constitutes a modification to the *use* of the adopted standard, not a modification to the standard itself. The term ''implementation specification'' is defined broadly at 45 CFR 160.103 as ''specific requirements or instructions for implementing a standard.'' Under the HIPAA regulations, implementation specifications are not limited to just those developed by standard setting organizations, which we adopt as HIPAA standards and incorporate by reference in the CFR. Implementation specifications are also requirements we establish for covered entities to comply with a standard. Under § 162.923(a), which specifies that we may require covered entities to comply with the adopted HIPAA standards except as otherwise provided, we are providing an exception.

Comment: Some commenters, recognizing that NCPDP's November 2012 Version of D.0 was limited to just Medicare Part D, recommended, as a work-around, that HHS adopt the November 2012 publication of Version D.0 and include language in the final rule stating that ''covered entities must designate the situational field, Quantity

[10] *https://www.hhs.gov/opioids/about-the-epidemic/index.html.*

Prescribed (460–ET) field as required for Schedule II Drugs, within applicable trading partner materials.'' To that end, the commenters suggested that NCPDP payer sheets, which are used to define required field submission, could be used as part of trading partner materials where payers could require the submission of the Quantity Prescribed (460–ET) field for all claims or equivalent encounter information, prior authorization, and coordination of benefits transactions where the drug dispensed is a Schedule II drug.

Response: We considered the commenters' suggestion, but continue to believe that our proposal to modify the requirements for the use of Version D.0 is the least burdensome approach for covered entities. As noted earlier in this final rule, that November 2012 publication includes modifications NCPDP made subsequent to the version we adopted as the HIPAA standard; if we were to adopt the November 2012 publication, covered entities would be required to implement a number of changes in addition to the one associated with the Quantity Prescribed (460–ET) field.

Comment: A commenter noted that the proposed change would make apparent the discrepancies between the prescribed and dispensed quantities, but would not help explain the discrepancies. The commenter illustrated this point with the following example. ''[I]f the physician wrote the prescription for #60 and the pharmacy only dispenses #30, this does not mean it is a 'partial fill,' the discrepancy could instead be due to insurance restricting the drug supply, or other insurance requirements. The Quantity Prescribed (460–ET) field does not specifically indicate if a partial fill happens. This could lead to erroneous conclusions about the fill event in certain instances, such as when the insurance plan may have limited how much was allowed for coverage, or if there was not enough quantity in stock, which would not provide the intended data surrounding actual partial fills.'' The commenter recommended that HHS instead utilize the following combination of fields, which the commenter asserted would clarify a discrepancy between prescribed and dispensed quantities—Dispensing Status (343–HD) field; Quantity Intended To Be Dispensed (344–HF) field; and Day Supply Intended To Be Dispensed (345–HG) field. The commenter noted that these fields are not required, but are available and supported by Version D.0.

Response: The fields to which the commenter refers are presently and purposefully only intended for use in the case of a pharmacy inventory shortage. We believe the approach we proposed, and adopt here, is superior to the commenter's recommended approach, which would be significantly more burdensome to covered entities by requiring them to comply with different requirements for each type of partial fill and to implement more software systems updates.

Comment: A commenter suggested that it would be easier for many pharmacies to implement systems changes to effectuate HHS's proposal so that the modification to the requirements for the use of the Quantity Prescribed (460–ET) field could cover more than just Schedule II drugs. Therefore, the commenter suggested that HHS expand this proposal to include Schedule III through V drugs as well. Conversely, several commenters supported HHS's proposed approach, which limits the modification to just Schedule II drugs.

Response: As discussed earlier in this final rule, the need for regulatory action to modify the requirements for the use of the August 2007 version of the NCPDP D.0 standard and the concerns motivating our proposed modification stem partly from CARA's change to the partial fill requirements for Schedule II drugs. We believe that requiring the Quantity Prescribed (460–ET) field to apply to all drugs, not just Schedule II drugs, would increase the burden on pharmacies, nor would it further the goals discussed herein. Therefore, we are finalizing our proposal without modification, but appreciate the commenters' varied perspectives, and may in the future consider expanding this requirement to include prescribed drugs in Schedules III through V.

Comment: A commenter encouraged the Secretary to expedite a proposed rule seeking the adoption of the NCPDP Telecommunication Standard Implementation Guide Version F2, which the commenter asserts provides enhanced transparency and improves patient safety measures for all controlled substances. By contrast, another commenter was pleased that we did not propose to adopt Version F2 because the commenter believes the language of the relevant field to be ''chilling'' as it suggests penalties may apply when the field is misused.

Response: We appreciate that there are arguments for and against expedited rulemaking for the adoption of NCPDP Telecommunication Standard Implementation Guide Version F2. Were we to adopt Version F2, covered entities would need to make significant changes. While we continue to carefully evaluate the NCVHS's May 17, 2018 recommendation encouraging HHS to adopt the updated NCPDP pharmacy standards, we believe the public health emergency caused by the opioid crisis, and the urgent need for better data and information to help combat it, dictate that we now take this narrow, targeted approach as proposed.

Comment: A number of commenters supported HHS's proposal that the term ''Schedule II drugs,'' be included in the modifications to §§ 162.1102, 162.1302, and 162.1802, to mirror the Drug Enforcement Administration's definition of the term at 21 CFR 1308.12. Some of these commenters agreed with HHS that Schedule III through V drugs should not be included in this rule.

Response: We thank the commenters for their support. We note that in this final rule, we are making a technical change to the regulation text to remove the phrase ''as updated'' from each of the three provisions that define Schedule II drugs, that is, §§ 162.1102(d)(1), 162.1302(d)(1), and 162.1802(d)(1), because the phrase is superfluous.

After reviewing the public comments received, we are finalizing the modification of the requirements for the use of the Quantity Prescribed (460–ET) field for retail pharmacy transactions, which will be reflected in the regulations at §§ 162.1102, 162.1302, and 162.1802.

B. Effective and Compliance Dates

We proposed that the final rule would be effective 60 days after publication in the **Federal Register** and that the compliance date would be 180 days after the effective date, in accordance with section 1175(b)(2) of the Social Security Act.

Comment: A number of commenters supported HHS's proposed effective and compliance dates for the modification.

Response: We thank the commenters for their support.

Comment: Some commenters urged HHS to revise the implementation timeline of the proposed modification. These commenters suggested that HHS should not adopt a compliance date that would interfere with end-of-year industry processing requirements. Commenters explained that they estimated the compliance date for this final rule would be January 2020, which coincides with the 2020 Medicare Part D rule's implementation timeframe for the NCPDP SCRIPT Standard Version 2017071 as well as the normal annual benefit plan changes. Another commenter stated that a short compliance timeframe would cause beneficiaries to be unable to access their

medications because payers would not have sufficient time to make the necessary systems changes. A commenter recommended that HHS implement a transitional period for this modification whereby payers may begin using the Quantity Prescribed (460–ET) field on the effective date of the final rule, but mandatory use of the field for all entities be no earlier than June 2020. Finally, some commenters stated their belief that the compliance date and effective date are the same, which they believed would result in a hard cut-over that could engender risks in patient access to care as well as burdensome administrative and operational challenges.

Response: In considering these comments, we recognize commenters' confusion with respect to the distinct concepts of compliance and effective dates, and we have clarified the regulation text in this final rule to be clear that the compliance date is 180 days after the effective date of the rule. As we noted previously in this document, this final rule will be effective 60 days after publication in the **Federal Register**. The compliance date, or the date on which covered entities must comply with the modification, follows that by 180 days. In the spring 2019 Unified Regulatory Agenda, we noted that, this final rule would be published in December 2019. Based on that, we anticipate that the effective date of this rule will be in February 2020 and the compliance date will be in August 2020. We believe this explanation ameliorates commenters' concerns. After consideration of the public comments received and the clarification offered here, we are finalizing the effective and compliance dates of this final rule without modification.

III. Incorporation by Reference

The incorporation by reference of the standards referenced in this rule (Telecommunication Standard Implementation Guide, Version D, Release 0 (Version D.0), August 2007 and equivalent Batch Standard Implementation Guide, Version 1, Release 2 (Version 1.2), National Council for Prescription Drug Programs) was previously approved for the amended sections. We are making no changes to the incorporation.

IV. Collection of Information Requirements

The Office of Management and Budget (OMB) has determined that the establishment of standards for electronic transactions under HIPAA (which mandate that the private sector disclose information and do so in a particular format) constitutes an agency-sponsored third-party disclosure as defined under the Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3501 *et seq.*). (See 65 FR 50350 (August 17, 2000).) With respect to the scope of its review under the PRA, however, OMB has concluded that its review would be limited to the review and approval of initial standards, and to changes in industry standards which would substantially reduce administrative costs. (See 65 FR 50350 (August 17, 2000).) This document, which requires the use of a data element that was not previously used and the disclosure of additional information in a particular location in the transaction, would usually constitute an information collection requirement because it requires third-party disclosures. However, because of OMB's determination, noted above, there is no need for OMB review under the PRA. But see 5 CFR 1320.3(b)(2) (time, effort, and financial resources necessary to comply with an information collection that would otherwise be incurred in the normal course of business can be excluded from PRA ''burden'' if the agency demonstrates that such activities needed to comply with the information collection are usual and customary).

V. Regulatory Impact Statement

We have examined the impacts of this rule as required by Executive Order 12866 on Regulatory Planning and Review (September 30, 1993), Executive Order 13563 on Improving Regulation and Regulatory Review (January 18, 2011), the Regulatory Flexibility Act (RFA) (September 19, 1980, Pub. L. 96–354), section 1102(b) of the Social Security Act, section 202 of the Unfunded Mandates Reform Act of 1995 (March 22, 1995; Pub. L. 104–4), Executive Order 13132 on Federalism (August 4, 1999), the Congressional Review Act (5 U.S.C. 804(2)), and Executive Order 13771 on Reducing Regulation and Controlling Regulatory Costs (January 30, 2017).

Executive Orders 12866 and 13563 direct agencies to assess all 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). A Regulatory Impact Analysis (RIA) must be prepared for major rules with economically significant effects ($100 million or more in any 1 year). This rule does not reach the economic threshold and thus is not considered a major rule. We did not receive any comments on the regulatory impact statement from the January 2019 proposed rule. Therefore, we are finalizing it in this rule with no modifications.

Covered entities inconsistently reflect partial fills and fill numbers for Schedule II drugs in retail pharmacy transactions that utilize Version D.0 because Version D.0 does not permit covered entities to use the Quantity Prescribed (460–ET) field. As a result, stakeholders cannot reliably discern from transactions data when a Schedule II drug has been partially filled or refilled. To help understand the economic burden of this issue, in the January 2019 proposed rule, HHS referred back to the previously mentioned 2012 OIG report, which estimated that pharmacies inaccurately billed $25 million worth of partial fills as refills in 2009 paid by the Medicare Part D program. The OIG also expressed concerns about the possibility of these inappropriately dispensed Schedule II drugs being resold on the street.[11] As previously stated, and discussed in the January 2019 proposed rule, CMS noted its concern that the OIG's strict interpretation of PDE data did not support the OIG's findings, instead believing that the OIG's findings were based in part on a misinterpretation that Schedule II drug partial fills dispensed to LTC facility residents were refills. However, these findings represent a helpful starting point for this estimate. The White House Council of Economic Advisers estimates that opioid abuse exacted a cost of $504 billion in 2015 and contributed to a significant number of prescription and illicit drug overdose deaths.[12] Furthermore, in the January 2019 proposed rule and in this final rule, HHS discussed that the Secretary declared a public health emergency to combat the opioid crisis.

For this analysis, HHS continues to leverage the historical cost and benefit data from the study conducted to support the Modifications to the Health Insurance Portability and Accountability Act (HIPAA) Electronic Transaction Standards August 2008 proposed rule and the January 2009 final rule (73 FR 49742 and 74 FR 3295 and 3296, respectively) (hereinafter referenced as the study). The impact analysis for this final rule utilizes the historical cost estimates derived from the study across covered entities. The final estimate provided an overall cost of $38 million to fully implement the then-new requirements of the 2007

[11] Inappropriate Medicare Part D Payments for Schedule II Drugs Billed as Refills, *https://oig.hhs.gov/oei/reports/oei-02-09-00605.asp.*

[12] *https://www.whitehouse.gov/opioids/.*

Version D.0 for chain pharmacies (73 FR 49772). Since this is a very narrow, targeted modification that is limited to requiring covered entities to use the Quantity Prescribed (460–ET) field of the currently adopted Version D.0 in certain specified situations, we anticipate the aggregate costs will be minimal. HHS expects minor system and implementation expenses, which consist of modifying software configurations, updating business processes, and minimal personnel training. We continue to believe the investments to adopt this modification and update existing systems have the same cost variables as the adoption of the current Version D.0. As discussed in the January 2019 proposed rule (84 FR 636), we used these same considerations from the January 16, 2009 final rule (74 FR 3296) to formulate our assumptions on implementing system upgrades, and staff training costs. While it is difficult to determine aggregate costs across the industry, we believe system costs for this modification to the requirements for use of Version D.0 to be limited IT resources, training, and business processes, and that this modification would cost between 1 to 5 percent of the original estimated cost, or between $380,000 and $1,900,000. The study also estimated a maximum upgrade fee cost of $1.08 million per year for independent pharmacies (73 FR 49772). This results in an estimated cost for this modification of $10,800 to $54,000 per year in service fees across all independent pharmacies.

Pharmacies will benefit from using the Quantity Prescribed (460–ET) field because it will facilitate better monitoring of Schedule II drugs for over- or inappropriate prescribing. By virtue of the more robust data that we believe can be used to help avoid audits and incorrect payments, HHS believes that large pharmacy chains can save up to $500,000 per year, while smaller chains can save approximately $100,000 per chain. Therefore, this can yield a total 10-year benefit of up to $10 million, and that does not account for the value of the time pharmacists and pharmacy technician staff who process these claims can save.

We believe health plans and their associated pharmacy benefit managers (PBMs) will also incur minimal cost since most have existing hardware and software platforms capable of using this field with their current technology and networks. Thus, we expect this change will have a similarly minimal cost impact of between 1 and 5 percent of the original implementation costs. The study originally estimated the total cost to implement the 2007 Version D.0 for plans and PBMs to be a maximum of $10.6 million for the industry (73 FR 49773). Thus, we continue to believe that the total cost for this change for health plans and PBMs to be between $106,000 and $530,000.

Executive Orders 12866 and 13563 direct agencies to assess all 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). An RIA must be prepared for major rules with economically significant effects ($100 million or more in any 1 year). This rule does not reach the economic threshold and thus is not considered a major rule. We anticipate that the modification to the requirements for the use of the Quantity Prescribed (460–ET) field will yield more data and information with respect to the dispensing, facilitate better monitoring of Schedule II drugs, and reinforce the Administration's commitment to lowering overall health care costs by reducing administrative burden and improving the quality of health care.

The RFA requires agencies to analyze options for regulatory relief of small entities if a rule has a significant impact on a substantial number of small entities. For purposes of the RFA, we estimate the great majority of independent retail pharmacies are small businesses as defined by the Small Business Administration's (SBA) definition of having revenues of less than $7.5 million up to $38.5 million in any 1 year. The SBA defines a size threshold in terms of annual revenues for pharmacies as $27.5 million. Our proposed estimate stated that 95 percent of independent retail pharmacies have revenues below $27.5 million or are nonprofit organizations and are considered small entities. Individuals and states are not included in the definition of a small entity. As stated earlier, for this analysis HHS used the same considerations from the January 16, 2009 final rule to formulate our assumptions for this RFA, we the reader to refer to that analysis for additional information. We continue to believe that the modification to the requirements for the use of the Quantity Prescribed (460–ET) field will have a de minimis effect on that analysis; therefore, the Secretary has determined that this final rule will not have a significant economic impact on independent retail pharmacies and is not preparing an analysis under the RFA.

In addition, section 1102(b) of the Act requires us to prepare an RIA if a rule may have a significant impact on the operations of a substantial number of small rural hospitals. This analysis must conform to the provisions of section 604 of the RFA. For purposes of section 1102(b) of the Act, we continue to define a small rural hospital as a hospital that is located outside of a Metropolitan Statistical Area for Medicare payment regulations and has fewer than 100 beds. This final rule will affect the operations of a substantial number of small rural hospitals because they are covered entities under HIPAA and must comply with the regulations; however, we do not believe the rule will have a significant impact on those entities, for the reasons stated above in reference to small businesses. Therefore, the Secretary has determined that this final rule will not have a significant impact on the operations of a substantial number of small rural hospitals and is not preparing an analysis under section 1102(b) of the Act.

Based on the information contained herein, including the 2009 analysis referenced above, the Secretary has determined and certifies that this final rule will not have a significant economic impact on a substantial number of small entities. Accordingly, HHS is not required to, and does not, prepare a regulatory impact analysis under the RFA.

Section 202 of the Unfunded Mandates Reform Act of 1995 also requires that agencies assess anticipated costs and benefits before issuing any rule whose mandates require spending in any 1 year of $100 million in 1995 dollars, updated annually for inflation. In 2019, that threshold is approximately $154 million. We believe that this final rule will have no consequential effect on state, local, or tribal governments or on the private sector in excess of that threshold.

Executive Order 13132 establishes certain requirements that an agency must meet when it promulgates a proposed rule (and subsequent final rule) that imposes substantial direct requirement costs on state and local governments, preempts state law, or otherwise has federalism implications. We believe that since this final rule does not impose substantial costs on state or local governments, the requirements of Executive Order 13132 are not applicable.

Executive Order 13771, titled Reducing Regulation and Controlling Regulatory Costs, was issued on January 30, 2017 and requires that the costs associated with significant new regulations ''shall, to the extent

permitted by law, be offset by the elimination of existing costs associated with at least two prior regulations.'' OMB's interim guidance, issued on April 5, 2017, *https://www.whitehouse.gov/sites/whitehouse.gov/files/omb/memoranda/2017/M-17-21-OMB.pdf,* explains that the requirements (as previously discussed) only apply to each new ''significant regulatory action that imposes costs.'' We have determined that this final rule is not a ''significant regulatory action'' and thus does not trigger the previously discussed requirements of Executive Order 13771.

We have assessed the anticipated costs and benefits of this final rule and continue to believe that it will yield more data and information with respect to the dispensing of Schedule II drugs.

In accordance with the provisions of Executive Order 12866, this final rule was not reviewed by the Office of Management and Budget.

List of Subjects in 45 CFR Part 162

Administrative practice and procedures, Electronic transactions, Health facilities, Health insurance, Hospitals, Incorporation by reference, Medicaid, Medicare, Reporting and recordkeeping requirements.

For the reasons set forth in the preamble, the Department of Health and Human Services amends 45 CFR part 162 as set forth below:

PART 162—ADMINISTRATIVE REQUIREMENTS

■ 1. The authority citation for part 162 continues to read as follows:

Authority: 42 U.S.C. 1320d—1320d–9 and secs. 1104 and 10109 of Pub. L. 111–148, 124 Stat. 146–154 and 915–917.

■ 2. Section 162.1102 is amended by adding paragraph (d) to read as follows:

§ 162.1102 Standards for health care claims or equivalent encounter information transaction.

* * * * *

(d) For the period on and after September 21, 2020, the Quantity Prescribed (460–ET) field, as set forth in the Telecommunication Standard Implementation Guide, Version D, Release 0 (Version D.0), August 2007 and equivalent Batch Standard Implementation Guide, Version 1, Release 2 (Version 1.2), National Council for Prescription Drug Programs, must be treated as required where the transmission meets both of the following:

(1) Is for a Schedule II drug, as defined in 21 CFR 1308.12.

(2) Uses the standard identified in paragraph (b)(2)(i) of this section.

■ 3. Section 162.1302 is amended by adding paragraph (d) to read as follows:

§ 162.1302 Standards for referral certification and authorization transaction.

* * * * *

(d) For the period on and after September 21, 2020, the Quantity Prescribed (460–ET) field, as set forth in the Telecommunication Standard Implementation Guide, Version D, Release 0 (Version D.0), August 2007 and equivalent Batch Standard Implementation Guide, Version 1, Release 2 (Version 1.2), National Council for Prescription Drug Programs, must be treated as required where the transmission meets both of the following:

(1) Is for a Schedule II drug, as defined in 21 CFR 1308.12.

(2) Uses the standard identified in paragraph (b)(2)(i) of this section.

■ 4. Section 162.1802 is amended by adding paragraph (d) to read as follows:

§ 162.1802 Standards for coordination of benefits information transaction.

* * * * *

(d) For the period on and after September 21, 2020, the Quantity Prescribed (460–ET) field, as set forth in the Telecommunication Standard Implementation Guide, Version D, Release 0 (Version D.0), August 2007 and equivalent Batch Standard Implementation Guide, Version 1, Release 2 (Version 1.2), National Council for Prescription Drug Programs, must be treated as required where the transmission meets both of the following:

(1) Is for a Schedule II drug, as defined in 21 CFR 1308.12.

(2) Uses the standard identified in paragraph (b)(2)(i) of this section.

Dated: December 19, 2019.

Alex M. Azar II,

Secretary, Department of Health and Human Services.

[FR Doc. 2020–00551 Filed 1–23–20; 8:45 am]

BILLING CODE 4120–01–P

Proposed Rules

Federal Register
Vol. 85, No. 16
Friday, January 24, 2020

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.

DEPARTMENT OF HOMELAND SECURITY

8 CFR Parts 103, 106, 204, 211, 212, 214, 216, 223, 235, 236, 240, 244, 245, 245a, 248, 264, 274a, 301, 319, 320, 322, 324, 334, 341, 343a, 343b, and 392

[CIS No. 2627–18; DHS Docket No. USCIS–2019–0010]

RIN 1615–AC18

U.S. Citizenship and Immigration Services Fee Schedule and Changes to Certain Other Immigration Benefit Request Requirements

AGENCY: U.S. Citizenship and Immigration Services (USCIS), Department of Homeland Security

ACTION: Proposed rule; reopening of the comment period.

SUMMARY: The Department of Homeland Security (DHS) announces the reopening and extension of the public comment period for the proposed rule titled ''U.S. Citizenship and Immigration Services Fee Schedule and Changes to Certain Other Immigration Benefit Request Requirements.'' DHS published the rule on November 14, 2019, with a comment period ending December 16, 2019. On December 9, 2019, the comment period was extended to December 30, 2019. DHS will reopen the comment period for an additional 15 days. As part of this rulemaking, DHS will consider comments received during the entire public comment period, including comments received since December 30, 2019.

DATES: The comment period for the proposed rule published November 14, 2019, at 84 FR 62280 and extended on December 9, 2019 at 84 FR 67243, is reopened. Written comments and related material must be submitted on or before February 10, 2020.

ADDRESSES: You must submit comments, identified as DHS Docket No. USCIS–2019–0010, through *one* of the following methods:

- *Federal eRulemaking Portal* (preferred): *http://www.regulations.gov.* Follow the website instructions for submitting comments.
- *Mail:* Samantha Deshommes, Chief, Regulatory Coordination Division, Office of Policy and Strategy, U.S. Citizenship and Immigration Services, Department of Homeland Security, 20 Massachusetts Avenue NW, Washington, DC 20529–2140. To ensure proper handling, please reference DHS Docket No. USCIS–2019–0010 in your correspondence. Mail must be postmarked by the comment submission deadline.

Comments submitted in a manner other than those listed above, including emails or letters sent to DHS or USCIS officials, will not be considered comments on the proposed rule. Please note that DHS and USCIS cannot accept any comments that are hand delivered or couriered. In addition, USCIS cannot accept mailed comments contained on any form of digital media storage devices, such as CDs/DVDs and USB drives.

FOR FURTHER INFORMATION CONTACT: Kika Scott, Chief Financial Officer, U.S. Citizenship and Immigration Services, Department of Homeland Security, 20 Massachusetts Avenue NW, Washington, DC 20529–2130, telephone (202) 272–8377.

SUPPLEMENTARY INFORMATION:

Public Participation

Interested persons are invited to participate in this rulemaking by submitting written data, views, or arguments on all aspects of this rule. DHS also invites comments that relate to the economic or federalism effects that might result from this rule. Comments that will provide the most assistance to DHS will reference a specific portion of the rule, explain the reason for any recommended change, and include data, information, or authority that support such recommended change.

Instructions: All submissions received must include DHS Docket No. USCIS–2019–0010. Providing comments is entirely voluntary. All comments received will be posted without change to *http://www.regulations.gov,* including any personal information that you provide. Because the information you submit will be publicly available, you should consider limiting the amount of personal information in your submission. DHS may withhold information provided in comments from public viewing if it determines that such information is offensive or may affect the privacy of an individual. For additional information, please read the Privacy Act notice available through the link in the footer of *http://www.regulations.gov.*

Docket: For access to the docket, go to *http://www.regulations.gov* and enter this rulemaking's eDocket number: USCIS–2019–0010. The docket includes additional documents that support the analysis contained in this proposed rule to determine the specific fees that are proposed. These documents include:

- Fiscal Year (FY) 2019/2020 Immigration Examinations Fee Account Fee Review Supporting Documentation;
- Regulatory Impact Analysis: U.S. Citizenship and Immigration Services Fee Schedule and Changes to Certain Other Immigration Benefit Request Requirements; and
- Small Entity Analysis for Adjustment of the U.S. Citizenship and Immigration Services Fee Schedule notice of proposed rulemaking.

You may review these documents on the electronic docket.

Background

On November 14, 2019, DHS published a proposed rule in the **Federal Register** at 84 FR 62280, wherein DHS proposed, among other things, to adjust certain immigration and naturalization benefit request fees charged by USCIS, add new fees for certain benefit requests, establish multiple fees for petitions for nonimmigrant workers, and limit the number of beneficiaries on certain forms to ensure that USCIS has the resources it needs to provide adequate service to applicants and petitioners.

On December 9, 2019, DHS published a proposed rule; extension of comment period; availability of supplemental information at 84 FR 67243. That document extended the comment period for the proposed rule through December 30, 2019.

This notice reopens and extends the comment period through February 10, 2020, to allow additional time for interested persons to provide comments on the proposed rule. As part of this rulemaking, DHS will consider comments received during the entire public comment period, including comments received since

December 30, 2019.

Chad F. Wolf,

Acting Secretary.

[FR Doc. 2020–01189 Filed 1–23–20; 8:45 am]

BILLING CODE 9111–97–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 71

[Docket No. FAA–2019–0790; Airspace Docket No. 19–ASW–10]

RIN 2120–AA66

Proposed Amendment of Class E Airspace; Tahlequah, OK

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Notice of proposed rulemaking (NPRM).

SUMMARY: This action proposes to amend Class E airspace extending upward from 700 feet above the surface at Tahlequah Municipal Airport in Tahlequah, OK. The FAA is proposing this action as the result of an airspace review caused by the decommissioning of the Tahlequah non-directional radio beacon (NDB). The geographic coordinates for the airport in the associated airspace would be updated to coincide with the FAA's aeronautical database. Airspace redesign is necessary for the safety and management of instrument flight rules (IFR) operations at this airport.

DATES: Comments must be received on or before March 9, 2020.

ADDRESSES: Send comments on this proposal to the U.S. Department of Transportation, Docket Operations, West Building Ground Floor, Room W12–140, 1200 New Jersey Avenue SE, Washington, DC 20590, telephone (202) 366–9826, or (800) 647–5527. You must identify FAA Docket No. FAA–2019–0790; Airspace Docket No. 19–ASW–10, at the beginning of your comments. You may also submit comments through the internet at *https://www.regulations.gov.* You may review the public docket containing the proposal, any comments received, and any final disposition in person in the Dockets Office between 9:00 a.m. and 5:00 p.m., Monday through Friday, except federal holidays.

FAA Order 7400.11D, Airspace Designations and Reporting Points, and subsequent amendments can be viewed online at *https://www.faa.gov/air_traffic/publications/.* For further information, you can contact the Airspace Policy Group, Federal Aviation Administration, 800 Independence Avenue SW, Washington, DC 20591; telephone: (202) 267–8783. The Order is also available for inspection at the National Archives and Records Administration (NARA). For information on the availability of FAA Order 7400.11D at NARA, email *fedreg.legal@nara.gov* or go to *https://www.archives.gov/federal-register/cfr/ibr-locations.html.*

FOR FURTHER INFORMATION CONTACT: Rebecca Shelby, Federal Aviation Administration, Operations Support Group, Central Service Center, 10101 Hillwood Parkway, Fort Worth, TX 76177; telephone (817) 222–5857.

SUPPLEMENTARY INFORMATION:

Authority for This Rulemaking

The FAA's authority to issue rules regarding aviation safety is found in Title 49 of the United States Code. 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. This rulemaking is promulgated under the authority described in Subtitle VII, Part A, Subpart I, Section 40103. Under that section, the FAA is charged with prescribing regulations to assign the use of airspace necessary to ensure the safety of aircraft and the efficient use of airspace. This regulation is within the scope of that authority as it would amend Class E airspace at Tahlequah Municipal Airport, in support of standard instrument approach procedures for IFR operations at the airport.

Comments Invited

Interested parties are invited to participate in this proposed rulemaking by submitting such written data, views, or arguments, as they may desire. Comments that provide the factual basis supporting the views and suggestions presented are particularly helpful in developing reasoned regulatory decisions on the proposal. Comments are specifically invited on the overall regulatory, aeronautical, economic, environmental, and energy-related aspects of the proposal. Communications should identify both docket numbers and be submitted in triplicate to the address listed above. Commenters wishing the FAA to acknowledge receipt of their comments on this notice must submit with those comments a self-addressed, stamped postcard on which the following statement is made: ''Comments to Docket No. FAA–2019–0790; Airspace Docket No. 19–ASW–10.'' The postcard will be date/time stamped and returned to the commenter.

All communications received before the specified closing date for comments will be considered before taking action on the proposed rule. The proposal contained in this notice may be changed in light of the comments received. A report summarizing each substantive public contact with FAA personnel concerned with this rulemaking will be filed in the docket.

Availability of NPRMs

An electronic copy of this document may be downloaded through the internet at *https://www.regulations.gov.* Recently published rulemaking documents can also be accessed through the FAA's web page at *https://www.faa.gov/air-traffic/publications/airspace-amendments/.*

You may review the public docket containing the proposal, any comments received, and any final disposition in person in the Dockets Office (see the **ADDRESSES** section for the address and phone number) between 9:00 a.m. and 5:00 p.m., Monday through Friday, except federal holidays. An informal docket may also be examined during normal business hours at the Federal Aviation Administration, Air Traffic Organization, Central Service Center, Operations Support Group, 10101 Hillwood Parkway, Fort Worth, TX 76177.

Availability and Summary of Documents for Incorporation by Reference

This document proposes to amend FAA Order 7400.11D, Airspace Designations and Reporting Points, dated August 8, 2019, and effective September 15, 2019. FAA Order 7400.11D is publicly available as listed in the **ADDRESSES** section of this document. FAA Order 7400.11D lists Class A, B, C, D, and E airspace areas, air traffic service routes, and reporting points.

The Proposal

The FAA is proposing an amendment to Title 14 Code of Federal Regulations (14 CFR) part 71 by amending Class E airspace extending upward from 700 feet above the surface within a 6.5-mile radius (increased from 6.4 miles) of the Tahlequah Municipal Airport, Tahlequah, OK. This action would enhance safety and the management of IFR operations at the airport. Also, the geographic coordinates would be adjusted to coincide with the FAA's aeronautical database.

Class E airspace designations are published in paragraph 6005 of FAA

Order 7400.11D, dated August 8, 2019, and effective September 15, 2019, which is incorporated by reference in 14 CFR 71.1. The Class E airspace designation listed in this document will be published subsequently in the Order.

FAA Order 7400.11, Airspace Designations and Reporting Points, is published yearly and effective on September 15.

Regulatory Notices and Analyses

The FAA has determined that this proposed regulation only involves an established body of technical regulations for which frequent and routine amendments are necessary to keep them operationally current, is non-controversial and unlikely to result in adverse or negative comments. It, therefore: (1) Is not a ''significant regulatory action'' under Executive Order 12866; (2) is not a ''significant rule'' under DOT Regulatory Policies and Procedures (44 FR 11034; February 26, 1979); and (3) does not warrant preparation of a regulatory evaluation as the anticipated impact is so minimal. Since this is a routine matter that will only affect air traffic procedures and air navigation, it is certified that this proposed rule, when promulgated, would not have a significant economic impact on a substantial number of small entities under the criteria of the Regulatory Flexibility Act.

Environmental Review

This proposal will be subject to an environmental analysis in accordance with FAA Order 1050.1F, ''Environmental Impacts: Policies and Procedures'' prior to any FAA final regulatory action.

List of Subjects in 14 CFR Part 71

Airspace, Incorporation by reference, Navigation (air).

The Proposed Amendment

Accordingly, pursuant to the authority delegated to me, the Federal Aviation Administration proposes to amend 14 CFR part 71 as follows:

PART 71—DESIGNATION OF CLASS A, B, C, D, AND E AIRSPACE AREAS; AIR TRAFFIC SERVICE ROUTES; AND REPORTING POINTS

■ 1. The authority citation for 14 CFR part 71 continues to read as follows:

Authority: 49 U.S.C. 106(f), 106(g); 40103, 40113, 40120; E.O. 10854, 24 FR 9565, 3 CFR, 1959–1963 Comp., p. 389.

§ 71.1 [Amended]

■ 2. The incorporation by reference in 14 CFR 71.1 of FAA Order 7400.11D, Airspace Designations and Reporting Points, dated August 8, 2019, and effective September 15, 2019, is amended as follows:

* * * * *

Paragraph 6005 Class E Airspace Areas Extending Upward From 700 Feet or More Above the Surface of the Earth.

* * * * *

ASW OK E5 Tahlequah, OK [Amended]

Tahlequah Municipal Airport, OK
(Lat. 35°55′49″ N long. 95°00′16″ W.)
Tahlequah City Hospital Heliport, OK, Point in Space Coordinates
(Lat. 35°55′14″ N long. 94°57′47″ W.)

That airspace extending upward from 700 feet above the surface within a 6.5-mile radius of the Tahlequah Municipal Airport and that airspace within a 6-mile radius of the Point in Space serving Tahlequah City Hospital Airport.

Issued in Fort Worth, Texas, on January 15, 2020.

Wayne Eckenrode,

Acting Manager, Operations Support Group, ATO Central Service Center.

[FR Doc. 2020–00996 Filed 1–23–20; 8:45 am]

BILLING CODE 4910–13–P

DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 71

[Docket No. FAA–2020–0004; Airspace Docket No. 19–AGL–16]

RIN 2120–AA66

Proposed Amendment, Establishment, and Revocation of Multiple Air Traffic Service (ATS) Routes in the Vicinity of Waukon, IA

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Notice of proposed rulemaking (NPRM).

SUMMARY: This action proposes to amend six VHF Omnidirectional Range (VOR) Federal airways, V–2, V–77, V–138, V–218, V–246 and V–398; establish two low altitude Area Navigation (RNAV) routes, T–348 and T–389; and remove one VOR Federal airway, V–411, in the vicinity of Waukon, IA. The Air Traffic Service (ATS) route modifications are necessary due to the planned decommissioning of the VOR portion of the Waukon, IA, VOR/Distance Measuring Equipment (VOR/DME) navigation aid (NAVAID). The NAVAIDs provide navigation guidance for portions of the affected air traffic service (ATS) routes. The VOR is being decommissioned as part of the FAA's VOR Minimum Operational Network (MON) program.

DATES: Comments must be received on or before March 9, 2020.

ADDRESSES: Send comments on this proposal to the U.S. Department of Transportation, Docket Operations, 1200 New Jersey Avenue SE, West Building Ground Floor, Room W12–140, Washington, DC 20590; telephone: (800) 647–5527, or (202) 366–9826. You must identify FAA Docket No. FAA–2020–0004; Airspace Docket No. 19–AGL–16 at the beginning of your comments. You may also submit comments through the internet at *https://www.regulations.gov.* FAA Order 7400.11D, Airspace Designations and Reporting Points, and subsequent amendments can be viewed online at *https://www.faa.gov/air_traffic/publications/.* For further information, you can contact the Rules and Regulations Group, Federal Aviation Administration, 800 Independence Avenue SW, Washington, DC 20591; telephone: (202) 267–8783. The Order is also available for inspection at the National Archives and Records Administration (NARA). For information on the availability of FAA Order 7400.11D at NARA, email: *fedreg.legal@nara.gov* or go to *https://www.archives.gov/federal-register/cfr/ibr-locations.html.*

FOR FURTHER INFORMATION CONTACT: Colby Abbott, Rules and Regulations Group, Office of Policy, Federal Aviation Administration, 800 Independence Avenue SW, Washington, DC 20591; telephone: (202) 267–8783.

SUPPLEMENTARY INFORMATION:

Authority for This Rulemaking

The FAA's authority to issue rules regarding aviation safety is found in Title 49 of the United States Code. 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. This rulemaking is promulgated under the authority described in Subtitle VII, Part A, Subpart I, Section 40103. Under that section, the FAA is charged with prescribing regulations to assign the use of the airspace necessary to ensure the safety of aircraft and the efficient use of airspace. This regulation is within the scope of that authority as it would modify the route structure as necessary to preserve the safe and efficient flow of air traffic within the National Airspace System.

Comments Invited

Interested parties are invited to participate in this proposed rulemaking by submitting such written data, views, or arguments as they may desire.

Comments that provide the factual basis supporting the views and suggestions presented are particularly helpful in developing reasoned regulatory decisions on the proposal. Comments are specifically invited on the overall regulatory, aeronautical, economic, environmental, and energy-related aspects of the proposal.

Communications should identify both docket numbers (FAA Docket No. FAA–2020–0004; Airspace Docket No. 19–AGL–16) and be submitted in triplicate to the Docket Management Facility (see **ADDRESSES** section for address and phone number). You may also submit comments through the internet at *https://www.regulations.gov.*

Commenters wishing the FAA to acknowledge receipt of their comments on this action must submit with those comments a self-addressed, stamped postcard on which the following statement is made: ''Comments to FAA Docket No. FAA–2020–0004; Airspace Docket No. 19–AGL–16.'' The postcard will be date/time stamped and returned to the commenter.

All communications received on or before the specified comment closing date will be considered before taking action on the proposed rule. The proposal contained in this action may be changed in light of comments received. All comments submitted will be available for examination in the public docket both before and after the comment closing date. A report summarizing each substantive public contact with FAA personnel concerned with this rulemaking will be filed in the docket.

Availability of NPRMs

An electronic copy of this document may be downloaded through the internet at *https://www.regulations.gov*. Recently published rulemaking documents can also be accessed through the FAA's web page at *https://www.faa.gov/air_traffic/publications/airspace_amendments/*.

You may review the public docket containing the proposal, any comments received and any final disposition in person in the Dockets Office (see **ADDRESSES** section for address and phone number) between 9:00 a.m. and 5:00 p.m., Monday through Friday, except federal holidays. An informal docket may also be examined during normal business hours at the office of the Operations Support Group, Central Service Center, Federal Aviation Administration, 10101 Hillwood Blvd., Fort Worth, TX 76177.

Availability and Summary of Documents for Incorporation by Reference

This document proposes to amend FAA Order 7400.11D, Airspace Designations and Reporting Points, dated August 8, 2019, and effective September 15, 2019. FAA Order 7400.11D is publicly available as listed in the **ADDRESSES** section of this document. FAA Order 7400.11D lists Class A, B, C, D, and E airspace areas, air traffic service routes, and reporting points.

Background

The FAA is planning decommissioning activities for the VOR portion of the Waukon, IA, VOR/DME in July, 2020. The VOR portion of the Waukon, IA, VOR/DME is a candidate VOR identified for discontinuance by the FAA's VOR MON program and listed in the final policy statement notice, ''Provision of Navigation Services for the Next Generation Air Transportation System (NextGen) Transition to Performance-Based Navigation (PBN) (Plan for Establishing a VOR Minimum Operational Network),'' published in the **Federal Register** of July 26, 2016 (81 FR 48694), Docket No. FAA–2011–1082.

Although the VOR portion of the Waukon VOR/DME is planned for decommissioning, the co-located DME portion of the NAVAID is being retained.

The ATS route dependencies to the Waukon, IA, VOR/DME are VOR Federal airways V–2, V–77, V–138, V–218, V–246, V–398, and V–411.

With the planned decommissioning of the VOR portion of the Waukon, IA, VOR/DME, the remaining ground-based NAVAID coverage in the area is insufficient to enable the continuity of the affected VOR Federal airways. As such, proposed modifications to the affected VOR Federal airways would result in an increased gap in one of the airways (V–2), the removal of affected airway segments at the end of five of the airways (V–77, V–138, V–218, V–246, and V–398), and the removal of the remaining affected airway (V–411). To overcome the airway gaps, instrument flight rules (IFR) traffic could use adjacent ATS routes, including V–13, V–24, V–82, V–100, V–120, V–129, V–158, V–170, V–228, V–503, and V–510, to circumnavigate the affected area. IFR traffic could also file point to point through the affected area using the existing airway fixes that will remain in place, as well as adjacent NAVAIDs, or receive air traffic control (ATC) radar vectors through the area. Visual flight rules pilots who elect to navigate via the airways through the affected area could also take advantage of the adjacent VOR Federal airways or ATC services listed previously.

Further, the FAA proposes to establish two RNAV routes, T–348 and T–389, through the affected area and beyond to continue supporting airspace users with an enroute ATS route structure, as well as ongoing FAA NextGen efforts to transition the national airspace system to performance-based navigation.

Lastly, the V–138 description contains two ''1,200 feet AGL'' references that establish controlled airspace (Class E) that extend upward from 1,200 feet above ground level (AGL) for the airway segments between the Grand Island, NE, VOR/DME and the Lincoln, NE, VOR/Tactical Air Navigation (VORTAC) NAVAIDs. By regulation, when such areas [Class E controlled airspace] are designated in conjunction with airways or routes, the extent of such designation has the lateral extent identical to that of the airway or route and extends upward from 1,200 feet above the surface, unless otherwise specified. As such, the two 1,200 feet AGL references listed in the description are unnecessary.

The Proposal

The FAA is proposing an amendment to Title 14 Code of Federal Regulations (14 CFR) part 71 by modifying VOR Federal airways V–2, V–77, V–138, V–218, V–246, and V–398; establishing low altitude RNAV routes T–348 and T–389; and removing VOR Federal airway V–411. The planned decommissioning of the VOR portion of the Waukon, IA, VOR/DME has made this action necessary.

The proposed VOR Federal airway changes are outlined below.

V–2: V–2 currently extends between the Seattle, WA, VORTAC and the intersection of the Nodine, MN, VORTAC 122° and Waukon, IA, VOR/DME 053° radials (WEBYE fix); and between the Buffalo, NY, VOR/DME and the Gardner, MA, VOR/DME. The FAA proposes to remove the airway segment between the Nodine, MN, VORTAC and the intersection of the Nodine, MN, VORTAC 122° and Waukon, IA, VOR/DME 053° radials (WEBYE fix). The unaffected portions of the existing airway would remain as charted.

V–77: V–77 currently extends between the San Angelo, TX, VORTAC and the Waukon, IA, VOR/DME. The FAA proposes to remove the airway segment between the Waterloo, IA, VOR/DME and the Waukon, IA, VOR/DME. The unaffected portions of the

existing airway would remain as charted.

V–138: V–138 currently extends between the Riverton, WY, VOR/DME and the Sidney, NE, VOR/DME; and between the Grand Island, NE, VOR/DME and the Waukon, IA, VOR/DME. The FAA proposes to remove the airway segment between the Mason City, IA, VOR/DME and the Waukon, IA, VOR/DME. Additionally, the FAA proposes to remove the two ''1,200 feet AGL'' references listed between the Grand Island, NE, VOR/DME and the Lincoln, NE, VORTAC. The unaffected portions of the existing airway would remain as charted.

V–218: V–218 currently extends between the International Falls, MN, VOR/DME and the Waukon, IA, VOR/DME. The FAA proposes to remove the airway segment between the Gopher, MN, VORTAC and the Waukon, IA, VOR/DME. The unaffected portions of the existing airway would remain as charted.

V–246: V–246 currently extends between the Janesville, WI, VOR/DME and the intersection of the Nodine, MN, VORTAC 055° and Eau Claire, WI, VORTAC 134° radials (MILTO fix). The FAA proposes to remove the airway segment between the Dubuque, IA, VOR/DME and the intersection of the Nodine, MN, VORTAC 055° and Eau Claire, WI, VORTAC 134° radials (MILTO fix). The unaffected portions of the existing airway would remain as charted.

V–398: V–398 currently extends between the Aberdeen, SD, VOR/DME and the Lone Rock, WI, VOR/DME. The FAA proposes to remove the airway segment between the Rochester, MN, VOR/DME and the Lone Rock, WI, VOR/DME. The unaffected portions of the existing airway would remain as charted.

V–411: V–411 currently extends between the Lone Rock, WI, VOR/DME and the Farmington, MN, VORTAC. The FAA proposes to remove the airway in its entirety. The airway segment between the Lone Rock, WI, VOR/DME and the Rochester, MN, VOR/DME would be removed due to the Waukon VOR/DME being decommissioned. The airway segment between the Rochester, MN, VOR/DME and the Farmington, MN, VORTAC would be removed as there are two alternate routes (one, using V–82/V–161, that is 5 nautical miles (NM) shorter and direct; and the second, using V–13 and V–24, that is slightly longer by 8 NM) that could be used to navigate between the Rochester VOR/DME and the Farmington VORTAC. Further, a portion of the V–411 airway segment between the Rochester VOR/DME and the Farmington VORTAC (DELZY fix to Farmington VORTAC) actually overlaps V–13.

The proposed new low altitude RNAV routes are outlined below.

T–348: T–348 is a proposed new route that would extend between the BRAIN, MN, waypoint (WP) and the Lungs, WI, WP. This T-route would mitigate the loss of the V–398 and V–411 airways proposed to be removed between the Rochester, MN, VOR/DME and the Lone Rock, WI, VOR/DME and provide RNAV routing capability from the Sioux Falls, SD, area eastward to just beyond the Madison, WI, area.

T–389: T–389 is a proposed new route that would extend between the Farmington, MO, VORTAC and the KOETZ, WI, WP being established. This T-route would mitigate the loss of the V–77 and V–246 airway segments proposed to be removed between the Waterloo, IA, VOR/DME and the Nodine, MN, VORTAC and provide RNAV routing capability from the Farmington, MO, area, northward to the Arcadia, WI, area.

All radials in the VOR Federal airway descriptions below are unchanged and stated in True degrees.

VOR Federal airways are published in paragraph 6010(a) and low altitude RNAV routes are published in paragraph 6011 of FAA Order 7400.11D dated August 8, 2019, and effective September 15, 2019, which is incorporated by reference in 14 CFR 71.1. The ATS routes listed in this document would be subsequently published in the Order.

FAA Order 7400.11, Airspace Designations and Reporting Points, is published yearly and effective on September 15.

Regulatory Notices and Analyses

The FAA has determined that this proposed regulation only involves an established body of technical regulations for which frequent and routine amendments are necessary to keep them operationally current. It, therefore: (1) Is not a ''significant regulatory action'' under Executive Order 12866; (2) is not a ''significant rule'' under Department of Transportation (DOT) Regulatory Policies and Procedures (44 FR 11034; February 26, 1979); and (3) does not warrant preparation of a regulatory evaluation as the anticipated impact is so minimal. Since this is a routine matter that will only affect air traffic procedures and air navigation, it is certified that this proposed rule, when promulgated, will not have a significant economic impact on a substantial number of small entities under the criteria of the Regulatory Flexibility Act.

Environmental Review

This proposal will be subject to an environmental analysis in accordance with FAA Order 1050.1F, ''Environmental Impacts: Policies and Procedures'' prior to any FAA final regulatory action.

List of Subjects in 14 CFR Part 71

Airspace, Incorporation by reference, Navigation (air).

The Proposed Amendment

In consideration of the foregoing, the Federal Aviation Administration proposes to amend 14 CFR part 71 as follows:

PART 71—DESIGNATION OF CLASS A, B, C, D, AND E AIRSPACE AREAS; AIR TRAFFIC SERVICE ROUTES; AND REPORTING POINTS

■ 1. The authority citation for part 71 continues to read as follows:

Authority: 49 U.S.C. 106(f), 106(g); 40103, 40113, 40120; E.O. 10854, 24 FR 9565, 3 CFR, 1959–1963 Comp., p. 389.

§ 71.1 [Amended]

■ 2. The incorporation by reference in 14 CFR 71.1 of FAA Order 7400.11D, Airspace Designations and Reporting Points, dated August 8, 2019 and effective September 15, 2019, is amended as follows:

Paragraph 6010(a) Domestic VOR Federal Airways.

* * * * *

V–2 [Amended]

From Seattle, WA; Ellensburg, WA; Moses Lake, WA; Spokane, WA; Mullan Pass, ID; Missoula, MT; Helena, MT; INT Helena 119° and Livingston, MT, 322° radials; Livingston; Billings, MT; Miles City, MT; 24 miles, 90 miles 55 MSL, Dickinson, ND; 10 miles, 60 miles 38 MSL, Bismarck, ND; 14 miles, 62 miles 34 MSL, Jamestown, ND; Fargo, ND; Alexandria, MN; Gopher, MN; to Nodine, MN. From Buffalo, NY; Rochester, NY; Syracuse, NY; Utica, NY; Albany, NY; INT Albany 084° and Gardner, MA, 284° radials; to Gardner.

* * * * *

V–77 [Amended]

From San Angelo, TX; Abilene, TX; INT Abilene 047° and Wichita Falls, TX, 204° radials; Wichita Falls; INT Wichita Falls 028° and Will Rogers, OK, 216° radials; Will Rogers; INT Will Rogers 002° and Pioneer, OK, 201° radials; Pioneer; Wichita, KS; INT Wichita 042° and Topeka, KS, 236° radials; Topeka; St Joseph, MO; Lamoni, IA; Des Moines, IA; Newton, IA; to Waterloo, IA.

* * * * *

V–138 [Amended]

From Riverton, WY; 35 miles, 80 miles 107 MSL, 16 miles 85 MSL, Medicine Bow, WY; Cheyenne, WY; to Sidney, NE. From Grand Island, NE; INT of Grand Island 099° and Lincoln, NE, 267° radials; Lincoln; Omaha, IA; INT Omaha 032° and Fort Dodge, IA, 222° radials; Fort Dodge; to Mason City, IA.

* * * * *

V–218 [Amended]

From International Falls, MN; Grand Rapids, MN; to Gopher, MN.

* * * * *

V–246 [Amended]

From Janesville, WI; to Dubuque, IA.

* * * * *

V–398 [Amended]

From Aberdeen, SD, via INT Aberdeen 101° and Watertown, SD, 312° radials; Watertown; Redwood Falls, MN; to Rochester, MN.

* * * * *

V–411 [Removed]

* * * * *

6011 United States Area Navigation Routes.

* * * * *

T–348 BRAIN, MN to LUNGS, WI [New]

BRAIN, MN	WP	(Lat. 43°39′00.24″ N, long. 96°26′12.58″ W)
GRSIS, MN	WP	(Lat. 43°38′45.54″ N, long. 94°25′21.17″ W)
FOOLS, MN	WP	(Lat. 43°46′58.20″ N, long. 92°35′44.93″ W)
GABDE, MN	WP	(Lat. 43°38′50.04″ N, long. 92°18′26.46″ W)
KRRTR, IA	WP	(Lat. 43°16′18.12″ N, long. 91°22′30.62″ W)
Madison, WI (MSN)	VORTAC	(Lat. 43°08′41.41″ N, long. 89°20′22.91″ W)
LUNGS, WI	WP	(Lat. 43°02′43.66″ N, long. 88°56′54.86″ W)

* * * * * * *

T–389 Farmington, MO (FAM) to KOETZ, WI [New]

Farmington, MO (FAM)	VORTAC	(Lat. 37°40′24.46″ N, long. 90°14′02.61″ W)
Foristell, MO (FTZ)	VORTAC	(Lat. 38°41′39.60″ N, long. 90°58′16.57″ W)
RIVRS, IL	WP	(Lat. 39°25′21.41″ N, long. 90°55′56.70″ W)
KAYUU, MO	WP	(Lat. 40°19′05.81″ N, long. 91°41′36.59″ W)
MERKR, IA	WP	(Lat. 40°49′16.02″ N, long. 92°08′26.88″ W)
AGEN, IA	FIX	(Lat. 41°01′43.78″ N, long. 92°20′50.25″ W)
PICRA, IA	WP	(Lat. 41°35′00.72″ N, long. 92°32′34.29″ W)
HAVOS, IA	WP	(Lat. 42°04′16.32″ N, long. 92°28′29.38″ W)
Wterloo, IA (ALO)	VOR/DME	(Lat. 42°33′23.39″ N, long. 92°23′56.13″ W)
ZEZDU, IA	WP	(Lat. 42°49′29.02″ N, long. 92°04′58.05″ W)
FALAR, MN	WP	(Lat. 43°34′26.04″ N, long. 91°30′18.32″ W)
KOETZ, W	WP	(Lat. 44°13′15.00″ N, long. 91°28′14.00″ W)

Issued in Washington, DC, on January 15, 2020.

Scott M. Rosenbloom,

Acting Manager, Rules and Regulations Group.

[FR Doc. 2020–00997 Filed 1–23–20; 8:45 am]

BILLING CODE 4910–13–P

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 52

[EPA–R05–OAR–2019–0311; FRL–10004–20–Region 5]

Air Plan Approval; Illinois; Emissions Statement Rule Certification for the 2015 Ozone Standard

AGENCY: Environmental Protection Agency (EPA).

ACTION: Proposed rule.

SUMMARY: The Environmental Protection Agency (EPA) is proposing to approve a State Implementation Plan (SIP) submission from the Illinois Environmental Protection Agency (IEPA) dated May 16, 2019. The submission provides IEPA's certification that its existing emissions statement program, titled ''Annual Emissions Report'', remains in effect and satisfies the Clean Air Act (CAA) emissions statement requirement for the Illinois portions of the Chicago, Illinois-Indiana-Wisconsin and St. Louis, Missouri-Illinois nonattainment areas under the 2015 ozone National Ambient Air Quality Standard. Under the CAA, states' SIPs must require stationary sources in ozone nonattainment areas classified as marginal or above to annually report emissions of Volatile Organic Compounds and Oxides of Nitrogen.

DATES: Comments must be received on or before February 24, 2020.

ADDRESSES: Submit your comments, identified by Docket ID No. EPA–R05–OAR–2019–0311 at *http://www.regulations.gov* or via email to *Arra.Sarah@epa.gov.* For comments submitted at *Regulations.gov*, follow the online instructions for submitting comments. Once submitted, comments cannot be edited or removed from *Regulations.gov*. For either manner of submission, 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. 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 *http://www2.epa.gov/dockets/commenting-epa-dockets.*

FOR FURTHER INFORMATION CONTACT: Kathleen D'Agostino, Attainment Planning and Maintenance Section, Air Programs Branch (AR–18J), Environmental Protection Agency, 77 West Jackson Boulevard, Chicago, Illinois 60604, (312) 886–1767, *Dagostino.Kathleen@epa.gov.*

SUPPLEMENTARY INFORMATION: In the Final Rules section of this **Federal Register**, EPA is approving IEPA's SIP revision as a direct final rule without prior proposal because EPA views this as a noncontroversial submittal and anticipates no adverse comments. A detailed rationale for the approval is set forth in the direct final rule. If no adverse comments are received in response to this rule, no further activity is contemplated. If EPA receives adverse comments, the direct final rule will be

withdrawn and all public comments received will be addressed in a subsequent final rule based on this proposed rule. EPA will not institute a second comment period. Any parties interested in commenting on this action should do so at this time. Please note that, if EPA receives adverse comment on an amendment, paragraph, or section of this rule and if that provision may be severed from the remainder of the rule, EPA may adopt as final those provisions of the rule that are not the subject of an adverse comment. For additional information see the direct final rule, which is located in the Rules section of this **Federal Register**.

Dated: December 30, 2019.

Cheryl L Newton,

Acting Regional Administrator, Region 5.

[FR Doc. 2020–00540 Filed 1–23–20; 8:45 am]

BILLING CODE 6560–50–P

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 300

[EPA–HQ–SFUND–2002–0008; FRL–10004–52–Region 8]

National Oil and Hazardous Substances Pollution Contingency Plan; National Priorities List: Partial Deletion of the OU1 of the Libby Asbestos Superfund Site

AGENCY: Environmental Protection Agency (EPA).

ACTION: Proposed rule; notice of intent.

SUMMARY: The Environmental Protection Agency (EPA) Region 8 is issuing a Notice of Intent to Delete Operable Unit 1 (OU1), Former Export Plant, of the Libby Asbestos Superfund Site (Site), located in Lincoln County, Montana, from the National Priorities List (NPL) and requests public comments on this proposed action. The NPL, promulgated pursuant to section 105 of the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) of 1980, as amended, is an appendix of the National Oil and Hazardous Substances Pollution Contingency Plan (NCP). The EPA and the State of Montana (State), through the Department of Environmental Quality (DEQ), have determined that all appropriate response actions at OU1 under CERCLA, other than operation and maintenance and five-year reviews (FYR), have been completed. However, this partial deletion does not preclude future actions under Superfund. This partial deletion pertains only to OU1. Operable Unit 2 (OU2), Former Screening Plant, was deleted from the NPL on April 10, 2019. Operable Unit 3 (OU3), Former Vermiculite Mine; Operable Unit 4 and Operable Unit 7 (OU4/OU7), Residential/Commercial Properties of Libby and Troy; Operable Unit 5 (OU5), Former Stimson Lumber Mill; Operable Unit 6 (OU6), BNSF Rail Corridor; and Operable Unit 8 (OU8), Highways and Roadways, are not being considered for deletion as part of this proposed action and will remain on the NPL.

DATES: Comments must be received by February 24, 2020.

ADDRESSES: Submit your comments, identified by Docket ID no. EPA–HQ–SFUND–2002–0008 by one of the following methods:

- *https://www.regulations.gov.* Follow on-line 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.epa2.gov/dockets/commenting-epa-dockets.*
- *Email:* Dania Zinner, *zinner.dania@epa.gov.*
- *Mail:* Dania Zinner, Remedial Project Manager, U.S. EPA, Region 8, Mail Code 8SEM–RB, 1595 Wynkoop Street, Denver, CO 80202–1129.

Instructions: Direct your comments to Docket ID no. EPA–HQ–SFUND–2002–0008. 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 Confidential Business Information (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. The *https://www.regulations.gov* website is an ''anonymous access'' system, which means 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 disk or CD–ROM 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 avoid the use of special characters, any form of encryption, and be free of any defects or viruses.

Docket: All documents in the docket are listed in the *https://www.regulations.gov* index. 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 the hard copy. Publicly available docket materials are available electronically in *http://www.regulations.gov;* by calling EPA Region 8 at (303) 312–7279 and leaving a message; and at the EPA Info Center, 108 E 9th Street, Libby, MT 59923, (406) 293–6194, Monday through Thursday from 8:00 a.m.–4:00 p.m.

FOR FURTHER INFORMATION CONTACT: Dania Zinner, Remedial Project Manager, U.S. Environmental Protection Agency, Region 8, Mailcode SEM–RB, 1595 Wynkoop Street, Denver, CO 80202–1129, (303) 312–7122, email *zinner.dania@epa.gov.*

SUPPLEMENTARY INFORMATION:

Table of Contents

I. Introduction

EPA Region 8 announces its intent to delete all of Operable Unit 1 (OU1), Former Export Plant, of the Libby Asbestos Superfund Site (Site) from the NPL and requests public comment on this proposed action. The NPL constitutes appendix B of 40 CFR part 300 which is the NCP, which the EPA promulgated pursuant to section 105 of the CERCLA of 1980, as amended. The EPA maintains the NPL as those sites

that appear to present a significant risk to public health, welfare, or the environment. Sites on the NPL may be the subject of remedial actions financed by the Hazardous Substance Superfund (Fund). This partial deletion of OU1 of the Libby Asbestos Superfund Site is proposed in accordance with 40 CFR 300.425(e) and is consistent with the Notice of Policy Change: Partial Deletion of Sites Listed on the National Priorities List. 60 FR 55466 (Nov. 1, 1995). As described in § 300.425(e)(3) of the NCP, a portion of a site deleted from the NPL remains eligible for Fund-financed remedial action if future conditions warrant such actions.

The EPA will accept comments on the proposal to partially delete this site for thirty (30) days after publication of this document in the **Federal Register**.

Section II of this document explains the criteria for deleting sites from the NPL. Section III discusses procedures that the EPA is using for this action. Section IV discusses where to access and review information that demonstrates how the deletion criteria have been met at OU1 of the Libby Asbestos Superfund Site.

II. NPL Deletion Criteria

The NCP establishes the criteria that EPA uses to delete sites from the NPL. In accordance with 40 CFR 300.425(e), sites may be deleted from the NPL where no further response is appropriate. In making such a determination pursuant to 40 CFR 300.425(e), the EPA will consider, in consultation with the State, whether any of the following criteria have been met:

i. Responsible parties or other persons have implemented all appropriate response actions required;

ii. All appropriate Fund-financed response under CERCLA has been implemented, and no further response action by responsible parties is appropriate; or

iii. The remedial investigation has shown that the release poses no significant threat to public health or the environment and, therefore, the taking of remedial measures in not appropriate.

Pursuant to CERCLA section 121(c) and the NCP, the EPA conducts five-year reviews to ensure the continued protectiveness of remedial actions where hazardous substances, pollutants, or contaminants remain at a site above levels that allow for unlimited use and unrestricted exposure. The EPA conducts such five-year reviews even if a site is deleted from the NPL. The EPA may initiate further action to ensure continued protectiveness at a deleted site if new information becomes available that indicates it is appropriate. Whenever there is a significant release from a site deleted from the NPL, the deleted site may be restored to the NPL without application of the hazard ranking system.

III. Deletion Procedures

The following procedures apply to deletion of OU1 of the Libby Asbestos Superfund Site:

(1) The EPA consulted with the State before developing this Notice of Intent for Partial Deletion.

(2) The EPA has provided the State 30 working days for review of this document prior to its publication in the **Federal Register**.

(3) In accordance with the criteria discussed above, EPA has determined that no further response is appropriate;

(4) The State of Montana, through the DEQ, has concurred with deletion of OU1 of the Libby Asbestos Superfund Site, from the NPL.

(5) Concurrently with the publication of this Notice of Intent for Partial Deletion in the **Federal Register**, notices are being published in the Western News, the Kootenai Valley Record, and The Montanian. The newspaper notices announce the 30-day public comment period concerning the Notice of Intent for Partial Deletion of the Site from the NPL.

(6) The EPA placed copies of documents supporting the proposed partial deletion in the deletion docket, made these items available for public inspection, and copying at the Site information repositories identified above.

If comments are received within the 30-day comment period on this document, the EPA will evaluate and respond to the comments before making a final decision to delete OU1. If necessary, the EPA will prepare a Responsiveness Summary to address any significant public comments received. After the public comment period, if the EPA determines it is still appropriate to delete OU1 of the Libby Asbestos Superfund Site, the Regional Administrator will publish a final Notice of Partial Deletion in the **Federal Register**. Public notices, public submissions and copies of the Responsiveness Summary, if prepared, will be made available to interested parties and included in the site information repositories listed above.

Deletion of a portion of a site from the NPL does not itself create, alter, or revoke any individual's rights or obligations. Deletion of a portion of a site from the NPL does not in any way alter the EPA's right to take enforcement actions, as appropriate. The NPL is designed primarily for informational purposes and to assist EPA management. Section 300.425(e)(3) of the NCP states that the deletion of a site from the NPL does not preclude eligibility for future response actions, should future conditions warrant such actions.

IV. Basis for Intended Partial Site Deletion

The EPA placed copies of documents supporting the proposed partial deletion in the deletion docket. The material provides explanation of EPA's rationale for the partial deletion and demonstrates how it meets the deletion criteria. This information is made available for public inspection in the dockets identified above.

List of Subjects in 40 CFR Part 300

Environmental protection, Air pollution control, Chemicals, Hazardous substances, Hazardous waste, Intergovernmental relations, Penalties, Reporting and recordkeeping requirements, Superfund, Water pollution control, Water supply.

Authority: 33 U.S.C. 1321(c)(2); 42 U.S.C. 9601–9657; E.O. 13626, 77 FR 56749, 3 CFR, 2013 Comp., p. 306; E.O. 12777, 56 FR 54757, 3 CFR, 1991 Comp., p. 351; E.O. 12580, 52 FR 2923, 3 CFR, 1987 Comp., p. 193.

Dated: December 9, 2019.

Gregory E. Sopkin,

Regional Administrator, EPA Region 8.

[FR Doc. 2020–00983 Filed 1–23–20; 8:45 am]

BILLING CODE 6560–50–P

DEPARTMENT OF COMMERCE

National Oceanic and Atmospheric Administration

50 CFR Parts 216 and 300

[Docket No. 200113–0011

RIN 0648–BJ23

International Fisheries; Pacific Tuna Fisheries; Fishing Restrictions for Silky Shark, Fish Aggregating Device, and Observer Safety in the Eastern Pacific Ocean

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

ACTION: Proposed rule; request for comments.

SUMMARY: NMFS proposes regulations under the Tuna Conventions Act to implement Resolutions C–19–01 (*Amendment to Resolution C–18–05 on the Collection and Analyses of Data on Fish-Aggregating Devices*); C–19–05

(*Amendment to the Resolution C–16–06 Conservation Measures for Shark Species, with Special Emphasis on the Silky Shark (Carcharhinus Falciformis), for the Years 2020 and 2021*); and C–18–07 (*Resolution on Improving Observer Safety at Sea: Emergency Action Plan)* of the Inter-American Tropical Tuna Commission (IATTC). NMFS also proposes regulations under the Marine Mammal Protection Act to implement Resolution A–18–03 (*On Improving Observer Safety At Sea: Emergency Action Plan*) of the Agreement on the International Dolphin Conservation Program (AIDCP). This proposed rule is necessary for the United States to satisfy its obligations as a member of the IATTC and Party to the AIDCP.

DATES: Comments on the proposed rule and supporting documents must be submitted in writing by February 24, 2020.

ADDRESSES: You may submit comments on this document, identified by NOAA–NMFS–2019–0149, by any of the following methods:

- *Electronic Submission:* Submit all electronic public comments via the Federal e-Rulemaking Portal. Go to *http://www.regulations.gov/#!docketDetail;D=NOAA-NMFS-2019-0149,* click the ''Comment Now!'' icon, complete the required fields, and enter or attach your comments.
- *Mail:* Submit written comments to Rachael Wadsworth, NMFS West Coast Region Long Beach Office, 501 W Ocean Blvd., Suite 4200, Long Beach, CA 90802. Include the identifier ''NOAA–NMFS–2019–0149'' in the comments.

Instructions: Comments must be submitted by one of the above methods to ensure they are received, documented, and considered by NMFS. 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. 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).

Copies of the draft Regulatory Impact Review and other supporting documents are available via the Federal eRulemaking Portal: *http://www.regulations.gov,* docket NOAA–NMFS–2019–0149, or by contacting the Regional Administrator, Barry A. Thom, NMFS West Coast Region, 1201 NE Lloyd Boulevard, Suite 1100, Portland, OR 97232–1274, or *RegionalAdministrator.WCRHMS@noaa.gov.*

FOR FURTHER INFORMATION CONTACT: Rachael Wadsworth, NMFS at 562–980–4036, or Will Stahnke at 562–980–4088.

SUPPLEMENTARY INFORMATION:

Background on the AIDCP and IATTC

The AIDCP has been ratified or acceded by 13 countries, including the United States, and is applied provisionally by another two. Among the objectives of the AIDCP are to reduce dolphin mortalities and ensure the long-term sustainability of the tuna stocks within the AIDCP Agreement Area. The full text of the AIDCP Agreement is available at: *https://www.iattc.org/PDFFiles/AIDCP/_English/AIDCP-amended-Oct-2017.pdf.*

The United States is a member of the IATTC, which was established under the 1949 Convention for the Establishment of an Inter-American Tropical Tuna Commission. Effective in 2010, the 1949 Convention was updated by the Convention for the Strengthening of the IATTC Established by the 1949 Convention between the United States of America and the Republic of Costa Rica (Antigua Convention). The full text of the Antigua Convention is available online: *https://www.iattc.org/PDFFiles/IATTC-Instruments/_English/Antigua_Convention_Jun_2003.pdf.*

The IATTC consists of 21 member nations and five cooperating non-member nations. It facilitates scientific research into, as well as the conservation and management of, tuna and tuna-like species in the IATTC Convention Area. The IATTC Convention Area is defined as waters of the eastern Pacific Ocean (EPO) within the area bounded by the west coast of the Americas and by 50° N latitude, 150° W longitude, and 50° S latitude. The IATTC maintains a scientific research and fishery monitoring program and regularly assesses the status of tuna, sharks, and billfish stocks in the IATTC Convention Area to determine appropriate catch limits and other measures deemed necessary to promote sustainable fisheries and prevent the overexploitation of these stocks.

International Obligations of the United States Under the Antigua Convention and Agreement on International Dolphin Conservation Program (AIDCP)

As a Party to the Antigua Convention and AIDCP Agreement and a member of the IATTC and AIDCP, the United States is legally bound to implement decisions of the IATTC under the Tuna Conventions Act (16 U.S.C. 951 *et seq.*) and the AIDCP under the Marine Mammal Protection Act (16 U.S.C. 1361 *et seq.*). The Tuna Conventions Act (16 U.S.C. 951 *et seq.*) directs the Secretary of Commerce, in consultation with the Secretary of State and, with respect to enforcement measures, the U.S. Coast Guard, to promulgate such regulations as may be necessary to carry out the United States' obligations under the Antigua Convention, including recommendations and decisions adopted by the IATTC. The authority of the Secretary of Commerce to promulgate such regulations has been delegated to NMFS.

IATTC and AIDCP Resolutions

At its 94th Meeting of the IATTC in July 2019, the IATTC adopted amendments to two Resolutions: C–19–01 (*Amendment to Resolution C–18–05 on the Collection and Analyses of Data on Fish-Aggregating Devices*) and C–19–05 (*Amendment to the Resolution C–16–06 Conservation Measures for Shark Species, with Special Emphasis on the Silky Shark (Carcharhinus Falciformis), for the Years 2020 and 2021*). Resolution C–19–01 amended the previously adopted Resolution C–18–05 on fish aggregating devices (FADs) and revised data collection requirements to reduce the duplicative reporting on FAD interactions. The proposed regulations would eliminate duplicative reporting of FAD data that is currently required from purse seine vessel captains but that is already being collected by onboard observers. Captains would still be required to provide the observer with the FAD identification code and, as appropriate, the other information in the standard format. Resolution C–19–05 amended the previously adopted resolution C–16–06 on silky shark and extended its applicability through 2021. The amendments implement further restrictions on longline vessels and increase flexibility for accidental retention on purse seine vessels.

The IATTC adopted Resolution C–18–07 (*Resolution on Improving Observer Safety at Sea: Emergency Action Plan)* in August 2018. The Parties to the AIDCP adopted Resolution A–18–03 (*On Improving Observer Safety at Sea: Emergency Action Plan*) in October

2018. These Resolutions were adopted to strengthen protections for observers in longline and transshipment observer programs required by the IATTC and on purse seine vessels required by the AIDCP. The observer safety Resolutions detail responsibilities for vessel owners and operators, responsibilities for IATTC and AIDCP members to which fishing vessels are flagged, responsibilities for members that have jurisdiction over ports, and responsibilities for observer providers.

Proposed Regulations

This proposed rule would implement provisions in three IATTC Resolutions and one AIDCP Resolution related to FAD data reporting, silky sharks, and observer safety. This proposed rule would apply to U.S. commercial fishing vessels that fish for tuna or tuna-like species in the IATTC Convention Area.

First, the proposed rule would revise existing regulations for FAD data collection requirements to remove the reporting requirements for captains of purse seine vessels fishing on FADs that have observers onboard. Because IATTC observers are now expected to be collecting all the information previously required on the FAD data collection form, the Commission removed this requirement for captains. Captains would still be required to provide the observer with the FAD identification code and, as appropriate, the other information in the standard format. On purse seine vessels without an observer aboard, the captain would still be responsible for recording the information on the FAD form developed by the IATTC staff.

Second, the proposed rule would ban the retention of silky shark by U.S. longline vessels. Paragraph 5 of Resolution C–19–05 on silky shark requires establishment of an inspection system at landing ports for members and cooperating non-members (CPCs) that allow retention of silky shark by longline vessels. However, when NMFS considered the time and effort required to implement a port inspection system and the impacts on U.S. longline vessels that would be subjected to such an inspection process, implementing the port inspection requirement of the Resolution would be more of a burden to the U.S. government and the public than simply prohibiting all retention of silky shark on U.S. longline vessels in the IATTC Convention Area. Therefore, this proposed rule would institute such a ban. Because U.S. longline vessels fishing in the IATTC Convention Area do not target, and infrequently catch, silky sharks, a retention ban for longline vessels would not impact current fishing practices. Data from 2008 to 2015 indicate that virtually all incidentally caught silky sharks in the IATTC Convention Area were released by U.S. longline vessels, and almost all were released alive. In addition, such a prohibition in the eastern Pacific Ocean would be consistent with U.S. regulations in the western Pacific Ocean. Since 2015, U.S. vessels fishing in the western and central Pacific Ocean have been subject to a prohibition on the retention on board, transshipping, storing, or landing any part or whole carcass of a silky shark that is caught in the Western and Central Pacific Fisheries Commission Convention Area (50 CFR 300.226).

The proposed rule would also increase flexibility for accidental retention of silky shark on purse seine vessels. Since January 2017 the IATTC Resolution and U.S. regulations have prohibited retention of silky shark on purse seine vessels caught in the IATTC Convention Area. This proposed rule would allow for exemptions in the case of any silky shark that is not seen during fishing operations and is delivered into the vessel hold. In such case, the silky shark may be stored on board and landed, but the vessel owner or operator must surrender the whole silky shark to a government authority present at the point of landing. In U.S. ports the responsible governmental authority is the NOAA Office of Law Enforcement divisional office nearest to the port. If government authorities are unavailable, the whole silky shark must not be sold or bartered but must be donated for purposes of domestic human consumption consistent with relevant laws and policies. The vessel owner, or operator shall report any silky sharks surrendered in this manner to the IATTC Secretariat by recording the incident in the note section of the IATTC Pacific Tuna Regional Logbook.

U.S. purse seine vessels do not target or intentionally retain silky shark in the IATTC Convention Area, yet they are caught incidentally and are primarily discarded. The proposed regulations are expected to provide regulatory relief from the previous prohibition on the retention of silky shark that are unintentionally caught and frozen during fishing operations, which is an infrequent event for U.S. purse seine vessels.

Observer Safety

Third, the proposed rule would implement provisions of Resolutions C–18–07 and A–18–03 to strengthen protections for observers in longline and transshipment observer programs required by the IATTC and on purse seine vessels required by the AIDCP. Paragraph 2 of the measures also provides that the measure shall not prejudice the rights of members to enforce their laws with respect to the safety of observers consistent with international law.

The observer safety Resolutions detail responsibilities for vessel owners and operators, responsibilities for IATTC and AIDCP members to which fishing vessels are flagged, responsibilities for members that have jurisdiction over ports, and responsibilities for observer providers. Most of the requirements in these Resolutions are already required by procedures implemented by the U.S. Coast Guard (USCG) in its marine casualty regulations at 46 CFR part 4. This proposed rule is intended to fill the gaps between the existing USCG procedures and these Resolutions. There are two categories of observer safety incidents (serious illness and harassment) that are specified in the IATTC and AIDCP decisions and are not included in USCG marine casualty regulations. This proposed rule would not expand the USCG marine casualty regulations to include serious illness and harassment of observers.

Both Resolutions detail a number of requirements for vessel owners and operators specifically related to vessel operations, notification, search and rescue procedures, and investigations in the event of death, injury, serious illness, missing or presumed fallen overboard, or harassment of an observer. The United States requires U.S. vessel owners or operators to notify the USCG about marine casualties, which applies in the event of death, missing or presumed fallen overboard, or serious injury of an observer. The USCG regulations in 46 CFR part 4 specify requirements for notifications, reporting, and investigations. Thus, NMFS would not promulgate additional regulations for cases of death, missing or presumed fallen overboard, or serious injury of an observer. However, the Resolutions also require that the observer provider be notified in cases of an observer that dies or goes missing, and this proposed rule includes requirements for the vessel owner or operator to notify the observer provider and a government contact.

This rule proposes additional regulations that would govern cases of serious illness, assault, intimidation, threats, interference, or harassment of observers. NMFS notes that some of these incidents lead to civil rather than criminal proceedings and can even involve circumstances that do not create emergency situations needing a specific or immediate response from the U.S.

government. The NMFS West Coast Regional Administrator would post a list of appropriate contacts for U.S. government offices as well as observer providers on the NMFS WCR website: *https://www.fisheries.noaa.gov/west-coast/partners/emergency-contacts-vessel-owners-operators-and-observers-longline-and-purse.* This website includes emails and phone numbers, which are not referenced here. In the event that an observer on a fishing vessel of the United States has been assaulted, intimidated, threatened or harassed, the owner or operator of the fishing vessel would be required to immediately notify the observer provider and the NOAA Office of Law Enforcement West Coast Division Duty Officer line at (206) 526–4851 of the situation and the status and location of the observer.

The USCG continues to be the point of contact for other emergency situations that would necessitate an immediate USCG search and rescue, or law enforcement response. NMFS WCR does not maintain a 24-hour hotline to handle such emergencies. Thus, in emergency situations that need an immediate response, vessel owners and operators are encouraged to contact the nearest U.S. Coast Guard Rescue Coordination Center (RCC) that can help coordinate with the closest Search and Rescue (SAR) facility in the area of the vessel: *https://www.dco.uscg.mil/Our-Organization/Assistant-Commandant-for-Response-Policy-CG-5R/Office-of-Incident-Management-Preparedness-CG-5RI/US-Coast-Guard-Office-of-Search-and-Rescue-CG-SAR/RCC-Numbers/.*

In addition, the proposed rule sets forth procedures the vessel owner or operator would be required to follow in the event that an observer has a serious illness. The owner or operator of a fishing vessel of the United States would be required to immediately report serious illness or injury that threatens the life and/or long-term health or safety of an observer to the observer provider and a U.S. government contact.

The rule proposes that, in the event that the observer has a serious illness or injury that threatens his or her life and/or long-term health or safety, the owner or operator of the fishing vessel must: (i) Immediately cease fishing operations; (ii) take all reasonable actions to care for the observer and provide any medical treatment available and possible on board the vessel, and where appropriate seek external medical advice; (iii) where directed by the observer provider, if not already directed by the appropriate U.S. government contact, facilitates the disembarkation and transport of the observer to a medical facility equipped to provide the required care, as soon as practicable; and (iv) cooperate fully in any official investigations into the cause of the illness or injury. The Resolution and proposed regulations specify that the owner or operator of the fishing vessel must ''immediately cease fishing operations.'' NMFS anticipates that there may be circumstances where ''immediately cease'' could allow for gear to be retrieved and NMFS does not encourage abandoning fishing gear.

The proposed rule sets forth procedures the vessel owner or operator would be required to follow in the event that an observer has been assaulted, intimidated, threatened or harassed. The rule proposes that, in the event that an observer on a fishing vessel of the United States has been assaulted, intimidated, threatened or harassed, the owner or operator of the fishing vessel must: (i) Immediately take action to preserve the safety of the observer and mitigate and resolve the situation on board; (ii) if the observer or the observer provider indicate that they wish for the observer to be removed from the vessel, facilitate the safe disembarkation of the observer in a manner and place, as agreed by the observer provider, that facilitates access to any needed medical treatment; and (iii) cooperates fully in any official investigations into the incident.

Classification

After consultation with the Department of State and Department of Homeland Security, the NMFS Assistant Administrator has determined that this proposed rule is consistent with the Tuna Conventions Act of 1950, as amended, the Marine Mammal Protection Act, and other applicable laws, subject to further consideration after public comment.

This proposed rule has been determined to be not significant for purposes of Executive Order 12866. This proposed rule is not an Executive Order 13771 regulatory action because this rule is not significant under Executive Order 12866.

NMFS is amending the supporting statement for the West Coast Region Pacific Tuna Fisheries Logbook and Fish Aggregating Device Form, Office of Management and Business (OMB) Paperwork Reduction Act (PRA) requirements (OMB Control No. 0648–0148) to clarify that the data collection requirements for FADs are only required for purse seine vessels without an observer onboard, include requirements to report incidentally caught silky shark that are surrendered or donated, and report incidences involving observers on purse seine vessels. NMFS estimates that the public reporting burden for FAD reporting would be reduced by five minutes. The requirements to report accidentally caught silky shark is expected to average one minute per form and the reporting related to observer safety on purses seine vessels is estimated to average five minutes per reporting incident. These estimates include time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information.

NMFS is also amending the supporting statement for the Pacific Islands Region Logbook Family of Forms, Office of Management and Business (OMB) Paperwork Reduction Act (PRA) requirements Control No. 0648–0214. Notifications related to observer safety on longline vessels are expected to be rare, and are estimated to average five minutes per reporting incident. Regarding the elements of the rule pertaining to prohibiting retention of silky sharks on longline vessels; there are no new collection-of-information requirements associated with this action that are subject to the PRA, and existing collection-of-information requirements still apply under the following Control Numbers: 0648–0593 and 0648–0214.

NMFS requests any comments on the PRA package, including whether the paperwork would unnecessarily burden any vessel owners and operators. Public comment is sought regarding: Whether this proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility; the accuracy of the burden estimate; ways to enhance the quality, utility, and clarity of the information to be collected; and ways to minimize the burden of the collection of information, including through the use of automated collection techniques or other forms of information technology. Send comments on these or any other aspects of the collection of information to the **ADDRESSES** above, and by email to *OIRA_Submission@omb.eop.gov,* or fax to (202) 395–5806.

Notwithstanding any other provision of the law, no person is required to respond to, nor shall any person be subject to a penalty for failure to comply with, a collection of information subject to the requirements of the PRA, unless that collection of information displays a currently valid OMB Control Number. All currently approved NOAA collections of information may be viewed at: *http://www.cio.noaa.gov/services_programs/prasubs.html.*

Pursuant to the Regulatory Flexibility Act, 5 U.S.C. 605(b), the Chief Counsel for Regulation of the Department of Commerce certified to the Chief Counsel for Advocacy of the Small Business Administration that this proposed rule, if adopted, would not have a significant economic impact on a substantial number of small entities. The rationale for the certification is provided in the following paragraphs.

The United States Small Business Administration (SBA) defines a ''small business'' (or ''small entities'') as one with annual revenue that meets or is below an established size standard. NMFS has established that the small business size standard for all businesses primarily engaged in the commercial fishing industry (NAICS 11411) for Regulatory Flexibility Act (RFA) compliance purposes (80 FR 81194, December 29, 2015), is $11 million in annual gross receipts. The standard is to be used in place of the U.S. SBA standards of $20.5 million, $5.5 million, and $7.5 million for the finfish (NAICS 114111), shellfish (NAICS 114112), and other marine fishing (NAICS 114119) sectors, respectively, of the U.S. commercial fishing industry.

The action would apply to United States purse seine, longline, and transshipment vessels registered and authorized to fish for tuna or tuna-like species in IATTC Convention Area. The IATTC Convention Area includes the waters bounded by the coast of the Americas, the 50° N and 50° S parallels, and the 150° W meridian. This area includes the United States West Coast Exclusive Economic Zone (EEZ). The entities directly affected by the actions of this proposed action are: (1) U.S. purse seine vessels that use FADs to fish for tuna or tuna-like species in the IATTC Convention Area, (2) U.S. purse seine and longline vessels that catch silky shark, and (3) U.S. purse seine and longline vessels that carry observers. Per the $11 million size standard, the FAD components of this rule would affect both large and small business; the longline vessels that would be affected by the silky shark component of this rule are small businesses. No U.S. transshipment vessels would be affected by the proposed regulations, therefore, impacts to these vessels are not discussed below.

Purse Seine

As of October 2019, there are 17 large, size class six (greater than or equal to 425 cubic meters) U.S. purse seine vessels registered to fish in the EPO that are expected to be impacted by this rule; these vessels always carry observers, potentially fish on FADs, and incidentally catch silky shark. These vessels have typically been based in the western and central Pacific Ocean (WCPO). U.S. large purse seine vessels fishing in the EPO primarily target yellowfin, skipjack, and bigeye tuna by fishing on floating objects and unassociated sets. They do not target silky sharks. Additionally, there are 14 small (less than 425 cubic meters) registered U.S. purse seine vessels that are not subject to the 100 percent observer requirement and currently do not carry observers, do not fish using FADs, do not target or incidentally catch silky sharks, and fish primarily in or near coastal zones. As such, this action does not currently apply to, and is not expected to impact these smaller vessels.

Estimates of ex-vessel revenues for large U.S. purse seine vessels fishing in the IATTC Convention Area from 2005 to 2014 have been confidential and may not be publicly disclosed because of the small number of vessels in the fishery. However, beginning in 2015, more than three large purse seine vessels fished either exclusively in the EPO, or fished in both the EPO and WCPO. Thus, information from 2015 to 2018 is not confidential.

Ex-vessel price information specific to individual large purse seine vessels are not available to NMFS because these vessels did not land on the U.S. West Coast and the cannery receipts are not available through the IATTC. However, Regional Purse Seine Logbook (RPL) data from the Pacific Islands Fisheries Science Center (PIFSC), and observer data from the IATTC may be used as a proxy for fish landings by large U.S. purse seiners, in lieu of cannery receipts. Since neither gross receipts nor ex-vessel price information specific to individual fishing vessels are available to NMFS, NMFS applied indicative regional cannery prices—as approximations of ex-vessel prices—to annual catches of individual vessels attained from RPLs and IATTC observer data, to estimate the vessels' annual receipts. Indicative regional cannery prices are available through 2018 (developed by the Pacific Islands Forum Fisheries Agency; available at *https://www.ffa.int/node/425*). NMFS estimated annual receipts for vessels during 2016 to 2018 for purse seine vessels that fished in both the EPO and WCPO and those that fish only the EPO. Using this approach, NMFS estimates that among the affected vessels, the range in annual average receipts in 2016 to 2018 was $2 million to $15 million with an average of about $9 million. Thus, NMFS estimates that slightly more than half of the affected large purse seine vessels are small entities.

Based on limited financial information about the affected fishing fleets, and using individual vessels as proxies for individual businesses, NMFS believes that almost 75 percent of the purse seine fishing entities, are small entities as defined by the RFA; that is, they are independently owned and operated and not dominant in their fields of operation, and have annual receipts of no more than $11.0 million. Analysis of the average revenue, by vessel, for the three years of 2016–2018 (most recent data available) shows that average annual revenue among vessels in the fleet was about $9.0 million. The three-year annual averages were less than the $11 million threshold for 28 vessels in the fleet, including 13 of the 16 vessels on both the IATTC Regional Vessel Register (RVR) and WCPFC Vessel Register.

U.S. vessel owners and operators of purse seine vessels that carry observers in the EPO, use FADs to fish for tuna or tuna-like species, and that catch silky shark in the IATTC Convention Area, are all large purse seine vessels and are both large and small entities. The impacts of the proposed action are described in detail below.

Proposed Action on Silky Shark

Since 2005, the observer coverage rate on class size six vessels in the EPO has been 100 percent. The best available data from observers on large purse seine vessels from 2005 forward, show that the incidental catches of silky shark are primarily discarded, but that a small percentage has been landed in the past ten years. For example, in 2015, about three percent of the total catch of silky sharks caught by U.S. purse seine vessels in the IATTC Convention Area were landed, and the rest were discarded either dead or alive. Resolution C–16–06 entered into force on January 1, 2017, which implemented a prohibition on silky shark retention. From 2017 to 2018, 0.2 percent of silky sharks that were caught by U.S. purse seine vessels in the EPO were retained. The proposed action would allow exemptions for silky shark not seen during fishing operations and delivered into the vessel hold. In these situations, the silky shark may be stored on board and landed, but the vessel owner or operator must surrender the whole silky shark to the responsible government authority present at the point of landing. If the governmental authorities are unavailable, the whole silky shark surrendered must not be sold or bartered but must be donated for purposes of domestic human

consumption. The observers or the vessel owner or operator shall report these incidences to the IATTC. It is not expected that the proposed changes in retention requirements would substantially change the vessels' fishing practices, and would impose a minimal reporting time burden for vessel owners and operators to report these incidences, and is not expected to reduce profitability.

Proposed Action on Observer Safety

As explained in the preamble of this proposed rule, several provisions of the emergency action plan included in Resolutions C–18–07 and A–18–03 are already required by the USCG. However, this proposed action is intended to fill the gaps between the existing USCG marine casualty requirements at 46 CFR part 4 and these Resolutions. These gaps consist primarily of how to handle cases of harassment, intimidation, and serious illness of an observer onboard a purse seine vessel. Resolution A–18–03 applies to observers on purse seine vessels. There is 100 percent observer coverage on class size six purse seine vessels fishing in the IATTC Convention Area, while smaller purse seine vessels are not subject to the 100 percent observer coverage requirement and currently are not observed. The proposed action defines responsibilities for EPO purse seine vessel owners and operators, for IATTC and AIDCP members to which the fishing vessels are flagged, for members that have jurisdiction over ports, and for observer providers in these cases, and would require the vessel owner or operator to contact identified U.S. government contacts and observer providers. These safety action and reporting protocols are not expected to incur negative economic impacts to the affected vessels, fishing practices are not expected to change, and these emergency situations are expected to occur infrequently.

Proposed Action on FAD Reporting

Currently, captains of the 17 large purse seiners that use FADs, as well as onboard observers, collect FAD information, inventory, and activity data. The proposed action to implement Resolution C–19–01, will eliminate the duplicative FAD data reporting requirement for purse seine vessel captains to collect this data, as onboard fishery observers already collect FAD data. The proposed action is not expected to have any impact on FAD usage or fishing practices and would decrease the record-keeping burden for captains in the large purse seine FAD fishery. No negative economic impacts resulting from the proposed action are expected to occur.

Longline

As of October 2019, there are 159 U.S. longline vessels registered on the IATTC RVR and have the option to fish in the IATTC Convention Area. The majority of these longline vessels possess Hawaii Longline Limited Access Permits (issued under 50 CFR 665.13). Under the Hawaii longline limited access program, no more than 164 permits may be issued. Additionally, there are U.S. longline vessels based on the U.S. West Coast, some of which operate solely under the Pacific Highly Migratory Species (HMS) permit. U.S. West Coast-based longline vessels operating under the Pacific HMS permit fish primarily in the EPO and are currently restricted to fishing with deep-set longline gear outside of the U.S. West Coast EEZ. These vessels primarily target tuna species with a small percentage of swordfish and other highly migratory species taken incidentally. Since 2008, the observer coverage rates on shallow-set and deep-set longline vessels in the EPO have been a minimum of 100 and 20 percent, respectively.

There have been less than three West Coast-based vessels operating under the HMS permit since 2005; therefore, landings and ex-vessel revenue are confidential. However, the number of Hawaii-permitted longline vessels that have landed in West Coast ports has increased from one vessel in 2006 to 22 vessels in 2018. In 2018, 996 mt of highly migratory species were landed by Hawaii permitted longline vessels with an average ex-vessel revenue of approximately $255,636 per vessel, well below the $11 million threshold for finfish harvesting businesses. NMFS considers all longline vessels, for which data is non-confidential, that catch silky sharks in the IATTC Convention Area to be small entities for the purposes of the RFA. The impacts of the proposed action on these vessels are described in detail below.

Proposed Action on Silky Shark

U.S. longline vessels fishing in the IATTC Convention Area, whether under the Hawaii Longline Limited Access Permit or the Pacific HMS permit, do not target silky shark and all those caught incidentally, are released. From 2008 to 2018, data collected by observers aboard U.S. Hawaii deep-set longline vessels fishing in the IATTC Convention Area, showed a total of 65 silky sharks were caught; 72 percent of which were released alive, and the remaining 28 percent were discarded. During the same period, observers did not record any catch of silky shark on longline vessels using shallow-set gear. The proposed action would implement a full prohibition on the retention of silky shark on these vessels. It is not expected that the proposed changes would have a substantial impact on the vessels' fishing practices, due to the vessels already not having any intentional or unintentional retention of silky shark in the EPO. The proposed action is not expected to reduce profitability, thus, compliance with this measure is not expected to incur negative economic impacts to affected EPO U.S. longline vessels.

Proposed Action on Observer Safety

Resolution C–18–07 applies to observers in longline and transshipment observer programs required by the IATTC. The proposed action defines responsibilities for EPO longline vessel owners and operators, for IATTC and AIDCP Members to which the fishing vessels are flagged, for Members that have jurisdiction over ports, and for observer providers in these cases. These safety action and reporting protocols are not expected to incur negative economic impacts to the affected vessels, fishing practices are not expected to change, and issues that arise where the protocols are applicable occur infrequently.

Conclusion

In summary, the proposed action is not expected to substantially change the typical fishing practices of affected vessels, and any impact to the profitability of U.S. vessels is expected to be minor. NMFS has determined that the action is not expected to have a significant economic impact on a substantial number of small entities. The action is also not expected to have a disproportional economic impact on small business entities relative to the large entities. As a result, an initial regulatory flexibility analysis is not required and none has been prepared.

List of Subjects in 50 CFR Parts 216 and 300

Administrative practice and procedure, Fish, Fisheries, Fishing, Marine resources, Reporting and recordkeeping requirements, Treaties.

Dated: January 14, 2020.

Samuel D. Rauch, III,

Deputy Assistant Administrator for Regulatory Programs, National Marine Fisheries Service.

For the reasons set out in the preamble, 50 CFR parts 216 and 300 are proposed to be amended as follows:

PART 216—REGULATIONS GOVERNING THE TAKING AND IMPORTING OF MARINE MAMMALS

■ 1. The authority citation for part 216 continues to read as follows:

Authority: 16 U.S.C. 1361 *et seq.,* unless otherwise noted.

■ 2. Revise § 216.24, all references to ''Southwest Region'' to read ''West Coast Region'' and add paragraph (e)(4)(i) to read as follows:

§ 216.24 Taking and related acts in commercial fishing operations including tuna purse seine vessels in the eastern tropical Pacific Ocean.

* * * * *

(e) * * *

(4) * * *

(ii) Requirements for owners and operators of U.S. purse seine vessels for reporting and actions in response to observer safety are at 50 CFR 300.29.

(ii) [Reserved]

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PART 300—INTERNATIONAL FISHERIES REGULATIONS

Subpart C—Eastern Pacific Tuna Fisheries

■ 3. The authority citation for part 300, subpart C, continues to read as follows:

Authority: 16 U.S.C. 951 *et seq.*

■ 4. In § 300.22, revise paragraph (a)(3)(i) to read as follows:

§ 300.22 Recordkeeping and reporting requirements.

(a) * * *

(3) * * *

(i) *Reporting on FAD interactions:* U.S. purse seine vessel operators shall provide the observer with the FAD identification code and, as appropriate, the other information in the FAD interaction standard format provided by the HMS Branch. U.S. vessel owners and operators, without an observer onboard, must ensure that any interaction or activity with a FAD is reported using a FAD interaction standard format provided by the HMS Branch. The owner and operator shall ensure that the form is submitted within 30 days of each landing or transshipment of tuna or tuna-like species to the address specified by the HMS Branch.

* * * * *

■ 5. In § 300.24, revise paragraphs (ff) through (hh) to read as follows:

§ 300.24 Prohibitions.

* * * * *

(ff) Fail to provide information to an observer or record or report data on FADs as required in § 300.22(a)(3).

(gg) Use a commercial purse seine or longline fishing vessel of the United States to retain on board, transship, store, or land any part or whole carcass of a silky shark (*Carcharhinus falciformis*) in contravention of § 300.27(e).

(hh) Fail to follow observer safety requirements as specified under § 300.29.

* * * * *

■ 6. In § 300.27, revise paragraphs (e) and (f) to read as follows:

§ 300.27 Incidental catch and tuna retention requirements.

* * * * *

(e) *Silky shark restrictions for purse seine vessels.* The crew, operator, and owner of a commercial purse seine or longline fishing vessel of the United States used to fish for tuna or tuna-like species is prohibited from retaining on board, transshipping, storing, or landing any part or whole carcass of a silky shark (*Carcharhinus falciformis*) that is caught in the IATTC Convention Area, except as provided in paragraph (f) of this section.

(f) *Exception for silky shark unintentionally caught and frozen:* In the case of a purse seine vessel operating in the IATTC Convention Area that catches a silky shark that is not seen during fishing operations and is delivered into the vessel hold, the silky shark may be stored on board and landed, but the vessel owner or operator must surrender the whole silky shark to the responsible government authority present at the point of landing. In U.S. ports the responsible governmental authority is the NOAA Office of Law Enforcement divisional office nearest to the port, or other authorized personnel. If no governmental authorities are available, the whole silky shark surrendered must not be sold or bartered but must be donated for purposes of domestic human consumption consistent with relevant laws and policies. The vessel owner or operator shall report these incidences to the IATTC Secretariat by recording them in the IATTC Regional Purse Seine Logbook, or another form identified by NMFS.

* * * * *

■ 7. Add § 300.29 to read as follows:

§ 300.29 Observers.

Observer Safety. The following requirements apply to all on-board fisheries observers required under this subpart, which includes observers on purse seine, longline vessels, and transshipment carrier vessels, and while on a fishing trip in the IATTC Convention Area.

(a) *Contact information.* A full list of U.S. longline and IATTC purse seine observer providers and U.S. government contacts for situations described below is available at the following website: *https://www.fisheries.noaa.gov/west-coast/partners/emergency-contacts-vessel-owners-operators-and-observers-longline-and-purse.*

(b) *Loss of life.* In the event that an observer dies, is missing or presumed fallen overboard, the fishing vessel must immediately notify a U.S. government contact and the observer provider.

(c) *Serious illness or injury.* The owner or operator of a fishing vessel of the United States shall immediately report serious illness or injury that threatens the life and/or long-term health or safety of an observer to the observer provider and a U.S. government contact. In addition, the fishing vessel must:

(1) Immediately cease fishing operations;

(2) Take all reasonable actions to care for the observer and provide any medical treatment available and possible on board the vessel, and where appropriate seek external medical advice;

(3) Where directed by the observer provider, if not already directed by the appropriate U.S. government contact, facilitates the disembarkation and transport of the observer to a medical facility equipped to provide the required care, as soon as practicable; and

(4) Cooperate fully in any official investigations into the cause of the illness or injury.

(d) *Assault, intimidation, threat, or harassment.* For reporting violations in the event that an observer on a fishing vessel of the United States has been assaulted, intimidated, threatened or harassed, the owner or operator of the fishing vessel shall immediately notify the observer provider and the NOAA Office of Law Enforcement West Coast Division Duty Officer line at (206) 526–4851 of the situation and the status and location of the observer. In addition, the fishing vessels must:

(1) Immediately take action to preserve the safety of the observer and mitigate and resolve the situation on board;

(2) If the observer or the observer provider indicate that they wish for the observer to be removed from the vessel, facilitate the safe disembarkation of the observer in a manner and place, as agreed by the observer provider and a U.S. government contact, that facilitates access to any needed medical treatment; and

(3) Cooperates fully in any official investigations into the incident.

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DEPARTMENT OF COMMERCE

National Oceanic and Atmospheric Administration

50 CFR Part 600

[Doc. No. 200113–0010]

RIN 0648–BJ15

Vessel Monitoring Systems; Requirements for Type-Approval of Cellular Transceiver Units

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

ACTION: Proposed rule; request for comments.

SUMMARY: The U.S. Vessel Monitoring System (VMS) program type-approves enhanced mobile transceiver units (EMTUs) for use in U.S. fisheries. Currently, the only approved method for transferring VMS data from a vessel to NMFS is by satellite-linked communication services. This proposed rule would amend the existing VMS type-approval regulations to add cellular-based EMTUs (EMTU-Cs) type-approval application and testing procedures; compliance and revocation processes; and technical, service, and performance standards. This proposed rule is necessary to allow for the use of EMTU-Cs and cellular communication service, in addition to satellite-only models, in federally managed fisheries.

DATES: Comments on this proposed rule must be received by February 24, 2020.

ADDRESSES: You may submit comments on this proposed rule identified by ''NOAA–NMFS–2019–0126'' by either 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-2019-0126,* click the ''Comment Now!'' icon, complete the required fields, and enter or attach your comments.
- *Mail:* Send all written comments to Kelly Spalding, 1315 East-West Highway, Room 3207, Silver Spring, MD 20910.

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, *etc.*), 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).

Written comments regarding the burden-hour estimates or other aspects of the collection-of-information requirements contained in this proposed rule may be submitted to Kelly Spalding, Vessel Monitoring System Program Manager, 1315 East-West Highway, Room 3207, Silver Spring, MD 20910, by email to *OIRA_Submission@omb.eop.gov,* or by fax to 202–395–5806.

FOR FURTHER INFORMATION CONTACT: Kelly Spalding, Vessel Monitoring System Program Manager, NMFS: 301–427–8269 or *kelly.spalding@noaa.gov.*

SUPPLEMENTARY INFORMATION:

Purpose of This Proposed Rule

EMTU-Cs transmit data via cellular communication services, which are less expensive than satellite communications services used with EMTUs. EMTU-Cs are capable of collecting global positioning system (GPS) location data at regular intervals while vessels are at the dock and at sea; however, they can only transmit the data when the EMTU-Cs are within range of their land-based cellular receivers. Thus, unlike EMTUs, EMTU-C data cannot be sent at near real-time during the majority of fishing trips in Federal waters.

Whether EMTU-Cs are appropriate for a particular fishery needs to be evaluated under the relevant fishery management plan and its regulations. If EMTU-Cs are required, this proposed rule would amend the existing type-approval requirements to allow for type-approval of the EMTU-Cs for use in the fishery. NMFS regulations at 50 CFR part 600, subpart Q, specify the procedures and requirements for EMTUs for initial type-approvals; compliance with, and revocations and appeals of type-approvals; and technical, service, and performance standards. This proposed rule would use the same procedures and requirements for EMTU-Cs, amending existing regulations accordingly to add in EMTU-Cs. It is important to note that this proposed rule would not affect the existing satellite-based EMTU type-approval process; therefore, no impacts on current VMS applicants or end users are anticipated.

Background

If federal fishery regulations require use of VMS, fishing vessels must have a NMFS-approved EMTU (or mobile transmitter unit, although MTUs are no longer approved for new installations). EMTUs are affixed to fishing vessels as required by Federal regulations, and report GPS locations and potentially other fisheries information to NMFS. The EMTU allows NMFS Office of Law Enforcement (OLE) to determine the geographic position of the vessel at specified intervals or during specific events, via satellite mobile communication services (MCSs). These satellite MCSs and EMTUs send data securely and at near real-time so that fisheries management and enforcement can monitor vessels' activity as it occurs.

Fishermen must comply with applicable Federal fishery VMS regulations, and in doing so, may select from a variety of EMTU vendors that have been approved by NMFS to participate in the VMS program for specific fisheries. NMFS uses national VMS type-approval standards (50 CFR part 600, subpart Q) to approve an EMTU, including any installed software, and associated MCS, collectively referred to as a bundle, before they are authorized for use in federally managed fisheries (79 FR 77399, December 24, 2014).

On October 26, 2018, NMFS published a proposed rule that would require owners and operators of recreational charter vessels and headboats (for-hire vessels) with Gulf of Mexico (Gulf) permits for reef fish or coastal migratory pelagic species to report GPS vessel location information to NMFS, among other management measures (83 FR 54069). NMFS approved an amendment to the fishery management plans associated with that proposed rule, and is drafting a final rule to implement those requirements. The Gulf of Mexico Fishery Management Council determined that real-time satellite transmission is not necessary to meet the requirements for the Gulf for-hire reporting rule's vessel monitoring purposes, and that cellular data transmission will be sufficient.

NMFS seeks to accommodate the requirements for for-hire Gulf permit holders and to adapt to NMFS fishery monitoring trends while also maintaining type-approval standards that are equitably applied to all fisheries. So, in light of the above rule, this proposed rule would modify the existing NMFS VMS type-approval

regulations to provide for type-approval of EMTU-Cs and allow VMS communications to be sent through secure cellular communication services. Having a single, codified type-approval process for satellite *and* cellular-based tracking devices would ensure the approval process is efficient, transparent, and enforceable for all approved devices nation-wide. Although the impetus for this proposed rule was the Gulf proposed rule, this rule would be applied nationally for type-approval of EMTU-Cs, if adopted in other NMFS regions and monitoring programs.

Management Measures Contained in This Proposed Rule

The measures described below are the current type-approval process and requirements for satellite-based EMTUs and associated communication services. This proposed rule would amend the measures to include EMTU-Cs. EMTU-Cs would not be universally allowed for use in all fisheries, and the specific type-approvals may differ among fisheries and areas. The type-approved units for each applicable Federal fishery or area are located at *https://www.fisheries.noaa.gov/national/enforcement/noaa-fisheries-type-approved-vms-units.*

A requestor seeking type-approval would submit a written request and electronic copies of supporting materials to NMFS OLE along with two EMTU-Cs for testing. The documentation would list each of the type-approval requirements, and the requestor must certify that the required features and components comply with each requirement specified in subpart Q. OLE would test the EMTU-C and, unless additional time is required for testing, OLE would notify the requestor, in writing, of their approval or disapproval within 90 days from receipt of complete written request.

Specific standards for automatic position reporting, two-way communications, and billing are described at 50 CFR 600.1502. Regulations at 50 CFR 600.1503 would require that the EMTU-C be able to transmit position reports that meet the latency standards (the time delay between transmission and receipt of position reports) and automatically begin reporting upon power-up. Section 600.1503 describe the GPS reporting requirements for EMTU and EMTU-C, such as a minimum of 100-meter (328.1-ft) accuracy and position fix precision to the decimal minute hundredths. Section 600.1503 would also specify the requirements related to storage capacities, reporting intervals, and specially identified position reports such as EMTU-C power-ups and power-downs, and loss of communication signals.

Delivery of VMS data to NMFS would be required to be encrypted and sent securely through all associated cellular, satellite and internet communication pathways and channels, and the EMTU-C must also have the durability and reliability necessary to meet all requirements in subpart Q. The EMTU-C cabling and antennas must be resistant to salt, moisture, and shock associated with sea-going vessels in the marine environment.

The proposed rule would establish a latency requirement that 90 percent of the positions reports during each 24-hour period reach NMFS within 15 minutes of being sent from the EMTU-C, and gives notice of NMFS continual monitoring of latency compliance.

Messaging and electronic forms requirements and capabilities are stated in 50 CFR 600.1505 and 600.1506. The EMTU-C must support, or be able to connect to a device that supports, a 1-KB minimum message length, message delivery confirmation, notice to senders of failed message delivery to the EMTU-C and the reason for the failure, and an address book capability. The EMTU-C must store, or be able to connect to a device that can store, a minimum of 50 messages in a format that can be searched by date or by sender.

The EMTU-C must support, or be able to connect to a device that supports, forms software and a minimum of 20 electronic forms that can be selected from a menu. Each form must be capable of being defined as optional, mandatory or logic driven, and mandatory fields must be filled before the form can be submitted. A minimum of 20 previous forms must be stored and searchable, and they must indicate whether or not the form was successfully delivered, the cause for any delivery failure, and the option of attempting redelivery. Each form must be capable of including VMS position data, including latitude, longitude, and date and time. Data to populate these fields must be automatically generated by the EMTU-C, and prevented from being manually entered or altered.

The proposed rule would require that the EMTU-C and MCS be capable of providing updates to forms or adding new form requirements via wireless transmission and without manual installation, as NMFS may provide type-approved vendors with requirements for new forms or modifications to existing forms periodically. NMFS may also provide notice of forms and form changes through the NMFS Work Order System. Type-approved vendors would be given at least 60 calendar days from the time of notification to complete their implementation of new or changed forms.

The type-approved vendor would be responsible for field and technical services as described at 50 CFR 600.1508 of this proposed rule. The vendor must be able to receive customer service requests 24-hours per day with initial response times of no more than 24 hours. Field and technical services may include diagnostic and trouble-shooting support to NMFs and to fishermen, warranty and maintenance agreements, escalation procedures for resolution of problems, and assistance to the fishermen with the maintenance and repair of their EMTU-C and any communications anomalies caused by the EMTU-C or MCS. This level of customer service is necessary to reduce the economic impacts of cancelled trips due to equipment problems. Customer services to NMFS OLE and its contractors, upon request, would include issue resolution efforts regarding the VMS operation, other technical issues, and data analyses related to the VMS Program or system. In light of NMFS OLE's established practice of paying the reasonable cost for such assistance via NMFS-authorized service or purchase agreements, work order or contracts, NMFS is proposing to strike the provision in the existing regulations at § 600.1508(h) stating that the assistance would be provided free of charge by the type-approved vendor unless otherwise specified by NMFS.

Section 600.1509 of the proposed rule specifies the required handling of personally identifying information (PII), business identifying information (BII), and VMS data, which are confidential. All such data would be handled by NMFS in accordance with 16 U.S.C. 1881a and other applicable state and Federal laws and policies. Any release of PII or other protected information by NMFS beyond authorized entities may require a written request and approval. Any PII, BII, or VMS information sent electronically by the type-approval holder to NMFS OLE would require secure transmission that meets all state and Federal laws, Department of Commerce Information Technology Privacy Policy, 16 U.S.C. 1881a, and NMFS policies.

Section 600.1515 of the proposed rule would also require the type-approval holder's litigation support. All technical aspects of a type-approved EMTU-C, MCS, or bundle are subject to being admitted as evidence in a court of law, if needed, and the type-approval holder

would be required to provide technical and expert support for litigation to substantiate the EMTU-C, MCS, and/or bundle capabilities to establish NMFS OLE cases against potential violators. NMFS will pay the reasonable cost for such assistance in NMFS-authorized service or purchase agreements, work orders or contracts. If these technologies have previously been subject to such scrutiny in a court of law, the type-approval holder must provide NMFS with a brief summary of the litigation and any court findings on the reliability of the technology.

The proposed rule would establish a type-approval letter that would serve as NMFS' official notice of type-approval and it would also require type-approval holders to notify NMFS within 2 calendar days of any substantive changes from the original submission for type-approval. Timely notification of such changes is needed to allow NMFS OLE to be aware of a change that would affect monitoring, and to give notice of any change to our stakeholders, and to ensure that the unit is still in a type-approved status. Within 60 calendar days of receiving such notice, NMFS OLE would notify the type-approval holder if an amended type-approval would be required, including additional testing, or provide notice that OLE would initiate the type-approval revocation process.

If NMFS were to issue notice of the intent to revoke a type-approval, it would issue a revocation letter to the type-approval holder. The type-approval holder would be given the opportunity to respond, in writing, if they believe the revocation is in error or they could propose a solution to correct the issue. Any response would have to be submitted by a specified response date set by NMFS for between 30 to 120 calendar days from the date of the notification letter, depending on the impact and urgency of the alleged failure.

A type-approval holder may file an appeal of a type-approval revocation with the NMFS Assistant Administrator at the address stated in the revocation letter. Under proposed regulations at 50 CFR 600.1513, a petition must be filed within 14 calendar days of the date of any revocation letter. A type-approval holder would not be able to request an extension of time to file a petition to appeal.

An appeal to NMFS about a type-approval revocation must include a complete copy of the revocation letter and its attachments and a written statement detailing any facts or circumstances explaining and/or refuting the details contained in the revocation notice. Within 21 days of receipt of the appeal, the NMFS Assistant Administrator would affirm, vacate, or modify the revocation letter by sending a letter to the type-approval holder explaining their determination. The NMFS Assistant Administrator's determination constitutes the final agency decision.

Following the issuance of a revocation, NMFS would notify affected fishermen, and offer reimbursement of the cost of a new type-approved EMTU or EMTU-C, as appropriate for that fishery, should funding for reimbursement be available pursuant to 50 CFR 600.1516. Under those proposed regulations NMFS would offer, subject to the availability of funds, a reimbursement opportunity for the purchase price of a replacement EMTU or EMTU-C provided that all eligibility and process requirements specified by NMFS are met as described in NMFS Policy Directive 06–102 (available at: *https://www.fisheries.noaa.gov/national/laws-and-policies/law-enforcement-policy-directives*); and the replacement type-approved EMTU or EMTU-C is installed on the vessel, and reporting to NMFS OLE; and the type-approval for the previously installed EMTU-C has been revoked by NMFS; or NMFS requires the vessel owner to purchase a new EMTU or EMTU-C prior to the end of an existing unit's service life. The monetary cap for individual reimbursement payments is currently $3,100 for the EMTU or EMTU-C, only, and the cap is subject to change by NMFS.

Classification

The NMFS Assistant Administrator has determined that this proposed rule is consistent with the Magnuson-Stevens Act, and other applicable laws, subject to further consideration after public comment.

Executive Order 12866

This proposed rule has been determined to be not significant for purposes of Executive Order 12866.

Executive Order 13771

This proposed rule is expected to be an Executive Order 13771 deregulatory action.

Regulatory Flexibility Act (RFA)

NMFS prepared an initial regulatory flexibility analysis (IRFA) for this proposed rule, as required by section 603 of the RFA (5 U.S.C. 603). The IRFA describes the economic impact this proposed rule, if adopted, would have on small entities. A description of this proposed rule, why it is being considered, and the objectives of this proposed rule are contained in the preamble. A copy of the full analysis is available from NMFS (see **ADDRESSES**). A summary of the IRFA follows.

The Magnuson-Stevens Act provides the statutory basis for this proposed rule. No duplicative, overlapping, or conflicting Federal rules have been identified.

This proposed rule would directly apply to any companies that wish to obtain VMS type-approval for EMTU-Cs in the future. There are currently no EMTU-C units that have been type-approved by NMFS and no end users of such devices. NMFS received inquiries and quotes from six prospective telecommunications and/or computer and electronic product manufacturing companies within the past year expressing interest in seeking VMS type-approval for EMTU-Cs. Half of these are foreign companies based in either the United Kingdom or New Zealand. Because these foreign companies do not have a place of business located in the United States, do not operate primarily within the United States, or make a significant contribution to the U.S. economy through payment of taxes or use of American products, materials, or labor, they are not considered to be small businesses by the Small Business Administration (SBA) and only the effects on U.S. applicant companies will be discussed. One of the prospective U.S. companies is a publicly traded firm that primarily operates in the satellite telecommunications industry. The other two prospective U.S. applicant companies for EMTU-Cs are privately held businesses that do not publicly disclose total earnings or employment numbers. Based on information from their websites and product offerings, NMFS believes that one of them primarily operates in the radio and television broadcasting, and wireless communications equipment manufacturing industry, and the other primarily operates in the search, detection, navigation, guidance, aeronautical, and nautical system and instrument manufacturing industry. It is not possible to estimate how many additional companies may enter the marketplace for NMFS approved EMTU-Cs in the future.

It is important to note that this proposed rule would not be expected to affect the existing satellite-based EMTU type-approval process; therefore, no impacts on current VMS type-approval holders or end users are anticipated.

Additionally, this proposed rule would not directly apply to fishing businesses or end users of EMTU-C

devices. This proposed rule may affect the availability of EMTU-Cs for purchase, the retail price of these devices, monthly service charges, and future replacement costs; however, these would all be indirect effects of this proposed rule. Consideration of indirect effects is outside the scope of the RFA and, therefore, only the effects on EMTU-C vendor companies will be discussed.

The SBA has established size standards for all major industry sectors in the U.S. including satellite telecommunications businesses (NAICS code 517410), radio and television broadcasting and wireless communications equipment manufacturers (NAICS code 334220), and search, detection, navigation, guidance, aeronautical, and nautical system and instrument manufacturers (NAICS 334511). A business primarily involved in the satellite telecommunications industry is classified as a small business if it is independently owned and operated, is not dominant in its field of operation (including its affiliates), and has combined annual receipts not in excess of $32.5 million for all its affiliated operations worldwide. A business primarily involved in the radio and television broadcasting and wireless communications equipment manufacturing industry is classified as a small business if it is independently owned and operated, is not dominant in its field of operation (including its affiliates), and employs 1,250 or fewer persons on a full-time, part-time, temporary, or other basis at all its affiliated operations worldwide. Finally, a business primarily involved in the search, detection, navigation, guidance, aeronautical, and nautical system and instrument manufacturing industry is classified as a small business if it is independently owned and operated, is not dominant in its field of operation (including its affiliates), and employs 1,250 or fewer persons on a full-time, part-time, temporary, or other basis at all its affiliated operations worldwide.

Based on financial records from a 2018 annual report to stockholders, NMFS has determined that the publicly traded U.S. vendor company that may be directly affected by this proposed rule would not be considered a small business under the SBA size criteria for its industry designation, the satellite telecommunications industry. NMFS conservatively assumes that the other two prospective U.S. vendor companies for EMTU-Cs that are believed to primarily operate in either the radio and television broadcasting, and wireless communications equipment manufacturing industry, or the search, detection, navigation, guidance, aeronautical, and nautical system and instrument manufacturing industry are small entities. NMFS therefore estimates that this rule would impact at least two small entities in the short term and likely more in the long term.

This proposed rule would involve reporting, record keeping, and other compliance requirements for the type-approval application process, notifications to NMFS for any substantive changes to type-approved EMTU-Cs or MCSs, customer service, potential responses to revocation notices or revocation appeals, and litigation support.

The type-approval application process would require an applicant requesting type-approval of an EMTU-C, MCS, or bundle to make a written request to NMFS that must include the following information pertaining to the EMTU-C, MCS, or bundle: Communication class; manufacturer; brand name; model name; model number; software version and date; firmware version number and date; hardware version number and date; antenna type; antenna model number and date; tablet, monitor or terminal model number and date; MCS to be used in conjunction with the EMTU-C; entity providing MCS to the end user; current global and regional coverage of the MCS; the requestor-approved third party business entities associated with the EMTU-C and its use; the NMFS region(s) and/or Federal fisheries reporting program for which type-approval is sought; copies of, or citation to, applicable VMS regulations and requirements; communications functionality; position report data formats and transmission standards; latency specifications; messaging and electronic form capabilities; communications security specifications; details of customer service that would be provided to NMFS and fishermen; general durability and reliability of the unit; protection of PII, BII, and other protected information associated with the purchase or activation of an EMTU-C from disclosure; certification that the features, components, configuration, and services of the requestor's EMTU-C, MCS, or bundle comply with each applicable requirement set out in proposed 50 CFR 600.1502 through 600.1509 and the applicable VMS regulations and requirements in effect for the NMFS region(s) and/or Federal fisheries reporting program for which the requestor seeks type-approval; and a certification that the requestor accepts responsibility for ensuring compliance with type-approval regulations during the type-approval period. In addition, the application must include two EMTU-Cs, loaded with forms and software if required by the applicable fishery(s), with activated MCS, at no cost to the government for each NMFS region or Federal fishery for which the application is made for a minimum of 90 calendar days for testing and evaluation. Two EMTU-Cs are needed for testing in each NMFS region or Federal fishery in order to quickly conduct in-office and field trials simultaneously. The application must also include thorough documentation, including EMTU-C fact sheets, installation guides, user manuals, any necessary interfacing software, MCS global and regional coverage, performance specifications, and technical support information. This application process would likely require engineering and product manager expertise for preparation of the application.

The proposed rule would also require type-approval holders to notify NMFS within 2 calendar days of any substantive changes from the original submission for type-approval. Such change or modification notices would likely require engineering and product manager support as well.

EMTU-C type-approval holders would be responsible for ensuring that customer service includes diagnostic and troubleshooting support to NMFS and fishermen, which is available 24 hours a day, 7 days per week, and year round. This may require dedicated customer service representative or technician support.

If NMFS issues a Notification Letter indicating intent to revoke a type-approval, the type-approval holder must respond, in writing, within 30 to 120 calendar days from the date specified in the NMFS Notification Letter if they believe the notification is in error or can propose a solution to correct the issue. This response would likely require engineering and product manager expertise to develop. Additionally, a type-approval holder may file a petition to appeal a type-approval revocation, which could involve additional technical or legal support.

Finally, as a condition of type-approval, the type-approval holder would be required to provide technical and expert support for litigation to substantiate the EMTU-C, MCS, or bundle capabilities to establish NMFS OLE cases against potential violators, as needed. If the technology has been subject to prior scrutiny in a court of law, the type-approval applicant or holder would be required to provide a brief summary of the litigation and any

court finding on the reliability of the technology.

The proposed rule, if implemented, would apply to all companies that wish to obtain VMS type-approval for EMTU-Cs in the future. As discussed previously, there are currently no EMTU-C units that have been type-approved by NMFS and no end users of such devices; however, three U.S. companies are expected to request type-approvals for EMTU-Cs. NMFS believes two of these companies are small entities. It is unknown how many additional companies may enter this market in the future. Because the majority of prospective applicant companies that are likely to be directly regulated by this proposed rule are believed to be small entities, NMFS conservatively assumes that this rule would affect a substantial number of small entities.

All entities likely to be affected by this rule are expected to face comparable costs for the type-approval application process. Although detailed company information is not available for the small entities that would be directly regulated by this proposed rule, based on the nature of the products and services sold by these businesses, it is assumed they have the requisite resources to comply with most of the technical requirements included in this proposed rule as well. The requirement for customer service that is available 24 hours a day, 7 days per week, and year round would, however, have the potential to disproportionately burden small entities relative to large entities. This proposed rule may necessitate that small businesses hire dedicated customer service support staff. This increase in overhead costs could place them at a competitive disadvantage to large businesses that likely already have robust customer service resources. Small entities are typically not able to achieve the same economies of scale or scope as large entities. In other words, large entities are able to drive down overhead costs per unit by operating at higher levels of output or spreading overhead costs, such as customer service labor, across multiple products. This requirement may create a barrier to entry for small businesses that wish to participate in the EMTU-C market.

The following information summarizes the expected direct effects of this proposed rule on small entities.

Vessel Monitoring System Type-Approval Application Process

Under this proposed rule, an applicant would need to submit a written type-approval request and electronic copies of supporting materials that include the information required under proposed 50 CFR 600.1501 to NMFS OLE. The application process would likely require engineering and product manager expertise for preparation of the application. NMFS estimates that applicants would utilize up to approximately 40 hours of engineering labor and 40 hours of product management labor to compile the written request and statement that details how the applicant's EMTU-C meets the minimum national VMS standards as required by this rule. This estimate also includes the amount of time it would take to compile the EMTU-C documentation and the packaging of the EMTU-Cs to ship to each NMFS region or Federal fishery for which an application is submitted. Based on the Bureau of Labor Statistics May 2018 National Occupational Employment and Wage Estimates, the mean hourly wage for engineers is $47.71 per hour; for general and operations managers it is approximately $59.56 per hour. Therefore, NMFS estimates the total wage costs to be approximately $4,300 per EMTU-C application.

With respect to providing OLE two EMTU-Cs for each NMFS region, NMFS estimates that applicants would likely spend between $55 and $86 per shipment (two units each) based on current United States Postal Service (USPS) ground shipping rates for a package of up to 30 pounds ($49.62–$80.51 depending on the region) and box/packaging costs of $5.00. Upon completion of testing and evaluation by OLE in each NMFS region, applicants would also be responsible for the cost of EMTU-C return shipments. Therefore, assuming an applicant sends units to all five NMFS regions, the total shipping cost per application would be $674 based on USPS ground delivery costs of approximately $50 per region in the continental United States and $81 per region for the Alaska and the Pacific Islands offices. The cost would be lower if type-approval is requested for fewer regions.

In addition, applicants would be responsible for covering the costs of the MCS during the testing period. Using the average applicant quoted monthly service charge to customers, NMFS estimates that this would run approximately $25 per month per unit. Assuming a 90-day testing period for 10 units (2 sent to each NMFS region), the total MCS cost would be approximately $750. It would be less for requests that involve fewer regions.

The average estimated retail price of an EMTU-C unit, as based on six different vendor quotes, is approximately $458. The applicant seeking type-approval will be unable to sell the EMTU-C units as new after providing them to NMFS for testing and evaluation for 90 days. They might only get 60 to 80 percent of the regular retail value on refurbished units. If 10 EMTU-Cs that regularly retail new for $458 each are sent to 5 regions, the reduced retail revenue would total approximately $916 to $1,832 per type-approval application. Again, if type-approval is requested for fewer than five regions, the cost would be lower. Alternatively, the applicant may opt to use these units as demo units for trade shows and other marketing purposes and therefore considerably lower the costs of providing the evaluation units. It is difficult to estimate the exact costs associated with providing the units to NMFS given the uncertainty associated with what applicants would do with these EMTU-Cs after the 90-day evaluation period.

The total upper bound cost to applicants of the VMS type-approval application process is estimated to be $6,631 to $7,547 per application ($4,291 in wages, plus $674 in shipping, plus $750 in MCS charges, plus $916 to $1,832 in reduced retail revenue for the demo units). This cost would be lower if type-approval is requested for fewer than five regions.

Changes or Modifications to Type-Approvals

After a type-approval is issued, the type-approval holder must notify NMFS OLE in writing no later than 2 days following modification to or replacement of any functional component or piece of their type-approved EMTU-C, MCS, or bundle. If the changes are substantial, NMFS OLE will notify the type-approval holder in writing within 60 calendar days that an amended type-approval is required or that NMFS will initiate the type-approval revocation process. NMFS estimates that small entities would utilize up to approximately 4 hours of engineering labor and 4 hours of product management labor to notify NMFS of any substantive changes to the original type-approval submission and provide the agency with the details of those changes. NMFS estimates the total wage costs to be approximately $429 for the change notification process. NMFS estimates that there would likely be less than two change/modification notices submitted per year based on past experience. There were two change/modification notices submitted in 2017 for existing VMS type-approvals, as well as two in 2018. Therefore, the annual

total cost to small entities for this provision would likely be less than $858 per year.

Customer Service

The type-approval holder would be responsible for ensuring that customer service includes: Diagnostic and troubleshooting support to NMFS and fishermen, which is available 24 hours a day, 7 days per week, and year round; response times for customer service inquiries that do not exceed 24 hours; warranty and maintenance agreements; escalation procedures for resolution of problems; established facilities and procedures to assist fishermen in maintaining and repairing their EMTU-C; assistance to fishermen in the diagnosis of the cause of communications anomalies; assistance in resolving communications anomalies that are traced to the EMTU-C; and assistance to NMFS OLE and its contractors, upon request, in VMS operation, resolving technical issues, and data analyses related to the VMS Program or system. NMFS is unable to estimate the direct costs to businesses to comply with these customer service requirements; however, they may be nontrivial. Costs would likely vary depending on each vendor's existing assets, liabilities, and profit maximization strategies.

Revocation Process

If at any time, a type-approved EMTU-C or bundle fails to meet requirements at proposed 50 CFR 600.1502 through 600.1509 or applicable VMS regulations and requirements in effect for the region(s) and Federal fisheries for which the EMTU-C is type-approved, NMFS OLE may issue a Notification Letter to the type-approval holder that: Identifies the EMTU-C, MCS, or bundle that allegedly fails to comply with type-approval regulations and requirements; identifies the alleged failure to comply with type-approval regulations and requirements, and the urgency and impact of the alleged failure; cites relevant regulations and requirements under proposed 50 CFR 600, subpart Q; describes the indications and evidence of the alleged failure; provides documentation and data demonstrating the alleged failure; sets a response date by which the type-approval holder must submit to NMFS OLE a written response to the Notification Letter, including, if applicable, a proposed solution; and explains the type-approval holder's options if the type-approval holder believes the Notification Letter is in error.

NMFS will establish a response date between 30 and 120 calendar days from the date of the Notification Letter. The type-approval holder's response must be received in writing by NMFS on or before the response date. If the type-approval holder fails to respond by the response date, the type-approval will be revoked. At its discretion and for good cause, NMFS may extend the response date to a maximum of 150 calendar days from the date of the Notification Letter. A type-approval holder who has submitted a timely response may meet with NMFS within 21 calendar days of the date of that response to discuss a detailed and agreed-upon procedure for resolving the alleged failure. The meeting may be in person, conference call, or webcast.

If the type-approval holder disagrees with the Notification Letter and believes that there is no failure to comply with the type-approval regulations and requirements, NMFS has incorrectly defined or described the failure or its urgency and impact, or NMFS is otherwise in error, the type-approval holder may submit a written objection letter to NMFS on or before the response date in accordance with proposed 50 CFR 600.1512.

NMFS estimates that the proposed revocation process would potentially involve 16 hours of engineering labor and 8 hours of product management labor, per instance, to investigate the issues raised by NMFS and prepare a written response. Based on the wage costs previously discussed, NMFS estimates the revocation process could result in approximately $1,240 in labor costs. However, the actual amount of labor costs could vary considerably depending on the complexity of the issues causing the potential violations NMFS identified. Some vendors may decide not to challenge the revocation or may be unable to bring the issue to final resolution to NMFS' satisfaction and then face the revocation of the type-approval for their product. The vendor would then be impacted by the loss of future EMTU-C sales and monthly data communication fees from vessels required to carry and operate a type-approved EMTU-C, MCS, or bundle.

The vendor could also opt to appeal the type-approval revocation. In addition to the costs associated with the engineering and product management support provided during the revocation process, the vendor may also decide to employ legal assistance to challenge the agency's decision. These costs could vary considerably depending on the complexity of the appeal arguments.

Litigation Support

Finally, in accordance with proposed 50 CFR 600.1515, the proposed rule would also require the type-approval holder's litigation support. All technical aspects of a type-approved EMTU-C, MCS, or bundle are subject to being admitted as evidence in a court of law, if needed, and the type-approval holder would be required to provide technical and expert support for litigation to substantiate the EMTU-C, or bundle capabilities to establish NMFS OLE cases against violators. NMFS will pay the reasonable cost for such assistance in NMFS-authorized service or purchase agreements, work orders or contracts. If the technologies have previously been subject to such scrutiny in a court of law, the type-approval holder must provide NMFS with a brief summary of the litigation and any court findings on the reliability of the technology. This litigation support, if not fully paid for by NMFS, would be another potential cost of this proposed rule to EMTU-C vendors or mobile communications service providers. Because details of future litigation support needs are unknown, it is not possible to estimate these costs.

In conclusion, participation in the EMTU-C market would be voluntary. It is assumed vendors are profit maximizing firms that would only apply for type-approvals if the expected profits from selling EMTU-C units and services justify the costs presented in this RFA analysis. However, there may be disproportionate effects on small entities relative to large entities, due to the customer service requirements included as part of this proposed rule.

The following discussion describes the alternatives that were not selected as preferred by NMFS.

Only two alternatives were considered for this rule. The first alternative, the no-action alternative, would not add EMTU-Cs and cellular based transmissions of VMS data to the VMS type-approval regulations. Currently there is no type-approval process for EMTU-Cs. This alternative was not selected by NMFS, because a type-approval process is required in order to facilitate the use of EMTU-Cs and cellular-based VMS transmissions in federally regulated fisheries that will require, or allow the use of, such in the future. Therefore, the no-action alternative was not a viable alternative. The second alternative, which includes all of the provisions laid out in this proposed rule, is the preferred alternative. NMFS has not identified any other alternatives that would meet the objectives of the proposed rule while minimizing economic impacts on small entities.

Paperwork Reduction Act (PRA)

This proposed rule contains a collection-of-information requirement subject to review and approval by the Office of Management and Budget (OMB) under the PRA. This requirement has been submitted to OMB for approval. Public reporting burden for the application process is estimated to average 80 hours per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection information.

Public comment is sought regarding: Whether this proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility; the accuracy of the burden estimate; ways to enhance the quality, utility, and clarity of the information to be collected; and ways to minimize the burden of the collection of information, including through the use of automated collection techniques or other forms of information technology. Send comments on these or any other aspects of the collection of information to the NMFS OLE at the **ADDRESSES** above, by email to *OIRA_Submission@omb.eop.gov,* or fax to 202–395–7285.

Notwithstanding any other provision of the law, no person is required to respond to, and no person shall be subject to penalty for failure to comply with, a collection of information subject to the requirements of the PRA, unless that collection of information displays a currently valid OMB control number.

NMFS requests public comment on this decision, the associated analysis and all other aspects of this proposed rule. Send comments to NMFS at the **ADDRESSES** above.

List of Subjects in 50 CFR Part 600

Administrative practice and procedure, Fisheries, Fishing, Reporting and recordkeeping requirements.

Dated: January 13, 2020.

Samuel D. Rauch III,

Deputy Assistant Administrator for Regulatory Programs, National Marine Fisheries Service.

For the reasons set out in the preamble, 50 CFR part 600 is proposed to be amended as follows:

PART 600—MAGNUSON-STEVENS ACT PROVISIONS

■ 1. The authority citation for part 600 continues to read as follows:

Authority: 5 U.S.C. 561 and 16 U.S.C. 1801 *et seq.*

■ 2. Revise subpart Q to part 600 to read as follows:

Subpart Q—Vessel Monitoring System Type-Approval

§ 600.1500 Definitions and acronyms.

In addition to the definitions in the Magnuson-Stevens Act and in § 600.10, and the acronyms in § 600.15, the terms and acronyms in this subpart have the following meanings:

Authorized entity means a person, defined at 16 U.S.C. 1802(36), authorized to receive data transmitted by a VMS unit.

Bench configuration means the configuration of a VMS unit after it has been customized to meet the Federal VMS requirements.

Bundle means a mobile communications service and VMS unit sold as a package and considered one product. If a bundle is type-approved, the requestor will be the type-approval holder for the bundled MCS and VMS unit.

Cellular communication means the wireless transmission of VMS data via a cellular network.

Communication class means the satellite or cellular communications operator from which communications services originate.

Electronic form means a pre-formatted message transmitted by a VMS unit that is required for the collection of data for a specific fishery program (*e.g.,* declaration system, catch effort reporting).

Enhanced Mobile Transceiver Unit (EMTU) means a type of MTU that is capable of supporting two-way communication, messaging, and electronic forms transmission via satellite. An EMTU is a transceiver or communications device, including an antenna, and dedicated message terminal and display which can support a dedicated input device such as a tablet or keyboard, installed on fishing vessels participating in fisheries with a VMS requirement.

Enhanced Mobile Transceiver Unit, Cellular Based (EMTU-C) means an EMTU that transmits and receives data via cellular communications, except that it may not need a dedicated message terminal and display component at the time of approval as explained at § 600.1502(a)(6). An EMTU-C only needs to be capable of transmission and reception when in the range of a cellular network.

Latency means the state of untimely delivery of Global Positioning System position reports and electronic forms to NMFS (*i.e.,* information is not delivered to NMFS consistent with timing requirements of this subpart).

Mobile Communications Service (MCS) means the satellite and/or cellular communications services used with particular VMS units.

Mobile Communications Service Provider (MCSP) means an entity that sells VMS satellite and/or cellular communications services to end users.

Mobile Transmitter Unit (MTU) means a VMS unit capable of transmitting Global Positioning System position reports via satellite. (MTUs are no longer approved for new installations on VMS vessels).

Notification Letter means a letter issued by NMFS to a type-approval holder identifying an alleged failure of a VMS unit, MCS, or the type-approval holder to comply with the requirements of this subpart.

Position report means the unique global positioning system (GPS) report generated by a vessel's VMS unit, which identifies the vessel's latitude/longitude position at a point in time. Position reports are sent from the VMS unit via the MCS, to authorized entities.

Requestor means a vendor seeking type-approval.

Service life means the length of time during which a VMS unit remains fully operational with reasonable repairs.

Sniffing means the unauthorized and illegitimate monitoring and capture, through use of a computer program or device, of data being transmitted over a network.

Spoofing means the reporting of a false Global Positioning System position and/or vessel identity.

Time stamp means the time, in hours, minutes, and seconds in a position report. Each position report is time stamped.

Type-approval holder means an applicant whose type-approval request has been approved pursuant to this subpart.

Vendor means a commercial provider of VMS hardware, software, and/or mobile communications services.

Vessel Monitoring System (VMS) means, for purposes of this subpart, a satellite and/or cellular based system designed to monitor the location and movement of vessels using onboard VMS units that send Global Positioning System position reports to an authorized entity.

Vessel Monitoring System (VMS) data means the data transmitted to authorized entities from a VMS unit.

Vessel Monitoring System Program means the Federal program that manages the vessel monitoring system, data, and associated program-components, nationally and in each NMFS region; it is housed in the Department of Commerce, National Oceanic and Atmospheric Administration, National Marine Fisheries Service's Office of Law Enforcement.

Vessel Monitoring System (VMS) Unit means MTU, EMTU or EMTU-C, as well as the units that can operate as both an EMTU and an EMTU-C.

Vessel Monitoring System (VMS) Vessels means vessels that operate in federally managed fisheries with a requirement to carry and operate a VMS unit.

§ 600.1501 Vessel Monitoring System type-approval process.

(a) *Applicability.* Unless otherwise specified, this section applies to EMTUs, EMTU-Cs, units that operate as both an EMTU and EMTU-C, and MCSs. Units that can operate as both an EMTU and EMTU-C must meet the requirements for both an EMTU and an EMTU-C in order to gain type-approval as both. MTUs are no longer eligible for type-approval.

(b) *Application submission.* A requestor must submit a written type-approval request and electronic copies of supporting materials that include the information required under this section to the NMFS Office of Law Enforcement (OLE) at: U.S. Department of Commerce; National Oceanic and Atmospheric Administration; National Marine Fisheries Service; Office of Law Enforcement; Attention: Vessel Monitoring System Office; 1315 East-West Highway, SSMC3, Suite 3301, Silver Spring, Maryland 20910.

(c) *Application requirements.* (1) EMTU, EMTU-C, and MCS Identifying Information: In a type-approval request, the requestor should indicate whether the requestor is seeking approval for an EMTU, EMTU-C, MCS, or bundle and must specify identifying characteristics, as applicable: Communication class; manufacturer; brand name; model name; model number; software version and date; firmware version number and date; hardware version number and date; antenna type; antenna model number and date; tablet, monitor or terminal model number and date; MCS to be used in conjunction with the EMTU/EMTU-C; entity providing MCS to the end user; and current global and regional coverage of the MCS.

(2) Requestor-approved third party business entities: The requestor must provide the business name, address, phone number, contact name(s), email address, specific services provided, and geographic region covered for the following third party business entities:

(i) Entities providing bench configuration for the EMTU/EMTU-C at the warehouse or point of supply.

(ii) Entities distributing/selling the EMTU/EMTU-C to end users.

(iii) Entities currently approved by the requestor to install the EMTU/EMTU-C onboard vessels.

(iv) Entities currently approved by the requestor to offer a limited warranty.

(v) Entities approved by the requestor to offer a maintenance service agreement.

(vi) Entities approved by the requestor to repair or install new software on the EMTU/EMTU-C.

(vii) Entities approved by the requestor to train end users.

(viii) Entities approved by the requestor to advertise the EMTU/EMTU-C.

(ix) Entities approved by the requestor to provide other customer services.

(3) Regulatory Requirements and Documentation: In a type-approval request, a requestor must:

(i) Identify the NMFS region(s) and/or Federal fisheries for which the requestor seeks type-approval.

(ii) Include copies of, or citation to, applicable VMS regulations and requirements in effect for the region(s) and Federal fisheries identified under paragraph (c)(3)(i) of this section that require use of VMS.

(iii) Provide a table with the type-approval request that lists in one column each requirement set out in §§ 600.1502 through 600.1509 and regulations described under paragraph (c)(3)(ii) of this section. NMFS OLE will provide a template for the table upon request. The requestor must indicate in subsequent columns in the table:

(A) Whether the requirement applies to the type-approval; and

(B) Whether the EMTU, EMTU-C, MCS, or bundle meets the requirement.

(iv) Certify that the features, components, configuration and services of the requestor's EMTU/EMTU-C, MCS, or bundle comply with each requirement set out in §§ 600.1502 through 600.1509 and the regulations described under paragraph (c)(3)(ii) of this section.

(v) Certify that, if the request is approved, the requestor agrees to be responsible for ensuring compliance with each requirement set out in §§ 600.1502 through 600.1509 and the regulations described under paragraph (c)(3)(ii) of this section over the course of the type-approval period.

(vi) Provide NMFS OLE with two EMTU/EMTU-Cs loaded with forms and software, if applicable, for each NMFS region or Federal fishery, with activated MCS, for which a type-approval request is submitted for a minimum of 90 calendar days for testing and evaluation. For EMTU-Cs, the forms and software may be loaded onto a dedicated message terminal and display component to which the EMTU-C can connect. Copies of forms currently used by NMFS are available upon request. As part of its review, NMFS OLE may perform field tests and at-sea trials that involve demonstrating every aspect of EMTU/EMTU-C and communications operation. The requestor is responsible for all associated costs including paying for: Shipping of the EMTU/EMTU-C to the required NMFS regional offices and/or headquarters for testing; the MCS during the testing period; and shipping of the EMTU/EMTU-C back to the vendor.

(vii) Provide thorough documentation for the EMTU/EMTU-C and MCS, including: EMTU/EMTU-C fact sheets; installation guides; user manuals; any necessary interfacing software; MCS global and regional coverage; performance specifications; and technical support information.

(d) *Certification.* A requestor seeking type-approval of an EMTU/EMTU-C to operate with a class or type of communications, as opposed to type-approval for use with a specific MCS, shall certify that the EMTU/EMTU-C meets requirements under this subpart when using at least one MCSP within that class or type of communications.

(e) *Notification.* Unless additional time is required for EMTU/EMTU-C testing, NMFS OLE will notify the requestor within 90 days after receipt of a complete type-approval request as follows:

(1) If a request is approved or partially approved, NMFS OLE will provide notice as described under § 600.1510 and the type-approval letter will serve as official documentation and notice of

type-approval. OLE will publish and maintain the list of type-approved units on their Vessel Monitoring System web page.

(2) If a request is disapproved or partially disapproved:

(i) OLE will send a letter to the requestor that explains the reason for the disapproval/partial disapproval.

(ii) The requestor may respond to NMFS OLE in writing with additional information to address the reasons for disapproval identified in the NMFS OLE letter. The requestor must submit this response within 21 calendar days of the date of the OLE letter sent under paragraph (e)(2)(i) of this section.

(iii) If any additional information is submitted under paragraph (e)(2)(ii) of this section, NMFS OLE, after reviewing such information, may either take action under paragraph (e)(1) of this section or determine that the request should continue to be disapproved or partially disapproved. In the latter case, the NMFS OLE Director will send a letter to the requestor that explains the reasons for the continued disapproval/partial disapproval. The NMFS OLE Director's decision is final upon issuance of this letter and is not appealable.

§ 600.1502 Communications functionality.

(a) Unless otherwise specified, this subsection applies to all VMS units. Units that can operate as both an EMTU and EMTU-C must meet the requirements for both an EMTU and an EMTU-C in order to gain type-approval as both. The VMS unit must:

(1) Be able to transmit all automatically-generated position reports.

(2) Provide visible or audible alarms onboard the vessel to indicate malfunctioning of the VMS unit.

(3) Be able to disable non-essential alarms in non-Global Maritime Distress and Safety System (GMDSS) installations.

(4) EMTU/EMTU-Cs must be able to send communications that function uniformly throughout the geographic area(s) covered by the type-approval, except an EMTU-C only needs to be capable of transmission and reception when in the range of a cellular network.

(5) EMTU/EMTU-Cs must have two-way communications between the unit and authorized entities, via MCS, or be able to connect to a device that has two-way communications.

(6) EMTU/EMTU-Cs must be able to run or to connect to a dedicated message terminal and display component that can run software and/or applications that send and receive electronic forms and internet email messages for the purpose of complying with VMS reporting requirements in Federal fisheries. Depending on the reporting requirements for the fishery(s) in which the requester is seeking type-approval, an EMTU-C type-approval may not require the inclusion of a dedicated message terminal and display component at the time of approval, but the capability to support such a component must be shown.

(7) Have messaging and communications mechanisms that are completely compatible with NMFS vessel monitoring and surveillance software.

(b) In addition, messages and communications from a VMS unit must be able to be parsed out to enable clear billing of costs to the government and to the owner of a vessel or EMTU/EMTU-C, when necessary. Also, the costs associated with position reporting and the costs associated with other communications (for example, personal email or communications/reports to non-NMFS Office of Law Enforcement entities) must be parsed out and billed to separate parties, as appropriate.

§ 600.1503 Position report data formats and transmission.

Unless otherwise specified, this subsection applies to all VMS units, MCSs and bundles. Units that can operate as both an EMTU and EMTU-C must meet the requirements for both an EMTU and an EMTU-C in order to gain type-approval as both. To be type-approved in any given fishery, a VMS unit must also meet any additional positioning information as required by the applicable VMS regulations and requirements in effect for each fishery or region for which the type-approval applies. The VMS unit must meet the following requirements:

(a) Transmit all automatically-generated position reports, for vessels managed individually or grouped by fleet, that meet the latency requirement under § 600.1504.

(b) When powered up, must automatically re-establish its position reporting function without manual intervention.

(c) Position reports must contain all of the following:

(1) Unique identification of an EMTU/EMTU-C and clear indication if the unit is an EMTU-C.

(2) Date (year/month/day with century in the year) and time stamp (GMT) of the position fix.

(3) Date (year/month/day with century in the year) and time stamp (GMT) that the EMTU-C position report was sent from the EMTU-C.

(4) Position fixed latitude and longitude, including the hemisphere of each, which comply with the following requirements:

(i) The position fix precision must be to the decimal minute hundredths.

(ii) Accuracy of the reported position must be within 100 meters (328.1 ft).

(d) An EMTU/EMTU-C must have the ability to:

(1) Store 1,000 position fixes in local, non-volatile memory.

(2) Allow for defining variable reporting intervals between 5 minutes and 24 hours.

(3) Allow for changes in reporting intervals remotely and only by authorized users.

(e) An EMTU/EMTU-C must generate specially identified position reports upon:

(1) Antenna disconnection.

(2) Loss of positioning reference signals.

(3) Security events, power-up, power down, and other status data.

(4) A request for EMTU/EMTU-C status information such as configuration of programming and reporting intervals.

(5) The EMTUs loss of the mobile communications signals.

(6) An EMTU must generate a specially identified position report upon the vessel crossing of a pre-defined geographic boundary.

§ 600.1504 Latency requirement.

(a) Ninety percent of all pre-programmed or requested Global Positioning System position reports during each 24-hour period must reach NMFS within 15 minutes or less of being sent from the VMS unit, for 10 out of 11 consecutive days (24-hour time periods).

(b) NMFS will continually examine latency by region and by type-approval holder.

(c) Exact dates for calculation of latency will be chosen by NMFS. Days in which isolated and documented system outages occur will not be used by NMFS to calculate a type-approval holder's latency.

§ 600.1505 Messaging.

(a) Unless otherwise specified, this section applies to all VMS units, MCSs, and bundles. Units that can operate as both an EMTU and EMTU-C must meet the requirements for both an EMTU and an EMTU-C in order to gain type-approval as both. Depending on the reporting requirements for the fishery(s) in which the requester is seeking type-approval, an EMTU-C type-approval may not require the inclusion of a dedicated message terminal and display component at the time of approval, but the capability to support such a component must be shown. To be type-

approved in any given fishery, a VMS unit must meet messaging information requirements under the applicable VMS regulations and requirements in effect for each fishery or region for which the type-approval applies. The VMS unit must also meet the following requirements:

(b) An EMTU must be able to run software and/or applications that send email messages for the purpose of complying with VMS reporting requirements in Federal fisheries that require email communication capability. An EMTU-C must be able to run or connect to a device that can run such software and/or applications. In such cases, the EMTU/EMTU-C messaging must provide for the following capabilities:

(1) Messaging from vessel to shore, and from shore to vessel by authorized entities, must have a minimum supported message length of 1 KB. For EMTU-Cs, this messaging capability need only be functional when in range of shore-based cellular communications.

(2) There must be a confirmation of delivery function that allows a user to ascertain whether a specific message was successfully transmitted to the MCS email server(s).

(3) Notification of failed delivery to the EMTU/EMTU-C must be sent to the sender of the message. The failed delivery notification must include sufficient information to identify the specific message that failed and the cause of failure (*e.g.,* invalid address, EMTU/EMTU-C switched off, *etc.*).

(4) The EMTU/EMTU-C must have an automatic retry feature in the event that a message fails to be delivered.

(5) The EMTU/EMTU-C user interface must:

(i) Support an ''address book'' capability and a function permitting a ''reply'' to a received message without re-entering the sender's address.

(ii) Provide the ability to review by date order, or by recipient, messages that were previously sent. The EMTU/EMTU-C terminal must support a minimum message history of 50 sent messages—commonly referred to as an ''Outbox'' or ''Sent'' message display.

(iii) Provide the ability to review by date order, or by sender, all messages received. The EMTU/EMTU-C terminal must support a minimum message history of at least 50 messages in an inbox.

§ 600.1506 Electronic forms.

Unless otherwise specified, this subsection applies to all EMTUs, EMTU-Cs, MCSs, and bundles.

(a) *Forms.* An EMTU/EMTU-C must be able to run, or to connect to and transmit data from a device that can run electronic forms software. Depending on the reporting requirements for the fishery(s) in which the requester is seeking type-approval, an EMTU-C type-approval may not require the inclusion of a dedicated message terminal and display component at the time of approval, but the capability to support such a component must be shown. The EMTU/EMTU-C must be able to support forms software that can hold a minimum of 20 electronic forms, and it must also meet any additional forms requirements in effect for each fishery or region for which the type-approval applies. The EMTU/EMTU-C must meet the following requirements:

(1) Form Validation: Each field on a form must be capable of being defined as Optional, Mandatory, or Logic Driven. Mandatory fields are those fields that must be entered by the user before the form is complete. Optional fields are those fields that do not require data entry. Logic-driven fields have their attributes determined by earlier form selections. Specifically, a logic-driven field must allow for selection of options in that field to change the values available as menu selections on a subsequent field within the same form.

(2) A user must be able to select forms from a menu on the EMTU/EMTU-C.

(3) A user must be able to populate a form based on the last values used and ''modify'' or ''update'' a prior submission without unnecessary re-entry of data. A user must be able to review a minimum of 20 past form submissions and ascertain for each form when the form was transmitted and whether delivery was successfully sent to the type-approval holder's VMS data processing center. In the case of a transmission failure, a user must be provided with details of the cause and have the opportunity to retry the form submission.

(4) VMS Position Report: Each form must include VMS position data, including latitude, longitude, date and time. Data to populate these fields must be automatically generated by the EMTU/EMTU-C and unable to be manually entered or altered.

(5) Delivery and Format of Forms Data: Delivery of form data to NMFS must employ the same transport security and reliability as set out in § 600.1507 of this subpart. The forms data and delivery must be completely compatible with NMFS vessel monitoring software.

(b) *Updates to Forms.* (1) The EMTU/EMTU-C and MCS must be capable of providing updates to forms or adding new form requirements via wireless transmission and without manual installation.

(2) From time to time, NMFS may provide type-approved applicants with requirements for new forms or modifications to existing forms. NMFS may also provide notice of forms and form changes through the NMFS Work Order System. Type-approved applicants will be given at least 60 calendar days to complete their implementation of new or changed forms. Applicants will be capable of, and responsible for translating the requirements into their EMTU/EMTU-C-specific forms definitions and wirelessly transmitting the same to all EMTU/EMTU-C terminals supplied to fishing vessels.

§ 600.1507 Communications security.

Communications between an EMTU/EMTU-C and MCS must be secure from tampering or interception, including the reading of passwords and data. The EMTU/EMTU-C and MCS must have mechanisms to prevent to the extent possible:

(a) Sniffing and/or interception during transmission from the EMTU/EMTU-C to MCS.

(b) Spoofing.

(c) False position reports sent from an EMTU/EMTU-C.

(d) Modification of EMTU/EMTU-C identification.

(e) Interference with Global Maritime Distress and Safety System (GMDSS) or other safety/distress functions.

(f) Introduction of malware, spyware, keyloggers, or other software that may corrupt, disturb, or disrupt messages, transmission, and the VMS system.

(g) The EMTU/EMTU-C terminal from communicating with, influencing, or interfering with the Global Positioning System antenna or its functionality, position reports, or sending of position reports. The position reports must not be altered, corrupted, degraded, or at all affected by the operation of the terminal or any of its peripherals or installed-software.

(h) VMS data must be encrypted and sent securely through all associated cellular, satellite, and internet communication pathways and channels.

§ 600.1508 Field and Technical Services.

As a requirement of its type-approval, a type-approval holder must communicate with NMFS to resolve technical issues with a VMS Unit, MCS or bundle and ensure that field and technical services includes:

(a) Diagnostic and troubleshooting support to NMFS and fishers, which is available 24 hours a day, seven days per week, and year-round.

(b) Response times for customer service inquiries that shall not exceed 24 hours.

(c) Warranty and maintenance agreements.

(d) Escalation procedures for resolution of problems.

(e) Established facilities and procedures to assist fishers in maintaining and repairing their EMTU, EMTU-C, or MTU.

(f) Assistance to fishers in the diagnosis of the cause of communications anomalies.

(g) Assistance in resolving communications anomalies that are traced to the EMTU, EMTU-C, or MTU.

(h) Assistance to NMFS Office of Law Enforcement and its contractors, upon request, in VMS system operation, resolving technical issues, and data analyses related to the VMS Program or system.

§ 600.1509 General.

(a) *Durability.* An EMTU/EMTU-C must have the durability and reliability necessary to meet all requirements of §§ 600.1502 through 600.1507 regardless of weather conditions, including when placed in a marine environment where the unit may be subjected to saltwater (spray) in smaller vessels, and in larger vessels where the unit may be maintained in a wheelhouse. The unit, cabling and antenna must be resistant to salt, moisture, and shock associated with sea-going vessels in the marine environment.

(b) *PII and Other Protected Information.* Personally identifying information (PII) and other protected information includes Magnuson-Stevens Act confidential information as provided at 16 U.S.C. 1881a and Business Identifiable Information (BII), as defined in the Department of Commerce Information Technology Privacy Policy. A type-approval holder is responsible for ensuring that:

(1) All PII and other protected information is handled in accordance with applicable state and Federal law.

(2) All PII and other protected information provided to the type-approval holder by vessel owners or other authorized personnel for the purchase or activation of an EMTU/EMTU-C or arising from participation in any Federal fishery are protected from disclosure not authorized by NMFS or the vessel owner or other authorized personnel.

(3) Any release of PII or other protected information beyond authorized entities must be requested and approved in writing, as appropriate, by the submitter of the data in accordance with 16 U.S.C. 1881a, or by NMFS.

(4) Any PII or other protected information sent electronically by the type-approval holder to the NMFS Office of Law Enforcement must be transmitted by a secure means that prevents interception, spoofing, or viewing by unauthorized individuals.

§ 600.1510 Notification of type-approval.

(a) If a request made pursuant to § 600.1501 (type-approval) is approved or partially approved, NMFS will issue a type-approval letter to indicate the specific EMTU/EMTU-C model, MCSP, or bundle that is approved for use, the MCS or class of MCSs permitted for use with the type-approved EMTU, and the regions or fisheries in which the EMTU/EMTU-C, MCSP, or bundle is approved for use.

(b) The NMFS Office of Law Enforcement will maintain a list of type-approved EMTUs/EMTU-C, MCSPs, and bundles on a publicly available website and provide copies of the list upon request.

§ 600.1511 Changes or modifications to type-approvals.

Type-approval holders must notify NMFS Office of Law Enforcement (OLE) in writing no later than 2 days following modification to or replacement of any functional component or piece of their type-approved EMTU, EMTU-C, or MTU configuration, MCS, or bundle. If the changes are substantial, NMFS OLE will notify the type-approval holder in writing within 60 calendar days that an amended type-approval is required or that NMFS will initiate the type-approval revocation process.

§ 600.1512 Type-approval revocation process.

(a) If at any time, a type-approved EMTU/EMTU-C, MCS, or bundle fails to meet requirements at §§ 600.1502 through 600.1509 or applicable VMS regulations and requirements in effect for the region(s) and Federal fisheries for which the EMTU/EMTU-C or MCS is type-approved, or if an MTU fails to meet the requirements under which it was type-approved, OLE may issue a Notification Letter to the type-approval holder that:

(1) Identifies the MTU, EMTU, EMTU-C, MCS, or bundle that allegedly fails to comply with type-approval regulations and requirements;

(2) Identifies the alleged failure to comply with type-approval regulations and requirements, and the urgency and impact of the alleged failure;

(3) Cites relevant regulations and requirements under this subpart;

(4) Describes the indications and evidence of the alleged failure;

(5) Provides documentation and data demonstrating the alleged failure;

(6) Sets a response date by which the type-approval holder must submit to NMFS OLE a written response to the Notification Letter, including, if applicable, a proposed solution; and

(7) Explains the type-approval holder's options if the type-approval holder believes the Notification Letter is in error.

(b) NMFS will establish a response date between 30 and 120 calendar days from the date of the Notification Letter. The type-approval holder's response must be received in writing by NMFS on or before the response date. If the type-approval holder fails to respond by the response date, the type-approval will be revoked. At its discretion and for good cause, NMFS may extend the response date to a maximum of 150 calendar days from the date of the Notification Letter.

(c) A type-approval holder who has submitted a timely response may meet with NMFS within 21 calendar days of the date of that response to discuss a detailed and agreed-upon procedure for resolving the alleged failure. The meeting may be in person, conference call, or webcast.

(d) If the type-approval holder disagrees with the Notification Letter and believes that there is no failure to comply with the type-approval regulations and requirements, NMFS has incorrectly defined or described the failure or its urgency and impact, or NMFS is otherwise in error, the type-approval holder may submit a written objection letter to NMFS on or before the response date. Within 21 calendar days of the date of the objection letter, the type-approval holder may meet with NMFS to discuss a resolution or redefinition of the issue. The meeting may be in person, conference call, or webcast. If modifications to any part of the Notification Letter are required, then NMFS will issue a revised Notification Letter to the type-approval holder; however, the response date or any other timeline in this process would not restart or be modified unless NMFS decides to do so, at its discretion.

(e) The total process from the date of the Notification Letter to the date of final resolution should not exceed 180 calendar days, and may require a shorter timeframe, to be determined by NMFS, depending on the urgency and impact of the alleged failure. In rare circumstances, NMFS, at its discretion, may extend the time for resolution of the alleged failure. In such a case, NMFS will provide a written notice to the type-approval holder informing him

or her of the extension and the basis for the extension.

(f) If the failure to comply with type-approval regulations and requirements cannot be resolved through this process, the NMFS OLE Director will issue a Revocation Letter to the type-approval holder that:

(1) Identifies the MTU, EMTU, EMTU-C, MCS, or bundle for which type-approval is being revoked;

(2) Summarizes the failure to comply with type-approval regulations and requirements, including describing its urgency and impact;

(3) Summarizes any proposed plan, or attempts to produce such a plan, to resolve the failure;

(4) States that revocation of the MTU, EMTU, EMTU-C, MCS, or bundle's type-approval has occurred;

(5) States that no new installations of the revoked unit will be permitted in any NMFS-managed fishery requiring the use of VMS;

(6) Cites relevant regulations and requirements under this subpart;

(7) Explains why resolution was not achieved;

(8) Advises the type-approval holder that:

(i) The type-approval holder may reapply for a type-approval under the process set forth in § 600.1501, and

(ii) A revocation may be appealed pursuant to the process under § 600.1513.

§ 600.1513 Type-approval revocation appeals process.

(a) If a type-approval holder receives a Revocation Letter pursuant to § 600.1512, the type-approval holder may file an appeal of the revocation to the NMFS Assistant Administrator.

(b) An appeal must be filed within 14 calendar days of the date of the Revocation Letter. A type-approval holder may not request an extension of time to file an appeal.

(c) An appeal must include a complete copy of the Revocation Letter and its attachments and a written statement detailing any facts or circumstances explaining and refuting the failures summarized in the Revocation Letter.

(d) The NMFS Assistant Administrator may, at his or her discretion, affirm, vacate, or modify the Revocation Letter and send a letter to the type-approval holder explaining his or her determination, within 21 calendar days of receipt of the appeal. The NMFS Assistant Administrator's determination constitutes the final agency decision.

§ 600.1514 Revocation effective date and notification to vessel owners.

(a) Following issuance of a Revocation Letter pursuant to § 600.1512 and any appeal pursuant to § 600.1513, NMFS will provide notice to all vessel owners impacted by the type-approval revocation via letter and **Federal Register** notice. NMFS will provide information to impacted vessel owners on:

(1) The next steps vessel owners should take to remain in compliance with regional and/or national VMS requirements;

(2) The date, 60–90 calendar days from the notice date, on which the type-approval revocation will become effective;

(3) Reimbursement of the cost of a new type-approved EMTU/EMTU-C, should funding for reimbursement be available pursuant to § 600.1516.

§ 600.1515 Litigation support.

(a) All technical aspects of a type-approved EMTU, EMTU-C, MTU, MCS, or bundle are subject to being admitted as evidence in a court of law, if needed. The reliability of all technologies utilized in the EMTU, EMTU-C, MTU, MCS, or bundle may be analyzed in court for, inter alia, testing procedures, error rates, peer review, technical processes and general industry acceptance.

(b) The type-approval holder must, as a requirement of the holder's type-approval, provide technical and expert support for litigation to substantiate the EMTU/EMTU-C, MCS, or bundle capabilities to establish NMFS Office of Law Enforcement cases against violators, as needed. If the technologies have previously been subject to such scrutiny in a court of law, the type-approval holder must provide NMFS with a brief summary of the litigation and any court findings on the reliability of the technology.

(c) The type-approval holder will be required to sign a non-disclosure agreement limiting the release of certain information that might compromise the effectiveness of the VMS operations.

§ 600.1516 Reimbursement opportunities for revoked Vessel Monitoring System type-approval products.

(a) Subject to the availability of funds, vessel owners may be eligible for reimbursement payments for a replacement EMTU/EMTU-C if:

(1) All eligibility and process requirements specified by NMFS are met as described in NMFS Policy Directive 06–102; and

(2) The replacement type-approved EMTU/EMTU-C is installed on the vessel, and reporting to NMFS Office of Law Enforcement; and

(3) The type-approval for the previously installed EMTU/EMTU-C has been revoked by NMFS; or

(4) NMFS requires the vessel owner to purchase a new EMTU/EMTU-C prior to the end of an existing unit's service life.

(b) The cap for individual reimbursement payments is subject to change. If this occurs, NMFS Office of Law Enforcement will publish a notice in the **Federal Register** announcing the change.

[FR Doc. 2020–00675 Filed 1–23–20; 8:45 am]

BILLING CODE 3510–22–P

Notices

Federal Register
Vol. 85, No. 16
Friday, January 24, 2020

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

DEPARTMENT OF AGRICULTURE

Submission for OMB Review; Comment Request

January 21, 2020.

The Department of Agriculture has submitted the following information collection requirement(s) to OMB for review and clearance under the Paperwork Reduction Act of 1995, Public Law 104–13. Comments are requested regarding; whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; the accuracy of the agency's estimate of burden including the validity of the methodology and assumptions used; ways to enhance the quality, utility and clarity of the information to be collected; and ways to 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.

Comments regarding this information collection received by February 24, 2020 will be considered. Written comments should be addressed to: Desk Officer for Agriculture, Office of Information and Regulatory Affairs, Office of Management and Budget (OMB), *OIRA_Submission@omb.eop.gov* or fax (202) 395–5806 and to Departmental Clearance Office, USDA, OCIO, Mail Stop 7602, Washington, DC 20250–7602. Copies of the submission(s) may be obtained by calling (202) 720–8958.

An agency may not conduct or sponsor a collection of information unless the collection of information displays a currently valid OMB control number and the agency informs potential persons who are to respond to the collection of information that such persons are not required to respond to the collection of information unless it displays a currently valid OMB control number.

Food and Nutrition Service

Title: Supplemental Nutrition Assistance Program: Trafficking Controls and Investigations (Card Replacement Revision).

OMB Control Number: 0584–0587.

Summary of Collection: The Food and Nutrition Service (FNS) requires States agencies to issue a warning notice to withhold replacement electronic benefit transfer (EBT) cards or a warning notice for excessive EBT card replacements for individual members of a Supplemental Nutrition Assistance Program (SNAP) household requesting four EBT cards in a 12-month period. These notices are being issued to educate SNAP recipients on use of the EBT card and to deter fraudulent activity.

Need and Use of the Information: The data collected will be used for a variety of purposes, mainly statutory and regulatory compliance. The data is gathered at various times, ranging from monthly, quarterly, annual or final submissions. Without the information, FNS would be unable to ensure integrity or effectively monitor any over-issued, under-issued, or trafficking.

Description of Respondents: 238,644 Individuals/Households and 53 State, Local or Tribal Government.

Number of Respondents: 238,697.

Frequency of Responses: Reporting: Quarterly, Semi-annually, Monthly; Annually.

Total Burden Hours: 22,988.73.

Ruth Brown,

Departmental Information Collection Clearance Officer.

[FR Doc. 2020–01146 Filed 1–23–20; 8:45 am]

BILLING CODE 3410–30–P

DEPARTMENT OF AGRICULTURE

Forest Service

Proposed New Fee Sites

AGENCY: USDA, Forest Service.

ACTION: Notice of proposed fee increase and new fee sites.

SUMMARY: The Bridger-Teton National Forest is proposing to add two campgrounds and one guard station as fee sites. The campgrounds are currently in use by the public but had improvements made in the past years that justify a standard amenity fee. The proposed rental cabin is not open to the public currently, but would provide a recreation opportunity that is not currently offered in the area. A review of visitor use data and fee collection information for existing fee campgrounds and rental cabins on the Forest demonstrate public need and demand for the variety of recreation opportunities these facilities provide.

DATES: Comments will be accepted through February 1, 2020. New fees would go into effect May 2020; if possible.

ADDRESSES: Cindy Stein, Forest Recreation Program Manager, P.O. Box 419, Pinedale, WY 82941, or email to *cindy.stein@usda.gov* with ''BT Recreation Fee Proposal'' as the subject line. Comments will be taken until February 1, 2020.

FOR FURTHER INFORMATION CONTACT: Cindy Stein, Forest Recreation Program Manager, (307) 367–5717. Information about proposed fee changes can also be found on the Bridger-Teton National Forest website: *http://www.fs.usda.gov/btnf.*

SUPPLEMENTARY INFORMATION: The Federal Recreation Lands Enhancement Act (Title VII, Pub. L. 108–447) directed the Secretary of Agriculture to publish a six month advance notice in the **Federal Register** whenever new recreation fee areas are established. A market analysis indicates that the proposed fees are both reasonable and acceptable for the type of recreation experience they provide.

The fees are only proposed at this time, and will be determined upon further analysis and public comment. The following campgrounds and guard stations are included in this proposal for new fees:

Site name	Ranger district	Current fee	Proposed fee
Middle Piney Lake Campground	Big Piney		$10.00
Willow Lake Campground	Pinedale		10.00
Sagebrush Cowboy Cabin	Blackrock		40.00

Improvements have been made at all sites in the last 5 years including: Water system updates, new vault toilets, bear-resistant food storage and trash receptacles, and new flooring, windows, stoves, refrigerators, furniture, and heaters at guard stations. The proposed fees will provide for the increased operational costs, and continued operation and maintenance of the campgrounds and guard stations on all Districts. Fees collected from these sites will also be used for enhancing the recreation experience at the sites.

Once public involvement is complete, these new fees will be reviewed by a Recreation Resource Advisory Committee prior to a final decision and implementation. People wishing to reserve these cabins would need to do so through the National Recreation Reservation Service, at *www.recreation.gov* or by calling 1–877–444–6777 when it becomes available.

Dated: December 6, 2019.

Mary E. Farnsworth,

Acting Associate Deputy Chief, National Forest System.

[FR Doc. 2020–01117 Filed 1–23–20; 8:45 am]

BILLING CODE 3411–15–P

DEPARTMENT OF AGRICULTURE

National Agricultural Statistics Service

Notice of Intent To Request Revision and Extension of a Currently Approved Information Collection

AGENCY: National Agricultural Statistics Service, USDA.

ACTION: Notice and request for comments.

SUMMARY: In accordance with the Paperwork Reduction Act of 1995, this notice announces the intention of the National Agricultural Statistics Service (NASS) to request revision and extension of a currently approved information collection, the Agricultural Surveys Program. Revision to burden hours will be needed due to changes in the size of the target population, sampling design, and/or questionnaire length.

DATES: Comments on this notice must be received by March 24, 2020 to be assured of consideration.

ADDRESSES: • *Email: omboffi cer@nass.usda.gov.* Include the docket number above in the subject line of the message.

• *Efax:* (855) 838–6382.

• *Mail:* Mail any paper, disk, or CD–ROM submissions to: David Hancock, NASS Clearance Officer, U.S. Department of Agriculture, Room 5336 South Building, 1400 Independence Avenue SW, Washington, DC 20250–2024.

• *Hand Delivery/Courier:* Hand deliver to: David Hancock, NASS Clearance Officer, U.S. Department of Agriculture, Room 5336 South Building, 1400 Independence Avenue SW, Washington, DC 20250–2024.

FOR FURTHER INFORMATION CONTACT: Kevin L. Barnes, Associate Administrator, National Agricultural Statistics Service, U.S. Department of Agriculture, (202) 720–4333. Copies of this information collection and related instructions can be obtained without charge from David Hancock, NASS—OMB Clearance Officer, at (202) 690–2388 or at *omboffi cer@nass.usda.gov.*

SUPPLEMENTARY INFORMATION:

Title: Agricultural Surveys Program.

OMB Control Number: 0535–0213.

Expiration Date of Approval: June 30, 2020.

Type of Request: To revise and extend a currently approved information collection for a period of three years.

Abstract: The primary objective of the National Agricultural Statistics Service (NASS) is to collect, prepare and issue State and national estimates of crop and livestock production, prices and disposition as well as economic statistics, farm numbers, land values, on-farm pesticide usage, pest crop management practices, as well as the Census of Agriculture. The Agricultural Surveys Program contains a series of surveys that obtains basic agricultural data from farmers, ranchers, and feedlots throughout the Nation for preparing agricultural estimates and forecasts of crop acreage, yield, and production; stocks of grains and soybeans; hog and pig numbers; sheep inventory and lamb crop; cattle inventory; cattle on feed; grazing fees; and land values. Uses of the statistical information collected by these surveys are extensive and varied. Producers, farm organizations, agribusinesses, commodity exchanges, State and national farm policy makers, and government agencies are important users of these statistics. Agricultural statistics are used to plan and administer other related Federal and State programs in such areas as consumer protection, conservation, foreign trade, education, and recreation.

In December 2019, OMB approved a non-substantive change request to modify the Agricultural Land Value survey and the June Area Survey to make the land value questions easier for the respondents to complete. In the next three year cycle the only significant change being proposed to the surveys included in this docket will be in 2021 where NASS plans to add additional questions to the January Sheep and Goat Survey, and the Cattle Report to include questions regarding predator loss issues. These additional questions are being included under a cooperative agreement between NASS and the USDA, Animal and Plant Health Inspection Service (APHIS).

These data will be collected under the authority of 7 U.S.C. 2204(a). Individually identifiable data collected under this authority are governed by Section 1770 of the Food Security Act of 1985, as amended, 7 U.S.C. 2276, which requires USDA to afford strict confidentiality to non-aggregated data provided by respondents. This Notice is submitted in accordance with the Paperwork Reduction Act of 1995 Public Law 104–13 (44 U.S.C. 3501, *et seq.*) and Office of Management and Budget regulations at 5 CFR part 1320. NASS also complies with OMB Implementation Guidance, ''Implementation Guidance for Title V of the E-Government Act, Confidential Information Protection and Statistical Efficiency Act of 2002 (CIPSEA),'' **Federal Register**, Vol. 72, No. 115, June 15, 2007, p. 33362.

Estimate of Burden: Public reporting burden for this collection of information will range from 5 to 30 minutes per response.

Respondents: Farmers, Ranchers and Feed Lots.

Estimated Number of Respondents: 510,000.

Estimated Total Annual Burden on Respondents: 175,000 hours.

Comments: Comments are invited on: (a) 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;

(b) 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; (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 on those who are to respond, through the use of appropriate automated, electronic, mechanical, technological or other forms of information technology collection methods.

All responses to this notice will become a matter of public record and be summarized in the request for OMB approval.

Signed at Washington, DC, January 08, 2020.

Kevin L. Barnes,

Associate Administrator.

[FR Doc. 2020–01159 Filed 1–23–20; 8:45 am]

BILLING CODE 3410–20–P

DEPARTMENT OF COMMERCE

Bureau of Industry and Security

Order Temporarily Denying Export Privileges

Muhammad Kamran Wali, 1st Floor, Jahanzeb Center, Bank Road, Saddar, Rawalpindi, Pakistan
Muhammad Ahsan Wali, 4453 Weeping Willow Drive, Mississauga, Ontario, Canada
Haji Wali Muhammad Sheikh, 4453 Weeping Willow Drive, Mississauga, Ontario, Canada
Ahmed Waheed, 143 Wards Road, Ilford, Essex, United Kingdom
Ashraf Khan Muhammad, M/F 20 Pei Ho Street, Sham Shui Po, Kowloon, Hong Kong
Business World, 1st Floor, Jahanzeb Center, Bank Road, Saddar, Rawalpindi, Pakistan
Buziness World, 4453 Weeping Willow Drive, Mississauga, Ontario, Canada
Business World, 2nd Floor, Kau On Building, 251–253 Cheung Shaw Wan Road, Kowloon, Hong Kong
Industria Hong Kong Ltd, d/b/a Transcool Auto Air Conditioning Products, d/b/a Electro-Power Solutions, 2nd Floor, Kau On Building, 251–253 Cheung Shaw Wan Road, Kowloon, Hong Kong
Product Engineering, Unit 10, Chowk Gowalmandi, Daryabad, Gowalmandi, Rawalpindi, Punjab, Pakistan

I. Introduction and Background on the Parties

Pursuant to Section 766.24 of the Export Administration Regulations (the ''Regulations'' or ''EAR''),[1] the Bureau of Industry and Security (''BIS''), U.S. Department of Commerce, through its Office of Export Enforcement (''OEE''), has requested that I issue an order temporarily denying, for a period of 180 days, the export privileges of Muhammad Kamran Wali, Muhammad Ahsan Wali, Haji Wali Muhammad Sheikh, Ahmed Waheed, Ashraf Khan Muhammad, Business World (of Pakistan), Buziness World (of Canada), Business World (of Hong Kong), and Industria Hong Kong Ltd, d/b/a Transcool Auto Air Conditioning Products, d/b/a Electro-Power Solutions (collectively, ''Respondents'' and when only referring to natural persons ''individual Respondents''). OEE also has requested, pursuant to Sections 766.23 and 766.24 of the Regulations, that this order (''the TDO'') be applied to Product Engineering as a related person.

OEE has presented evidence that the Respondents have been operating an international procurement scheme to illegally obtain U.S.-origin items on behalf of two entities involved in nuclear and missile proliferation activities, the Pakistan Atomic Energy Commission (''PAEC'') and Pakistan's Advanced Engineering Research Organization (''AERO''), without the required BIS licenses. The PAEC and AERO have been on BIS's Entity List since November 1998, and September 2014, respectively, and a license is required for all items subject to the EAR for export, reexport or in-country transfer to the PAEC or AERO.[2]

Beginning in or around at least September 2014, the individual Respondents involved in the procurement scheme have used entities that they own, operate or control to undertake efforts to obtain U.S.-origin items, either directly or through transshipment via third countries, while masking that the items were intended for the PAEC and later for AERO. OEE's evidence indicates that members of the scheme concealed the fact that the PAEC and AERO were the true end users, including at times falsely identifying other entities in Pakistan as the end users, thereby causing unlicensed exports and the filing of false or misleading Electronic Export Information (''EEI'') in the Automated Export System (''AES''). In addition, these individual Respondents have regularly used the names of other companies or intermediaries on shipping documents, or had such entities pay for the U.S.-origin items through a third country, to further conceal the identity of the true end users from U.S. manufacturers and suppliers and U.S. law enforcement authorities. No BIS licenses were sought or obtained for any of the exports identified by OEE and described below.

Respondent Haji Wali Muhammad Sheikh, his sons Muhammad Kamran Wali and Muhammad Ahsan Wali, and business associates Ashraf Khan Muhammad and Ahmed Waheed, have each been charged with conspiracy to violate the International Emergency Economic Powers Act and conspiracy to violate the Export Control Reform Act of 2018 in an indictment returned in the U.S. District Court for the District of New Hampshire, which is being unsealed in conjunction with the issuance of this TDO. The Respondent-Defendants in that criminal case remain at large. Additionally, OEE's ongoing investigation of the Respondents shows that they continue to seek similar U.S.-origin items as recently as September 2019, underscoring OEE's concern that absent the issuance of a TDO, Respondents will continue to divert items to prohibited end users such as the PAEC and AERO. A review of EEI

[1] The Regulations, currently codified at 15 CFR parts 730–774 (2019), originally issued pursuant to the Export Administration Act (50 U.S.C. 4601–4623 (Supp. III 2015) (''EAA''), which lapsed on August 21, 2001. The President, through Executive Order 13222 of August 17, 2001 (3 CFR 2001 Comp. 783 (2002)), as extended by successive Presidential Notices, continued the Regulations in 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, 50 U.S.C. 4801–4852 (''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 orders, rules, regulations, and other forms of administrative action 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. Moreover, Section 1761(a)(5) of ECRA authorizes the issuance of temporary denial orders.

[2] The PAEC was originally added to the BIS Entity List, along with a number of other Pakistani government (and parastatal and private) entities involved in nuclear or missile activities, on November 19, 1998, shortly after Pakistan detonated a nuclear device. 63 FR 64322. Its current listing has remained unchanged since September 18, 2014. 15 CFR part 744, Supplement No. 4. All items subject to the EAR require a BIS license for export, reexport or in-country transfer to the PAEC. *Id.* AERO was originally added to the entity list on September 18, 2014. 79 FR 56003 (Sept. 18, 2014) (listing AERO on the Entity List for involvement in the procurement of sensitive U.S. technology in support of Pakistan's development of its missile and strategic unmanned aerial vehicle (UAV) programs). The listing was most recently revised on January 26, 2018. 83 FR 3580 (adding an alias and two additional addresses to the entry for AERO). 15 CFR part 744, Supplement No. 4. All items subject to the EAR require a BIS license for export, reexport or in-country transfer to AERO, and licenses are subject to a presumption of denial. *Id., see also* 15 CFR 744.11.

indicates that members of the scheme have obtained U.S.-origin items as recently as November 2019.

Named Individual Respondents and Related Entities

Set out below is an overview of the individual Respondents involved in the procurement scheme, their personal and business relationships with each other, and the entities and email accounts that they controlled and used in their efforts to unlawfully obtain U.S.-origin items for the PAEC and AERO.

Muhammad Kamran Wali (''Kamran'') is believed to be a citizen and resident of Pakistan. He is the owner of Business World, located in Rawalpindi, Pakistan (''Business World Pakistan''), which is believed to be related to or have business affiliations with Product Engineering. Kamran is the son of Respondent Haji Wali Muhammad Sheikh and the brother of Respondent Muhammad Ahsan Wali, discussed below. Typically, Kamran or Business World Pakistan received the underlying tender inquiry or other order from the PAEC or AERO. Kamran is believed to control and use the email addresses *buzinessworld@gmail.com* and *kamran@buzinessworld.com,* through which he communicates with both U.S. companies and procurement offices of the PAEC and AERO.

Muhammad Ahsan Wali (''Ahsan'') is believed to be a citizen and resident of Mississauga, Ontario, Canada. He is also believed to be a citizen of Pakistan. He is the son of Haji Wali Muhammad Sheikh and the brother of Respondent Kamran. Ahsan and his father Haji Wali Muhammad Sheikh are believed to control and use the email address *bzworld@hotmail.com.* Ahsan assisted in paying for exports from the United States and at least in one instance used a credit card in his name to pay for an order of U.S.-origin items.

Haji Wali Muhammad Sheikh (''Haji'') is a resident of Canada and a citizen of Pakistan. Haji is the owner of the Buziness World, located in Canada (''Buziness World Canada''). Respondents Kamran and Ahsan are his sons. Haji and his son Ahsan are believed to control and use the email address *bzworld@hotmail.com.* Buziness World Canada often appears as the payee in transactions and is at times listed as the shipper from the United States, even if it is not otherwise involved in the export.

Ashraf Khan Muhammad (''Khan'') is a resident of Hong Kong. His nationality is not known. He identifies himself as the owner of Business World, located in Hong Kong (''Business World Hong Kong''), and the corporate secretary of Industria Hong Kong Limited (''Industria Hong Kong''). Another company called Transcool Auto Air Conditioning Products of Hong Kong identifies as a branch of Business World Hong Kong. Khan is believed to control and use several email addresses, including *shakeelraza77@gmail.com* and *businessworldhk@hotmail.com.* He is a business associate of Kamran discussed above and Ahmed Waheed of Ilford, UK.

Ahmed Waheed (''Waheed'') is a resident of Ilford, England. He is a United Kingdom citizen. He was the owner of Business International GB Ltd of the United Kingdom, which is now dissolved. He is also the owner of Industria Hong Kong. Waheed is believed to control the email address *buzinessintl@gmail.com.* He is a business associate of Khan of Hong Kong, who also has interests in Industria Hong Kong.

II. Legal Standard

Pursuant to Section 766.24 of the Regulations, BIS may issue, on an *ex parte* basis, an order temporarily denying a respondent's export privileges upon a showing that the order is necessary in the public interest to prevent an ''imminent violation'' of the Regulations. 15 CFR 766.24(a)–(b). ''A violation may be 'imminent' either in time or degree of likelihood.'' 15 CFR 766.24(b)(3). BIS may show ''either that a violation is about to occur, or that the general circumstances of the matter under investigation or case under criminal or administrative charges demonstrate a likelihood of future violations.'' *Id.* As to the likelihood of future violations, BIS may show that the violation under investigation or charge ''is significant, deliberate, covert and/or likely to occur again, rather than technical or negligent[.]'' *Id.* A ''[l]ack of information establishing the precise time a violation may occur does not preclude a finding that a violation is imminent, so long as there is sufficient reason to believe the likelihood of a violation.'' *Id.*

Pursuant to Sections 766.23 and 766.24, a TDO also may be made applicable to other persons if BIS has reason to believe that they are related to a respondent and that applying the order to them is necessary to prevent its evasion. 15 CFR 766.23(a)–(b) and 766.24(c). A ''related person'' is a person, either at the time of the TDO's issuance or thereafter, who is related to a respondent ''by ownership, control, position of responsibility, affiliation, or other connection in the conduct of trade or business.'' 15 CFR 766.23(a).

III. Respondents Are Engaged in a Longstanding Conspiracy To Procure U.S.-Origin Items for the PAEC and AERO

OEE has presented evidence to show that the individual Respondents identified above used a series of entities to surreptitiously obtain U.S.-origin items on behalf of prohibited parties the PAEC and AERO without the required export licenses. As uncovered in this investigation, Kamran or Business World Pakistan received purchase orders or tender inquiries from the PAEC and AERO, and he or Business World Pakistan would either seek to obtain these items from U.S. suppliers, or engage other members of the procurement scheme to obtain the items either directly or through intermediary entities. The Respondents used a series of aliases and alternative shipping addresses to avoid detection by law enforcement and having the shipment flagged or questioned by the freight forwarder's export compliance program. The investigation uncovered a number of shipments using a similar pattern, though using slightly different entities or routes so as to escape suspicion and detection. The examples, as outlined in detail below, establish reasonable cause to believe that, despite the indictment, the Respondents will continue to operate this well-established and durable international procurement network for the PAEC and AERO absent action by this order.

A. Recent Transactions

Through its investigation, OEE has developed reasonable cause to believe that the Respondents and other members of the procurement network continue to obtain U.S.-origin items from U.S. companies in violation of U.S. law. Further, because the procurement channels change to avoid detection, a PAEC or AERO order may take several months for the procurement network to fulfill from a given U.S. company and even longer to ultimately reach the prohibited end users. Accordingly, the issuance of this TDO is necessary to stop transactions-in-progress and prevent U.S.-origin items from reaching prohibited end users. Moreover, the scheme is ongoing as OEE's investigation has uncovered that the Respondents continued to obtain items in 2018 as detailed below and have initiated the process to obtain additional U.S.-origin items in late 2019.

1. Company A Transaction

Company A is a manufacturer located in the United States. OEE's investigation indicates that from in or around January

2018 through in or around July 2018, Kamran of Business World Pakistan ordered U.S.-origin items for the PAEC's Heavy Mechanical Complex-3 (''HMC–3''). The evidence also establishes that Kamran continues to solicit U.S.-origin items for the same customer. Kamran made false statements in a purchase order, claiming that the items were intended for end use by MRI fielded rooms in various hospitals in Pakistan through a manufacturer named ''Precision Engineering Services'' in Islamabad, Pakistan. In fact, evidence indicates that the items were actually intended for end use by the PAEC.

Specifically, email correspondence dated February 7, 2018, reflects that Business World Pakistan (through email address *buzinessworld@gmail.com*) had received a tender order from HMC–3, which, according to the PAEC's website, is actually the PAEC's ''in house design, manufacturing, inspection, testing facilities.'' The tender order requested several items specifically manufactured by Company A. These were the same items that Business World Pakistan had sought in its purchase order to Company A on or about January 8, 2018, and had represented were for a hospital rather than a PAEC facility.

On or about April 19, 2018, Kamran of Business World Pakistan placed an order with Company A for the same items in the HMC–3 request. On or about April 20, 2018, Kamran of Business World Pakistan forwarded to Haji in Canada copies of the Company A's pro forma invoices and payment instructions.

About a week later, Haji in Canada made a wire transfer payment to Company A in the United States for $26,266 for the order with the HMC–3 items. The funds came from Buziness World Canada's account connected with Haji. When asked by Company A to explain the relationship between Buziness World Canada and Business World Pakistan, Kamran described the funds as coming from a ''proprietary'' account and the ''funds transfer have been made by them as a favour as we had returned money to customer and it will be repaid against delivery to us which we will settle with Buziness World Canada later.''

Business World Pakistan arranged for shipping from Company A, though the freight forwarder collecting the shipment from Company A listed the shipper as ''Buziness World Canada.'' Shipping records indicate that the items were sent from the United States to Pakistan in or about June 2018. Based on BIS's investigation, BIS has reasonable cause to believe that the U.S.-origin items were intended for the PAEC.

2. Company B Transaction

Company B is a manufacturer located in the United States. From at least in or around 2017 through in or around 2018, Kamran and others at Business World Pakistan contacted Company B to obtain U.S.-origin industrial safety equipment that BIS has reasonable cause to believe was intended for the Chasma Nuclear Power Project of the PAEC. These items included Foreign Material Exclusion or ''FME'' placards. The payments for these items were facilitated through middle parties, and the shipper was listed as Buziness World Canada, even though the order was exported directly from the United States to Pakistan.

On or about June 7, 2018, Kamran of Business World Pakistan contacted Company B regarding the delivery status of parts for its existing order of FME placards. The Company B representative responded the same day indicating that the company was still waiting for the delivery of parts.

Around the same time, Kamran of Business World Pakistan was also in contact with freight forwarder Airways Freight Pakistan to pick up the shipment from Company B's facilities in New Hampshire. In an email dated on or about June 21, 2018, Kamran provided his freight forwarder with contact information for the Company B representative. The freight forwarder subsequently provided a booking reference that identified the shipment as bound for Karachi with the shipper identified as Company B and the consignee as ''Business World'' Pakistan. The booking reference identified the commodity as ''safety tarps and supplies'' and the subject line included a reference to ''FMEZ.'' In response to this email from the freight forwarder with the booking reference, Kamran of Business World Pakistan requested that the shipper be changed from Company B to Buziness World Canada.

In an email dated August 2, 2018, a Business World Pakistan representative, who had been copied on the email to the freight forwarder, notified the procurement manager of the PAEC's Chasma Nuclear Power Project of delivery delays related to its purchase order and sought an extension of delivery time until August 31, 2018. Business World Pakistan attached to its email the bill of lading from its freight forwarder and referenced the same bill of lading as the one identified for Business World Pakistan's shipment from Company B. Business World Pakistan had sent its email to *procnpp3@gmail.com,* which is believed to be an email associated with the procurement arm of the Chasma Nuclear Power Project-3.

B. Historical Transactions

OEE's investigation revealed that the Respondents have, over a period of years, been engaged in a flexible procurement scheme in order to illegally route U.S.-origin items to Pakistan. OEE identified a number of prior export transactions where the Respondents' procurement network obscured the originator of the transaction by incorporating middle parties and alternative entities and destinations. OEE has demonstrated that the Respondents should be included in this TDO to prevent further diversion of U.S.-origin items to the prohibited parties the PAEC and AERO.

1. Unlicensed Export to AERO From Company C and Ties to Waheed and Hong Kong Company Transcool

Company C is a manufacturer located in the United States. On or about October 4, 2016, Company C of State College, Pennsylvania, sold electronics valued at $4,370 to a company in Beckley, West Virginia. These items were later transshipped through Hong Kong for ultimate export to AERO in Pakistan in fulfillment of a purchase order request made through Kamran of Business World Pakistan and routed through entities in the United Kingdom, United States, Hong Kong and ultimately Pakistan.

OEE's investigation uncovered that *buzinessworld@gmail.com,* an email account owned and controlled by Kamran of Business World Pakistan, received an AERO tender inquiry dated July 24, 2015, for items manufactured by Company C. In a purchase order dated March 10, 2016, Business World Pakistan requested the same items of Business International UK, a company that was owned and controlled by Waheed. Business International UK sent an invoice acknowledging the sales order on or about March 15, 2016. Thereafter, a company in the United States in Beckley, West Virginia, contacted Company C regarding obtaining the same items.

Although Business International UK requested the order and the items were ultimately exported via Hong Kong to Pakistan, the company in Beckley, West Virginia, was listed as the ''sold to'' and ''ship to'' party, and at this time BIS does not have evidence indicating that the company in Beckley, West Virginia, which is now dissolved, disclosed that the items were for export. OEE's investigation uncovered that the

shipment was sent to a freight forwarder in Hong Kong and a related invoice for the Company C items listed ''Transcool Auto Air Conditioning Products'' as the recipient at the same address as Business World Hong Kong and Industria Hong Kong. An invoice dated December 2, 2016, from Kamran of Business World Pakistan (using email address *businesworld.proc1@gmail.com*) to ''Khan'' at Business World Hong Kong (received at email address businessworldhk@hotmail), with a carbon copy to Waheed (to email address *buzinessintl@gmail.com*) included an invoice with the exact same Company C items in product code and quantity and in exactly the same order as in the AERO request. Based on these facts, BIS has reasonable cause to believe that the Respondents engaged in a scheme to transship items that were ultimately intended for delivery to AERO in Pakistan.

2. Unlicensed Exports to AERO From Company D and Ties to Business World Hong Kong, Business World Canada and Product Engineering in Pakistan

Company D is an electronics parts supplier located in the United States. A series of exports by Company D of Casselberry, Florida, highlight the variety of entities and transshipment routes used to export U.S.-origin items to AERO. Throughout 2016 and 2017, the procurement network used entities in Pakistan, Canada, and Hong Kong to fulfill orders for AERO. Company D identified several shipments to Business World entities in this time frame, and OEE's investigation uncovered the items were connected to purchase orders or other requests from either the PAEC or AERO. Examples of these transactions include:

- On or about March 5, 2016, Company D exported capacitors to Business World Hong Kong, with Business World Hong Kong listed on the invoice as the ''bill to'' and ''ship to'' party. Emails from Business World Hong Kong included those signed by ''M.A. Khan.'' OEE has reason to believe that this is the same Khan identified above in the list of Respondents. OEE's investigation identified an AERO tender dated July 2, 2015, and sent to *buzinessworld@gmail.com,* an email address believed to be controlled by Kamran of Business World Pakistan, that listed AERO as seeking the exact same product in the same quantity.
- On or about April 20, 2017, Company D exported U.S.-origin electronic components to Business World Pakistan. The related invoice identifying the ''bill to'' party as Business World Canada and the ''ship to'' party as Business World Pakistan. OEE's investigation identified an AERO purchase order to Business World Pakistan dated November 18, 2016, that includes the exact same ten items by part number in the same quantity and in exactly the same order as those listed on the Company D invoice.
- On or about July 20, 2017, Company D exported U.S.-origin semiconductors to Business World Canada. The invoice listed the ''bill to'' party as Buziness World Canada and the ''ship to'' party as Product Engineering in Pakistan. OEE's investigation identified an AERO purchase order dated September 22, 2016, to Business World Pakistan that includes the exact same 27 items by part number in the same quantity and in exactly the same order as those listed on the Company D invoice.

3. Unlicensed Export to the PAEC From Company E and Ties to Electro-Power Solutions and Industria Hong Kong

Company E is a supplier located in the United States. In another example, the procurement network used entities in Hong Kong, including the company name ''Electro-Power Solutions,'' to obtain items for the PAEC. Some common elements remained, however, such as oversight and direction by Kamran of Business World Pakistan and payment by Business World Canada.

On or about November 10, 2016, Company E of Brentwood, New Hampshire, exported cartridge heaters to Industria Hong Kong for an order placed by Electro-Power Solutions of Hong Kong, a company located at the same address as Business World Hong Kong and Industria Hong Kong. Kamran of Business World Pakistan, through his email address of *kamran@buzinessworld.com,* directed Business World Canada at *bzworld@hotmail.com* to make a wire transfer payment of $1,557.50 to Company E. OEE's investigation identified ''ICCC'' or the Instrumentation Control and Computer Complex, an arm of the PAEC, as requesting the U.S.-origin cartridge heaters from Kamran of Business World Pakistan based on an email dated July 25, 2016. A Business World Pakistan purchase order to ICCC dated December 30, 2016, confirms that the order was revised to 125 cartridge heaters, rather than 150, matching the Company E export.

4. Unlicensed Export to AERO From Company F and Ties to Business World Hong Kong and Ahsan

Company F is a manufacturer and distributor located in the United States. In another variation of Respondents' procurement scheme, Business World Canada used a credit card to pay for an order for AERO that was routed through middle parties in Hong Kong for ultimate transshipment to Pakistan.

On or about January 8, 2016, Company F of Las Vegas, Nevada, exported electronic connectors to Business World Hong Kong. The related invoice listed the ''ship to'' party as Business World Hong Kong and the ''bill to'' party as Business World Pakistan, though the actual payor was Ahsan of Business World Canada, who paid $9,846 using a credit card in his name. OEE's investigation identified an AERO tender dated June 8, 2015, with the exact same parts in the same quantity as in the Company F invoice; the AERO tender had been forwarded from the *buzinessworld@gmail.com* to others at Business World Pakistan. OEE's investigation also identified shipping documents where ''M.A. Khan'' of Business World Hong Kong reexported the items listed on the Company F invoice to Business World Pakistan on or about March 30, 2017. No license was obtained for the shipment since Business World Pakistan concealed the true end user.

IV. Ongoing Nature of Respondents' Procurement Scheme

BIS's investigation has uncovered that Respondents continue to seek U.S.-origin items from companies which they have previously obtained items on behalf of the PAEC and AERO, and with which they have an established business relationship. As recently as September 2019, Business World Hong Kong, using a well-established *modus operandi,* including the same email addresses and aliases used in prior efforts to illegally obtain U.S.-origin items for the PAEC, sought to obtain additional items from U.S. companies. Specifically, on or about April 12, 2019, Business World Hong Kong re-engaged the U.S. company to seek new items—picking up an earlier email exchange that had been used as part of the illegal procurement scheme on behalf of the PAEC. Not only was the means of engagement identical, Business World Hong Kong sought the same cartridge heaters as had been acquired previously. Further, based on OEE's review of the procurement scheme's prior transaction and the entities involved here, OEE has reasonable cause to believe that the current request is also for listed entities, the PAEC and AERO. Similarly, continuing through late 2019, Kamran contacted U.S. companies to obtain other U.S.-origin items that BIS has reasonable cause to believe are for listed entities, such as the PAEC and AERO, based on his prior transactions. These

transactions included payments from seemingly unrelated entities in third countries in a method similar to other transactions.

In sum, Respondents operated a well-developed procurement scheme for at least five years, designed to circumvent U.S. restrictions on exports of items to the PAEC and AERO based on their involvement in the proliferation of nuclear and missile technology. This scheme involved multinational entities and players located in at least three countries, the use of related and unrelated companies, changeable transshipment routes, and duplicitous methods of payment. Respondents themselves routinely generated false information to avoid detection of the scheme. In addition, on its own, the unsealing of the criminal indictment against the individual Respondents will not give the public sufficient notice of the individuals and entities involved in the ongoing procurement scheme. Thus, with the identification of the Respondents as set forth in this TDO, the undersigned expects to reduce the likelihood that U.S.-origin items will be exported, reexported or transferred to listed entities as part of the procurement scheme.

Based on the foregoing evidence, the scheme is durable and ongoing, and violations of the Regulations are thereby imminent.

V. Related Persons

Section 766.23 of the Regulations provides that in order to prevent evasion, TDOs ''may be made applicable not only to the respondent, but also to other persons then or thereafter related to the respondent by ownership, control, position of responsibility, affiliation, or other connection in the conduct of trade or business.'' 15 CFR 766.23(a). Related persons may be added to a TDO on an ex-parte basis in accordance with Section 766.23(b) of the Regulations. 15 CFR 766.23(b). The designation of Product Engineering's name and address as the ''ship to'' party in at least one transaction highlights that Respondents regularly used their affiliations and business relationships to obscure the true end user of an export of U.S.-origin items. Product Engineering is intertwined in its conduct of business with Kamran of Business World Pakistan, and as such is properly designated as a related person. As noted above, the Respondents regularly procured U.S.-origin items for the PAEC and AERO, and OEE uncovered evidence that U.S.-origin items shipped to Product Engineering were ultimately destined for the prohibited end users.

VI. Findings

I find that the evidence presented by BIS demonstrates that a violation of the Regulations is imminent in both time and degree of likelihood. The Respondents have engaged in knowing violations of the Regulations relating to the procurement of U.S.-origin items subject to the Regulations for export to persons on the BIS Entity List, at times via transshipment through Hong Kong, while providing false or misleading information regarding the ultimate consignee and final destination of the items to U.S. suppliers and/or the U.S. Government. Respondents structured and routed their transactions in a manner designed to conceal or obscure the destinations, end users, and/or end uses of the U.S.-origin items they procure, thereby attempting to avoid export control scrutiny and possible detection by U.S. law enforcement.

In sum, the facts and circumstances taken together, including the transshipment of U.S.-origin items, misrepresentations made in AES filings, and concerted actions of the Respondents, coupled with very recent activity employing the same *modus operandi,* provide strong indicators that violations likely are imminent absent the issuance of a TDO. Therefore, a TDO is needed to give notice to persons and companies in the United States and abroad that they should cease dealing with the Respondents in export transactions involving items subject to the EAR. Accordingly, I find that an order denying the export privileges of Muhammad Kamran Wali, Muhammad Ahsan Wali, Haji Wali Muhammad Sheikh, Ahmed Waheed, Ashraf Khan Muhammad, Business World (of Pakistan), Buziness World (of Canada), Business World (of Hong Kong), and Industria Hong Kong Ltd, d/b/a Transcool Auto Air Conditioning Products, d/b/a Electro-Power Solutions is necessary, in the public interest, to prevent an imminent violation of the EAR. Additionally, I find that Product Engineering meets the criteria set out in Section 776.23 and should be added to the TDO as a related person in order to prevent evasion.

This Order is being issued on an *ex parte* basis without a hearing based upon BIS's showing of an imminent violation in accordance with Sections 766.24 and 766.23(b) of the Regulations.

It is therefore ordered:

First, that MUHAMMAD KAMRAN WALI, with the last known address of 1st Floor Jahanzeb Center, Bank Road, Saddar, Rawalpindi, Pakistan; MUHAMMAD AHSAN WALI, with the last known address of 4453 Weeping Willow Drive, Mississauga, Ontario, Canada; HAJI WALI MUHAMMAD SHEIKH, with the last known address of 4453 Weeping Willow Drive, Mississauga, Ontario, Canada; AHMED WAHEED, with the last known address of 143 Wards Road, Ilford, Essex, United Kingdom; ASHRAF KHAN MUHAMMAD, M/F 20 Pei Ho Street, Sham Shui Po, Kowloon, Hong Kong; BUSINESS WORLD, with the last known address of 1st Floor Jahanzeb Center, Bank Road, Saddar, Rawalpindi, Pakistan; BUZINESS WORLD, with the last known address of 4453 Weeping Willow Drive, Mississauga, Ontario, Canada; BUSINESS WORLD, with the last known address of 2nd Floor, Kau On Building, 251–253 Cheung Shaw Wan Road, Kowloon, Hong Kong; INDUSTRIA HONG KONG LTD, d/b/a TRANSCOOL AUTO AIR CONDITIONING PRODUCTS, d/b/a ELECTRO-POWER SOLUTIONS, with the last known address of 2nd Floor, Kau On Building, 251–253 Cheung Shaw Wan Road, Kowloon, Hong Kong; and PRODUCT ENGINEERING, Unit 10, Chowk Gowalmandi, Daryabad, Gowalmandi, Rawalpindi, Punjab, Pakistan, and when acting for or on their behalf, any successors, assigns, directors, officers, employees, or agents (each a ''Denied Person'' and collectively the ''Denied Persons'') 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 Export Administration Regulations (''EAR''), or in any other activity subject to the EAR 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 EAR, or engaging in any other activity subject to the EAR; 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 EAR, or from any other activity subject to the EAR.

Second, that no person may, directly or indirectly, do any of the following:

A. Export or reexport to or on behalf of a Denied Person any item subject to the EAR;

B. Take any action that facilitates the acquisition or attempted acquisition by

a Denied Person of the ownership, possession, or control of any item subject to the EAR that has been or will be exported from the United States, including financing or other support activities related to a transaction whereby a 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 a Denied Person of any item subject to the EAR that has been exported from the United States;

D. Obtain from a Denied Person in the United States any item subject to the EAR 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 EAR that has been or will be exported from the United States and which is owned, possessed or controlled by a Denied Person, or service any item, of whatever origin, that is owned, possessed or controlled by a Denied Person if such service involves the use of any item subject to the EAR 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, that, after notice and opportunity for comment as provided in Section 766.23 of the EAR, any other person, firm, corporation, or business organization or entity related to Muhammad Kamran Wali, Muhammad Ahsan Wali, Haji Wali Muhammad Sheikh, Ahmed Waheed, Ashraf Khan Muhammad, Business World (of Pakistan), Buziness World (of Canada), Business World (of Hong Kong), and Industria Hong Kong Ltd 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 accordance with the provisions of Section 766.24(e) of the EAR, Muhammad Kamran Wali, Muhammad Ahsan Wali, Haji Wali Muhammad Sheikh, Ahmed Waheed, Ashraf Khan Muhammad, Business World (of Pakistan), Buziness World (of Canada), Business World (of Hong Kong), and Industria Hong Kong Ltd may, at any time, appeal this Order by filing a full written statement in support of the appeal with the Office of the Administrative Law Judge, U.S. Coast Guard ALJ Docketing Center, 40 South Gay Street, Baltimore, Maryland 21202–4022.

In accordance with the provisions of Sections 766.23(c)(2) and 766.24(e)(3) of the EAR, Product Engineering may, at any time, appeal its inclusion as a related person by filing a full written statement in support of the appeal with the Office of the Administrative Law Judge, U.S. Coast Guard ALJ Docketing Center, 40 South Gay Street, Baltimore, Maryland 21202–4022.

In accordance with the provisions of Section 766.24(d) of the EAR, BIS may seek renewal of this Order by filing a written request not later than 20 days before the expiration date. Muhammad Kamran Wali, Muhammad Ahsan Wali, Haji Wali Muhammad Sheikh, Ahmed Waheed, Ashraf Khan Muhammad, Business World (of Pakistan), Buziness World (of Canada), Business World (of Hong Kong), and Industria Hong Kong Ltd may oppose a request to renew this Order by filing a written submission with the Assistant Secretary for Export Enforcement, which must be received not later than seven days before the expiration date of the Order.

A copy of this Order shall be sent to Muhammad Kamran Wali, Muhammad Ahsan Wali, Haji Wali Muhammad Sheikh, Ahmed Waheed, Ashraf Khan Muhammad, Business World (of Pakistan), Buziness World (of Canada), Business World (of Hong Kong), Industria Hong Kong Ltd and Product Engineering, and shall be published in the **Federal Register.**

This Order is effective upon issuance and shall remain in effect for 180 days.

Dated: January 15, 2020.

Douglas Hassebrock,

Acting Assistant Secretary of Commerce for Export Enforcement.

[FR Doc. 2020–01118 Filed 1–23–20; 8:45 am]

BILLING CODE 3510–33–P

DEPARTMENT OF COMMERCE

Bureau of Industry and Security

[Case No. 18–BIS–0002]

Order Relating to Marjan Caby

In the Matter of: Marjan Caby, 8500 SW 109th Avenue, Apt. 211, Miami, FL 33173, et al., Respondents.

The Bureau of Industry and Security, U.S. Department of Commerce (''BIS''), has notified Marjan Caby, of Miami, Florida, that it has initiated an administrative proceeding against her pursuant to Section 766.3 of the Export Administration Regulations (the ''Regulations''),[1] through the issuance of a Charging Letter alleging that Marjan Caby, Ali Caby, Arash Caby, AW-Tronics LLC, (''AW-Tronics'') and Arrowtronic, LLC (''Arrowtronic'') (collectively, ''Respondents'') violated the Regulations as follows:

Charge 1 15 CFR 764.2(d)—Conspiracy

Beginning as early as in or about September 2013, and continuing through in or about March 2014, Respondents conspired and acted in concert with others, known and unknown, to bring about one or more acts that constitute a violation of the Regulations. The purpose and object of the conspiracy was to unlawfully export goods from the United States through transshipment points to Syria, including to Syrian Arab Airlines (''Syrian Air''), the flag carrier airline of Syria and a Specially Designated Global Terrorist (''SDGT''), and in doing so evade the prohibitions and licensing requirements of the Regulations and avoid detection by U.S. law enforcement.

Pursuant to Section 746.9 of the Regulations, a license is required for the export or reexport to Syria of all items subject to the Regulations, except food and medicine classified as EAR99. Furthermore, pursuant to Section 744.12 of the Regulations, a license is required to export or reexport items subject to the Regulations to SDGTs. Syrian Air was designated as an SDGT on May 16, 2013 (see 78 FR 32304, May 29, 2013), under authority granted to the Department of the Treasury by Executive Order 13,224, and was at all times pertinent hereto (and remains) listed as an SDGT. At all pertinent times, AW-Tronics and Arrowtronic were active limited liability companies incorporated in the State of Florida. Documentary evidence and

[1] The Regulations originally issued under the Export Administration Act of 1979, as amended, 50 U.S.C. 4601–4623 (Supp. III 2015) (''the EAA''), which lapsed on August 21, 2001. The President, through Executive Order 13222 of August 17, 2001 (3 CFR, 2001 Comp. 783 (2002)), which was extended by successive Presidential Notices, 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, 50 U.S.C. 4801–4852 (''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. The Regulations are currently codified in the Code of Federal Regulations at 15 CFR parts 730–774 (2018). The charged violation occurred in 2013–2014. The Regulations governing the violation at issue are found in the 2013–2014 versions of the Code of Federal Regulations (15 CFR parts 730–774 (2013–2014)). The 2019 Regulations set forth the procedures that apply to this matter.

email correspondence shows that AW-Tronics personnel represented to various transaction parties that AW-Tronics and Arrowtronic (collectively, ''AW-Tronics/Arrowtronic'') were the same company. Arash Caby was listed on Florida corporate records as a Managing Member of AW-Tronics at the time of the violations. From January 2014 until its most recent annual report in January 2017, Ali Caby was listed on Florida corporate records as the registered agent of AW-Tronics. AW-Tronics/Arrowtronic has maintained offices in Miami, Florida and Sofia, Bulgaria, as well as other locations.

As part of the conspiracy, the co-conspirators used electronic mail (email) and other forms of communication to communicate with each other between the United States, Bulgaria, United Arab Emirates (UAE), and Syria. Under their scheme, co-conspirators would purchase from U.S. suppliers or vendors items subject to the Regulations for export to Syrian Air in Syria, including aircraft parts and equipment, and would provide materially false or misleading documents and information to conceal the illegal exports. In furtherance of the conspiracy, they also would arrange for payment for the illegal exports to be made using third-party companies to transfer payments between the co-conspirators. Overall, between in or about September 2013 and in or about March 2014, Respondents engaged in multiple transactions with Syrian Air involving the export of aircraft parts and equipment subject to the Regulations from the Miami office of AW-Tronics/Arrowtronic to Syrian Air's transshipment point in Dubai, United Arab Emirates. These items were actually intended for, and some or all were ultimately delivered to, Syrian Air in Syria.

During the conspiracy, Ali Caby managed the Bulgaria office of AW-Tronics/Arrowtronic, while Arash Caby managed its Miami office, and Marjan Caby was its internal auditor. In furtherance of the conspiracy, each of these respondents exchanged numerous emails with other AW-Tronics/Arrowtronic employees authorizing or otherwise discussing the above-described exports to Syrian Air. These email communications included, for example, instructions that were designed to prevent U.S. law enforcement from detecting the unlawful exports to Syria and to allow them to continue by changing the routing of exports from AW-Tronics/Arrowtronic's Miami, Florida office. In March 2014, United States Customs and Border Protection seized a shipment of micro switches that, according to Electronic Export Information (EEI) filed in the Automated Export System, was destined for Syrian Air in the UAE, when, in fact, the ultimate destination was Syria. On March 5, 2014, Marjan Caby sent an email to AW-Tronics/Arrowtronic logistics employees, copying Alex Caby, that explained, ''We will . . . have packages stopped by the US Customs and Border Control [and] have a case file like this for the same client[,]'' and provided instructions stating, ''NOTHING WILL BE SHIPPED TO CLIENTS IN THE MIDDLE EAST FROM THE USA OFFICE. WE HAVE TO SEND TO BG [Bulgaria] THEN TO CLIENT.'' (Emphasis in original). ''SYRIA'' was specifically listed as one country for which Respondents would use Bulgaria as a transshipment point. (Same).

Caby, Arash Caby, a/k/a ''Axel'' Caby, Marjan Caby, AW-Tronics, LLC, and Arrowtronic, LLC violated Section 764.2(d) of the Regulations, for which they are jointly and severally liable.

Whereas, BIS and Marjan Caby have entered into a Settlement Agreement pursuant to Section 766.18(b) of the Regulations, whereby they agreed to settle this matter in accordance with the terms and conditions set forth therein;

Whereas, I have taken into consideration the plea agreement entered into by Marjan Caby with the U.S. Attorney's Office for the Southern District of Florida, and the sentence imposed against her following or upon the entry of her guilty plea and conviction (''the plea agreement and sentence''); and

Whereas, I have approved of the terms of the Settlement Agreement;

It is therefore ordered:

First, for the period of four (4) years from the date of this Order, Marjan Caby, with a last known address of 8500 SW 109th Avenue, Apt. 211, Miami, FL 33173, and when acting for or on her behalf, her successors, assigns, representatives, agents, or employees (hereinafter collectively referred to as 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 to or to be exported from the United States that is subject to the Regulations, or in any other activity 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, any licenses issued under the Regulations in which Marjan Caby has an interest as of the date of this Order shall be revoked by BIS.

Fourth, after notice and opportunity for comment as provided in Section 766.23 of the Regulations, any person, firm, corporation, or business organization related to the Denied Person by affiliation, ownership, control, or position of responsibility in the conduct of trade or related services

may also be made subject to the provisions of the Order.

Fifth, Marjan Caby shall not take any action or make or permit to be made any public statement, directly or indirectly, denying the allegations in the Charging Letter or this Order.

Sixth, the Charging Letter, the Settlement Agreement, and this Order shall be made available to the public.

Seventh, this Order shall be served on Marjan Caby and shall be published in the **Federal Register**.

This Order, which constitutes the final agency action in this matter related to Marjan Caby, is effective immediately.

Issued this 17th day of January, 2020.

Douglas R. Hassebrock,

Acting Assistant Secretary of Commerce for Export Enforcement.

[FR Doc. 2020–01177 Filed 1–23–20; 8:45 am]

BILLING CODE P

DEPARTMENT OF COMMERCE

National Oceanic and Atmospheric Administration

[RTID 0648–XR049]

Takes of Marine Mammals Incidental to Specified Activities; Taking Marine Mammals Incidental to Construction Activities for the Statter Harbor Improvement Project

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

ACTION: Notice; issuance of an incidental harassment authorization.

SUMMARY: In accordance with the regulations implementing the Marine Mammal Protection Act (MMPA) as amended, notification is hereby given that NMFS has issued an incidental harassment authorization (IHA) to the City of Juneau to incidentally harass, by Level A and Level B harassment only, marine mammals during construction activities associated with the Statter Harbor improvement project in Auke Bay, Alaska.

DATES: This authorization is effective from October 1, 2020 to September 30, 2021.

FOR FURTHER INFORMATION CONTACT: Sara Young, Office of Protected Resources, NMFS, (301) 427–8401. Electronic copies of the application and supporting documents, as well as a list of the references cited in this document, may be obtained online at: *https://www.fisheries.noaa.gov/permit/incidental-take-authorizations-under-marine-mammal-protection-act.* In case of problems accessing these documents, please call the contact listed above.

SUPPLEMENTARY INFORMATION:

Background

The MMPA prohibits the ''take'' of marine mammals, with certain exceptions. Sections 101(a)(5)(A) and (D) of the MMPA (16 U.S.C. 1361 *et seq.*) direct the Secretary of Commerce (as delegated to NMFS) to allow, upon request, the incidental, but not intentional, taking of small numbers of marine mammals by U.S. citizens who engage in a specified activity (other than commercial fishing) within a specified geographical region if certain findings are made and either regulations are issued or, if the taking is limited to harassment, a notice of a proposed incidental take authorization may be provided to the public for review.

Authorization for incidental takings shall be granted if NMFS finds that the taking will have a negligible impact on the species or stock(s) and will not have an unmitigable adverse impact on the availability of the species or stock(s) for taking for subsistence uses (where relevant). Further, NMFS must prescribe the permissible methods of taking and other ''means of effecting the least practicable adverse impact'' on the affected species or stocks and their habitat, paying particular attention to rookeries, mating grounds, and areas of similar significance, and on the availability of such species or stocks for taking for certain subsistence uses (referred to in shorthand as ''mitigation''); and requirements pertaining to the mitigation, monitoring and reporting of such takings are set forth.

The definitions of all applicable MMPA statutory terms cited above are included in the relevant sections below.

Summary of Request

On April 15, 2019, NMFS received a request from the City of Juneau for an IHA to take marine mammals incidental to construction activities at Statter Harbor in Auke Bay, Alaska. The application was deemed adequate and complete on September 26, 2019. The City of Juneau's request is for take of a small number of eight species of marine mammals, by Level B harassment and Level A harassment. Neither the City of Juneau nor NMFS expects serious injury or mortality to result from this activity and, therefore, an IHA is appropriate.

NMFS previously issued an IHA to the City of Juneau for related work (84 FR 11066; March 25, 2019), which covers the first phase of activities (dredging, blasting, pile removal) and is effective from October 1, 2019 to September 30, 2020. The City of Juneau has not yet conducted any work under the previous IHA and therefore no monitoring results are available at the time of writing.

This IHA covers one year of a larger project for which the City of Juneau obtained one prior IHA. The larger multi-year project involves several harbor improvement projects including dismantling and demolition of existing docks, construction of a mechanically stabilized earth wall, and installation of concrete floats.

Description of Specified Activity

Overview

The harbor improvements described in the application include installation of timber floats supported by 20 16-inch steel pipe piles, installation of a gangway, replacement of piles supporting a transient float, and removal of temporary fill that will be placed under the first IHA and construction of the permanent mechanically stabilized earth (MSE) wall.

Dates and Duration

The activities are expected to occur between October 1, 2020 and May 1, 2021 but the IHA will be valid for one year to account for any delays in the construction timeline. In winter months, shorter 8-hour to 10-hour workdays in available daylight are anticipated. To be conservative, 12-hour work days were assumed for the purposes of analysis in this notice.

Specific Geographic Region

The activities will occur at Statter Harbor in Auke Bay, Alaska which is in the southeast portion of the state. See Figure 3 in the application for detailed maps of the project area. Statter Harbor is located at the most northeasterly point of Auke Bay.

Detailed Description of Specific Activity

New infrastructure to be installed includes 9,136 square feet (848.8 square meters) of timber floats supported by twenty (20) 16-inch (4.1-decimeter) diameter steel pipe piles, an 10-foot by 100-foot gangway (3-meters by 30.5-meters), removal of the temporary surcharge fill and construction of the permanent MSE wall. In addition to the new infrastructure, three existing piles will be repaired. The previously installed temporary piles will be removed with a crane or vibratory hammer and reinstalled with rock sockets to provide sufficient moorage capacity for the float.

Pile driving/removal will be conducted from a floating barge, utilizing a drill to install rock sockets and a vibratory hammer to install piles. Use of impact hammers is not anticipated, and will only be used for piles that encounter soils too dense to penetrate with the vibratory equipment. Due to the substrate in the harbor, it is anticipated all of the piles will require drilling for rock sockets, referred to in this notice as down the hole drilling. The drilling will likely occur midway through vibratory installation of a pile and will occur on the same day the pile is being driven. A summary of the number and type of piles planned to be driven is included in Table 1 below.

TABLE 1—PILE DRIVING AND REMOVAL SUMMARY

Activity	Number piles	Pile size/type	Method	Average piles day [1] (Range)	Driving days	Strike/pile or minutes/pile	Estimated total daily duration
Pile Removal	3	16-inch (4.1-decimeter) Steel Pipe	Vibratory	3	1	30	12 hours/500 strikes.
Pile Installation	23		Vibratory	1.5 (1–3)	8–23	120	
			Impact	1 (0–2)		250	
			Drilling	1.5 (1–3)		240	

A detailed description of the planned construction project is provided in the **Federal Register** notice for the proposed IHA (84 FR 55920; October 18, 2019). Since that time, no changes have been made to the planned pile driving and removal activities. Therefore, a detailed description is not provided here. Please refer to that **Federal Register** notice for the description of the specific activity.

Required mitigation, monitoring, and reporting measures are described in detail later in this document (please see *Mitigation* and *Monitoring and Reporting*).

Comments and Response

A notice of NMFS's proposal to issue an IHA to the City of Juneau was published in the **Federal Register** on October 18, 2019 (84 FR 55920). That notice described, in detail, the City of Juneau's activity, the marine mammal species that may be affected by the activity, and the anticipated effects on marine mammals. During the 30-day public comment period, NMFS received comments from the Marine Mammal Commission outlined below.

Comment: The Commission recommended that NMFS ensure that the City keeps a running tally of the total takes, both observed and extrapolated takes for each species, as the activity could continue into periods of low visibility and the entirety of the Level B harassment zone would not be visible to observers.

Response: We agree that the City of Juneau must ensure they do not exceed authorized takes. We have included in the authorization that the City of Juneau must include extrapolation of the estimated takes by Level B harassment based on the number of observed exposures within the Level B harassment zone and the percentage of the Level B harassment zone that was not visible in the draft and final reports.

Comment: The Commission questioned whether the public notice provision, for IHA renewals, including the 15-day comment period, fully satisfy the public notice and comment provision in the MMPA. The Commission also noted the potential burden on reviewers of reviewing key documents and developing comments quickly. Therefore the Commission recommended that NMFS refrain from using the proposed renewal process for the City's authorization. The Commission also recommended that NMFS use the IHA Renewal process sparingly and selectively for activities expected to have the lowest levels of impacts to marine mammals and that require less complex analysis. The Commission's final recommendation to NMFS was to provide the Commission and other reviewers the full 30-day comment period as set forth in section 101(a)(5)(D)(iii) of the MMPA.

Response: We appreciate the Commission's input and direct the reader to our recent response to a similar comment, which can be found at 84 FR 52464 (October 2, 2019; 84 FR 52466).

Comment: The Commission recommended that, prior to issuing an IHA for year 2 of Statter Harbor construction activities, NMFS determine whether it can make its determinations regarding small numbers, negligible impact, and unmitigable adverse impact on subsistence use regarding the total taking of each species or stock on the authorizations of Statter Harbor Year 1 and Year IHAs combined. If NMFS cannot make those determinations, the Commission recommended NMFS refrain from issuing a Phase 1 renewal without issuing a coincident one-year delay for the Phase 2 authorization.

Response: NMFS disagrees with the Commission's assertion that our statutorily required determinations must be made on the cumulative analyses of both IHAs issued to Statter Harbor. The phases of construction are separate entities and intended to occur in sequential order, although operational delays could realign the timing such that the construction does not occur as far apart temporally as originally expected. The IHA requests were submitted separately and have been analyzed separately as they are independent actions and NMFS is not required to consider cumulative effects of other issued IHAs to make our determinations under the MMPA. We do consider overall context-specific criteria such as the likely nature of any response by marine mammals, the context of any responses as well as the likelihood of mitigation.

Changes From Proposed to Final IHA

No significant changes were made from the proposed to final IHA. Several typos were corrected, including addressing errors in Tables 5 and 6 of the Proposed and Final Notice of IHA. A typo in the harbor seal take estimation has been corrected from an estimate of 121 to 122 harbor seals per day. Similarly, calculation of take by Level A harassment for harbor seals was corrected to 276 from 253, as we incorrectly used 11 and not 12 seals per day for our calculation. This adjustment does not alter our findings or determinations presented in the notice of proposed issuance of an IHA. Group size of Dall's porpoise has been adjusted from two to four individuals, based on Navy data provided by the MMC, resulting in authorization of 24 incidents of Level A harassment 24 Dall's porpoise. Updated take numbers are reflected in Table 7 below. After input from the Marine Mammal Commission and discussion with the applicant, the shutdown zone for harbor seals from impact driving has been adjusted to 25 meters from the 100 meters included in the notice of proposed IHA (Table 8) to ensure that the City of Juneau can complete the work within the timeline described and

avoid impracticable shutdowns for frequently occurring resident pinnipeds.

Description of Marine Mammals in the Area of Specified Activities

Eight species of marine mammal have been documented in southeast Alaska waters in the vicinity of Statter Harbor. These species are: Harbor seal, harbor porpoise, Dall's porpoise, killer whale, humpback whale, minke whale, California sea lion, and Steller sea lion. Of these species, only three are known to occur in Statter Harbor regularly: Harbor seal, Steller sea lion, and humpback whale.

Sections 3 and 4 of the application summarize available information regarding status and trends, distribution and habitat preferences, and behavior and life history, of the potentially affected species. Additional information regarding population trends and threats may be found in NMFS's Stock Assessment Reports (SARs; *https://www.fisheries.noaa.gov/national/marine-mammal-protection/marine-mammal-stock-assessments)* and more general information about these species (*e.g.,* physical and behavioral descriptions) may be found on NMFS's website (*https://www.fisheries.noaa.gov/find-species*).

Table 2 lists all species with expected potential for occurrence in Statter Harbor and summarizes information related to the population or stock, including regulatory status under the MMPA and ESA and potential biological removal (PBR), where known. For taxonomy, we follow Committee on Taxonomy (2018). PBR is defined by the MMPA as the maximum number of animals, not including natural mortalities, that may be removed from a marine mammal stock while allowing that stock to reach or maintain its optimum sustainable population (as described in NMFS's SARs). While no mortality is anticipated or authorized here, PBR and annual serious injury and mortality from anthropogenic sources are included here as gross indicators of the status of the species and other threats.

Marine mammal abundance estimates presented in this document represent the total number of individuals that make up a given stock or the total number estimated within a particular study or survey area. NMFS's stock abundance estimates for most species represent the total estimate of individuals within the geographic area, if known, that comprises that stock. For some species, this geographic area may extend beyond U.S. waters. All managed stocks in this region are assessed in NMFS's U.S. Alaska Region and Pacific Region SARs (Carretta *et al.,* 2019; Muto *et al.,* 2019). All values presented in Table 2 are the most recent available at the time of publication and are available in the 2018 SARs (Carretta *et al.,* 2019; Muto *et al.,* 2019).

TABLE 2—SPECIES WITH THE POTENTIAL TO OCCUR IN STATTER HARBOR

Common name	Scientific name	Stock	ESA/MMPA status; Strategic (Y/N) [1]	Stock abundance (CV, N_{min}, most recent abundance survey) [2]	PBR	Annual M/SI [3]
Order Cetartiodactyla—Cetacea—Superfamily Mysticeti (Baleen Whales)						
Family Balaenopteridae (rorquals):						
Humpback whale	Megaptera noveangliae	Central North Pacific	E, D,Y	10,103 (0.3, 7,891, 2006)	83	26
Minke whale	Balaenoptera acutorostrata	Alaska	-;N	N/A	Und	0
Superfamily Odontoceti (Toothed Whales, Dolphins, and Porpoises)						
Family Delphinidae:						
Killer whale	Orcinus orca	Alaska Resident	-;N	2,347 (N/A, 2,347, 2012)	24	1
Killer whale	Orcinus orca	Northern Resident	-;N	261 (N/A, 261, 2011)	1.96	0
Killer whale	Orcinus orca	Gulf of Alaska transient	-;N	587 (N/A, 587, 2012)	5.87	1
Killer whale	Orcinus orca	West Coast Transient	-;N	243 (N/A, 243, 2009)	2.4	0
Family Phocoenidae (porpoises):						
Harbor porpoise	Phocoena phocoena	Southeast Alaska	-; Y	975 (0.14, 872, 2012)	8.7	34
Dall's porpoise	Phocoenoides dalli	Alaska	-;N	83,400 (0.097, N/A, 1991).	Und	38
Order Carnivora—Superfamily Pinnipedia						
Family Otariidae (eared seals and sea lions):						
California sea lion	*Zalophus califonrianus*	U.S.	-;N	257,606 (N/A, 233,515, 2014).	14,011	197
Steller sea lion	Eumetopias jubatus	Western DPS	E/D; Y	54,267 (N/A; 54,267, 2017).	326	252
Steller sea lion	Eumetopias jubatus	Eastern DPS	T/D; Y	41,638 (N/A, 41,638, 2015).	2498	108
Family Phocidae (earless seals):						
Harbor seal	Phoca vitulina	Lynn Canal	-; N	9,478 (N/A, 8,605, 2011)	155	50

[1] Endangered Species Act (ESA) status: Endangered (E), Threatened (T)/MMPA status: Depleted (D). A dash (-) indicates that the species is not listed under the ESA or designated as depleted under the MMPA. Under the MMPA, a strategic stock is one for which the level of direct human-caused mortality exceeds PBR or which is determined to be declining and likely to be listed under the ESA within the foreseeable future. Any species or stock listed under the ESA is automatically designated under the MMPA as depleted and as a strategic stock.

[2] NMFS marine mammal stock assessment reports online at: *https://www.fisheries.noaa.gov/national/marine-mammal-protection/marine-mammal-stock-assessments.* CV is coefficient of variation; Nmin is the minimum estimate of stock abundance. In some cases, CV is not applicable.

[3] These values, found in NMFS's SARs, represent annual levels of human-caused mortality plus serious injury from all sources combined (*e.g.,* commercial fisheries, ship strike). Annual M/SI often cannot be determined precisely and is in some cases presented as a minimum value or range.

All species that could potentially occur in the action areas are included in Table 2. As described below, all eight species (with eleven managed stocks) temporally and spatially co-occur with the activity to the degree that take is reasonably likely to occur, and we have authorized it.

A detailed description of the of the species likely to be affected by the Statter Harbor project, including brief introductions to the species and relevant stocks as well as available information regarding population trends and threats, and information regarding local occurrence, were provided in the **Federal Register** notice for the proposed IHA (84 FR 55920; October 18, 2019); since that time, we are not aware of any changes in the status of these species and stocks; therefore, detailed descriptions are not provided here. Please refer to that **Federal Register** notice for these descriptions. Please also refer to NMFS' website (*https://www.fisheries.noaa.gov/find-species*) for generalized species accounts.

Marine Mammal Hearing

Hearing is the most important sensory modality for marine mammals underwater, and exposure to anthropogenic sound can have deleterious effects. To appropriately assess the potential effects of exposure to sound, it is necessary to understand the frequency ranges marine mammals are able to hear. Current data indicate that not all marine mammal species have equal hearing capabilities (*e.g.,* Richardson *et al.,* 1995; Wartzok and Ketten, 1999; Au and Hastings, 2008). To reflect this, Southall *et al.* (2007) recommended that marine mammals be divided into functional hearing groups based on directly measured or estimated hearing ranges on the basis of available behavioral response data, audiograms derived using auditory evoked potential techniques, anatomical modeling, and other data. Note that no direct measurements of hearing ability have been successfully completed for mysticetes (*i.e.,* low-frequency cetaceans).

Subsequently, NMFS (2018) described generalized hearing ranges for these marine mammal hearing groups. Generalized hearing ranges were chosen based on the approximately 65 decibel (dB) threshold from the normalized composite audiograms, with the exception for lower limits for low-frequency cetaceans where the lower bound was deemed to be biologically implausible and the lower bound from Southall *et al.* (2007) retained. Marine mammal hearing groups and their associated hearing ranges are provided in Table 3.

TABLE 3—MARINE MAMMAL HEARING GROUPS

[NMFS, 2018]

Hearing group	Generalized hearing range *
Low-frequency (LF) cetaceans (baleen whales)	7 Hz to 35 kHz.
Mid-frequency (MF) cetaceans (dolphins, toothed whales, beaked whales, bottlenose whales)	150 Hz to 160 kHz.
High-frequency (HF) cetaceans (true porpoises, *Kogia,* river dolphins, cephalorhynchid, *Lagenorhynchus cruciger* & *L. australis*).	275 Hz to 160 kHz.
Phocid pinnipeds (PW) (underwater) (true seals)	50 Hz to 86 kHz.
Otariid pinnipeds (OW) (underwater) (sea lions and fur seals)	60 Hz to 39 kHz.

* Represents the generalized hearing range for the entire group as a composite (*i.e.,* all species within the group), where individual species' hearing ranges are typically not as broad. Generalized hearing range chosen based on ~65 dB threshold from normalized composite audiogram, with the exception for lower limits for LF cetaceans (Southall *et al.,* 2007) and PW pinniped (approximation).

The pinniped functional hearing group was modified from Southall *et al.* (2007) on the basis of data indicating that phocid species have consistently demonstrated an extended frequency range of hearing compared to otariids, especially in the higher frequency range (Hemilä *et al.,* 2006; Kastelein *et al.,* 2009; Reichmuth and Holt, 2013).

For more detail concerning these groups and associated frequency ranges, please see NMFS (2018) for a review of available information. Eight marine mammal species (five cetacean and three pinniped (two otariid and one phocid) species) have the reasonable potential to co-occur with the construction activities. Please refer to Table 2. Of the cetacean species that may be present, two are classified as low-frequency cetaceans (*i.e.,* all mysticete species), one is classified as mid-frequency cetaceans (killer whale), and two are classified as high-frequency cetaceans (harbor and Dall's porpoise).

Potential Effects of Specified Activities on Marine Mammals and Their Habitat

The effects of underwater noise from the City of Juneau's construction at Statter Harbor have the potential to result in behavioral harassment of marine mammals in the vicinity of the action area. The **Federal Register** notice for the proposed IHA (84 FR 55920; October 18, 2019) included a discussion of the effects of anthropogenic noise on marine mammals, therefore that information is not repeated here; please refer to the **Federal Register** notice (84 FR 55920; October 18, 2019) for that information.

The main impact associated with the Statter Harbor project will be temporarily elevated sound levels and the associated direct effects on marine mammals. The project will not result in permanent impacts to habitats used directly by marine mammals, such as haulout sites, but may have potential short-term impacts to food sources such as forage fish, and minor impacts to the immediate substrate during installation and removal of piles during the project. These potential effects are discussed in detail in the **Federal Register** notice for the proposed IHA (84 FR 55920; October 18, 2019), therefore that information is not repeated here; please refer to that **Federal Register** notice for that information.

Estimated Take

This section provides an estimate of the number of incidental takes authorized through this IHA, which will inform both NMFS' consideration of ''small numbers'' and the negligible impact determination.

Harassment is the only type of take expected to result from these activities. Except with respect to certain activities not pertinent here, section 3(18) of the MMPA defines ''harassment'' as any act of pursuit, torment, or annoyance, which (i) has the potential to injure a marine mammal or marine mammal stock in the wild (Level A harassment); or (ii) has the potential to disturb a marine mammal or marine mammal stock in the wild by causing disruption of behavioral patterns, including, but not limited to, migration, breathing, nursing, breeding, feeding, or sheltering (Level B harassment).

Authorized takes will primarily be by Level B harassment, as use of the acoustic sources (*i.e.,* pile driving, removal, down the hole drilling) has the potential to result in disruption of behavioral patterns for individual marine mammals. There is also some potential for auditory injury (Level A

harassment) to result, primarily for high frequency cetacean species and phocid pinnipeds because predicted auditory injury zones are larger than for mid-frequency species or otariid pinnipeds and they are known to frequent the harbor close to the docks where the construction will occur. Auditory injury is unlikely to occur for low or mid-frequency species. The mitigation and monitoring measures are expected to minimize the severity of such taking to the extent practicable.

As described previously, no mortality is anticipated or authorized for this activity. Below we describe how the take is estimated.

Generally speaking, we estimate take by considering: (1) Acoustic thresholds above which NMFS believes the best available science indicates marine mammals will be behaviorally harassed or incur some degree of permanent hearing impairment; (2) the area or volume of water that will be ensonified above these levels in a day; (3) the density or occurrence of marine mammals within these ensonified areas; and, (4) and the number of days of activities. We note that while these basic factors can contribute to a basic calculation to provide an initial prediction of takes, additional information that can qualitatively inform take estimates is also sometimes available (*e.g.,* previous monitoring results or average group size). Below, we describe the factors considered here in more detail and present the take estimate.

Acoustic Thresholds

Using the best available science, NMFS has developed acoustic thresholds that identify the received level of underwater sound above which exposed marine mammals will be reasonably expected to be behaviorally harassed (equated to Level B harassment) or to incur PTS of some degree (equated to Level A harassment).

Level B Harassment for non-explosive sources—Though significantly driven by received level, the onset of behavioral disturbance from anthropogenic noise exposure is also informed to varying degrees by other factors related to the source (*e.g.,* frequency, predictability, duty cycle), the environment (*e.g.,* bathymetry), and the receiving animals (hearing, motivation, experience, demography, behavioral context) and can be difficult to predict (Southall *et al.,* 2007, Ellison *et al.,* 2012). Based on what the available science indicates and the practical need to use a threshold based on a factor that is both predictable and measurable for most activities, NMFS uses a generalized acoustic threshold based on received level to estimate the onset of behavioral harassment. NMFS predicts that marine mammals are likely to be behaviorally harassed in a manner we consider Level B harassment when exposed to underwater anthropogenic noise above received levels of 120 dB re 1 μPa (rms) for continuous (*e.g.,* vibratory pile-driving, drilling) and above 160 dB re 1 μPa (rms) for non-explosive impulsive (*e.g.,* seismic airguns) or intermittent (*e.g.,* scientific sonar) sources.

The City of Juneau's activity includes the use of continuous (vibratory pile driving/removal and down the hole drilling) and impulsive (impact pile driving) sources, and therefore the 120 and 160 dB re 1 μPa (rms) thresholds are applicable.

Level A harassment for non-explosive sources—NMFS' Technical Guidance for Assessing the Effects of Anthropogenic Sound on Marine Mammal Hearing (Version 2.0) (NMFS 2018) identifies dual criteria to assess auditory injury (Level A harassment) to five different marine mammal groups (based on hearing sensitivity) as a result of exposure to noise from two different types of sources (impulsive or non-impulsive). The City of Juneau's activity includes the use of impulsive (impact pile driving) and non-impulsive (vibratory pile driving/removal and down the hole drilling) sources.

These thresholds are provided in the table below. The references, analysis, and methodology used in the development of the thresholds are described in NMFS 2018 Technical Guidance, which may be accessed at *https://www.fisheries.noaa.gov/national/marine-mammal-protection/marine-mammal-acoustic-technical-guidance.*

TABLE 4—THRESHOLDS IDENTIFYING THE ONSET OF PERMANENT THRESHOLD SHIFT

Hearing group	PTS onset acoustic thresholds * (received level)	
	Impulsive	Non-impulsive
Low-Frequency (LF) Cetaceans	*Cell 1:* $L_{pk,flat}$: 219 dB; $L_{E,LF,24h}$: 183 dB	*Cell 2:* $L_{E,LF,24h}$: 199 dB.
Mid-Frequency (MF) Cetaceans	*Cell 3:* $L_{pk,flat}$: 230 dB; $L_{E,MF,24h}$: 185 dB	*Cell 4:* $L_{E,MF,24h}$: 198 dB.
High-Frequency (HF) Cetaceans	*Cell 5:* $L_{pk,flat}$: 202 dB; $L_{E,HF,24h}$: 155 dB	*Cell 6:* $L_{E,HF,24h}$: 173 dB.
Phocid Pinnipeds (PW) (Underwater)	*Cell 7:* $L_{pk,flat}$: 218 dB; $L_{E,PW,24h}$: 185 dB	*Cell 8:* $L_{E,PW,24h}$: 201 dB.
Otariid Pinnipeds (OW) (Underwater)	*Cell 9:* $L_{pk,flat}$: 232 dB; $L_{E,OW,24h}$: 203 dB	*Cell 10:* $L_{E,OW,24h}$: 219 dB.

* Dual metric acoustic thresholds for impulsive sounds: Use whichever results in the largest isopleth for calculating PTS onset. If a non-impulsive sound has the potential of exceeding the peak sound pressure level thresholds associated with impulsive sounds, these thresholds should also be considered.

Note: Peak sound pressure (L_{pk}) has a reference value of 1 μPa, and cumulative sound exposure level (L_E) has a reference value of 1μPa²s. In this Table, thresholds are abbreviated to reflect American National Standards Institute standards (ANSI 2013). However, peak sound pressure is defined by ANSI as incorporating frequency weighting, which is not the intent for this Technical Guidance. Hence, the subscript "flat" is being included to indicate peak sound pressure should be flat weighted or unweighted within the generalized hearing range. The subscript associated with cumulative sound exposure level thresholds indicates the designated marine mammal auditory weighting function (LF, MF, and HF cetaceans, and PW and OW pinnipeds) and that the recommended accumulation period is 24 hours. The cumulative sound exposure level thresholds could be exceeded in a multitude of ways (*i.e.,* varying exposure levels and durations, duty cycle). When possible, it is valuable for action proponents to indicate the conditions under which these acoustic thresholds will be exceeded.

Ensonified Area

Here, we describe operational and environmental parameters of the activity that will feed into identifying the area ensonified above the acoustic thresholds, which include source levels and transmission loss coefficient.

The sound field in the project area is the existing background noise plus additional construction noise from the project. Marine mammals are expected to be affected via sound generated by the primary components of the project (*i.e.,* impact pile driving, vibratory pile driving and removal and down-the-hole drilling).

In order to calculate distances to the Level A and Level B harassment thresholds for piles of various sizes being used in this project, NMFS used acoustic monitoring data from other locations. Note that piles of differing

sizes have different sound source levels. It is anticipated all of the piles will require drilling for rock sockets and will be installed at the rate of a single pile per day.

Vibratory removal—The closest known measurements of vibratory pile removal similar to this project are from the Kake Ferry Terminal project for vibratory extraction of an 18-inch steel pile. The extraction of 18-inch steel pipe piles using a vibratory hammer resulted in underwater noise levels reaching 152.4 dBRMS at 55.8 feet (17 meters) (Denes *et al.,* 2016). The pile diameters for this project are smaller than those used in Denes *et al.,* thus the use of noise levels associated with the pile extraction at Kake are conservative.

Down the hole drilling—Little source level data are available for down-the-hole drilling. Denes *et al.* (2016) measured sound emanating from the drilling of 24-in (61-cm) piles at Kodiak and calculated a median SPL of 166.2 dB (at 10 m) which was used to calculate the PTS onset isopleths. Denes *et al.* (2016) also noted a transmission loss coefficient of 18.9 for drilling suggesting high attenuation when drilling below the seafloor. As the activity will not occur in the same location as the Denes *et al.* (2016) measurements, NMFS is using a transmission loss coefficient of 15 in this notice.

Vibratory driving—The closest known measurements of sound levels for vibratory pile installation of 16-inch (41-cm) steel piles are from the U.S. Navy Proxy Sound Source Study for projects in Puget Sound. Based on the projects analyzed it was determined that 16- to 24-inch (41- to 61-cm) piles exhibited similar sound source levels for projects in Puget Sound resulting in a recommended source level of 161 dB RMS at 33 feet (10 m) for piles diameters ranging from 16- to 24-inches (41- to 61-cm) (U.S. Navy 2015). However, as each pile that will be driven through vibratory driving will also utilize down the hole drilling, within the same day, the ensonified area for the down the hole drilling, which is larger and potentially a more conservative estimate, was used.

Impact driving—For impact pile driving of 16-inch (41-cm) piles, sound measurements were used from the literature review in Appendix H of the AKDOT&PF study (Yurk *et al.,* 2015) for 24-inch (61-cm) piles driven in the Columbia River with a diesel impact hammer. To estimate the sound source levels of 16-inch (41-cm) piles data for the 24-inch (61-cm) piles were used as the available data for 16-inch piles did not report a peak level, thus these noise levels used in this notice are likely overestimating the acoustic isopleths. The impact driving source levels used were a SPL of 190dB RMS at 10 meters, 175 dB single strike SEL, and 205dB peak pressure.

When the NMFS Technical Guidance (2018) was published, in recognition of the fact that ensonified area/volume could be more technically challenging to predict because of the duration component in the new thresholds, we developed a User Spreadsheet that includes tools to help predict a simple isopleth that can be used in conjunction with marine mammal density or occurrence to help predict takes. We note that because of some of the assumptions included in the methods used for these tools, we anticipate that isopleths produced are typically going to be overestimates of some degree, which may result in some degree of overestimate of Level A harassment take. However, these tools offer the best way to predict appropriate isopleths when more sophisticated 3D modeling methods are not available, and NMFS continues to develop ways to quantitatively refine these tools, and will qualitatively address the output where appropriate. For stationary sources, such as the pile driving/removal and down the hole drilling, the NMFS User Spreadsheet predicts the distance at which, if a marine mammal remained at that distance the whole duration of the activity, it will incur PTS. Inputs used in the User Spreadsheet, and the resulting isopleths are reported below.

TABLE 5—NMFS USER SPREADSHEET INPUTS

	Vibratory driving **	Vibratory removal	Down the hole drilling **		Impact driving
Spreadsheet Tab Used.	A.1) Non-impulsive, continuous.	A.1) Non-impulsive, continuous.	A.1) Non-impulsive, continuous.	Spreadsheet Tab Used.	E.1) Impulsive, intermittent.
Source Level (RMS SPL).	161	152.4	**166.2**	Source level (Single shot SEL).	175.
Weighting Factor Adjustment (kHz).	2.5	2.5	2.5	Weighting Factor Adjustment (kHz).	2.
Number of piles in 24 hours.	2	**3**	**3**	Number of strikes per pile.	**250.**
Activity Duration (min) to drive 1 pile.	360	**30**	**240**	Number of piles per day.	2.
Propagation (xLogR)	15	15	15	Propagation (xLogR)	15.
Distance of source level measurement (meters).	10	17	10	Distance of source level measurement (meters).	10.
Other factors if using different tab for other source.				Source level (PK SPL).	205.
				Distance of source level measurement (meters).	10.

* Bold values indicate corrected typos from Proposed IHA.
** For our analysis, it is conservatively assumed drilling and vibratory pile driving will occur throughout the 12 hour work day.

TABLE 6—NMFS USER SPREADSHEET OUTPUTS

Source type	PTS isopleth (meters)				
	Low-frequency cetaceans	Mid-frequency cetaceans	High-frequency cetaceans	Phocid pinnipeds	Otariid pinnipeds
Vibratory driving	35.8	3.2	52.9	21.8	1.5.
Vibratory removal	**4.1**	**0.4**	**6.0**	**2.5**	**0.2**.
Down the hole drilling.	79.5	7.0	117.6	48.3	3.4.
Impact driving (SEL/PK).	184.2/1.2	6.6/NA	219.5/15.8	98.6/1.4	7.2/NA.
	Level B Behavioral Harassment Isopleth (m)				
Vibratory driving	5,411.7				
Vibratory removal	2,457.2				
Down the hole drilling.	12,022.64				
Impact driving	1,000				

* Bold values indicate corrected typos from Proposed IHA.

Marine Mammal Occurrence

In this section we provide the information about the presence, density, or group dynamics of marine mammals that will inform the take calculations.

Reliable densities are not available for Statter Harbor or the Auke Bay area. Generalized densities for the North Pacific are not applicable given the high variability in occurrence and density at specific inlets and harbors. Therefore, the applicant consulted opportunistic sightings data from oceanographic surveys in Auke Bay and sightings from Auke Bay Marine Station observation pier for Statter Harbor to arrive at a number of animals expected to occur within the harbor per day. For humpback whales, it is assumed that a maximum of four animals per day are likely to occur in the harbor. For Steller sea lions, the potential maximum daily occurrence of animals is 121 individuals within the harbor. For harbor seals, the maximum daily occurrence of animals is 52 individuals. For Dall's porpoises, it was assumed a large pod (20 individuals) might occur in the project area once per month in the spring months of March, April, and May. For harbor porpoises, it was assumed that up to one pair may enter the project area daily. For killer whales, it was conservatively assumed that up to one pod of resident killer whales (41 individuals) and one pod of transient killer whales (14 killer whales) might enter Auke Bay over the course of the project. It was assumed that one minke whale might enter the bay per month across the eight months when work could potentially be conducted. Take of California sea lions have been requested on a precautionary basis and it is assumed no more than one sea lion per day of in-water work will enter Auke Bay.

Take Calculation and Estimation

Here we describe how the information provided above is brought together to produce a quantitative take estimate. Because reliable densities are not available, the applicant requests take based on the above mentioned maximum number of animals that may occur in the harbor per day multiplied by the number of days of the activity. For species occurring less frequently in the area, some take estimates were calculated based on potential monthly occurrence. The applicant varied these calculations based on certain factors.

Humpback whales—Because humpback whale individuals of different DPS (natal) origin are indistinguishable from one another (unless fluke patterns are linked to the individual in both feeding and breeding ground), the frequency of occurrence of animals by DPS is only estimated using the DPS ratio, based upon the assumption that the ratio is consistent throughout the Southeast Alaska region (Wade *et al.,* 2016). Work is expected to occur over 23 days and will involve a mixture of vibratory pile driving and drilling each day. Based on the available information and the extent of the Level B harassment zone it is estimated up to 4 humpback whales could be exposed to elevated noise during each day of pile driving and drilling. Using a daily potential maximum rate of four humpback whales per day, the project could take up to 92 humpback whales. Based on the allocation by DPS expected in the project area, it is assumed 6.1 percent of the humpbacks sighted will be from the ESA-listed Mexico DPS, or a potential 6 takes. No Level A harassment takes are requested for humpback whales as the Level A harassment zones are small and shutdown measures can be implemented prior to any humpback whales enter Level A harassment zones.

Steller sea lions—Using a potential daily maximum rate, the project could take up to 121 Steller sea lions each day of pile driving activities due to the large Level B harassment zones. The maximum daily count of 121 was used to make this determination as Steller sea lions have been observed in large herds within vicinity of the harbor in excess of seven days when prey is abundant and the Level B harassment zones are large and in relatively close proximity to Benjamin Island (~22 km from project site). Thus, during these times it is likely that the rate of taking will be higher as the animals will be counted more than once if they dive and/or leave and re-enter the monitoring zone. On other days when dense groups are not present, fewer takes will be encountered, and it is assumed the overall take levels will even out. While there are a small number of resident harbor seals, it is anticipated there will be larger numbers of Steller sea lion takes, due to the large herds they have been observed in, the large size of the Level B harassment zones (up to12.1 km) and the relative proximity to an established haulout at Benjamin Island. While the Level B harassment zones for the first phase of construction were generally smaller, much of the larger zones in this second phase are truncated due to land masses. Further, take numbers are estimated based on the largest group observed rafting in the Auke Bay vicinity and thus is considered an appropriate estimate for this phase as well.

Assuming 121 Steller sea lion takes per day, the total requested number of Steller sea lion takes for 23 days of work is 2,783 Steller sea lions. Based on the recently published literature ascribing sighted Steller sea lions in the zone of mixing to an allocated DPS, it is assumed 18 percent of the total takes, or 501 individuals, will be from the ESA-listed Western DPS. No Level A harassment takes are requested for Steller sea lions as the Level A harassment zones are small and shutdown measures can be implemented prior to Steller sea lions entering any Level A harassment zone.

Harbor seals—Up to 52 individual seals have been photographed simultaneously hauled out on the nearby dock at Fishermen's Bend (Ridgway unpubl. data). Direct effects of construction noise in this area will be partially blocked by the recently constructed Phase II boat launch and parking area. We assume that the majority of animals that haul out on the nearby floats at Fishermen's Bend are likely to go under water and resurface throughout the duration of the project. The action area also extends into Stephens Passage near the location of a known harbor seal haulout near Horse Island. Abundance estimates within this area are 276.5 harbor seals (NOAA 2018). However, only a small portion of this survey unit is located within the project area and thus it is estimated that 25 percent (70 harbor seals) may also be located within the action area each day. With both areas combined it is estimated up to 122 harbor seals (52 + 70) may be exposed to elevated sound levels during each day of drilling, resulting in a total of 2,806 harbor seal takes by Level B harassment during the activity.

Due to the number of harbor seals commonly within the Level A harassment zones for impact pile driving and drilling, there is a chance the injury zone will not be free of harbor seals for sufficient time to allow for impact driving as harbor seals frequently use the nearby habitat. It is assumed that no more than 12 seals are likely to be found within the inner harbor, which will be used as the maximum of harbor seals that may be taken by Level A harassment for each day of the project. This results in a total estimate of 253 Level A harassment takes of harbor seals.

Dall's porpoise—Dall's porpoises have been observed to have strong seasonal patterns with the highest number being observed in the spring and the fewest in the fall (Dahlheim *et al.,* 2009). Group size in Alaska typically ranging from 10 to 20 individuals (Wells 2008). Should Dall's porpoise be present within the project area it is most likely to be during the spring months based on the strong seasonal patterns observed. The project is located in habitat that it not typical for Dall's porpoise, however they may still be present during the spring months of March, April and May. It is assumed that a large pod of 20 Dall's porpoises (Wells 2008) may enter the harassment zones once each of these months, resulting in a take estimate of 60 Level B harassment takes of Dall's porpoise.

Dall's porpoises can generally be observed by monitors due to the ''rooster tail'' splash often made when surfacing (Wells 2008). However, due to the size of the Level A harassment zone associated with drilling (120 meters) and impact driving (220 meters), and due to the possibility for night work, it is possible Dall's porpoises may enter and remain in the Level A harassment zone undetected. It is conservatively assumed that one group of four Dall's porpoises may enter the Level A harassment zone and remain undetected every fourth day of pile driving, resulting in a take estimate of 24 Level A takes of Dall's porpoise across during the activity.

Harbor porpoise—There is little data regarding harbor porpoise presence in the project area, however they have been observed in the project vicinity during several surveys of nearby waterways including Lynn Canal and Stephens Passage (Dahlheim *et al.,* 2009; Dahlheim *et al.,* 2015). The average group size ranged from 1.24 to 1.57 throughout the study years, consistent with our estimate that one pair per day may be present in the Auke Bay Area. Based on the available information is estimated that up to one pair of harbor porpoises may be taken by Level B harassment during each of the 23 days of pile driving, resulting in a total estimated 46 takes by Level B harassment.

Harbor porpoises are stealthy, having no visible blow and a low profile in the water making the species difficult for monitors to detect (Dahlheim *et al.,* 2015). The Level A harassment zones extend up to 220 meters, because of this distance it is possible harbor porpoises may enter the Level A harassment zone undetected. It is conservatively assumed that one pair of harbor porpoises may enter the Level A harassment zone every other day of pile driving, resulting in a total estimated take of 24 harbor porpoises by Level A harassment.

Killer whale—From 2010–2017 an average of 25 killer whale sightings were recorded in the project area per year (Ridgeway unpubl. data 2017). Data did not make distinctions between the stocks and thus the ratio between stocks is unknown. However, a resident pod identified as the AG pod is known to frequent the Juneau area (Dahlheim *et al.,* 2009; personal observation) and has 41 members recorded in the North Gulf Oceanic Society's Identification Guide (NGOS 2019). This pod is seen in the area intermittently in groups of up to approximately 25 individuals (personal observation), consistent with the data for the area. Transient killer whales have been observed in nearby waterways as well and one group of 14 individuals were observed during surveys (Dahlheim *et al.,* 2009). Killer whales move fast and have large ranges, and while they may occasionally enter the Level B harassment zones they are unlikely to linger in the area. Based on the information available it is conservatively estimated that one pod of residents (41 individuals) and one pod of transients (14 individuals) may be taken during the duration of the project. As killer whales may not be able to be readily distinguished between resident and transients, or the applicable stock populations, a total of 55 takes of killer whales are requested. Based on the intermittent occurrence of killer whales from various stocks, if killer whales appear in Auke Bay during construction activities, it will be difficult to estimate what proportion of observed killer whales will be from each potential stock. Therefore, for the purposes of this analysis, we assume the total amount of estimated take of killer whales could be entirely from each of the three stocks in the area and have made our findings assuming the total amount of authorized take could be entirely from each of the three stocks. No Level A takes are requested for killer whales due to the small size of the Level A harassment zones and the conspicuous nature of killer whales that should allow for effective implementation of shutdowns before killer whales could incur PTS.

Minke whale—There are no known occurrences of minke whales within the action area, however since their ranges extend into the project area and they have been observed in southeast Alaska (Dahlheim *et al.,* 2009) it is possible the species could occur near the project area given the large harassment zones associated with drilling. Therefore, one take is being requested per month of the potential project window (October 2020 through May 2021) for a total of 8 estimated takes of minke whale by Level B harassment. Due to the unlikely occurrence of minke whales in the general area and the additional unlikely of a minke whale occurring within 200

meters of the construction activity, no Level A takes of minke whales is authorized.

California sea lion—California sea lions are not typically found in the project area, however one hauled out on Statter Harbor boat launch ramp float in September of 2017. For take purposes it is estimated that one California sea lion may be present each day of in-water work, resulting in a total of 23 estimated takes by Level B harassment. Due to the rarity of California sea lions in the area, no Level A harassment take is authorized.

The total number of takes authorized are summarized in Table 7 below.

TABLE 7—TAKES AUTHORIZED BY LEVEL A AND LEVEL B HARASSMENT

	Total level B harassment takes	Total level A harassment takes	Total takes authorized
Humpback whale *	92	0	92
Steller sea lion eDPS	2,282	0	2,282
Steller sea lion wDPS	501	0	501
Harbor seal	2,806	276	3,082
Dall's porpoise	60	24	84
Harbor porpoise	46	24	70
Killer whale, Alaska Resident, Northern Resident, Gulf of Alaska Transient, West Coast Transient	55	0	55
Minke whale	8	0	8
California sea lion	23	0	23

* For ESA section 7 consultation purposes, 6.1 percent are designated to the Mexico DPS and the remaining are designated to the Hawaii DPS; therefore, we assigned 6 Level B takes to the Mexico DPS.

Mitigation

In order to issue an IHA under Section 101(a)(5)(D) of the MMPA, NMFS must set forth the permissible methods of taking pursuant to such activity, and other means of effecting the least practicable impact on such species or stock and its habitat, paying particular attention to rookeries, mating grounds, and areas of similar significance, and on the availability of such species or stock for taking for certain subsistence uses (latter not applicable for this action). NMFS regulations require applicants for incidental take authorizations to include information about the availability and feasibility (economic and technological) of equipment, methods, and manner of conducting such activity or other means of effecting the least practicable adverse impact upon the affected species or stocks and their habitat (50 CFR 216.104(a)(11)).

In evaluating how mitigation may or may not be appropriate to ensure the least practicable adverse impact on species or stocks and their habitat, as well as subsistence uses where applicable, we carefully consider two primary factors:

(1) The manner in which, and the degree to which, the successful implementation of the measure(s) is expected to reduce impacts to marine mammals, marine mammal species or stocks, and their habitat. This considers the nature of the potential adverse impact being mitigated (likelihood, scope, range). It further considers the likelihood that the measure will be effective if implemented (probability of accomplishing the mitigating result if implemented as planned), the likelihood of effective implementation (probability implemented as planned), and;

(2) the practicability of the measures for applicant implementation, which may consider such things as cost, impact on operations, and, in the case of a military readiness activity, personnel safety, practicality of implementation, and impact on the effectiveness of the military readiness activity.

In addition to the measures described later in this section, the City of Juneau will employ the following standard mitigation measures:

- Conduct briefings between construction supervisors and crews and the marine mammal monitoring team prior to the start of all pile driving activity, and when new personnel join the work, to explain responsibilities, communication procedures, marine mammal monitoring protocol, and operational procedures;
- For in-water heavy machinery work other than pile driving (*e.g.,* standard barges, *etc.*), if a marine mammal comes within 10 m, operations shall cease and vessels shall reduce speed to the minimum level required to maintain steerage and safe working conditions;
- Work may not begin during nighttime hours, or during periods of low visibility when visual monitoring of marine mammals can be conducted. However, work can continue into the nighttime hours if necessary;
- For those marine mammals for which Level B harassment has not been authorized, in-water pile installation/removal and drilling will shut down immediately if such species are observed within or on a path towards the monitoring zone (*i.e.,* Level B harassment zone); and
- If take reaches the authorized limit for an authorized species, pile installation will be stopped as these species approach the Level B harassment zone to avoid additional take.

The following measures will apply to the City of Juneau's mitigation requirements:

Establishment of Shutdown Zone for Level A Harassment—For all pile driving/removal and drilling activities, the City of Juneau will establish a shutdown zone, as described in Table 8 below. The purpose of a shutdown zone is generally to define an area within which shutdown of activity will occur upon sighting of a marine mammal (or in anticipation of an animal entering the defined area). The placement of Protected Species Observers (PSOs) during all pile driving and drilling activities (described in detail in the Monitoring and Reporting Section) will ensure marine mammals in the shutdown zones are visible.

TABLE 8—MONITORING AND SHUTDOWN ZONES FOR EACH PROJECT ACTIVITY

Source	Shutdown zones (m)					Monitoring zones (m)
	Low frequency cetacean	Mid-frequency cetacean	High frequency ceteacean	Phocid	Otariid	All species
Vibratory Removal	20	10	25	10	10	2,500
Vibratory Installation/Drilling	80	10	120	50	10	2,500
Impact Driving	185	10	220	25	10	1,000

Establishment of Monitoring Zones for Level B Harassment—The City of Juneau will establish monitoring zones to correlate when possible with Level B harassment zones which are areas where SPLs are equal to or exceed the 160 dB rms threshold for impact driving and the 120 dB rms threshold during vibratory driving and drilling. Monitoring zones provide utility for observing by establishing monitoring protocols for areas adjacent to the shutdown zones. Monitoring zones enable observers to be aware of and communicate the presence of marine mammals in the project area outside the shutdown zone and thus prepare for a potential cease of activity should the animal enter the shutdown zone. The monitoring zones are described in Table 8 above. If visibility is such that observers are able to make observations beyond the monitoring zone distance, these observations will be recorded and reported. The Level B harassment zone for vibratory pile installation and down the hole drilling is so large that a smaller and more feasible zone will be implemented as monitoring zones. Given that the PSOs cannot observe the entireties of the various Level B harassment zones, Level B harassment takes will be recorded and extrapolated based upon the number of takes observed and the percentage of the Level B harassment zone that was not visible.

Soft Start—The use of soft-start procedures are believed to provide additional protection to marine mammals by providing warning and/or giving marine mammals a chance to leave the area prior to the hammer operating at full capacity. For impact pile driving, contractors will be required to provide an initial set of strikes from the hammer at reduced energy, with each strike followed by a 30-second waiting period. This procedure will be conducted a total of three times before impact pile driving begins. Soft start will be implemented at the start of each day's impact pile driving and at any time following cessation of impact pile driving for a period of thirty minutes or longer. Soft start is not required during vibratory pile driving and removal activities.

Pre-Activity Monitoring—Prior to the start of daily in-water construction activity, or whenever a break in pile driving/removal or drilling of 30 minutes or longer occurs, PSOs will observe the shutdown and monitoring zones for a period of 30 minutes. The shutdown zone will be cleared when a marine mammal has not been observed within the zone for that 30-minute period. If a marine mammal is observed within the shutdown zone, a soft-start cannot proceed until the animal has left the zone or has not been observed for 15 minutes. If the monitoring zone has been observed for 30 minutes and non-permitted species are not present within the zone, soft start procedures can commence and work can continue even if visibility becomes impaired within the monitoring zone. When a marine mammal permitted for Level B harassment take is present in the monitoring zone, activities may begin and Level B harassment take will be recorded. If work ceases for more than 30 minutes, the pre-activity monitoring of both the monitoring zone and shutdown zone will commence.

Due to the depth of the water column and strong currents present at the project site, bubble curtains will not be implemented as they will not be effective in this environment. The City will not be limited to daytime operations as the contractor cannot simply leave the equipment overnight due to safety concerns and the large tidal swings. As such they will either have to leave the equipment manned all night or fully remove it from the pile, assuming the pile is embedded enough to be safely left. Construction needs to be completed during the winter as it is a very active harbor and cannot feasibly be worked on during the summer. Construction during the winter also coincides with the time that most humpback whales are not present in Alaska, minimizing potential impacts.

Based on our evaluation of the applicant's measures, NMFS has determined that the mitigation measures provide the means effecting the least practicable impact on the affected species or stocks and their habitat, paying particular attention to rookeries, mating grounds, and areas of similar significance.

Monitoring and Reporting

In order to issue an IHA for an activity, Section 101(a)(5)(D) of the MMPA states that NMFS must set forth requirements pertaining to the monitoring and reporting of such taking. The MMPA implementing regulations at 50 CFR 216.104(a)(13) indicate that requests for authorizations must include the suggested means of accomplishing the necessary monitoring and reporting that will result in increased knowledge of the species and of the level of taking or impacts on populations of marine mammals that are expected to be present in the action area. Effective reporting is critical both to compliance as well as ensuring that the most value is obtained from the required monitoring.

Monitoring and reporting requirements prescribed by NMFS should contribute to improved understanding of one or more of the following:

- Occurrence of marine mammal species or stocks in the area in which take is anticipated (*e.g.,* presence, abundance, distribution, density).
- Nature, scope, or context of likely marine mammal exposure to potential stressors/impacts (individual or cumulative, acute or chronic), through better understanding of: (1) Action or environment (*e.g.,* source characterization, propagation, ambient noise); (2) affected species (*e.g.,* life history, dive patterns); (3) co-occurrence of marine mammal species with the action; or (4) biological or behavioral context of exposure (*e.g.,* age, calving or feeding areas).
- Individual marine mammal responses (behavioral or physiological) to acoustic stressors (acute, chronic, or cumulative), other stressors, or cumulative impacts from multiple stressors.
- How anticipated responses to stressors impact either: (1) Long-term

fitness and survival of individual marine mammals; or (2) populations, species, or stocks.

- Effects on marine mammal habitat (*e.g.,* marine mammal prey species, acoustic habitat, or other important physical components of marine mammal habitat).
- Mitigation and monitoring effectiveness.

Marine Mammal Visual Monitoring

Monitoring shall be conducted by NMFS-approved PSOs per the Marine Mammal Monitoring Plan provided in Appendix B of the City of Juneau's application. Trained observers shall be placed from the best vantage points practicable to monitor for marine mammals and implement shutdown or delay procedures when applicable through communication with the equipment operator. Observer training must be provided prior to project start, and shall include instruction on species identification (sufficient to distinguish the species in the project area), description and categorization of observed behaviors and interpretation of behaviors that may be construed as being reactions to the specified activity, proper completion of data forms, and other basic components of biological monitoring, including tracking of observed animals or groups of animals such that repeat sound exposures may be attributed to individuals (to the extent possible).

Monitoring will be conducted 30 minutes before, during, and 30 minutes after pile driving/removal and drilling activities. In addition, observers shall record all incidents of marine mammal occurrence, regardless of distance from activity, and shall document any behavioral reactions in concert with distance from piles being driven or removed. Pile driving/removal and drilling activities include the time to install or remove a single pile or series of piles, as long as the time elapsed between uses of the pile driving equipment is no more than 30 minutes.

A minimum of two PSOs will be based strategically with one PSO on land at the Statter Harbor project site and the other on land or potentially on a vessel partway into Auke Bay. These stations will allow full monitoring of the impact hammer monitoring zone and the Level A shutdown zones. Potential locations for the second observer are described on pages 5 and 6 in Appendix B of the City of Juneau's application.

PSOs will scan the waters using binoculars, and/or spotting scopes, and will use a handheld GPS or range-finder device to verify the distance to each sighting from the project site. All PSOs will be trained in marine mammal identification and behaviors and are required to have no other project-related tasks while conducting monitoring. In addition, monitoring will be conducted by qualified observers, who will be placed at the best vantage point(s) practicable to monitor for marine mammals and implement shutdown/delay procedures when applicable by calling for the shutdown to the hammer operator. The City of Juneau will adhere to the following observer qualifications:

(i) Independent observers (*i.e.,* not construction personnel) are required;

(ii) At least one observer must have prior experience working as an observer;

(iii) Other observers may substitute education (degree in biological science or related field) or training for experience; and

(iv) The City of Juneau shall submit observer CVs for approval by NMFS.

Additional standard observer qualifications include:

- Ability to conduct field observations and collect data according to assigned protocols;
- Experience or training in the field identification of marine mammals, including the identification of behaviors;
- Sufficient training, orientation, or experience with the construction operation to provide for personal safety during observations;
- Writing skills sufficient to prepare a report of observations including but not limited to the number and species of marine mammals observed; dates and times when in-water construction activities were conducted; dates and times when in-water construction activities were suspended to avoid potential incidental injury from construction sound of marine mammals observed within a defined shutdown zone; and marine mammal behavior; and
- Ability to communicate orally, by radio or in person, with project personnel to provide real-time information on marine mammals observed in the area as necessary.

The City of Juneau will submit a marine mammal monitoring report. A draft marine mammal monitoring report will be submitted to NMFS within 90 days after the completion of pile driving and removal and drilling activities. It will include an overall description of work completed, a narrative regarding marine mammal sightings, and associated PSO data sheets. Specifically, the report must include:

- Date and time that monitored activity begins or ends;
- Construction activities occurring during each observation period;
- Weather parameters (*e.g.,* percent cover, visibility);
- Water conditions (*e.g.,* sea state, tide state);
- Species, numbers, and, if possible, sex and age class of marine mammals;
- Description of any observable marine mammal behavior patterns, including bearing and direction of travel and distance from pile driving activity;
- Distance from pile driving activities to marine mammals and distance from the marine mammals to the observation point;
- Locations of all marine mammal observations; and
- Other human activity in the area.

If no comments are received from NMFS within 30 days, the draft final report will constitute the final report. If comments are received, a final report addressing NMFS comments must be submitted within 30 days after receipt of comments.

In the unanticipated event that the specified activity clearly causes the take of a marine mammal in a manner prohibited by the IHA (if issued), such as an injury, serious injury or mortality, the City of Juneau will immediately cease the specified activities and report the incident to the Chief of the Permits and Conservation Division, Office of Protected Resources, NMFS, and the Alaska Regional Stranding Coordinator. The report will include the following information:

- Description of the incident;
- Environmental conditions (*e.g.,* Beaufort sea state, visibility);
- Description of all marine mammal observations in the 24 hours preceding the incident;
- Species identification or description of the animal(s) involved;
- Fate of the animal(s); and
- Photographs or video footage of the animal(s) (if equipment is available).

Activities may not resume until NMFS is able to review the circumstances of the prohibited take. NMFS will work with the City of Juneau to determine what is necessary to minimize the likelihood of further prohibited take and ensure MMPA compliance. The City of Juneau will not be able to resume their activities until notified by NMFS via letter, email, or telephone.

In the event that the City of Juneau discovers an injured or dead marine mammal, and the lead PSO determines that the cause of the injury or death is unknown and the death is relatively recent (*e.g.,* in less than a moderate state of decomposition as described in the next paragraph), City of Juneau will immediately report the incident to the Chief of the Permits and Conservation

Division, Office of Protected Resources, NMFS, and the NMFS Alaska Stranding Hotline and/or by email to the Alaska Regional Stranding Coordinator. The report will include the same information identified in the paragraph above. Activities will be able to continue while NMFS reviews the circumstances of the incident. NMFS will work with City of Juneau to determine whether modifications in the activities are appropriate.

In the event that City of Juneau discovers an injured or dead marine mammal and the lead PSO determines that the injury or death is not associated with or related to the activities authorized in the IHA (*e.g.,* previously wounded animal, carcass with moderate to advanced decomposition, or scavenger damage), City of Juneau will report the incident to the Chief of the Permits and Conservation Division, Office of Protected Resources, NMFS, and the NMFS Alaska Stranding Hotline and/or by email to the Alaska Regional Stranding Coordinator, within 24 hours of the discovery. City of Juneau will provide photographs, video footage (if available), or other documentation of the stranded animal sighting to NMFS and the Marine Mammal Stranding Network.

Negligible Impact Analysis and Determination

NMFS has defined negligible impact as an impact resulting from the specified activity that cannot be reasonably expected to, and is not reasonably likely to, adversely affect the species or stock through effects on annual rates of recruitment or survival (50 CFR 216.103). A negligible impact finding is based on the lack of likely adverse effects on annual rates of recruitment or survival (*i.e.,* population-level effects). An estimate of the number of takes alone is not enough information on which to base an impact determination. In addition to considering estimates of the number of marine mammals that might be ''taken'' through harassment, NMFS considers other factors, such as the likely nature of any responses (*e.g.,* intensity, duration), the context of any responses (*e.g.,* critical reproductive time or location, migration), as well as effects on habitat, and the likely effectiveness of the mitigation. We also assess the number, intensity, and context of estimated takes by evaluating this information relative to population status. Consistent with the 1989 preamble for NMFS's implementing regulations (54 FR 40338; September 29, 1989), the impacts from other past and ongoing anthropogenic activities are incorporated into this analysis via their impacts on the environmental baseline (*e.g.,* as reflected in the regulatory status of the species, population size and growth rate where known, ongoing sources of human-caused mortality, or ambient noise levels).

Pile driving/removal and drilling activities associated with the Statter Harbor construction project as outlined previously, have the potential to disturb or displace marine mammals in Auke Bay. Specifically, the specified activities may result in take, in the form of Level A harassment and Level B harassment from underwater sounds generated from pile driving and removal and down-the-hole drilling. Potential takes could occur if individuals of these species are present in the ensonified zone when these activities are underway.

The takes from Level A and Level B harassment will be due to potential behavioral disturbance, TTS, and PTS (for select species). No mortality is anticipated given the nature of the activity and measures designed to minimize the possibility of injury to marine mammals. Level A harassment is only anticipated for Dall's porpoise, harbor porpoise, and harbor seal. The potential for harassment is minimized through the construction method and the implementation of the planned mitigation measures (see Mitigation section).

As described previously, killer whales, minke whales, and California sea lions are considered rare in the project area and we authorize only nominal and precautionary take of these species. Therefore, we do not expect meaningful impacts to these species and find that the total killer whale, minke whale, and California sea lion take from each of the specified activities will have a negligible impact on this species.

For remaining species, we discuss the likely effects of the specified activities in greater detail. Effects on individuals that are taken by Level B harassment, on the basis of reports in the literature as well as monitoring from other similar activities, will likely be limited to reactions such as increased swimming speeds, increased surfacing time, or decreased foraging (if such activity were occurring) (*e.g.,* Thorson and Reyff, 2006; Lerma, 2014; ABR, 2016). Most likely, individuals will move away from the sound source and be temporarily displaced from the areas of pile driving and drilling, although even this reaction has been observed primarily only in association with impact pile driving. The pile driving activities analyzed here are similar to, or less impactful than, numerous other construction activities conducted in southeast Alaska, which have taken place with no known long-term adverse consequences from behavioral harassment. Level B harassment will be reduced to the level of least practicable adverse impact through use of mitigation measures described herein and, if sound produced by project activities is sufficiently disturbing, animals are likely to avoid the area while the activity is occurring. While vibratory driving and drilling associated with the planned project may produce sound at distances of many kilometers from the project site, thus intruding on some habitat, the project site itself is located in a busy harbor and the majority of sound fields produced by the specified activities are close to the harbor. Therefore, we expect that animals annoyed by project sound will avoid the area and use more-preferred habitats.

In addition to the expected effects resulting from authorized Level B harassment, we anticipate that harbor porpoises, Dall's porpoises, and harbor seals may sustain some limited Level A harassment in the form of auditory injury. However, animals in these locations that experience PTS will likely only receive slight PTS, *i.e.,* minor degradation of hearing capabilities within regions of hearing that align most completely with the energy produced by pile driving. If hearing impairment occurs, it is most likely that the affected animal will lose only a small number of decibels in its hearing sensitivity, which in most cases is not likely to meaningfully affect its ability to forage and communicate with conspecifics. As described above, we expect that marine mammals will be likely to move away from a sound source that represents an aversive stimulus, especially at levels that will be expected to result in PTS, given sufficient notice through use of soft start.

The project also is not expected to have significant adverse effects on affected marine mammals' habitat. The project activities will not modify existing marine mammal habitat for a significant amount of time. The activities may cause some fish to leave the area of disturbance, thus temporarily impacting marine mammals' foraging opportunities in a limited portion of the foraging range; but, because of the short duration of the activities and the relatively small area of the habitat that may be affected, the impacts to marine mammal habitat are not expected to cause significant or long-term negative consequences.

In summary and as described above, the following factors primarily support our determination that the impacts resulting from this activity are not

expected to adversely affect the species or stock through effects on annual rates of recruitment or survival:

- No mortality is anticipated or authorized;
- The Level A harassment exposures are anticipated to result only in slight PTS, within the lower frequencies associated with pile driving;
- The anticipated incidents of Level B harassment are likely to consist of temporary modifications in behavior that are not anticipated to result in fitness impacts to individuals;
- The specified activity and ensonification area is very small relative to the overall habitat ranges of all species; and
- The presumed efficacy of the mitigation measures in reducing the effects of the specified activity to the level of least practicable adverse impact.

Based on the analysis contained herein of the likely effects of the specified activity on marine mammals and their habitat, and taking into consideration the implementation of the monitoring and mitigation measures, NMFS finds that the total marine mammal take from the activity will have a negligible impact on all affected marine mammal species or stocks.

Small Numbers

As noted above, only small numbers of incidental take may be authorized under Sections 101(a)(5)(A) and (D) of the MMPA for specified activities other than military readiness activities. The MMPA does not define small numbers and so, in practice, where estimated numbers are available, NMFS compares the number of individuals taken to the most appropriate estimation of abundance of the relevant species or stock in our determination of whether an authorization is limited to small numbers of marine mammals. Additionally, other qualitative factors may be considered in the analysis, such as the temporal or spatial scale of the activities.

Table 7 demonstrates the number of animals that could be exposed to received noise levels that could cause Level A harassment and Level B harassment for the planned activities in the Statter Harbor project area. Our analysis shows that less than one third of the population abundance of each affected stock could be taken by harassment. The numbers of animals anticipated to be taken for these stocks will be considered small relative to the relevant stock's abundances even if each estimated taking occurred to a new individual—an extremely unlikely scenario.

Calculated takes do not assume multiple harassments of the same individual(s), resulting in larger estimates of take as a percentage of stock abundance than are likely given resident individuals. This is the case with the resident harbor seals (Lynn Canal/Stephens Passage stock) as it is documented that the same small group of individuals frequent the Statter Harbor area.

As reported, a small number of harbor seals, most of which reside in Statter Harbor year-round, will be exposed to construction activities for 23 days. The total population estimate in the Lynn Canal/Stephens Passage stock is 9,478 animals over 1.37 million acres (5,500 km^2) of area in their range. The great majority of these exposures will be to the same animals given their residency patterns, however the number of repeat exposures is difficult to quantify due to the lack of visible markings on harbor seals in water. No more than 121 harbor seals have ever been sighted in the project area and the harbor seals are known to be resident. Therefore, it is unlikely that the harbor seals entering the area on each of the 23 days of construction activity are unique individuals and are rather repeated takes of the same small number of individuals.

Based on the analysis contained herein of the activity (including the mitigation and monitoring measures) and the anticipated take of marine mammals, NMFS finds that small numbers of marine mammals will be taken relative to the population size of the affected species or stocks.

Unmitigable Adverse Impact Analysis and Determination

In order to issue an IHA, NMFS must find that the specified activity will not have an ''unmitigable adverse impact'' on the subsistence uses of the affected marine mammal species or stocks by Alaskan Natives. NMFS has defined ''unmitigable adverse impact'' in 50 CFR 216.103 as an impact resulting from the specified activity: (1) That is likely to reduce the availability of the species to a level insufficient for a harvest to meet subsistence needs by: (i) Causing the marine mammals to abandon or avoid hunting areas; (ii) Directly displacing subsistence users; or (iii) Placing physical barriers between the marine mammals and the subsistence hunters; and (2) That cannot be sufficiently mitigated by other measures to increase the availability of marine mammals to allow subsistence needs to be met.

The project is not known to occur in an important subsistence hunting area. Auke Bay is a developed area with regular marine vessel traffic. Of the marine mammals considered in this IHA application, only harbor seals are known to be used for subsistence in the project area. In a previous consultation with ADF&G, the Douglas Indian Association, Sealaska Heritage Institute, and the Central Council of the Tlingit and Haida Indian Tribes of Alaska on other construction activities in Statter Harbor, representatives indicated that the primary concern with construction activities in Statter Harbor was impacts to herring fisheries, not marine mammals. As stated above, impacts to fish from the project are expected to be localized and temporary, so are not likely to impact herring fisheries. If any tribes express concerns regarding project impacts to subsistence hunting of marine mammals, further communication between will take place, including provision of any project information, and clarification of any mitigation and minimization measures that may reduce potential impacts to marine mammals. Therefore, NMFS has determined that the total taking of affected species or stocks will not have an unmitigable adverse impact on the availability of such species or stocks for taking for subsistence purposes.

Endangered Species Act (ESA)

Section 7(a)(2) of the Endangered Species Act of 1973 (ESA: 16 U.S.C. 1531 *et seq.*) requires that each Federal agency insure that any action it authorizes, funds, or carries out is not likely to jeopardize the continued existence of any endangered or threatened species or result in the destruction or adverse modification of designated critical habitat. To ensure ESA compliance for the issuance of IHAs, NMFS consults internally, in this case with the Alaska Region Office of Protected Resources, whenever we propose to authorize take for endangered or threatened species.

The effects of this Federal action were adequately analyzed in NMFS' 2019 Biological Opinion on the City and Borough of Juneau Docks and Harbors Department Statter Harbor Improvements Project, Juneau, Alaska, which concluded that the take NMFS authorized through this IHA will not jeopardize the continued existence of any endangered or threatened species or destroy or adversely modify any designated critical habitat.

National Environmental Policy Act

To comply with the National Environmental Policy Act of 1969 (NEPA; 42 U.S.C. 4321 *et seq.*) and NOAA Administrative Order (NAO) 216–6A, NMFS must review our action

(*i.e.,* the issuance of an incidental harassment authorization) with respect to potential impacts on the human environment.

This action is consistent with categories of activities identified in Categorical Exclusion B4 (incidental harassment authorizations with no anticipated serious injury or mortality) of the Companion Manual for NOAA Administrative Order 216–6A, which do not individually or cumulatively have the potential for significant impacts on the quality of the human environment and for which we have not identified any extraordinary circumstances that will preclude this categorical exclusion. Accordingly, NMFS has determined that the issuance of the IHA qualifies to be categorically excluded from further NEPA review.

Authorization

NMFS has issued an IHA to the City of Juneau for the potential harassment of small numbers of eight marine mammal species incidental to the Statter Harbor project in Auke Bay, Alaska, provided the previously mentioned mitigation, monitoring and reporting requirements are incorporated.

Dated: January 21, 2020.

Donna S. Wieting,

Director, Office of Protected Resources, National Marine Fisheries Service.

[FR Doc. 2020–01188 Filed 1–23–20; 8:45 am]

BILLING CODE 3510–22–P

DEPARTMENT OF COMMERCE

National Oceanic and Atmospheric Administration

Submission for OMB Review; Comment Request

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

Agency: National Oceanic and Atmospheric Administration (NOAA).

Title: Implementation of Vessel Speed Restrictions to Reduce the Threat of Ship Collisions with North Atlantic Right Whales.

OMB Control Number: 0648–0580.

Form Number(s): None.

Type of Request: Regular (Extension of a currently approved collection).

Number of Respondents: 3,263.

Average Hours per Response: 5 minutes.

Burden Hours: 272 hours.

Needs and Uses: Collisions with vessels continue to be a source of serious injury and mortality for the endangered North Atlantic right whale and are a threat to the species' recovery. On October 10, 2008, NMFS published a final rule implementing seasonal speed restrictions along the east coast of the U.S. to reduce the incidence and severity of vessel collisions with North Atlantic right whales (73 FR 60173). The final rule contained a collection-of-information requirement subject to the Paperwork Reduction Act (PRA).

Specifically, 50 CFR 224.105(c) provides for a safety deviation from the 10-knot seasonal speed limit if poor weather or sea going conditions severely restrict the maneuverability of a vessel. Under such conditions, a vessel master may opt to maintain a speed in excess of the speed restriction, if required for safety, provided a signed entry is made in the vessel logbook detailing the reasons for the deviation, the speed at which the vessel is operated, the area, and the time and duration of such deviation.

Affected Public: Business and other for-profit organizations, non-profit institutions and individuals or households.

Frequency: On occasion

Respondent's Obligation: Mandatory

This information collection request may be viewed at *reginfo.gov*. Follow the instructions to view Department of Commerce collections currently under review by OMB.

Written comments and recommendations for the proposed information collection should be sent within 30 days of publication of this notice to *OIRA_Submission@omb.eop.gov* or fax to (202) 395–5806.

Sheleen Dumas,

Department PRA Clearance Officer, Office of the Chief Information Officer, Commerce Department.

[FR Doc. 2020–01148 Filed 1–23–20; 8:45 am]

BILLING CODE 3510–22–P

DEPARTMENT OF COMMERCE

National Oceanic and Atmospheric Administration

Submission for OMB Review; Comment Request

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

Agency: National Oceanic and Atmospheric Administration (NOAA).

Title: Licensing of Private Remote-Sensing Space Systems.

OMB Control Number: 0648–0174.

Form Number(s): None.

Type of Request: Regular (Revision of a current approved information collection.)

Number of Respondents: 51.

Average Hours per Response: 40 hours for the submission of a license application; 10 hours for the submission of a data protection plan; 5 hours for the submission of a plan describing how the licensee will comply with data collection restrictions; 3 hours for the submission of an operations plan for restricting collection or dissemination of imagery of Israeli territory; 0.5 hours for the submission of a public summary for a licensed system; 1 hour for notification of completion of pre-ship review; 3 hours for the submission of a license amendment; 2 hours for the submission of a foreign agreement notification; 1 hour for the submission of spacecraft operational information submitted when a spacecraft becomes operational; 2 hours for notification of planned purges of information to the National Satellite Land Remote Sensing Data Archive; 3 hours for the submission of an operational quarterly report; 4 hours for an annual compliance audit; and 1 hour for notification of the demise of a system or a decision to discontinue system operations.

Burden Hours: 1,438.

Needs and Uses: The information is being collected as a necessary step to regulate the private space-based remote sensing industry, which involves issuing licenses to applicants and ensuring their compliance with license terms. The Department of Commerce (DOC), through the National Oceanic and Atmospheric Administration (NOAA), has the authority to regulate private space-based remote sensing under the Land Remote Sensing Policy Act of 1992, 51 U.S.C. 60101 *et seq.* (the Act) and regulations at 15 CFR part 960. The regulations facilitate the development of the U.S. private remote sensing industry and thus promote the collection and widespread availability of remote sensing data, while preserving essential U.S. national security interests and observing international obligations.

Applications are made in response to the requirements in the Act, as amended, and no collection forms are used. The application information received is used to determine if the applicant meets the legal criteria for issuance of a license to operate a private remote sensing space system *i.e.,* the proposed system will be operated in accordance with the Act, U.S. national

security concerns and international obligations. Application information includes: Corporate information; launch segment information; space segment information; ground segment information; plans and/or pricing policy for providing access to or distributing the unenhanced data generated by the system; and the plan for post-mission disposition of any Remote Sensing satellites.

Once an applicant holds a license, he/she is subject to amendment filings and notification requirements concerning an executive summary of the licensed system, foreign agreements, deviation in orbits, planned disposition of the spacecraft, data protection plans, preliminary design reviews, critical design reviews, certification of launch contract and pre-ship review of the satellite; and notification of system demise or decision to discontinue operations. The licensee is required to provide NOAA an executive summary that can be provided to the public within 30 days of obtaining a NOAA license.

Monitoring and compliance information is used to ascertain that the licensee's activities meet the requirements of the Act, applicable regulations, and license conditions. The following information collections serve as part of the monitoring and compliance function: Annual compliance audits; data collection restriction plans; operation plans for restricting collection and dissemination of imaging Israeli territory; data flow diagrams; satellite sub-system diagrams and imaging system specification sheets; operational declarations; quarterly reports; purge notifications; and annual operational audits.

NOAA notes the differences between this revision and the previous extension of this collection of information. First, although it appears that there are new collections of information (specifically, the Data Protection Plan, the Data Collection Restrictions Compliance Plan, the Plan for Restricted Operations Over Israel, and the Public Summary), each of these requirements were discussed in the 2017 **Federal Register** Notice and the Supporting Statement. These requirements are not new; they appear to have been inadvertently omitted from the list of information collections in the 2017 extension. This revision corrects that error.

Second, several information collections have been removed. The Data Flow Diagram has been removed as it is now part of the Data Protection Plan. The Satellite Subsystems Drawings, Submission of Preliminary Design Review, Submission of Critical Design Review, and Notification of Binding Launch Service Contract are no longer required because after NOAA's review of certain material information over the last 20 years, NOAA determined that these documents are no longer relevant to the license determination process. The Notification of Any Operational Deviation is now part of the Quarterly Audit. Finally, the Annual Operational Audit is now part of the Annual Compliance Audit.

Affected Public: Business or other for-profit organizations (primary); non-profit organizations (secondary).

Frequency: Quarterly, annually and on occasion.

Respondent's Obligation: Mandatory.

This information collection request may be viewed at *reginfo.gov*. Follow the instructions to view Department of Commerce collections currently under review by OMB.

Written comments and recommendations for the proposed information collection should be sent within 30 days of publication of this notice to *OIRA_Submission@omb.eop.gov* or fax to (202) 395–5806.

Sheleen Dumas,

Department PRA Clearance Officer, Office of the Chief Information Officer, Commerce Department.

[FR Doc. 2020–01149 Filed 1–23–20; 8:45 am]

BILLING CODE 3510–HR–P

DEPARTMENT OF COMMERCE

National Oceanic and Atmospheric Administration

U.S. Integrated Ocean Observing System (IOOS®) Advisory Committee

AGENCY: National Ocean Service, National Oceanic and Atmospheric Administration (NOAA), Department of Commerce.

ACTION: Notice of open meeting.

SUMMARY: Notice is hereby given of a public in-person meeting of the U. S. Integrated Ocean Observing System (IOOS®) Advisory Committee (Committee).

DATES: The meeting will be held on Tuesday February 11, 2020 from 9:00 a.m. to 5:00 p.m. EST and Wednesday February 12, 2020 from 9:00 a.m. to 3:00 p.m. EST. These times and the agenda topics described below are subject to change. Refer to the web page listed below for the most up-to-date agenda and dial-in information.

ADDRESSES: The meeting will be held at the Consortium for Ocean Leadership, 1201 New York Avenue NW, 4th Floor Conference Rooms AB&C, Washington, DC 20005. Refer to the web page listed below for the most up-to-date information.

FOR FURTHER INFORMATION CONTACT: Krisa Arzayus, Designated Federal Official, U.S. IOOS Advisory Committee, U.S. IOOS Program, 1315 East-West Highway, Silver Spring, MD 20910; Phone 240–533–9455; Fax 301–713–3281; Email *krisa.arzayus@noaa.gov* or visit the U.S. IOOS Advisory Committee website at *http://ioos.noaa.gov/community/u-s-ioos-advisory-committee/.*

SUPPLEMENTARY INFORMATION: The Committee was established by the NOAA Administrator as directed by Section 12304 of the Integrated Coastal and Ocean Observation System Act, part of the Omnibus Public Land Management Act of 2009 (Pub. L. 111–11). The Committee advises the NOAA Administrator and the Interagency Ocean Observation Committee (IOOC) on matters related to the responsibilities and authorities set forth in section 12302 of the Integrated Coastal and Ocean Observation System Act of 2009 and other appropriate matters as the Under Secretary refers to the Committee for review and advice.

The Committee will provide advice on:

(a) Administration, operation, management, and maintenance of the System;

(b) expansion and periodic modernization and upgrade of technology components of the System;

(c) identification of end-user communities, their needs for information provided by the System, and the System's effectiveness in dissemination information to end-user communities and to the general public; and

(d) any other purpose identified by the Under Secretary of Commerce for Oceans and Atmosphere or the Interagency Ocean Observation Committee.

The meeting will be open to public participation with a 15-minute public comment period on February 11, 2020, from 4:45 p.m. to 5:00 p.m. and on February 12, 2020 from 2:30 p.m.–2:45 p.m. (check agenda on website to confirm time.) The Committee expects that public statements presented at its meetings will not be repetitive of previously submitted verbal or written statements. In general, each individual or group making a verbal presentation will be limited to a total time of three (3) minutes. Written comments should be received by the Designated Federal Official by January 29, 2020 to provide sufficient time for Committee review.

Written comments received after January 29, 2020 will be distributed to the Committee, but may not be reviewed prior to the meeting date. Please send your name as it appears on driver's license and the organization/company affiliation you represent to Krisa Arzayus. This information must be received by January 29, 2020.

Matters to be Considered: The meeting will focus on ongoing committee priorities, and developing the next set of recommendations. The latest version of the agenda will be posted at *http://ioos.noaa.gov/community/u-s-ioos-advisory-committee/.*

Special Accomodations: These meetings are physically accessible to people with disabilities. Requests for sign language interpretation or other auxiliary aids should be directed to Krisa Arzayus, Designated Federal Official at 240–533–9455 by January 29, 2020.

Dated: December 19, 2019.

Carl C. Gouldman,

Director, U.S. IOOS Program, National Ocean Service.

[FR Doc. 2020–01128 Filed 1–23–20; 8:45 am]

BILLING CODE P

COMMITTEE FOR PURCHASE FROM PEOPLE WHO ARE BLIND OR SEVERELY DISABLED

Procurement List; Proposed Deletions

AGENCY: Committee for Purchase From People Who Are Blind or Severely Disabled.

ACTION: Proposed Deletions from the Procurement List.

SUMMARY: The Committee is proposing to delete product and a service from the Procurement List that were furnished by nonprofit agencies employing persons who are blind or have other severe disabilities.

DATES: Comments must be received on or before: February 23, 2020.

ADDRESSES: Committee for Purchase From People Who Are Blind or Severely Disabled, 1401 S Clark Street, Suite 715, Arlington, Virginia, 22202–4149.

FOR FURTHER INFORMATION CONTACT: For further information or to submit comments contact: Michael R. Jurkowski, Telephone: (703) 603–2117, Fax: (703) 603–0655, or email *CMTEFedReg@AbilityOne.gov.*

SUPPLEMENTARY INFORMATION: This notice is published pursuant to 41 U.S.C. 8503 (a)(2) and 41 CFR 51–2.3. Its purpose is to provide interested persons an opportunity to submit comments on the proposed actions.

Deletions

The following products and a service are proposed for deletion from the Procurement List:

Products

NSNs—Product Names:
- 8125–00–NIB–0041—Spray Bottle, BioRenewables Restroom Cleaner, Silk Screened, 8 oz, 12/BX
- 8125–00–NIB–0024—Tribase multi purpose silk screened 8oz bottle, 12/BX
- 8125–00–NIB–0025—Glass cleaner silk screened 8oz bottle, 12/BX
- 8125–00–NIB–0026—Neutral Disinfectant silk screened 8oz bottle, 12/BX
- 8125–00–NIB–0027—Industrial cleaner silk screened 8oz bottle, 12/BX

Mandatory Source of Supply: VisionCorps, Lancaster, PA
Contracting Activity: Central Office, Washington, DC

Service

Service Type: Janitorial/Custodial
Mandatory for: Veterans Administration Medical Center: 2600 M. L. King, Jr. Parkway, Des Moines, IA
Mandatory Source of Supply: Goodwill Solutions, Inc., Johnston, IA
Contracting Activity: Veterans Affairs, Department of, NAC

Patricia Briscoe,

Deputy Director, Business Operations (Pricing and Information Management).

[FR Doc. 2020–01161 Filed 1–23–20; 8:45 am]

BILLING CODE 6353–01–P

COMMITTEE FOR PURCHASE FROM PEOPLE WHO ARE BLIND OR SEVERELY DISABLED

Procurement List; Deletions

AGENCY: Committee for Purchase From People Who Are Blind or Severely Disabled.

ACTION: Deletions from the Procurement List.

SUMMARY: This action deletes services from the Procurement List that were furnished by nonprofit agencies employing persons who are blind or have other severe disabilities.

DATES: *Date deleted from the Procurement List:* February 23, 2020.

ADDRESSES: Committee for Purchase From People Who Are Blind or Severely Disabled, 1401 S. Clark Street, Suite 715, Arlington, Virginia, 22202–4149.

FOR FURTHER INFORMATION CONTACT: Michael R. Jurkowski, Telephone: (703) 603–2117, Fax: (703) 603–0655, or email *CMTEFedReg@AbilityOne.gov.*

SUPPLEMENTARY INFORMATION: This notice is published pursuant to 41 U.S.C. 8503 (a)(2) and 41 CFR 51–2.3. Its purpose is to provide interested persons an opportunity to submit comments on the proposed actions.

Deletions

On 12/20/2019, the Committee for Purchase From People Who Are Blind or Severely Disabled published notice of proposed deletions from the Procurement List.

After consideration of the relevant matter presented, the Committee has determined that the services listed below are no longer suitable for procurement by the Federal Government under 41 U.S.C. 8501–8506 and 41 CFR 51–2.4.

Regulatory Flexibility Act Certification

I certify that the following action will not have a significant impact on a substantial number of small entities. The major factors considered for this certification were:

1. The action will not result in additional reporting, recordkeeping or other compliance requirements for small entities.
2. The action may result in authorizing small entities to furnish the services to the Government.
3. There are no known regulatory alternatives which would accomplish the objectives of the Javits-Wagner-O'Day Act (41 U.S.C. 8501–8506) in connection with the services deleted from the Procurement List.

End of Certification

Accordingly, the following services are deleted from the Procurement List:

Services

Service Type: Custodial service
Mandatory for: DISA DECC Pacific, 1942 Gaffney Street, Suite 200, Pearl Harbor Naval Station, HI
Mandatory Source of Supply: Opportunities and Resources, Inc., Wahiawa, HI
Contracting Activity: Defense Information Systems Agency (DISA), IT Contracting Division—PL83
Service Type: Microfilming
Mandatory for: Government Printing Office: Program B510–S, Washington, DC
Mandatory Source of Supply: Alliance, Inc., Baltimore, MD
Contracting Activity: Government Printing Office
Service Type: Janitorial/Custodial
Mandatory for: VA Outpatient Clinic, Allentown, PA
Mandatory Source of Supply: Via of the Lehigh Valley, Inc., Bethlehem, PA
Contracting Activity: Veterans Affairs, Department of, NAC
Service Type: Mailing Services
Mandatory for: U.S. Department of Interior: Bureau of Land Management, Oregon State Office, Portland, OR
Mandatory Source of Supply: Relay

Resources, Portland, OR
Contracting Activity: Bureau of Land Management, OR—Oregon State Office
Service Type: Cleaning Services
Mandatory for: Laguna Atascosa NWR, Rio Hondo, TX
Mandatory Source of Supply: Training, Rehabilitation, & Development Institute, Inc., San Antonio, TX
Contracting Activity: Office of Policy, Management, and Budget, NBC Acquisition Services Division
Service Type: Janitorial/Custodial
Mandatory for: Department of the Treasury: Birmingham Regional Financial Center (BRFC), Birmingham, AL
Mandatory Source of Supply: Alabama Goodwill Industries, Inc., Birmingham, AL
Contracting Activity: Treasury, Department of the, Dept of Treas/
Service Type: Grounds Maintenance
Mandatory for: USCG, Chief of Staff Quarters, Bethesda, MD
Mandatory for: USCG, Commandant Quarters, Kenwood, MD
Mandatory for: USCG, Vice Commandant Quarters, Bethesda, MD
Mandatory Source of Supply: The Arc of Montgomery County, Inc., Rockville, MD
Contracting Activity: U.S. Coast Guard, U.S. Coast Guard

Patricia Briscoe,

Deputy Director, Business Operations (Pricing and Information Management).

[FR Doc. 2020–01160 Filed 1–23–20; 8:45 am]

BILLING CODE 6353–01–P

BUREAU OF CONSUMER FINANCIAL PROTECTION

[Docket No. CFPB–2020–0009]

Agency Information Collection Activities: Comment Request

AGENCY: Bureau of Consumer Financial Protection.

ACTION: Notice and request for comment.

SUMMARY: In accordance with the Paperwork Reduction Act of 1995 (PRA), the Bureau of Consumer Financial Protection (Bureau) is requesting a renewal of the Office of Management and Budget (OMB) approval for the information collection titled, ''Consumer Response Company Response Survey.''

DATES: Written comments are encouraged and must be received on or before March 24, 2020 to be assured of consideration.

ADDRESSES: You may submit comments, identified by the title of the information collection, OMB Control Number (see below), and docket number (see above), by any of the following methods:

- *Electronic: http://www.regulations.gov.* Follow the instructions for submitting comments.
- *Mail/Hand Delivery/Courier:* Bureau of Consumer Financial Protection (Attention: PRA Office), 1700 G Street NW, Washington, DC 20552.

Please note that comments submitted after the comment period will not be accepted. In general, all comments received will become public records, including any personal information provided. Sensitive personal information, such as account numbers or Social Security numbers, should not be included.

FOR FURTHER INFORMATION CONTACT: Documentation prepared in support of this information collection request is available at *www.regulations.gov.* Requests for additional information should be directed to the Bureau of Consumer Financial Protection (Attention: PRA Office), 1700 G Street NW, Washington, DC 20552; telephone: (202) 435–9575, or email: *PRA_Comments@cfpb.gov. Please do not submit comments to this mailbox.*

SUPPLEMENTARY INFORMATION:

Title of Collection: Consumer Response Company Response Survey.

OMB Control Number: 3170–0069.

Type of Review: Extension without change of a currently approved information collection.

Affected Public: Individuals or Households.

Estimated Number of Respondents: 47,900.

Estimated Total Annual Burden Hours: 3,830.

Abstract: The purpose of this information collection is to continue the collection of consumer feedback through an optional survey at the end of the consumer complaint process. Through the existing survey, consumers have the option to provide feedback on the company's response to and handling of their complaint. The results of this feedback are shared with the company that responded to the complaint to inform its complaint handling. The feedback is also used as one of several inputs to inform the Bureau's work to assess the accuracy, completeness, and timeliness of company responses to consumer complaints.

The consumer has the ability to answer three questions about the company's response to and handling of his or her complaint and provide a narrative description in support of each answer. Positive feedback about the company's handling of the consumer's complaint would be reflected by affirmative answers to each question and by the narrative in support of each answer. The Company Response Survey allows consumers to offer both positive and negative feedback on their complaint experience.

Request for Comments: Comments are invited on: (a) Whether the collection of information is necessary for the proper performance of the functions of the Bureau, including whether the information will have practical utility; (b) The accuracy of the Bureau's estimate of the burden of the collection of information, including the validity of the methods and the assumptions used; (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 on respondents, including through the use of automated collection techniques or other forms of information technology. Comments submitted in response to this notice will be summarized and/or included in the request for OMB approval. All comments will become a matter of public record.

Dated: January 21, 2020.

Darrin King,

Paperwork Reduction Act Officer, Bureau of Consumer Financial Protection.

[FR Doc. 2020–01156 Filed 1–23–20; 8:45 am]

BILLING CODE 4810–AM–P

DEPARTMENT OF DEFENSE

Office of the Secretary

[Transmittal No. 19–0Q]

Arms Sales Notification

AGENCY: Defense Security Cooperation Agency, Department of Defense.

ACTION: Arms sales notice.

SUMMARY: The Department of Defense is publishing the unclassified text of an arms sales notification.

FOR FURTHER INFORMATION CONTACT: Karma Job at *karma.d.job.civ@mail.mil* or (703) 697–8976.

SUPPLEMENTARY INFORMATION: This 36(b)(5)(C) arms sales notification is published to fulfill the requirements of section 155 of Public Law 104–164 dated July 21, 1996. The following is a copy of a letter to the Speaker of the House of Representatives, and Transmittal 19–0Q.

Dated: January 17, 2020.

Aaron T. Siegel,

Alternate OSD Federal Register Liaison Officer, Department of Defense.

BILLING CODE 5001–06–P

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

JAN 0 7 2020

The Honorable Nancy Pelosi
Speaker of the House
U.S. House of Representatives
H-209, The Capitol
Washington, DC 20515

Dear Madam Speaker:

Pursuant to the reporting requirements of Section 36(b)(5)(C) of the Arms Export Control Act (AECA), as amended, we are forwarding Transmittal No. 19-0Q. This notification relates to enhancements or upgrades from the level of sensitivity of technology or capability described in the Section 36(b)(1) AECA certification 15-09 of February 18, 2015.

Sincerely,

Charles W. Hooper
Lieutenant General, USA
Director

Enclosures:
1. Transmittal

BILLING CODE 5001–06–C

Transmittal No. 19-0Q

REPORT OF ENHANCEMENT OR UPGRADE OF SENSITIVITY OF TECHNOLOGY OR CAPABILITY (SEC. 36(B)(5)(C), AECA)

(i) *Prospective Purchaser*: Government of the Slovak Republic
(ii) *Sec. 36(b)(1), AECA Transmittal No.*: 15-09
Date: February 18, 2015
Military Department: Army
(iii) *Description*: On February 18, 2015, Congress was notified by Congressional certification transmittal number 15-09, of the possible sale under Section 36(b)(l) of the Arms Export Control Act of nine UH-60M Black Hawk Helicopters in standard U.S. Government configuration with designated unique equipment and Government Furnished Equipment (GFE); twenty T700-GE-701D Engines (18 installed and 2 spares); twenty Embedded Global Positioning Systems/ Inertial Navigation Systems; two Aviation Mission Planning Systems; one Aviation Ground Power Unit; eleven AN/APX-123 Identification Friend or Foe Transponders; twenty Very High Frequency/Digitally Selective Calling AN/ARC-231 radios; eleven ARN-147 VHF Omni Ranging/Instrument Landing System (VOR/ILS); eleven AN/ARN-153 Tactical Air Navigation Systems; and eleven AN/ARC-201D Single Channel Ground and Airborne Radio Systems radios. Also included are aircraft warranty, ammunition, air worthiness support, facility construction, spare and repair parts, support equipment, communication equipment, publications and technical documentation, personnel training and training equipment, site surveys, tool and test equipment, U.S. Government and contractor technical and logistics support services, and other related element of program and logistics support. The estimated total cost was $450 million. Major Defense Equipment

(MDE) constituted $250 million of this total.

On March 14, 2019, Congress was notified by Congressional certification transmittal number 0G-19 of the Slovak Republic's request to include twenty (20) M240H machine guns (MDE items). The estimated MDE value for these guns was $200,000 but due to price decreases in MDE items previously notified, the MDE cost remained $250 million. The total case value remained $450 million.

This transmittal reports the addition of:

1. Two (2) UH-60M Black Hawk helicopters in standard USG configuration with designated unique equipment and Government Furnished Equipment (GFE) (MDE);
2. Four (4) T700-GE-701D engines (MDE);
3. Five (5) H-764GU Embedded Global Positioning/Inertial Navigation (EGI) systems (MDE);
4. Five (5) AN/AAR-57 Common Missile Warning Systems (CMWS) (MDE);
5. Four (4) M240H machine guns (MDE); and,
6. Aviation Mission Planning Systems (AMPS), Engine Inlet Barrier Filter (EIBF) system, TALON III Forward Looking Infrared Radar (FLIR) EO/IR system, Fast Rope Insertion Extraction System (FRIES), External Rescue Hoist (ERH), Internal Auxiliary Fuel Tank System (IAFTS), EBC-406HM Emergency Locator Transmitter (ELT), AN/AVS-7 Night/Day Improved Heads-Up Display (iHUD), LRIP Crew Chief Gunner Seats, Ballistic Armor Protection System (BAPS), basic aircraft warranty, CONUS and OCONUS air worthiness support, calibration services, spare and repair parts, aviation and peculiar ground support equipment, communication equipment, weapons, ammunition, publications and technical documentation, personnel and equipment training, site surveys, special tools and test equipment, U.S. Government and contractor technical and logistics support services, and other related element of program and logistics support.

The estimated MDE value of these items is $150 million, resulting in a revised MDE cost of $400 million. There is also a $100 million non-MDE value increase. The revised total case value is $700 million.

(iv) *Significance*: This proposed sale will significantly increase the Slovak Air Force's capability to conduct domestic search and rescue missions, border surveillance operations, special operation forces (SOF) operations support, and contribute to NATO and other coalition operations.

(v) *Justification*: This proposed sale will support the foreign policy and national security of the United States by helping to improve the security of a NATO ally in developing and maintaining a strong and ready self-defense capability. This proposed sale will enhance U.S. national security objectives in the region.

(vi) *Sensitivity of Technology*: The statement contained in the original AECA 36(b)(1) transmittal applies to some of the MDE items reported here.

The AAR-57A Common Missile Warning System (CMWS) detects energy emitted by threat missile in-flight, evaluates potential false alarm emitters in the environment, declares validity of threat and selects appropriate counter-measures. The CMWS consists of an Electronic Control Unit (ECU), Electro-Optic Missile Sensors (EOMSs), and Sequencer and Improved Countermeasures Dispenser (ICMD). Reverse engineering is not a major concern. The ECU hardware is classified CONFIDENTIAL; releasable technical manuals for operation and maintenance are classified SECRET.

Common Missile Warning System (CMWS) User Data Module (UDM) to support Generation III Electronics Control Unit (ECU). The UDM is a ruggedized, portable, hand-held data storage device for securely receiving, storing, and transferring data between CMWS ECUs (similar to a flash, or ''thumb'' drive). The UDM itself is UNCLASSIFIED when initially received. However, when loaded with data, it becomes classified to the appropriate level of the data. In the case of CMWS Software, this raises the classification level to SECRET.

Common Missile Warning System (CMWS) Classified Software is provided as Country Specific Software required for the operation and support of the Common Missile Warning System (CMWS) AN/AAR-57. The software, once developed and encrypted, is loaded on a User Data Module (UDM) for transfer and use by the Customer. The software is classified SECRET.

The AN/APR-39A Radar Signal Detecting Set is a system that provides warning of radar directed air defense threat and allows appropriate countermeasures. This is the 1553 databus compatible configuration. The hardware is classified CONFIDENTIAL when programmed with U.S. threat data; releasable technical manual for operation and maintenance are classified CONFIDENTIAL; releasable technical data (technical performance) is classified SECRET.

Operational Mission Data Set (MDS) in support of the AN/APR-39C(V)l/4 including Software Development. The MDS is a Country Specific, customer defined software data set that defines the radar emitter specifications used by the APR-39C(V)l/4 Radar Warning Receiver to examine signal received signal for potential threats. The Data Set includes data Electronic Warfare Integrated Preprogramming Database (EWIRDB) emitter parametric information to generate the MDS. The MDS is classified SECRET.

The AN/AVR-2B Laser Detecting Set is a passive laser warning system that receives, processes and displays threat information resulting from aircraft illumination by lasers on multifunctional display. The hardware is classified CONFIDENTIAL; releasable technical manuals for operation and maintenance are classified SECRET.

(vii) *Date Report Delivered to Congress*: January 7, 2020

[FR Doc. 2020–01141 Filed 1–23–20; 8:45 am]

BILLING CODE 5001–06–P

DEPARTMENT OF DEFENSE

Office of the Secretary

Publication of Housing Price Inflation Adjustment

AGENCY: Office of the Under Secretary (Personnel and Readiness), Department of Defense (DoD).

ACTION: Notice of housing price inflation adjustment.

SUMMARY: The Department of Defense is announcing the 2019 rent threshold under the Servicemembers Civil Relief Act. Applying the inflation adjustment for 2019, the maximum monthly rental amount as of January 1, 2020, will be $3,991.90.

DATES: These housing price inflation adjustments are effective January 1, 2020.

FOR FURTHER INFORMATION CONTACT: Lt Col Ryan Hendricks, Office of the Under Secretary of Defense for Personnel and Readiness, (703) 571–9301.

SUPPLEMENTARY INFORMATION: The Servicemembers Civil Relief Act, as codified at 50 U.S.C. App. 3951, prohibits a landlord from evicting a Service member (or the Service member's family) from a residence during a period of military service, except by court order. The law as originally passed by Congress applied to dwellings with monthly rents of $2,400 or less. The law requires the DoD to adjust this amount annually to reflect inflation and to publish the new amount in the **Federal Register**. Applying the

inflation adjustment for 2019, the maximum monthly rental amount for 50 U.S.C. App. 3951(a)(1)(A)(ii) as of January 1, 2020, will be $3,991.90.

Dated: January 21, 2020.

Aaron T. Siegel,

Alternate OSD Federal Register Liaison Officer, Department of Defense.

[FR Doc. 2020–01202 Filed 1–23–20; 8:45 am]

BILLING CODE 5001–06–P

DEPARTMENT OF DEFENSE

Office of the Secretary

[Transmittal No. 20–06]

Arms Sales Notification

AGENCY: Defense Security Cooperation Agency, Department of Defense.

ACTION: Arms sales notice.

SUMMARY: The Department of Defense is publishing the unclassified text of an arms sales notification.

FOR FURTHER INFORMATION CONTACT: Karma Job at *karma.d.job.civ@mail.mil* or (703) 697–8976.

SUPPLEMENTARY INFORMATION: This 36(b)(1) arms sales notification is published to fulfill the requirements of section 155 of Public Law 104–164 dated July 21, 1996. The following is a copy of a letter to the Speaker of the House of Representatives, Transmittal 20–06, Policy Justification and Sensitivity of Technology.

Dated: January 17, 2020.

Aaron T. Siegel,

Alternate OSD Federal Register Liaison Officer, Department of Defense.

BILLING CODE 5001–06–P

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

JAN 0 9 2020

The Honorable Nancy Pelosi
Speaker of the House
U.S. House of Representatives
H-209, The Capitol
Washington, DC 20515

Dear Madam Speaker:

Pursuant to the reporting requirements of Section 36(b)(1) of the Arms Export Control Act, as amended, we are forwarding herewith Transmittal No. 20-06 concerning the Air Force's proposed Letter(s) of Offer and Acceptance to the Government of Singapore for defense articles and services estimated to cost $2.750 billion. After this letter is delivered to your office, we plan to issue a news release to notify the public of this proposed sale.

Sincerely,

Charles W. Hooper
Lieutenant General, USA
Director

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

BILLING CODE 5001–06–C

Transmittal No. 20-06

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

(i) *Prospective Purchaser*: Government of Singapore

(ii) *Total Estimated Value:*

Major Defense Equipment *	$1.625 billion
Other	$1.125 billion
TOTAL	$2.750 billion

(iii) *Description and Quantity or Quantities of Articles or Services under Consideration for Purchase*:

Major Defense Equipment (MDE):

Up to twelve (12) F-35B Short Take-Off and Vertical Landing (STOVL) Aircraft (Four (4) F-35B STOVL Aircraft with the option to purchase an additional Eight (8) F-35B STOVL Aircraft)

Up to thirteen (13) Pratt and Whitney F135 Engines (includes 1 initial spare)

Non-MDE:

Also included are Electronic Warfare Systems; Command, Control, Communication, Computers and Intelligence/Communication, Navigation and Identification (C4I/CNI) system; Autonomic Logistics Global

Support System (ALGS); Autonomic Logistics Information System (ALIS); F-35 Training System; Weapons Employment Capability and other Subsystems, Features and Capabilities; F-35 unique infrared flares; reprogramming center access and F-35 Performance Based Logistics; software development/integration; aircraft transport from Ft. Worth, TX to the CONUS initial training base and tanker support (if necessary); spare and repair parts; support equipment, tools and test equipment; technical data and publications; personnel training and training equipment; U.S. Government and contractor engineering, technical, and logistics support services; and other related elements of logistics support.

(iv) *Military Department*: Air Force (SN-D-SAE)

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

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

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

(viii) *Date Report Delivered to Congress*: January 9, 2020

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

POLICY JUSTIFICATION

Singapore—F-35B Short Take-Off and Vertical Landing (STOVL)

The Government of Singapore has requested to buy up to twelve (12) F-35B Short Take-Off and Vertical Landing (STOVL) aircraft (four (4) F-35B STOVL aircraft with the option to purchase an additional eight (8) F-35B STOVL aircraft); and up to thirteen (13) Pratt and Whitney F135 Engines (includes 1 initial spare). Also included are Electronic Warfare Systems; Command, Control, Communication, Computers and Intelligence/Communication, Navigation and Identification (C4I/CNI) system; Autonomic Logistics Global Support System (ALGS); Autonomic Logistics Information System (ALIS); F-35 Training System; Weapons Employment Capability and other Subsystems, Features and Capabilities; F-35 unique infrared flares; reprogramming center access and F-35 Performance Based Logistics; software development/integration; aircraft transport from Ft. Worth, TX to the CONUS initial training base and tanker support (if necessary); spare and repair parts; support equipment, tools and test equipment; technical data and publications; personnel training and training equipment; U.S. Government and contractor engineering, technical, and logistics support services; and other related elements of logistics support. The total estimated cost is $2.750 billion.

This proposed sale will support the foreign policy and national security objectives of the United States. Singapore is a strategic friend and Major Security Cooperation Partner and an important force for political stability and economic progress in the Asia Pacific region.

This proposed sale of F-35s will augment Singapore's operational aircraft inventory and enhance its air-to-air and air-to-ground self-defense capability, adding to an effective deterrence to defend its borders and contribute to coalition operations with other allied and partner forces. Singapore will have no difficulty absorbing these aircraft into its armed forces.

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

The prime contractors will be Lockheed Martin Aeronautics Company, Fort Worth, Texas, and Pratt and Whitney Military Engines, East Hartford, Connecticut. There are no known offset agreements proposed in connection with this potential sale.

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

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

Transmittal No. 20-06

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

Annex

Item No. vii

(vii) *Sensitivity of Technology*:

1. The F-35B Short Take-Off and Vertical Landing (STOVL) aircraft is a single-seat, single-engine, all-weather, stealth, fifth-generation, multirole aircraft. It contains sensitive technology including the low observable airframe/outer mold line, the Pratt and Whitney F135 engine, AN/APG-81 radar, an integrated core processor central computer, mission systems/electronic warfare suite, a multiple sensor suite, technical data/documentation, and associated software. Sensitive elements of the F-35B are also included in operational flight and maintenance trainers.

a. The Pratt and Whitney F135 engine is a single 40,000-lb thrust class engine designed for the F-35 and assures highly reliable, affordable performance. The engine is designed to be utilized in all F-35 variants, providing unmatched commonality and supportability throughout the worldwide base ofF-35 users. The Short Takeoff and Vertical Landing (STOVL) propulsion configuration consists of the main engine, diverter-less supersonic inlet, a three (3) Bearing Swivel Module, Roll Posts and Duct Assembly System, and Lift Fan.

b. The AN/APG-81 Active Electronically Scanned Array (AESA) is a high processing power/high transmission power electronic array capable of detecting air and ground targets from a greater distance than mechanically scanned array radars. It also contains a synthetic aperture radar (SAR), which creates high-resolution ground maps and provides weather data to the pilot, and provides air and ground tracks to the mission system, which uses it as a component to fuse sensor data.

c. The Electro-Optical Targeting System (EOTS) provides long-range detection and tracking as well as an infrared search and track (IRST) and forward-looking infrared (FLIR) capability for precision tracking, weapons delivery, and bomb damage assessment (BDA). The EOTS replaces multiple separate internal or podded systems typically found on legacy aircraft.

d. The Electro-Optical Distributed Aperture System (EODAS) provides the pilot with full spherical coverage for air-to-air and air-to-ground threat awareness, day/night vision enhancements, a fire control capability, and precision tracking of wingmen/friendly aircraft. The EODAS provides data directly to the pilot's helmet as well as the mission system.

e. The Electronic Warfare (EW) system is a reprogrammable, integrated system that provides radar warning and electronic support measures (ESM) along with a fully integrated countermeasures (CM) system. The EW system is the primary subsystem used to enhance situational awareness, targeting support and self-defense through the search, intercept, location, and identification of in-band emitters and to automatically counter IR and RF threats.

f. The Command, Control, Communications, Computers and Intelligence/Communications, Navigation, and Identification (C4I/CNI) system provides the pilot with unmatched connectivity to flight members, coalition forces, and the battlefield. It is an integrated subsystem designed to provide a broad spectrum of secure, anti-jam voice and data communications, precision radio navigation and landing capability, self-identification, beyond visual range target identification, and connectivity to

off-board sources of information. It also includes an inertial navigation and global positioning system (GPS) for precise location information. The functionality is tightly integrated within the mission system to enhance efficiency.

g. The aircraft C4I/CNI system includes two data links, the Multi-Function Advanced Data Link (MADL) and Link 16. The MADL is designed specifically for the F-35 and allows for stealthy communications between F-35s. Link 16 data link equipment allows the F-35 to communicate with legacy aircraft using widely distributed J-series message protocols.

h. The F-35 Autonomic Logistics Global Sustainment (ALGS) provides a fully integrated logistics management solution. ALGS integrates a number of functional areas including supply chain management, repair, support equipment, engine support, and training. The ALGS infrastructure employs a state-of-the-art information system that provides real-time, decision-worthy information for sustainment decisions by flight line personnel. Prognostic health monitoring technology is integrated with the air system and is crucial to predictive maintenance of vital components.

i. The F-35 Autonomic Logistics Information System (ALIS) provides an intelligent information infrastructure that binds all the key concepts of ALGS into an effective support system. ALIS establishes the appropriate interfaces among the F-35 Air Vehicle, the warfighter, the training system, government information technology (IT) systems, and supporting commercial enterprise systems. Additionally, ALIS provides a comprehensive tool for data collection and analysis, decision support, and action tracking.

j. The F-35 Training System includes several training devices to provide integrated training for pilots and maintainers. The pilot training devices include a Full Mission Simulator (FMS) and Deployable Mission Rehearsal Trainer (DMRT). The maintainer training devices include an Aircraft Systems Maintenance Trainer (ASMT), Ejection System Maintenance Trainer (ESMT), Outer Mold Line (OML) Lab, Flexible Linear Shaped Charge (FLSC) Trainer, Fl35 Engine Module Trainer, and Weapons Loading Trainer (WLT). The F-35 Training System can be integrated, where both pilots and maintainers learn in the same Integrated Training Center (ITC). Alternatively, the pilots and maintainers can train in separate facilities (Pilot Training Center and Maintenance Training Center).

k. Other subsystems, features, and capabilities include the F-35's low observable airframe, Integrated Core Processor (ICP) Central Computer, Helmet Mounted Display System (HMDS), Pilot Life Support System, Off-Board Mission Support (OMS) System, and publications/maintenance manuals. The HMDS provides a fully sunlight readable, bi-ocular display presentation of aircraft information projected onto the pilot's helmet visor. The use of a night vision camera integrated into the helmet eliminates the need for separate Night Vision Goggles (NVG). The Pilot Life Support System provides a measure of Pilot Chemical, Biological, and Radiological Protection through use of an On Board Oxygen Generating System (OBOGS); and an escape system that provides additional protection to the pilot. OBOGS takes the Power and Thermal Management System (PTMS) air and enriches it by removing gases (mainly nitrogen) by adsorption, thereby increasing the concentration of oxygen in the product gas and supplying breathable air to the pilot. The OMS provides a mission planning, mission briefing, and a maintenance/intelligence/tactical debriefing platform for the F-35.

2. The Reprogramming Center is located in the U.S. and provides F-35 customers a means to update F-35 electronic warfare databases.

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

4. A determination has been made that Singapore can provide substantially the same degree of protection for the sensitive technology being released as the U.S. Government. This proposed sale is necessary to further the U.S. foreign policy and national security objectives outlined in the Policy Justification. Moreover, the benefits to be derived from this sale, as outlined in the Policy Justification, outweigh the potential damage that could result if the sensitive technology were revealed to unauthorized persons.

5. All defense articles and services listed on this transmittal have been authorized for release and export to the Government of Singapore.

[FR Doc. 2020–01142 Filed 1–23–20; 8:45 am]

BILLING CODE 5001–06–P

DEPARTMENT OF DEFENSE

Office of the Secretary

Defense Advisory Committee on Investigation, Prosecution, and Defense of Sexual Assault in the Armed Forces; Notice of Federal Advisory Committee Meeting

AGENCY: General Counsel of the Department of Defense, Department of Defense (DoD).

ACTION: Notice of Federal Advisory Committee meeting.

SUMMARY: The DoD is publishing this notice to announce that the following Federal Advisory Committee meeting of the Defense Advisory Committee on Investigation, Prosecution, and Defense of Sexual Assault in the Armed Forces (DAC–IPAD) will take place.

DATES: Open to the public, Friday, February 14, 2020, from 9:00 a.m. to 3:30 p.m.

ADDRESSES: The Westin Arlington Gateway Hotel, 801 N Glebe Road, Arlington, VA 22203 Arlington, Virginia.

FOR FURTHER INFORMATION CONTACT: Dwight Sullivan, 703–695–1055 (Voice), *dwight.h.sullivan.civ@mail.mil* (Email). Mailing address is DAC–IPAD, One Liberty Center, 875 N Randolph Street, Suite 150, Arlington, Virginia 22203. Website: *http://dacipad.whs.mil/*. The most up-to-date changes to the meeting agenda can be found on the website.

SUPPLEMENTARY INFORMATION: This meeting is being held under the provisions of the Federal Advisory Committee Act (FACA) of 1972 (5 U.S.C., Appendix, as amended), the Government in the Sunshine Act of 1976 (5 U.S.C. 552b, as amended), and 41 CFR 102–3.140 and 102–3.150.

Purpose of the Meeting: In section 546 of the National Defense Authorization Act for Fiscal Year 2015 (Pub. L. 113–291), as modified by section 537 of the National Defense Authorization Act for Fiscal Year 2016 (Pub. L. 114–92), Congress tasked the DAC–IPAD to advise the Secretary of Defense on the investigation, prosecution, and defense of allegations of rape, forcible sodomy, sexual assault, and other sexual misconduct involving members of the Armed Forces. This will be the sixteenth public meeting held by the DAC–IPAD. At this meeting the Committee will receive testimony from former military judges about their views on the current military justice system and military sexual assault cases—including their perspectives on the conviction and acquittal rates for sexual

assault. The Committee will conduct final deliberations on its draft Fourth Annual Report. The Committee will also receive updates from the DAC–IPAD's Case Review, Policy, and Data Working Groups regarding each group's ongoing projects. Finally, DAC–IPAD staff will provide updates to the Committee on the military installation site visit plan for members in 2020; sexual assault court-martial attendance by Committee members; and the new tasks for the DAC–IPAD contained in the National Defense Authorization Act for Fiscal Year 2020.

Agenda: 9:00 a.m.–9:05 a.m. Public Meeting Begins—Welcome and Introduction; 9:05 a.m.–11:00 a.m. Military Judges' Perspectives Regarding the Military Justice System and Military Sexual Assault Cases—Including Conviction and Acquittal Rates; 11:00 a.m.–11:15 a.m. Break; 11:15 a.m.–12:00 p.m. Committee Deliberations on the Military Judges' Testimony; 12:00 p.m.–1:00 p.m. Lunch; 1:00 p.m.–1:30 p.m. Committee Final Deliberations on the DAC–IPAD's Draft Fourth Annual Report Chapter 1—Sexual Assault Case Review Project Observations; and Case Review Working Group Update; 1:30 p.m.–2:00 p.m. Committee Final Deliberations on the DAC–IPAD's Draft Fourth Annual Report Chapter 3—Article 32, UCMJ, Preliminary Hearings and the Convening Authority's Disposition Decision; and Policy Working Group Update; 2:00 p.m.–2:30 p.m. Committee Final Deliberations on the DAC–IPAD's Draft Fourth Annual Report Chapter 2—Case Adjudication Data; Chapter 4—Collateral Misconduct; and Committee Vote on Complete Report; 2:30 p.m.–2:45 p.m. Break; 2:45 p.m.–2:55 p.m. 2020 Military Installation Site Visit Update and Members Attending Sexual Assault Courts-Martial Update; 2:55 p.m.–3:15 p.m. New DAC–IPAD Tasks FY 2020 National Defense Authorization Act Presentation and Discussion; 3:15 p.m.–3:30 p.m. Meeting Wrap-Up and Public Comment; 3:30 p.m. Public Meeting Adjourned.

Meeting Accessibility: Pursuant to 5 U.S.C. 552b and 41 CFR 102–3.140 through 102–3.165, and the availability of space, this meeting is open to the public. Seating is limited and is on a first-come basis. Individuals requiring special accommodations to access the public meeting should contact the DAC–IPAD at *whs.pentagon.em.mbx.dacipad@mail.mil* at least five (5) business days prior to the meeting so that appropriate arrangements can be made. In the event the Office of Personnel Management closes the government due to inclement weather or for any other reason, please consult the website for any changes to the public meeting date or time.

Written Statements: Pursuant to 41 CFR 102–3.140 and section 10(a)(3) of the Federal Advisory Committee Act of 1972, the public or interested organizations may submit written comments to the Committee about its mission and topics pertaining to this public session. Written comments must be received by the DAC–IPAD at least five (5) business days prior to the meeting date so that they may be made available to the Committee members for their consideration prior to the meeting. Written comments should be submitted via email to the DAC–IPAD at *whs.pentagon.em.mbx.dacipad@mail.mil* in the following formats: Adobe Acrobat or Microsoft Word. Please note that since the DAC–IPAD operates under the provisions of the Federal Advisory Committee Act, as amended, all written comments will be treated as public documents and will be made available for public inspection. Oral statements from the public will be permitted, though the number and length of such oral statements may be limited based on the time available and the number of such requests. Oral presentations by members of the public will be permitted from 3:20 p.m. to 3:30 p.m. on February 14, 2020, in front of the Committee members.

Dated: January 21, 2020.

Aaron T. Siegel,

Alternate OSD Federal Register Liaison Officer, Department of Defense.

[FR Doc. 2020–01209 Filed 1–23–20; 8:45 am]

BILLING CODE 5001–06–P

DEPARTMENT OF DEFENSE

Office of the Secretary

[Transmittal No. 19–66]

Arms Sales Notification

AGENCY: Defense Security Cooperation Agency, Department of Defense.

ACTION: Arms sales notice.

SUMMARY: The Department of Defense is publishing the unclassified text of an arms sales notification.

FOR FURTHER INFORMATION CONTACT: Karma Job at *karma.d.job.civ@mail.mil* or (703) 697–8976.

SUPPLEMENTARY INFORMATION: This 36(b)(1) arms sales notification is published to fulfill the requirements of section 155 of Public Law 104–164 dated July 21, 1996. The following is a copy of a letter to the Speaker of the House of Representatives, Transmittal 19–66, Policy Justification and Sensitivity of Technology.

Dated: January 17, 2020.

Aaron T. Siegel,

Alternate OSD Federal Register Liaison Officer, Department of Defense.

BILLING CODE 5001–06–P

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

The Honorable Nancy Pelosi
Speaker of the House
U.S. House of Representatives
H-209, The Capitol
Washington, DC 20515

JAN 1 4 2020

Dear Madam Speaker:

Pursuant to the reporting requirements of Section 36(b)(1) of the Arms Export Control Act, as amended, we are forwarding herewith Transmittal No. 19-66 concerning the Navy's proposed Letter(s) of Offer and Acceptance to the Government of Australia for defense articles and services estimated to cost $1.50 billion. After this letter is delivered to your office, we plan to issue a news release to notify the public of this proposed sale.

Sincerely,

Charles W. Hooper
Lieutenant General, USA
Director

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

BILLING CODE 5001–06–C

Transmittal No. 19-66

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

(i) *Prospective Purchaser*: Government of Australia

(ii) *Total Estimated Value*:

Major Defense Equipment *	$ .50 billion
Other	$1.00 billion
TOTAL	$1.50 billion

(iii) *Description and Quantity or Quantities of Articles or Services under Consideration for Purchase*: The Government of Australia has requested to buy long lead items, engineering development activities, and other defense services to support the Australian Surface Combatant Program, including the modernization of three Hobart Class Destroyers, and construction of the first three (of nine total) Hunter Class Frigates.

Major Defense Equipment (MDE):

Three (3) Shipsets of the AEGIS Weapon System (AWS) in the MK 6 Mod 1 configuration to support the Modernization of the Hobart Class DDGs, including: AEGIS Combat System Support Equipment (ACSSE); Weapon

Data Recording Cabinet (WDRC) equipment; Multi-Mission Signal Processor (MMSP-R) equipment; Network, Processing and Storage (NPS) equipment; Consoles Displays and Peripherals (CDP) equipment; Embedded Training System (ETS); Kill Assessment System (KAS); and Shipboard Gridlock System (SGS).

Three (3) Shipsets of the AEGIS Weapon System (AWS) in the MK 6 Mod 1 configuration to support the New Construction of the Hunter Class FFGs, including AEGIS Combat System Support Equipment (ACSSE); Electronic Equipment Fluid Cooler (EEFC) equipment; and Network, Processing and Storage (NPS) equipment; and Consoles Displays and Peripherals (CDP) equipment; Shipboard Gridlock System (SGS); Embedded Training System (ETS) and AN/SPQ-15 equipment.

Three (3) shipsets of the MK 41 Vertical Launching Systems (VLS) for installation on the Hunter Class Frigates;

Three (3) shipsets (2 mounts per ship) of the Close-In Weapons System (CIWS) for installation on the Hunter Class Frigates;

Two (2) Australia AEGIS Weapon System Computer Programs (one for Hobart Class, one for Hunter Class), and associated computer programs for AEGIS Combat System components for installation on both the Hobart and Hunter Class ships;

Six (6) shipsets of the Global Positioning System (GPS)—Based Positioning, Navigation and Timing Service (GPNTS) Navigation Systems and associated Advanced Digital Antenna Production (ADAP) antennas and support equipment for installation on the Hobart and Hunter Class ships;

Six (6) shipsets of upgraded Cooperative Engagement Capability (CEC) equipment for installation on the Hobart and Hunter Class ships;

Six (6) shipsets of Command and Control Processor (C2P) equipment for installation on the Hobart and Hunter Class ships;

Eight (8) shipsets of Multifunctional Information Distribution System Joint Tactical Radio Set (MIDS JTRS) terminals for installation on the Hobart and Hunter Class ships.

Non-MDE:

Also included are:

Three (3) shipsets of MK 34 Gun Weapon System (GWS) modification equipment to include the Electro Optical Sight System and changes supporting Naval Fires Planner and associated TacLink Control System for installation on the Hobart Class Destroyers;

Three (3) shipsets of MK 34 Gun Weapon System components to include the MK 160 Gun Computing System and the MK 20 Electro Optical Sight System, and the Naval Fires Planner and associated TacLink Control System for installation on the Hunter Class Frigates;

Three (3) shipsets of: Mode 5/S capable Identification, Friend of Foe (IFF) Systems; Gigabit Ethernet Data Multiplexing System (GEDMS); AN/WSN-7 Ring Laser Gyrocompass Inertial Navigation Systems; WSN-9 Digital Hybrid Speed Log systems; Common Data Link Management System (CDLMS); and Global Command and Control System—Maritime (GCCS–M) systems for installation on the Hunter Class Frigates;

Six (6) shipsets of AN/SRQ–4 Hawklink and SQQ–89 Sonobuoy processing equipment for installation on the Hobart and Hunter Class ships;

Defense services for development and integration of a capability upgrade for the installed AEGIS Combat System on the Hobart Class Destroyer, including Integrated Air and Missile Defense capability and growth capability for Ballistic Missile Defense;

Development, integration and testing support for installation of a AEGIS Combat System for installation on the Hunter Class FFG, a Global Combat Ship Type 26 (BAE) platform, including the integration of the indigenous CEAFAR 2 Phased Array Radar (CEA Industries) with the AEGIS Combat System (including Cooperative Engagement Capability) and the primary radar sensor and illuminator;

Integration of selected Australian provided combat system components including Undersea Warfare and Ship Self Defense for installation on the Hobart and Hunter Class ships;

Integration of the MH–60R helicopter into the AEGIS Combat System for installation on the Hobart and Hunter Class ships;

Procurement and delivery of installation support material, special purpose test equipment, initial logistics outfitting, spares and other ancillary equipment to support the installation and integration of AEGIS Combat System equipment in the Hunter and Hobart class ship platforms;

Development of technical documentation to support both programs; provision of logistics and other support services to support the Hobart and Hunter Class ships;

Procurement, staging, delivery and installation support for AEGIS Combat System equipment for the Hobart and Hunter Class ships;

Provision of training support for curriculum development, training tool development, front-end analysis, and crew training for the Hobart and Hunter Class ships;

U.S. Government and contractor representative engineering, logistics, and technical support services; and other related elements of logistics and program support for the Hobart and Hunter Class ships.

(iv) *Military Department*: Navy (AT-P-LFZ)

(v) *Prior Related Cases, if any*: AT-P-LCQ, AT-P-GSU, and AT-P-GSC

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

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

(viii) *Date Report Delivered to Congress*: January 14, 2020

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

POLICY JUSTIFICATION

Australia – Australia Surface Combatant (ASC) Program

The Government of Australia has requested to buy long lead items, engineering development activities, and other defense services to support the Australian Surface Combatant Program, including the modernization of three Hobart Class Destroyers, and construction of the first three (of nine total) Hunter Class Frigates which includes: three (3) Shipsets of the AEGIS Weapon System (AWS) in the MK 6 Mod 1 configuration to support the Modernization of the Hobart Class DDGs; three (3) Shipsets of the AEGIS Weapon System (AWS) in the MK 6 Mod 1 configuration to support the New Construction of the Hunter Class FFGs; three (3) shipsets of the MK 41 Vertical Launching Systems (VLS) for installation on the Hunter Class Frigates; three (3) shipsets (2 mounts per ship) of the Close-In Weapons System (CIWS) for installation on the Hunter Class Frigates; two (2) Australia AEGIS Weapon System Computer Programs (one for Hobart Class, one for Hunter Class), and associated computer programs for AEGIS Combat System components for installation on both the Hobart and Hunter Class ships; six (6) shipsets of the Global Positioning System (GPS) - Based Positioning, Navigation and Timing Service (GPNTS) Navigation Systems and associated Advanced Digital Antenna Production (ADAP) antennas and support equipment for installation on the Hobart and Hunter Class ships; six (6) shipsets of upgraded Cooperative Engagement

Capability (CEC) equipment for installation on the Hobart and Hunter Class ships; six (6) shipsets of Command and Control Processor (C2P) equipment for installation on the Hobart and Hunter Class ships; and eight (8) shipsets of Multifunctional Information Distribution System Joint Tactical Radio Set (MIDS JTRS) terminals for installation on the Hobart and Hunter Class ships. Also included are: three (3) shipsets of MK 34 Gun Weapon System (GWS) modification equipment to include the Electro Optical Sight System and changes supporting Naval Fires Planner and associated TacLink Control System for installation on the Hobart Class Destroyers; three (3) shipsets of MK 34 Gun Weapon System components to include the MK 160 Gun Computing System and the MK 20 Electro Optical Sight System, and the Naval Fires Planner and associated TacLink Control System for installation on the Hunter Class Frigates; three (3) shipsets of: Mode 5/S capable Identification, Friend of Foe (IFF) Systems; Gigabit Ethernet Data Multiplexing System (GEDMS); AN/WSN-7 Ring Laser Gyrocompass Inertial Navigation Systems; WSN-9 Digital Hybrid Speed Log systems; Common Data Link Management System (CDLMS); and Global Command and Control System-Maritime (GCCS-M) systems for installation on the Hunter Class Frigates; six (6) shipsets of AN/SRQ-4 Hawklink and SQQ-89 Sonobuoy processing equipment for installation on the Hobart and Hunter Class ships; defense services for development and integration of a capability upgrade for the installed AEGIS Combat System on the Hobart Class Destroyer, including Integrated Air and Missile Defense capability and growth capability for Ballistic Missile Defense; development, integration and testing support for installation of a AEGIS Combat System for installation on the Hunter Class FFG, a Global Combat Ship Type 26 (BAE) platform, including the integration of the indigenous CEAFAR 2 Phased Array Radar (CEA Industries) with the AEGIS Combat System (including Cooperative Engagement Capability) and the primary radar sensor and illuminator; integration of selected Australian provided combat system components including Undersea Warfare and Ship Self Defense for installation on the Hobart and Hunter Class ships; integration of the MH-60R helicopter into the AEGIS Combat System for installation on the Hobart and Hunter Class ships; Procurement and delivery of installation support material, special purpose test equipment, initial logistics outfitting, spares and other ancillary equipment to support the installation and integration of AEGIS Combat System equipment in the Hunter and Hobart class ship platforms; development of technical documentation to support both programs; provision of logistics and other support services to support the Hobart and Hunter Class ships; procurement, staging, delivery and installation support for AEGIS Combat System equipment for the Hobart and Hunter Class ships; provision of training support for curriculum development, training tool development, front-end analysis, and crew training for the Hobart and Hunter Class ships; U.S. Government and contractor representative engineering, logistics, and technical support services; and other related elements of logistics and program support for the Hobart and Hunter Class ships. The total estimated cost is $1.50 billion.

This proposed sale will support the foreign policy and national security objectives of the United States. Australia is one of our most important allies in the Western Pacific. The strategic location of this political and economic power contributes significantly to ensuring peace and economic stability in the region.

The proposed sale will enhance Australia's Surface Combatant capability by modernizing their existing three AEGIS capable Hobart Class Destroyers with the latest technology and capability, and delivering the first three (of nine) AEGIS capable Hunter Class Future Frigates. This sale enhances Australia's self-defense capability, while significantly improving interoperability with U.S. Navy AEGIS combatants in the region. By deploying a surface combatant fleet that will incorporate Cooperative Engagement Capability (CEC), Australia will significantly improve network-centric warfare capability for US forces operating in the region. Australia will have no difficulty absorbing this equipment into its armed forces.

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

There are a significant number of companies under contract with the U.S. Navy that will provide components and systems as well as engineering services during the execution of this effort, with a significant portion of the effort to be performed by Lockheed Martin, Rotary and Mission Systems, Moorestown, NJ. There are no known offset agreements proposed in connection with this potential sale.

Implementation of this proposed sale will require travel of U.S. Government and/or contractor representatives to Australia on a temporary basis for program support and management oversight. No extended (long-term) visits to Australia will be required as part of this effort.

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

Transmittal No. 19-66

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

Annex

Item No. vii

(vii) *Sensitivity of Technology:*

1. This sale involves the procurement of long lead material and services to support the Australian Surface Combatant Program. The AEGIS Combat System (ACS) to be procured to support the modernization of the Hobart Class Destroyers is a multi-mission combat system providing Integrated Air and Missile Defense (IAMD) and a growth path to Ballistic Missile Defense (BMD) capability, derived from USN AEGIS Weapon System Baseline 9 capability. In addition to shipboard AEGIS equipment, this proposed sale will provide software, documentation (including combat system capabilities and limitations), training devices and services, and other technical support to ensure the proper installation, testing and operation of the provided equipment.

2. AEGIS Weapon System simulation software, documentation, training and study material will be provided a classification levels up to and including SECRET. Delivery of sensitive technological information, up to and including SECRET, will be limited to the minimum level of information required to progress activities associated with the integration of indigenous combat system systems into the AEGIS Combat System. This consists primarily of AEGIS Combat System requirements and integration information to support early combat system development activities, in the form of documentation, simulation software, and technical specifications. This information is sensitive as it provides limited insight into AEGIS Combat System capabilities and requirements - as tailored to the Australian AEGIS Combat System configurations.

3. The Cooperative Engagement Capability (CEC) is a system that fuses tracking data from shipboard sensors and distributes radar measurement data to other platforms with CEC capability. This data is filtered and combined to create a common tactical picture, based

on available sensor data from all platforms netted through the CEC system. The hardware is unclassified with the exception of a Communications Security (COMSEC) card which is classified SECRET. The software and documentation are classified SECRET. All manuals and technical documentation disclosure will be limited to those necessary for operational use and organizational maintenance.

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

5. This sale is necessary in furtherance of the U.S. foreign policy and national security objectives outlined in the enclosed Policy Justification. A determination has been made that Australia can provide the same degree of protection for the sensitive technology being released as the U.S. Government.

6. All defense articles and services listed on this transmittal have been authorized for release and export to the Government of Australia.

[FR Doc. 2020–01135 Filed 1–23–20; 8:45 am]

BILLING CODE 5001–06–P

DEPARTMENT OF DEFENSE

Office of the Secretary

[Transmittal No. 20–0B]

Arms Sales Notification

AGENCY: Defense Security Cooperation Agency, Department of Defense.

ACTION: Arms sales notice.

SUMMARY: The Department of Defense is publishing the unclassified text of an arms sales notification.

FOR FURTHER INFORMATION CONTACT: Karma Job at *karma.d.job.civ@mail.mil* or (703) 697–8976.

SUPPLEMENTARY INFORMATION: This 36(b)(5)(C) arms sales notification is published to fulfill the requirements of section 155 of Public Law 104–164 dated July 21, 1996. The following is a copy of a letter to the Speaker of the House of Representatives, and Transmittal 20–0B.

Dated: January 17, 2020.

Aaron T. Siegel,

Alternate OSD Federal Register Liaison Officer, Department of Defense.

BILLING CODE 5001–06–P

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

JAN 0 2 2020

The Honorable Nancy Pelosi
Speaker of the House
U.S. House of Representatives
H-209, The Capitol
Washington, DC 20515

Dear Madam Speaker:

Pursuant to the reporting requirements of Section 36(b)(5)(C) of the Arms Export Control Act (AECA), as amended, we are forwarding Transmittal No. 20-0B. This notification relates to enhancements or upgrades from the level of sensitivity of technology or capability described in the Section 36(b)(1) AECA certification 15-32 of May 4, 2015.

Sincerely,

Charles W. Hooper
Lieutenant General, USA
Director

Enclosures:
1. Transmittal

BILLING CODE 5001–06–C

Transmittal No. 20-0B

REPORT OF ENHANCEMENT OR UPGRADE OF SENSITIVITY OF TECHNOLOGY OR CAPABILITY (SEC. 36(B)(5)(C), AECA)

(i) *Purchaser*: Government of Japan
(ii) *Sec. 36(b)(1), AECA Transmittal No.*: 15-32
Date: May 4, 2015
Military Department: Navy
(iii) *Description*: On May 4, 2015, Congress was notified by Congressional Notification Transmittal Number 15-32, of the possible sale under Section 36(b)(1) of the Arms Export Control Act for the procurement of seventeen (17) V-22B Block C Osprey aircraft, forty (40) AE1107C Rolls Royce Engines, forty (40) AN/AAQ-27 Forward Looking InfraRed Radars, forty (40) AN/AAR-47 Missile Warning Systems, forty (40) AN/APR-39 Radar Warning Receivers, forty (40) AN/ALE-47 Countermeasure Dispenser Systems, forty (40) AN/APX-123 Identification Friend or Foe Systems, forty (40) AN/APN-194 Radar Altimeters, forty (40) AN/ARN-147 VHF Omni-directional Range (VOR) Instrument Landing System (ILS) Beacon Navigation Systems, forty (40) 629F-23 Multi-Band Radios (Non-COMSEC), forty (40) AN/ASN-163 Miniature Airborne Global Positioning Systems (GPS) Receivers (MAGR), forty (40) AN/ARN-153 Tactical Airborne Navigation Systems, eighty (80) Night Vision Goggles, Joint Mission Planning System (JMPS) with unique planning components, publications and technical documentation, aircraft spares and repair parts, repair and return, aircraft ferry services, tanker support, support and test equipment, personnel training and training equipment, software, U.S. Government and contractor engineering, logistics and technical support services, and other elements of technical and program support. The estimated total cost was $3 billion. Major Defense Equipment (MDE) constituted $1.8 billion of this total.

On December 19, 2016, Congress was notified by Congressional certification 0Y-16 of the inclusion of twenty (20) M240D 7.62mm Machine Guns as MDE,

twenty (20) GAU-21 .50 Caliber Machine Guns as non-MDE, and twenty (20) Traffic Collision Avoidance Systems (TCAS) II as non-MDE. The addition of this equipment did not result in a net increase in MDE cost or a net increase in the total case value. The total estimated MDE cost remained $1.8 billion. The total estimated case value remained $3 billion.

This transmittal reports the inclusion of an additional five (5) AE1107C Rolls Royce engines and twenty (20) 629F-23 Multi-Band radios (both non-MDE) and includes the extension of the sustainment that will support annual cases to fund manpower through Other Technical Assistance (OTA), Engineering Technical Assistance (ETA), Logistic Technical Assistance (LTA), and Contractor Engineering Technical Support (CETS).

The addition of these items and sustainment costs will result in a net increase in non-MDE value of $1 billion. The total estimated MDE cost will remain $1.8 billion. The total case value will increase to $4 billion.

(iv) *Significance*: This proposed equipment and sustainment will support Japan's continued modernization of its transport fleet to better support its defense and special mission needs.

(v) *Justification:* This proposed sale will support the foreign policy and national security of the United States by improving the security of a major ally that is a force for political stability and economic progress in the Asia-Pacific region. It is vital to U.S. national interests to assist Japan in developing and maintaining a strong and effective self-defense capability.

(vi) *Date Report Delivered to Congress*: January 2, 2020

[FR Doc. 2020–01139 Filed 1–23–20; 8:45 am]

BILLING CODE 5001–06–P

DEPARTMENT OF DEFENSE

Office of the Secretary

[Transmittal No. 19–58]

Arms Sales Notification

AGENCY: Defense Security Cooperation Agency, Department of Defense.

ACTION: Arms sales notice.

SUMMARY: The Department of Defense is publishing the unclassified text of an arms sales notification.

FOR FURTHER INFORMATION CONTACT: Karma Job at *karma.d.job.civ@mail.mil* or (703) 697–8976.

SUPPLEMENTARY INFORMATION: This 36(b)(1) arms sales notification is published to fulfill the requirements of section 155 of Public Law 104–164 dated July 21, 1996. The following is a copy of a letter to the Speaker of the House of Representatives, Transmittal 19–58 and Policy Justification.

Dated: January 17, 2020.

Aaron T. Siegel,

Alternate OSD Federal Register Liaison Officer, Department of Defense.

BILLING CODE 5001–06–P

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

DEC 1 9 2019

The Honorable Nancy Pelosi
Speaker of the House
U.S. House of Representatives
H-209, The Capitol
Washington, DC 20515

Dear Madam Speaker:

Pursuant to the reporting requirements of Section 36(b)(1) of the Arms Export Control Act, as amended, we are forwarding herewith Transmittal No. 19-58 concerning the Navy's proposed Letter(s) of Offer and Acceptance to the Government of Argentina for defense articles and services estimated to cost $78.032 million. After this letter is delivered to your office, we plan to issue a news release to notify the public of this proposed sale.

Sincerely,

Charles W. Hooper
Lieutenant General, USA
Director

Enclosures:
1. Transmittal
2. Policy Justification

BILLING CODE 5001–06–C

Transmittal No. 19-58

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

(i) *Prospective Purchaser*: Government of Argentina

(ii) *Total Estimated Value*:

Major Defense Equipment *	$ 0 million
Other	$78.032 million
TOTAL	$78.032 million

(iii) *Description and Quantity or Quantities of Articles or Services under Consideration for Purchase*:

Major Defense Equipment (MDE):

None

Non-MDE:

Equipment, support and services in support of Argentina's EDA purchase of four (4) P-3C aircraft including, four (4) turboprop engines on each airframe and an additional four (4) turboprop engines. The proposed sale will include communications equipment; radar equipment; Infrared (IR)/Electro-optic (EO) equipment; aircraft depot maintenance; depopulation and repopulation; supply support/spares and repair of repairables; support

equipment; publications; training; aviation life support systems; aircraft transportation; logistical and other technical assistance, and other related elements of logistical and program support.

(iv) *Military Department*: Navy (AR-P-GVQ)

(v) *Prior Related Cases, if any*: AR-P-SSA, AR-P-GSH, AR-P-GSI, AR-P-GSJ

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

(vii) *Sensitivity of Technology Contained in the Defense Article or Defense Services Proposed to be Sold*: None

(viii) *Date Report Delivered to Congress*: December 19, 2019

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

POLICY JUSTIFICATION

Argentina—Support for EDA P-3C Aircraft

The Government of Argentina has requested a possible sale of equipment, support and services in support of Argentina's EDA purchase of four (4) P-3C aircraft, including four (4) turboprop engines on each airframe and an additional four (4) turboprop engines. The proposed sale will include communications equipment; radar equipment; Infrared /Electro-optic equipment; aircraft depot maintenance; depopulation and repopulation; supply support/spares and repair of repairables; support equipment; publications; training; aviation life support systems; aircraft transportation; logistical and other technical assistance, and other related elements of logistical and program support. The total estimated program cost is $78.032 million.

This proposed sale will support the foreign policy and national security of the United States by helping to improve the security of a partner in South America.

Argentina's existing P-3B patrol aircraft have reached the end of their operational service life. To maintain maritime security, Argentina acquired four EDA P-3C aircraft to replace its older aircraft. These EDA aircraft need this refurbishment and equipment to be fully operational. It is vital to the U.S. national interest to assist Argentina in developing and maintaining a strong and ready self-defense maritime patrol aircraft capability. Argentina will have no difficulty absorbing these aircraft into its armed forces.

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

The prime contractors will be Logistic Services International, Jacksonville, FL; Lockheed Martin Aircraft Center, Greenville, SC; Eagle Systems, Jacksonville, FL; and Rockwell Collins, Cedar Rapids, IA. There are no known offset agreements in connection with this potential sale.

Implementation of this proposed sale will require the temporary assignment of approximately 12 U.S. contractor representatives to Argentina to support the program.

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

[FR Doc. 2020–01130 Filed 1–23–20; 8:45 am]

BILLING CODE 5001–06–P

DEPARTMENT OF DEFENSE

Department of the Navy

Certificate of Alternate Compliance for USS OAKLAND (LCS 24)

AGENCY: Department of the Navy, DoD.

ACTION: Notice of issuance of Certificate of Alternate Compliance.

SUMMARY: The U.S. Navy hereby announces that a Certificate of Alternate Compliance has been issued for USS OAKLAND (LCS 24). Due to the special construction and purpose of this vessel, the Deputy Assistant Judge Advocate General (DAJAG)(Admiralty and Maritime Law) has determined it is a vessel of the Navy which, due to its special construction and purpose, cannot comply fully with the navigation lights provisions of the International Regulations for Preventing Collisions at Sea, 1972 (72 COLREGS) without interfering with its special function as a naval ship. The intended effect of this notice is to warn mariners in waters where 72 COLREGS apply.

DATES: This Certificate of Alternate Compliance is effective January 24, 2020 and is applicable beginning January 10, 2020.

FOR FURTHER INFORMATION CONTACT: Lieutenant Tom Bright, JAGC, U.S. Navy, Admiralty Attorney, Office of the Judge Advocate General, Admiralty and Maritime Law Division (Code 11), 1322 Patterson Ave. SE, Suite 3000, Washington Navy Yard, DC 20374–5066, 202–685–5040, or *admiralty@navy.mil.*

SUPPLEMENTARY INFORMATION: Background and Purpose. Executive Order 11964 of January 19, 1977 and 33 U.S.C. 1605 provide that the requirements of the International Regulations for Preventing Collisions at Sea, 1972 (72 COLREGS), as to the number, position, range, or arc of visibility of lights or shapes, as well as to the disposition and characteristics of sound-signaling appliances, shall not apply to a vessel or class of vessels of the Navy where the Secretary of the Navy shall find and certify that, by reason of special construction or purpose, it is not possible for such vessel(s) to comply fully with the provisions without interfering with the special function of the vessel(s). Notice of issuance of a Certificate of Alternate Compliance must be made in the **Federal Register**.

In accordance with 33 U.S.C. 1605, the DAJAG (Admiralty and Maritime Law), under authority delegated by the Secretary of the Navy, hereby finds and certifies that USS OAKLAND (LCS 24) is a vessel of special construction or purpose, and that, with respect to the position of the following navigational lights, it is not possible to comply fully with the requirements of the provisions enumerated in the 72 COLREGS without interfering with the special function of the vessel:

Annex I, paragraph 2(a)(i), pertaining to the vertical position of the forward masthead light; Annex I, paragraph 3(a), pertaining to the horizontal position of the forward masthead light; Rule 21(a) and Annex I, paragraph 2(f)(i), pertaining to the aft masthead light being clear of obstructions; Annex I, paragraph 3(a), pertaining to the horizontal separation between the forward and aft masthead lights; Annex I, paragraph 2(f)(ii), pertaining to the vertical and horizontal spacing of task lights; and Rule 27(b)(i) and Annex I, paragraph 9(b), pertaining to task light obstructions.

The DAJAG (Admiralty and Maritime Law) further finds and certifies that these navigational lights are in closest possible compliance with the applicable provision of the 72 COLREGS.

Authority: 33 U.S.C. 1605(c), E.O. 11964

Approved: January 20, 2020.

D.J. Antenucci,

Commander, Judge Advocate General's Corps, U.S. Navy, Federal Register Liaison Officer.

[FR Doc. 2020–01143 Filed 1–23–20; 8:45 am]

BILLING CODE 3810–FF–P

DEPARTMENT OF DEFENSE

Department of the Navy

Notice of Intent To Prepare an Environmental Impact Statement for Navy Old Town Campus Revitalization at Naval Base Point Loma, California, and To Announce Public Scoping Meetings

AGENCY: Department of the Navy, DoD.

ACTION: Notice.

SUMMARY: Pursuant to Section 102(2)(C) of the National Environmental Policy Act (NEPA) of 1969, as implemented by the Council on Environmental Quality Regulations, the Department of the Navy (Navy) announces its intent to prepare an Environmental Impact Statement (EIS) to evaluate the potential environmental effects associated with revitalization of the Navy Old Town Campus (OTC) to support Naval Information Warfare Systems Command's (NAVWAR) current and future operational readiness. This EIS will also address provisions of the California Environmental Quality Act (CEQA) as it relates to non-federal development within the proposed alternatives. An EIS is considered the appropriate document for comprehensively analyzing the proposed action to demolish and construct buildings, utilities, and infrastructure at the OTC, Naval Base Point Loma, California. Specific proposed actions within the OTC proposal could include Navy recapitalization of the site or redevelopment through a public-private partnership.

DATES: The Navy is initiating a 30-day public scoping process to identify community interests and specific issues for analysis in the EIS. This public scoping process starts with the publication of this Notice of Intent. The Navy is planning two public scoping meetings to receive written comments on issues for analysis in the EIS. All public comments are due by February 24, 2020.

ADDRESSES: The meetings will be held in the following locations (all times local):

1. February 13, 2020, 4:00 p.m. to 7:00 p.m., Liberty Station Conference Center, Main Hall, Door A, 2600 Laning Road, San Diego, California 92106–6427.

2. February 19, 2020, 4:00 p.m. to 7:00 p.m., Liberty Station Conference Center, Main Hall, Door A, 2600 Laning Road, San Diego, California 92106–6427.

Additional information concerning meeting times and locations is available on the EIS website at *www.navwar-revitalization.com*. The Navy will announce public scoping meeting dates, times, and locations in the local news media.

Public scoping meetings will include open house sessions, with information stations staffed by Navy representatives. The Navy will collect comments during each of the two public scoping meetings. Written comments can also be made electronically on the project website.

FOR FURTHER INFORMATION CONTACT: Naval Facilities Engineering Command Southwest, Navy OTC Revitalization EIS Project Manager, Attn: Mr. Ron Bochenek, 1220 Pacific Highway (Code EV21.RB), San Diego, California 92132–5101; telephone: 619–379–3860.

SUPPLEMENTARY INFORMATION: The U.S. Army Air Corps first used the OTC site in 1940. Use of the site transitioned to the United States Air Force in 1947. General Dynamics Corporation operated the facility, known as Air Force Plant 19, from approximately 1940 to the mid-1970s, using it primarily for aircraft production. Beginning in the late 1970s, subassembly activities for various missile production programs replaced aircraft assembly as the primary function of the facility. In 1994, the Air Force transferred ownership of the property to the U.S. Navy (with oversight given to Naval Base Point Loma) and manufacturing activities focused on space launch vehicle assembly as conducted by various military contractors.

NAVWAR established the OTC site as their headquarters in 1996, with a mission focus of naval communications and space programs. Site activities have since grown to include development, acquisition, and life cycle management of command, control, communications, computers, intelligence, surveillance, and reconnaissance systems for Navy, Marine Corps, and selected joint service, allied nation, and other government agency programs.

The existing OTC facilities are beyond their useful life and their degradation is affecting NAVWAR's cyber warfare mission, security, and workforce safety. The Navy requires secure, safe, modern state-of-the-art space to support NAVWAR's mission requirements. NAVWAR proposes to revitalize the OTC, which would include the demolition of existing facilities and construction of new buildings, utilities, and infrastructure to provide mission capable facilities for NAVWAR on OTC.

NAVWAR's mission requirements include 1,064,268 square feet (SF) of space, as follows:

845,326 SF of office space;

29,156 SF of secure conference and auditorium space;

24,172 SF of warehouse/storage space; and

165,614 SF of lab space.

Parking will also be required for personnel working at OTC, either on site or at a separate nearby location.

During development of the NAVWAR's mission requirements, the Navy identified a portion of the existing OTC facilities, primarily open storage/laydown and warehouse space, could be accommodated at an off-site location. This EIS does not address the potential NAVWAR off-site facilities relocation. Therefore, subsequent NEPA may be required if alternative selection results in utilization of an off-site location.

The purpose of and need for the Proposed Action is to address substandard, inefficient, and obsolete facilities that are incapable of meeting and sustaining NAVWAR's mission requirements. Current facilities are beyond their useful life and negatively affect NAVWAR's cyber warfare mission, security, and workforce safety. NAVWAR requires secure, safe, efficient, modern, state-of-the-art facilities to meet information technology, artificial intelligence, and cyber warfare operational needs as a central component to NAVWAR's mission in defense of our Nation.

In September 2018, the Navy issued a Request for Interest (RFI) to evaluate the availability and adequacy of potential business sources to revitalize the OTC site through a public-private partnership. In November 2018, the Navy held an industry day to solicit responses to the RFI and highlight the Navy's willingness to consider all types of concepts to achieve Navy goals for revitalizing the OTC, including long-term leases, a land exchange, or sale. The RFI process resulted in twelve responses, four of which contained substantive market research. After considering the proposals received on the RFI, feedback received at industry day, and subsequent discussions with internal and external stakeholders, the Navy entered into an agreement with the San Diego Association of Governments (SANDAG) on September 19, 2019, to conduct a planning process intended to lead to the redevelopment of the OTC, to include a potential Transit Center and the redevelopment of NAVWAR facilities. SANDAG's proposed Transit Center would improve multimodal regional transportation efficiency for the residents and visitors of the greater San Diego area, and would support NAVWAR's mission by providing access that is more efficient to industry partners and transportation. SANDAG is considering various conceptual transportation solutions for improved regional airport connectivity; some of the concepts under consideration include possible construction at the NAVWAR facility, others do not. In consideration of the fact that Navy may proceed without SANDAG if SANDAG and the Navy do not agree to move forward with redevelopment of the site to include a Transit Center, the Navy has developed

five preliminary alternatives in addition to the No Action alternative for revitalizing the OTC.

Alternative 1 (Navy Recapitalization at OTC) would consist of revitalization of the OTC to meet NAVWAR's facility requirements with Navy-funded capital improvements only. This would potentially include consolidating NAVWAR operations into two of the existing 310,000 SF buildings (Buildings 2 and 3) on OTC Site 1.

Alternative 2 (High-Density Mixed Use Revitalization) would consist of construction of new Navy facilities for NAVWAR on the OTC site through an agreement with a public-private partner, and the relocation of some warehouse functions to a separate off-site location.

Alternative 3 (Low-Density Mixed Use Revitalization) would be similar to Alternative 2, but the development scenario for private development would be reduced. The development requirements for NAVWAR would be the same as under Alternative 2.

Alternative 4 (High-Density Mixed Use Revitalization Including a Transit Center) would be similar to Alternative 2, but a portion of the OTC site would be developed as a transit center. The development requirements for NAVWAR would be the same as under Alternative 2.

Alternative 5 (Low-Density Mixed Use Revitalization Including a Transit Center) would be similar to Alternative 2, but a portion of the OTC site would be developed as a transit center and the development scenario for private development would be reduced. The development requirements for NAVWAR would be the same as under Alternative 2.

Alternative 6 (No Action Alternative) would be no change from status quo. The Navy would continue to maintain and repair the existing facilities, and NAVWAR would continue to operate at the OTC site as is.

Environmental issues and resources to be examined and addressed in the EIS include, but are not limited to: Air Quality (including environmental effects analyses pursuant to CEQA for greenhouse gases/Climate Change and Odor), Transportation, Visual Resources, Land Use (including Agricultural Resources for CEQA), Socioeconomics (including Growth Inducing Impacts for CEQA), Cultural Resources (including Paleontology for CEQA), Hazardous Materials and Waste, Public Health and Safety (including Wildfire for CEQA), Environmental Justice, Infrastructure (including Schools, Utilities and Energy Consumption for CEQA), Airspace, Noise, Geology (including Mineral Resources for CEQA), Water Resources, and Biological Resources. The EIS will also analyze measures that would avoid or mitigate environmental effects. Additionally, the Navy will undertake any coordination and consultation activities required by the National Historic Preservation Act.

The Navy encourages interested persons to submit comments concerning the alternatives proposed for study, and environmental issues for analysis in the EIS. Federal, State, local, and Tribal agencies, and interested persons are encouraged to provide comments to the Navy to identify specific environmental issues or topics of environmental concern that the Navy should consider when developing the Draft EIS. The Navy will prepare the Draft EIS, incorporating issues identified by the commenting public. All comments received during the public scoping period will receive consideration during EIS preparation.

Mailed comments on the scope of the EIS should be postmarked no later than February 24, 2020. Comments may be mailed to: Naval Facilities Engineering Command Southwest, Navy OTC Revitalization EIS Project Manager, Attn: Mr. Ron Bochenek, 1220 Pacific Highway (Code EV21.RB), San Diego, California 92132–5101. Interested parties can also submit comments via the EIS website at *www.navwar-revitalization.com*.

Dated: January 20, 2020.

D.J. Antenucci,

Commander, Judge Advocate General's Corps, U.S. Navy, Federal Register Liaison Officer.

[FR Doc. 2020–01144 Filed 1–23–20; 8:45 am]

BILLING CODE 3810–FF–P

DEPARTMENT OF EDUCATION

Application Deadline for Fiscal Year 2020; Small, Rural School Achievement Program

AGENCY: Office of Elementary and Secondary Education, Department of Education.

ACTION: Notice.

SUMMARY: Under the Small, Rural School Achievement (SRSA) program, Catalog of Federal Domestic Assistance (CDFA) number 84.358A, the U.S. Department of Education (Department) awards grants on a formula basis to eligible local educational agencies (LEAs) to address the unique needs of rural school districts. In this notice, we establish the deadline and describe the submission procedures for fiscal year (FY) 2020 SRSA grant applications. All LEAs eligible for FY 2020 SRSA funds must submit an application electronically via the process described in this notice by the deadline in this notice.

DATES:

Applications Available: February 3, 2020.

Deadline for Transmittal of Applications: April 17, 2020.

FOR FURTHER INFORMATION CONTACT: Mr. Robert Hitchcock, U.S. Department of Education, 400 Maryland Avenue SW, Room 3E–218, Washington, DC 20202. Telephone: (202) 260–1472. Email: *reap@ed.gov.*

If you use a telecommunications device for the deaf or a text telephone, call the Federal Relay Service, toll free, at 1–800–877–8339.

SUPPLEMENTARY INFORMATION:

I. Award Information

Type of Award: Formula grant.

Available Funds: The Administration has requested $90,420,000 for SRSA in FY 2020. The actual level of funding, if any, depends on final congressional action. However, we are inviting applications to allow enough time to complete the grant process if Congress appropriates funds for this program.

Estimated Range of Awards: $0–$60,000.

Note: Depending on the number of eligible LEAs identified in a given year and the amount appropriated by Congress for the program, some eligible LEAs may receive an SRSA allocation of $0 under the statutory funding formula.

Estimated Number of Awards: 4,000.

II. Program Authority and Eligibility Information

Under what statutory authority will FY 2020 SRSA grant awards be made?

The FY 2020 SRSA grant awards will be made under title V, part B, subpart 1 of the Elementary and Secondary Education Act of 1965, as amended (ESEA).

Which LEAs are eligible for an award under the SRSA program?

For FY 2020, an LEA (including a public charter school that meets the definition of LEA in section 8101(30) of the ESEA) is eligible for an award under the SRSA program if it meets one of the following criteria:

(a)(1) The total number of students in average daily attendance at all of the schools served by the LEA is fewer than 600; or each county in which a school served by the LEA is located has a total population density of fewer than 10 persons per square mile; and

(2) All of the schools served by the LEA are designated with a school locale

code of 41, 42, or 43 by the Department's National Center for Education Statistics (NCES); or the Secretary has determined, based on a demonstration by the LEA and concurrence of the State educational agency, that the LEA is located in an area defined as rural by a governmental agency of the State; or

(b) The LEA is a member of an educational service agency (ESA) that does not receive SRSA funds, and the LEA meets the eligibility requirements described in (a)(1) and (2) above.

Note: The ''Choice of Participation'' provision under section 5225 of the ESEA gives LEAs eligible for both SRSA and the Rural and Low-Income School (RLIS) program authorized under title V, part B, subpart 2 of the ESEA the option to participate in either the SRSA program or the RLIS program. LEAs eligible for both SRSA and RLIS are henceforth referred to as ''dual-eligible LEAs.''

Which eligible LEAs must submit an application to receive an FY 2020 SRSA grant award?

Under 34 CFR 75.104(a), the Secretary makes a grant only to an eligible entity that submits an application.

In FY 2020, all LEAs eligible to receive an SRSA award are required to submit an SRSA application in order to receive SRSA funds, regardless of whether the LEA received an award or submitted an application in any previous year. This includes dual-eligible LEAs that choose to participate in the SRSA program instead of the RLIS program, and SRSA-eligible LEAs that are members of ESAs that do not receive SRSA funds. In the case of SRSA-eligible LEAs that are members of SRSA-eligible ESAs, the respective LEAs and ESAs must coordinate directly with each other to determine which entity will submit an SRSA application, as both entities may not apply for or receive SRSA funds. Additionally, pursuant to section 5225 of the ESEA, dual-eligible LEAs that apply for SRSA funds in accordance with these application submission procedures will not be considered for an RLIS award.

We also note that a separate application must be submitted for each eligible LEA. For example, if a rural community has two distinct LEAs—one composed of its elementary school(s) and one composed of its high school(s)—each distinct LEA would have to submit its own SRSA application.

A list of LEAs eligible for FY 2020 SRSA grant funds is available on the Department's website at: *https://oese.ed.gov/offices/office-of-formula-grants/rural-insular-native-achievement-programs/rural-education-achievement-program/small-rural-school-achievement-program/*.

If an LEA on the Department's list of LEAs eligible to receive an FY 2020 SRSA award will close prior to the 2020–2021 school year, that LEA is no longer eligible to receive an FY 2020 SRSA award and should not apply.

An LEA eligible to receive FY 2020 SRSA funds that fails to submit an FY 2020 SRSA application in accordance with the application and submission information below is at risk of not receiving an FY 2020 SRSA award. Such an LEA may receive an award only to the extent funds become available after awards are made to all eligible LEAs that complied with the application procedures.

III. Application and Submission Information

Electronic Submission of Applications Using Max.gov

All LEAs eligible for FY 2020 SRSA grant funds will be sent an email with a uniquely identifiable application link on February 3, 2020. The email will include customized instructions for completing the electronic application via the *Office of Management and Budget (OMB) Max Survey* platform.

An eligible LEA must submit an electronic application via *OMB Max Survey* by April 17, 2020, to be assured of receiving an FY 2020 SRSA grant award. The Department may consider applications submitted after the deadline to the extent practicable and contingent upon the availability of funding.

Please note the following:

- We estimate that it will take 30 minutes to submit an application. However, we strongly recommend that you do not wait until the application deadline date to begin the application process.
- To better ensure applications are processed in a more timely, accurate, and efficient manner, if an LEA has not submitted an application by March 1, 2020, we will send the LEA a reminder email to submit its application.
- Applications received by *OMB Max Survey* are date and time stamped upon submission and applicants will receive a confirmation email after the application is submitted.
- Once your application is submitted via *OMB Max Survey* you must contact the REAP program staff at *reap@ed.gov* to update any information in your application if necessary.

Application Deadline Date Extension in Case of Technical Issues With OMB Max Survey

If you are unable to submit an application by April 17, 2020, because of problems with *OMB Max Survey,* contact the REAP program staff at *reap@ed.gov* within five business days and provide an explanation of the technical problem you experienced. We will accept your late application as having met the deadline if we can confirm that a technical problem occurred with the *OMB Max Survey* system and that the problem affected your ability to submit your application by the application deadline date. As noted above, if you submit your application after the deadine and the late submission is not due to a technical issue about which you have notified the REAP program staff, the Department may consider your application to the extent practicable and contingent upon the availability of funding.

IV. Other Procedural Requirements

System for Award Management

To do business with the Department, you must register in the System for Award Management (SAM), the Government's primary registrant database, using the following information:

a. Data Universal Numbering System (DUNS) number.

b. Legal business name.

c. Physical address from your Dun & Bradstreet (D&B) record.

d. Taxpayer identification number (TIN).

e. Taxpayer name associated with your TIN.

f. Bank information to set up Electronic Funds Transfer (EFT) (*i.e.,* routing number, account number, and account type (checking/savings)).

Entities must have an active SAM registration throughout the grant performance period. You can obtain a DUNS number from Dun and Bradstreet at the following website: *http://fedgov.dnb.com/webform*. A DUNS number can be created within one to two business days.

If you are a corporate entity, agency (including an LEA), institution, or organization, you can find your taxpayer name and TIN in tax documents from the Internal Revenue Service (IRS) (such as a 1099 or W–2 form) or obtain one from the IRS.

The SAM registration process can take approximately seven business days, but may take upwards of several weeks, depending on the completeness and accuracy of the data you enter into the SAM database. Thus, if you think you

might want to apply for Federal financial assistance under a program administered by the Department, please allow sufficient time to register with SAM. We strongly recommend that you register by June 1.

If you are currently registered with SAM, you may not need to make any changes. However, please make certain that the TIN associated with your DUNS number is correct. Also note that you will need to update your registration annually. This may take three or more business days.

Information about SAM is available at *www.SAM.gov*. To further assist you with obtaining and registering your DUNS number and TIN in SAM or updating your existing SAM account, we have prepared a *SAM.gov* Tip Sheet, which you can find at: *http://www2.ed.gov/fund/grant/apply/sam-faqs.html*.

V. Acessibility Information and Program Authority

Accessible Format: Individuals with disabilities can obtain this document and a copy of the application package in an accessible format (*e.g.,* braille, large print, audiotape, or compact disc) on request to the program contact person listed under **FOR FURTHER INFORMATION CONTACT**.

Electronic Access to This Document: The official version of this document is the document published in the **Federal Register**. You may access the official edition of the **Federal Register** and the Code of Federal Regulations at *www.govinfo.gov*. At this site you can view this document, as well as all other documents of this Department published in the **Federal Register**, in text or Portable Document Format (PDF). To use PDF you must have Adobe Acrobat Reader, which is available free at the site.

You may also access documents of the Department published in the **Federal Register** by using the article search feature at: *www.federalregister.gov*. Specifically, through the advanced search feature at this site, you can limit your search to documents published by the Department.

Program Authority: Sections 5211–5212 of the ESEA, 20 U.S.C. 7345–7345a.

Dated: January 21, 2020.

Frank T. Brogan,

Assistant Secretary, Office of Elementary and Secondary Education.

[FR Doc. 2020–01193 Filed 1–23–20; 8:45 am]

BILLING CODE 4000–01–P

DEPARTMENT OF EDUCATION

National Advisory Committee on Institutional Quality and Integrity Meeting

AGENCY: U.S. Department of Education, National Advisory Committee on Institutional Quality and Integrity (NACIQI), Office of Postsecondary Education.

ACTION: Announcement of an open meeting.

SUMMARY: This notice sets forth the agenda, time, and location for the February 27, 2020 meeting of the National Advisory Committee on Institutional Quality and Integrity (NACIQI) and provides information to members of the public regarding the meeting, including requesting to make oral comments. The notice of this meeting is required under the Federal Advisory Committee Act (FACA) and the Higher Education Act (HEA).

DATES: The NACIQI meeting will be held on February 27, 2020, from 8:30 a.m. to 5:00 p.m.

ADDRESSES: Embassy Suites by Hilton Alexandria Old Town, Virginia Ballroom, 1900 Diagonal Road, Alexandria, VA 22314.

FOR FURTHER INFORMATION CONTACT: George Alan Smith, Acting Executive Director/Designated Federal Official, NACIQI, U.S. Department of Education, 400 Maryland Avenue SW, Room 271–03, Washington, DC 20202, telephone: (202) 453–7757, or email: *George.Alan.Smith@ed.gov*.

SUPPLEMENTARY INFORMATION:

NACIQI's Statutory Authority and Function: NACIQI is established under section 114 of the HEA. NACIQI advises the Secretary of Education with respect to:

- The establishment and enforcement of the standards of accrediting agencies or associations under subpart 2, part G, Title IV of the HEA, as amended.
- The recognition of specific accrediting agencies or associations.
- The preparation and publication of the list of nationally recognized accrediting agencies and associations.
- The eligibility and certification process for institutions of higher education under Title IV of the HEA and part C, subchapter I, chapter 34, Title 42, together with recommendations for improvement in such process.
- The relationship between (1) accreditation of institutions of higher education and the certification and eligibility of such institutions, and (2) State licensing responsibilities with respect to such institutions.
- Any other advisory function relating to accreditation and institutional eligibility that the Secretary of Education may prescribe by regulation.

Meeting Agenda: Agenda items for the February 27, 2020 meeting are below.

Application for Initial Recognition

1. National Nurse Practitioner Residency and Fellowship Training Consortium. Requested Scope of Recognition: The accreditation of postgraduate residency and fellowship nurse practitioner (NP) postgraduate training programs in the United States. This recognition also extends to the agency's Appeal Panel.

Application for Renewal of Recognition

1. New York State Board of Regents, State Education Department, Office of the Professions (Public Postsecondary Vocational Education, Practical Nursing).
2. Pennsylvania State Board of Vocational Education, Bureau of Career and Technical Education.
3. Kansas State Board of Nursing.
4. Maryland Board of Nursing.

Application for an Expansion of Scope

1. The Association for Biblical Higher Education, Commission on Accreditation. Scope of Recognition: The accreditation and preaccreditation (''Candidate for Accreditation''), at the undergraduate level, of institutions of biblical higher education in the United States offering both campus-based and distance education instructional programs. Requested Scope of Recognition: The accreditation and preaccreditation (''Candidate Status'') of institutions of biblical higher education in the United States offering undergraduate certificates, associate degrees, baccalaureate degrees, graduate certificates, master's degrees, including the accreditation of educational programs offered via distance education.

Compliance Report

1. The Oklahoma Board of Career and Technology Education (OBCTE) compliance report includes findings of noncompliance with the criteria in 34 Code of Federal Regulations (CFR) § 603 identified in the May 9, 2018 letter from the senior Department official following the February 7, 2018 NACIQI meeting available at: *https://opeweb.ed.gov/aslweb/finalstaffreports.cfm*.

Subcommittee on Governance

The subcommittee will provide an update on its research of accreditor and state/gubernatorial relations.

Accreditation Regulations

Diane Auer Jones, Principal Deputy Under Secretary delegated the duties of Under Secretary, will provide an update on the Administration's implementation of regulations under 34 CFR 602. The Department amended the rules governing the Secretary's recognition process, which were published November 1, 2019 and will take effect on July 1, 2020.

Committee Chair and Vice Chair Election

The Designated Federal Official will facilitate the election of a new chair and new vice chair for the Committee.

Submission of requests to make an oral comment regarding a specific accrediting agency under review, or to make an oral comment or written statement regarding other issues within the scope of NACIQI's authority: Opportunity to submit a written statement regarding a specific accrediting agency under review was solicited by a previous **Federal Register** notice published on September 4, 2019 (Vol. 84, No. 171). The period for submission of such statements are now closed. Additional written comments regarding a specific agency or state approval agency under review will not be accepted at this time. However, members of the public may submit written statements regarding other issues within the scope of NACIQI's authority (''Written Statements'') for consideration by NACIQI in the manner described below. No individual in attendance or making oral comments may distribute written materials at the meeting. Oral comments may not exceed three minutes.

Oral comments about an agency's recognition after review of a compliance report must relate to issues identified in the senior Department official's letter that requested the report, or in the Secretary's appeal decision, if any, and the criteria for recognition cited in the senior Department official's letter, or in the Secretary's appeal decision. Oral comments about an agency seeking expansion of scope must be directed to the agency's ability to serve as a recognized accrediting agency with respect to the kinds of institutions or programs requested to be added. Oral comments about the renewal of an agency's recognition must relate to its compliance with the Criteria for the Recognition of Accrediting Agencies, which are available at *http://www.ed.gov/admins/finaid/accred/index.html*. Written Statements and oral comments concerning NACIQI's work outside of a specific accrediting agency under review must be limited to the scope of NACIQI's authority as outlined under section 114 of the HEA.

To request to make a third-party oral comment of three minutes or less at the February 27, 2020 meeting, please follow either Method One or Method Two noted below. To submit a Written Statement to NACIQI concerning its work outside a specific accrediting agency under review, please follow Method One.

Method One: Submit a request by email to the *ThirdPartyComments@ed.gov* mailbox. Please do not send material directly to NACIQI members. Written Statements and requests to make oral comment must be received by February 14,2020. Include in the subject line ''Oral Comment Request: (agency name),'' ''Oral Comment Request: (subject)'' or ''Written Statement: (subject).'' The email must include the name(s), title, organization/affiliation, mailing address, email address, telephone number, of the person(s) submitting a Written Statement or requesting to speak, and a brief summary (not to exceed one page) of the principal points to be made during the oral presentation, if applicable. All individuals submitting an advance request in accordance with this notice will be afforded an opportunity to speak.

Method Two: Register at the meeting location on February 27, 2020, from 7:30 a.m.–8:30 a.m., to make an oral comment during NACIQI's deliberations. The requestor must provide the subject on which he or she wishes to comment, in addition to his or her name, title, organization/affiliation, mailing address, email address, and telephone number. A total of up to fifteen minutes for each agenda item will be allotted for oral commenters who register on February 27, 2020, by 8:30 a.m. Individuals will be selected on a first-come, first-served basis. If selected, each commenter may not exceed three minutes.

Access to Records of the Meeting: The Department will post the official report of the meeting on the NACIQI website within 90 days after the meeting. In addition, pursuant to the FACA, the public may request to inspect records of the meeting at 400 Maryland Avenue SW, Washington, DC, by emailing *aslrecordsmanager@ed.gov* or by calling (202) 453–7415 to schedule an appointment.

Reasonable Accommodations: The meeting site is accessible to individuals with disabilities. If you will need an auxiliary aid or service to participate in the meeting (*e.g.,* interpreting service, assistive listening device, or materials in an alternate format), notify the contact person listed in this notice at least two weeks before the scheduled meeting date. Although we will attempt to meet a request received after that date, we may not be able to make available the requested auxiliary aid or service because of insufficient time to arrange it.

Electronic Access to this Document: The official version of this document is the document published in the **Federal Register**. Free internet access to the official edition of the **Federal Register** and the Code of Federal Regulations is available via the Federal Digital System at: *www.gpo.gov/fdsys*. At this site you can view this document, as well as all other documents of this Department published in the **Federal Register**, in text or Adobe Portable Document Format (PDF). To use PDF, you must have Adobe Acrobat Reader, which is available free at the site. You may also access documents of the Department published in the **Federal Register** by using the article search feature at: *www.federalregister.gov*. Specifically, through the advanced search feature at this site, you can limit your search to documents published by the Department.

Authority: 20 U.S.C. 1011c.

Robert L. King,

Assistant Secretary, Office of Postsecondary Education.

[FR Doc. 2020–01190 Filed 1–23–20; 8:45 am]

BILLING CODE 4000–01–P

DEPARTMENT OF ENERGY

[FE Docket No. 19–156–LNG]

Dominion Energy Cove Point LNG, LP; Application for Blanket Authorization To Export Liquefied Natural Gas to Non-Free Trade Agreement Countries on a Short-Term Basis

AGENCY: Office of Fossil Energy, DOE.

ACTION: Notice of application.

SUMMARY: The Office of Fossil Energy (FE) of the Department of Energy (DOE) gives notice (Notice) of receipt of an application (Application), filed on December 23, 2019, by Dominion Energy Cove Point LNG, LP (DECP). DECP requests blanket authorization to export both domestically produced liquefied natural gas (LNG) and LNG previously imported by vessel from foreign sources in a total volume equivalent to 250 billion cubic feet (Bcf) of natural gas on a cumulative basis over a two-year period commencing on March 2, 2020. DECP seeks to export this LNG from the Cove Point LNG

Terminal (Terminal) located in Calvert County, Maryland. DECP filed the Application under section 3 of the Natural Gas Act (NGA). Protests, motions to intervene, notices of intervention, and written comments are invited.

DATES: Protests, motions to intervene, or notices of intervention, as applicable, requests for additional procedures, and written comments are to be filed using procedures detailed in the Public Comment Procedures section no later than 4:30 p.m., Eastern time, February 24, 2020.

ADDRESSES:

Electronic Filing by email: fergas@hq.doe.gov.

Regular Mail: U.S. Department of Energy (FE–34), Office of Regulation, Analysis, and Engagement, Office of Fossil Energy, P.O. Box 44375, Washington, DC 20026–4375.

Hand Delivery or Private Delivery Services (e.g., FedEx, UPS, etc.): U.S. Department of Energy (FE–34), Office of Regulation, Analysis, and Engagement, Office of Fossil Energy, Forrestal Building, Room 3E–042, 1000 Independence Avenue SW, Washington, DC 20585.

FOR FURTHER INFORMATION CONTACT:

Benjamin Nussdorf or Amy Sweeney, U.S. Department of Energy (FE–34), Office of Regulation, Analysis, and Engagement, Office of Fossil Energy, Forrestal Building, Room 3E–042, 1000 Independence Avenue SW, Washington, DC 20585, (202) 586–7893 or (202) 586–2627; *benjamin.nussdorf@hq.doe.gov* or *amy.sweeney@hq.doe.gov*

Cassandra Bernstein or Kari Twaite, U.S. Department of Energy (GC–76), Office of the Assistant General Counsel for Electricity and Fossil Energy, Forrestal Building, 1000 Independence Avenue SW, Washington, DC 20585, (202) 586–9793 or (202) 586–6978; *cassandra.bernstein@hq.doe.gov* or *kari.twaite@hq.doe.gov*

SUPPLEMENTARY INFORMATION: DECP requests a short-term blanket authorization to export LNG from the Terminal to any country with the capacity to import LNG via ocean-going carrier and with which trade is not prohibited by U.S. law or policy. This includes both countries with which the United States has entered into a free trade agreement (FTA) requiring national treatment for trade in natural gas (FTA countries) and all other countries (non-FTA countries). DECP intends to source these exports from both domestically produced LNG and LNG previously imported by vessel at the Terminal from foreign sources. This Notice applies only to the portion of the Application requesting authority to export LNG to non-FTA countries pursuant to section 3(a) of the NGA, 15 U.S.C. 717b(a).[1] DOE/FE will review DECP's request for a FTA export authorization separately pursuant to section 3(c) of the NGA, 15 U.S.C. 717b(c).

DECP requests this authorization on its own behalf and as agent for other entities who hold title to the LNG at the time of export. Additional details can be found in the Application, posted on the DOE/FE website at: *https://www.energy.gov/fe/downloads/dominion-energy-cove-point-llc-fe-dkt-no-19-156-lng.*

DOE/FE Evaluation

In reviewing DECP's request, DOE will consider any issues required by law or policy. DOE will consider domestic need for the natural gas, as well as any other issues determined to be appropriate, including whether the arrangement is consistent with DOE's policy of promoting competition in the marketplace by allowing commercial parties to freely negotiate their own trade arrangements. As part of this analysis, DOE will consider the study entitled, *Macroeconomic Outcomes of Market Determined Levels of U.S. LNG Exports* (2018 LNG Export Study),[2] and DOE/FE's response to public comments received on that Study.[3]

Additionally, DOE will consider the following environmental documents:

- *Addendum to Environmental Review Documents Concerning Exports of Natural Gas From the United States,* 79 FR 48132 (Aug. 15, 2014);[4]
- *Life Cycle Greenhouse Gas Perspective on Exporting Liquefied Natural Gas From the United States,* 79 FR 32260 (June 4, 2014);[5] and
- *Life Cycle Greenhouse Gas Perspective on Exporting Liquefied Natural Gas From the United States: 2019 Update,* 84 FR 49278 (Sept. 19, 2019), and DOE/FE's response to public comments received on that study.[6]

Parties that may oppose this Application should address these issues and documents in their comments and protests, as well as other issues deemed relevant to the Application.

The National Environmental Policy Act (NEPA), 42 U.S.C. 4321 *et seq.,* requires DOE to give appropriate consideration to the environmental effects of its proposed decisions. No final decision will be issued in this proceeding until DOE has met its environmental responsibilities.

Public Comment Procedures

In response to this Notice, any person may file a protest, comments, or a motion to intervene or notice of intervention, as applicable. Interested parties will be provided 30 days from the date of publication of this Notice in which to submit comments, protests, motions to intervene, or notices of intervention.

Any person wishing to become a party to the proceeding must file a motion to intervene or notice of intervention. The filing of comments or a protest with respect to the Application will not serve to make the commenter or protestant a party to the proceeding, although protests and comments received from persons who are not parties will be considered in determining the appropriate action to be taken on the Application. All protests, comments, motions to intervene, or notices of intervention must meet the requirements specified by the regulations in 10 CFR part 590.

Filings may be submitted using one of the following methods: (1) Emailing the filing to *fergas@hq.doe.gov,* with FE Docket No. 19–156–LNG in the title line; (2) mailing an original and three paper copies of the filing to the Office of Regulation, Analysis, and Engagement at the address listed in **ADDRESSES**; or (3) hand delivering an original and three paper copies of the filing to the Office of Regulation,

[1] DECP's existing non-FTA blanket authorization will expire on March 2, 2020. *Dominion Cove Point LNG, LP,* DOE/FE Order No. 4046, FE Docket No. 16–205–LNG, Order Granting Blanket Authorization to Export Liquefied Natural Gas by Vessel from the Cove Point Terminal Located in Calvert County, Maryland, to Free Trade Agreement and Non-Free Trade Agreement Nations (June 2, 2017), *as amended Dominion Energy Cove Point, LNG, LP,* DOE/FE Order No. 4046–A, FE Docket No. 16–205–LNG, Order Granting Request to Amend Authorizations to Export Liquefied Natural Gas to Reflect Corporate Name Change (Aug. 4, 2017).

[2] *See* NERA Economic Consulting, Macroeconomic Outcomes of Market Determined Levels of U.S. LNG Exports (June 7, 2018), *available at: https://www.energy.gov/sites/prod/files/2018/06/f52/Macroeconomic%20LNG%20Export%20Study%202018.pdf.*

[3] U.S. Dep't of Energy, Study on Macroeconomic Outcomes of LNG Exports: Response to Comments Received on Study; Notice of Response to Comments, 83 FR 67251 (Dec. 28, 2018).

[4] The Addendum and related documents are available at: *http://energy.gov/fe/draft-addendum-environmental-review-documents-concerning-exports-natural-gas-united-states.*

[5] The 2014 Life Cycle Greenhouse Gas Report is available at: *http://energy.gov/fe/life-cycle-greenhouse-gas-perspective-exporting-liquefied-natural-gas-united-states.*

[6] U.S. Dep't of Energy, Life Cycle Greenhouse Gas Perspective on Exporting Liquefied Natural Gas From the United States: 2019 Update—Response to Comments, 85 FR 72 (Jan. 2, 2020). The 2019 Update and related documents are available at: *https://fossil.energy.gov/app/docketindex/docket/index/21.*

Analysis, and Engagement at the address listed in **ADDRESSES**. All filings must include a reference to FE Docket No. 19–156–LNG. *Please note:* If submitting a filing via email, please include all related documents and attachments (*e.g.,* exhibits) in the original email correspondence. Please do not include any active hyperlinks or password protection in any of the documents or attachments related to the filing. All electronic filings submitted to DOE must follow these guidelines to ensure that all documents are filed in a timely manner. Any hardcopy filing submitted greater in length than 50 pages must also include, at the time of the filing, a digital copy on disk of the entire submission.

A decisional record on the Application will be developed through responses to this Notice by parties, including the parties' written comments and replies thereto. Additional procedures will be used as necessary to achieve a complete understanding of the facts and issues. If an additional procedure is scheduled, notice will be provided to all parties. If no party requests additional procedures, a final Opinion and Order may be issued based on the official record, including the Application and responses filed by parties pursuant to this Notice, in accordance with 10 CFR 590.316.

The Application is available for inspection and copying in the Office of Regulation, Analysis, and Engagement docket room, Room 3E–042, 1000 Independence Avenue SW, Washington, DC 20585. The docket room is open between the hours of 8:00 a.m. and 4:30 p.m., Monday through Friday, except Federal holidays. The Application and any filed protests, motions to intervene, notices of interventions, and comments will also be available electronically by going to the following DOE/FE Web address: *http://www.fe.doe.gov/programs/gasregulation/index.html.*

Signed in Washington, DC, on January 21, 2020.

Amy Sweeney,

Director, Office of Regulation, Analysis, and Engagement, Office of Oil and Natural Gas.

[FR Doc. 2020–01166 Filed 1–23–20; 8:45 am]

BILLING CODE 6450–01–P

DEPARTMENT OF ENERGY

Environmental Management Advisory Board (EMAB)

AGENCY: Office of Environmental Management (EM), Department of Energy.

ACTION: Notice of renewal.

Pursuant to the Federal Advisory Committee Act, and in accordance with Title 41 of the Code of Federal Regulations, and following consultation with the Committee Management Secretariat, General Services Administration, notice is hereby given that the EMAB will be renewed for a two-year period, beginning January 17, 2020.

The Board provides the Assistant Secretary for EM with information and strategic advice on a broad range of corporate issues affecting the EM program. These corporate issues include, but are not limited to, project management and oversight activities, cost/benefit analyses, program performance, human capital development, and contracts and acquisition strategies. Recommendations to EM on the programmatic resolution of numerous difficult issues will help achieve EM's objective of the safe and efficient cleanup of its contaminated sites.

Additionally, the renewal of the EMAB has been determined to be essential to conduct DOE business and to be in the public interest in connection with the performance of duties imposed on DOE by law and agreement. EMAB will operate in accordance with the provisions of the Federal Advisory Committee Act, and rules and regulations issued in implementation of that Act.

FOR FURTHER INFORMATION CONTACT: David Borak, EMAB Designated Federal Officer, U.S. Department of Energy, 1000 Independence Avenue SW, Washington, DC 20585; Phone: (202) 586–9928; Email: *david.borak@em.doe.gov*.

Signed in Washington, DC on January 17, 2020.

Rachael J. Beitler,

Acting Committee Management Officer.

[FR Doc. 2020–01155 Filed 1–23–20; 8:45 am]

BILLING CODE 6450–01–P

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

Combined Notice of Filings #1

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

Docket Numbers: EC20–5–001.
Applicants: 83WI 8me, LLC, Lily Solar, LLC, Lily Solar Lessee, LLC, X-elio Energy SC York, LLC, Brookfield Renewable Power Ltd.
Description: Notice of Change in Circumstances of 83WI 8me, LLC, et al.
Filed Date: 1/15/20.
Accession Number: 20200115–5170.
Comments Due: 5 p.m. ET 2/5/20.

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

Docket Numbers: ER17–256–010; ER17–242–009; ER17–243–009; ER17–245–009; ER17–652–009.
Applicants: Darby Power, LLC, Gavin Power, LLC, Lawrenceburg Power, LLC, Waterford Power, LLC, Lightstone Marketing LLC.
Description: Notice of Non-Material Change in Status of Darby Power, LLC, et al.
Filed Date: 1/15/20.
Accession Number: 20200115–5180.
Comments Due: 5 p.m. ET 2/5/20.

Docket Numbers: ER18–1652–004; ER10–2960–011; ER15–356–013; ER19–2231–003; ER15–357–013; ER19–2232–003; ER10–1595–014; ER18–2418–003; ER10–1598–014; ER10–1616–014; ER10–1618–014; ER18–1821–006.
Applicants: AL Mesquite Marketing, LLC, Astoria Generating Company, L.P., Chief Conemaugh Power, LLC, Chief Conemaugh Power II, LLC, Chief Keystone Power, LLC, Chief Keystone Power II, LLC, Crete Energy Venture, LLC, Great River Hydro, LLC, Lincoln Generating Facility, LLC, New Covert Generating Company, LLC, Rolling Hills Generating, L.L.C., Walleye Power, LLC.
Description: Notice of Non-Material Change in Status of AL Mesquite Marketing, LLC, et al.
Filed Date: 1/14/20.
Accession Number: 20200114–5232.
Comments Due: 5 p.m. ET 2/4/20.

Docket Numbers: ER20–821–000.
Applicants: Texas Dispatchable Wind 1, LLC.
Description: Tariff Cancellation: Texas Dispatchable Wind 1, LLC Cancellation of Market-Based Rate Tariff to be effective 1/17/2020.
Filed Date: 1/16/20.
Accession Number: 20200116–5085.
Comments Due: 5 p.m. ET 2/6/20.

Docket Numbers: ER20–823–000.
Applicants: Niagara Mohawk Power Corporation, New York Independent System Operator, Inc.
Description: § 205(d) Rate Filing: 205 re: NMPC and LaChute Hydro Small Generator Interconnection Agreement SA2511 to be effective 12/19/2019.
Filed Date: 1/17/20.
Accession Number: 20200117–5014.
Comments Due: 5 p.m. ET 2/7/20.

Docket Numbers: ER20–824–000.
Applicants: AEP Texas Inc.
Description: § 205(d) Rate Filing: AEPTX-La Chalupa Interconnection Agreement Second Amend & Restated to be effective 1/13/2020.

Filed Date: 1/17/20.
Accession Number: 20200117–5022.
Comments Due: 5 p.m. ET 2/7/20.

Docket Numbers: ER20–827–000.
Applicants: Alabama Power Company.
Description: § 205(d) Rate Filing: JEA Interconnection Agreement Filing to be effective 12/17/2019.
Filed Date: 1/17/20.
Accession Number: 20200117–5048.
Comments Due: 5 p.m. ET 2/7/20.

Docket Numbers: ER20–828–000.
Applicants: Alabama Power Company.
Description: Tariff Cancellation: JEA Interchange Contract Termination Filing to be effective 12/17/2019.
Filed Date: 1/17/20.
Accession Number: 20200117–5049.
Comments Due: 5 p.m. ET 2/7/20.

Docket Numbers: ER20–829–000.
Applicants: Georgia Power Company.
Description: § 205(d) Rate Filing: JEA Interconnection Agreement Filing to be effective 12/17/2019.
Filed Date: 1/17/20.
Accession Number: 20200117–5050.
Comments Due: 5 p.m. ET 2/7/20.

Docket Numbers: ER20–830–000.
Applicants: Mississippi Power Company.
Description: § 205(d) Rate Filing: JEA Interconnection Agreement Filing to be effective 12/17/2019.
Filed Date: 1/17/20.
Accession Number: 20200117–5052.
Comments Due: 5 p.m. ET 2/7/20.

Docket Numbers: ER20–831–000.
Applicants: Southern California Edison Company.
Description: Notice of Cancellation of Rate Schedule No. 301 of Southern California Edison Company.
Filed Date: 1/16/20.
Accession Number: 20200116–5144.
Comments Due: 5 p.m. ET 2/6/20.

Docket Numbers: ER20–832–000.
Applicants: New Mexico Wind, LLC.
Description: § 205(d) Rate Filing: New Mexico Wind, LLC Amendment to MBR Tariff to be effective 1/18/2020.
Filed Date: 1/17/20.
Accession Number: 20200117–5071.
Comments Due: 5 p.m. ET 2/7/20.

Docket Numbers: ER20–833–000.
Applicants: NextEra Blythe Solar Energy Center, LLC.
Description: § 205(d) Rate Filing: NextEra Blythe Solar Energy, LLC Amendment to MBR Tariff to be effective 1/18/2020.
Filed Date: 1/17/20.
Accession Number: 20200117–5072.
Comments Due: 5 p.m. ET 2/7/20.

Docket Numbers: ER20–834–000.
Applicants: Pima Energy Storage System, LLC.
Description: § 205(d) Rate Filing: Pima Energy Storage System, LLC Amendment to MBR Tariff to be effective 1/18/2020.
Filed Date: 1/17/20.
Accession Number: 20200117–5074.
Comments Due: 5 p.m. ET 2/7/20.

Docket Numbers: ER20–835–000.
Applicants: Pinal Central Energy Center, LLC.
Description: § 205(d) Rate Filing: Pinal Central Energy Center, LLC Amendment to MBR Tariff to be effective 1/18/2020.
Filed Date: 1/17/20.
Accession Number: 20200117–5077.
Comments Due: 5 p.m. ET 2/7/20.

Docket Numbers: ER20–836–000.
Applicants: Shafter Solar, LLC.
Description: § 205(d) Rate Filing: Shafter Solar, LLC Amendment to MBR Tariff to be effective 1/18/2020.
Filed Date: 1/17/20.
Accession Number: 20200117–5080.
Comments Due: 5 p.m. ET 2/7/20.

Docket Numbers: ER20–837–000.
Applicants: Silver State Solar Power South, LLC.
Description: § 205(d) Rate Filing: Silver State Solar Power South, LLC Amendment to MBR Tariff to be effective 1/18/2020.
Filed Date: 1/17/20.
Accession Number: 20200117–5081.
Comments Due: 5 p.m. ET 2/7/20.

Docket Numbers: ER20–838–000.
Applicants: Duke Energy Ohio, Inc.
Description: § 205(d) Rate Filing: DEO–AEP Amended IA (PJM SA No. 1491) to be effective 12/21/2019.
Filed Date: 1/17/20.
Accession Number: 20200117–5084.
Comments Due: 5 p.m. ET 2/7/20.

Docket Numbers: ER20–839–000.
Applicants: Duke Energy Ohio, Inc.
Description: § 205(d) Rate Filing: DEO–DP&L Amended IA (PJM SA No. 5186) to be effective 12/21/2019.
Filed Date: 1/17/20.
Accession Number: 20200117–5086.
Comments Due: 5 p.m. ET 2/7/20.

Docket Numbers: ER20–840–000.
Applicants: Golden Fields Solar IV, LLC.
Description: § 205(d) Rate Filing: Amended and Restated Shared Facilities Agreement and Request for Waivers to be effective 1/18/2020.
Filed Date: 1/17/20.
Accession Number: 20200117–5098.
Comments Due: 5 p.m. ET 2/7/20.

Docket Numbers: ER20–841–000.
Applicants: Appalachian Power Company, PJM Interconnection, L.L.C.
Description: § 205(d) Rate Filing: PJM Transmission Owners submit revisions to OATT to add a new Attachment M–4 to be effective 3/17/2020.
Filed Date: 1/17/20.
Accession Number: 20200117–5100.
Comments Due: 5 p.m. ET 2/7/20.

Docket Numbers: ER88–31–009.; ER88–32–009;. EL88–1–010.
Applicants: Indiana Michigan Power Company.
Description: Report for 2019 on review of nuclear decommissioning costs and FERC wholesale requirement customer contributions of Indiana Michigan Power Company, et al.
Filed Date: 1/15/20.
Accession Number: 20200115–5190.
Comments Due: 5 p.m. ET 2/5/20.

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: January 17, 2020.

Nathaniel J. Davis, Sr.,

Deputy Secretary.

[FR Doc. 2020–01185 Filed 1–23–20; 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: EG20–66–000.
Applicants: White Cloud Wind Project, LLC.
Description: Notice of Self-Certification of Exempt Wholesale Generator Status of White Cloud Wind Project, LLC.
Filed Date: 1/17/20.
Accession Number: 20200117–5186.
Comments Due: 5 p.m. ET 2/7/20.

Docket Numbers: EG20–67–000.
Applicants: Outlaw Wind Project, LLC.
Description: Notice of Self-Certification of Exempt Wholesale

Generator Status of Outlaw Wind Project, LLC.

Filed Date: 1/17/20.

Accession Number: 20200117–5192.

Comments Due: 5 p.m. ET 2/7/20.

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

Docket Numbers: ER10–1819–022; ER10–1820–025; ER10–1818–020.

Applicants: Northern States Power Company, a Minnesota corporation, Northern States Power Company, a Wisconsin corporation, Public Service Company of Colorado.

Description: Notice of Change in Status of Northern States Power Company, a Minnesota corporation, et al.

Filed Date: 1/17/20.

Accession Number: 20200117–5127.

Comments Due: 5 p.m. ET 2/7/20.

Docket Numbers: ER10–2005–017; ER11–26–017; ER10–1841–017; ER19–987–004; ER19–1003–004; ER10–1845–017; ER19–1393–004; ER19–1394–004; ER10–1852–033; ER10–1905–017; ER10–1907–016; ER10–1918–017; ER10–1925–017; ER10–1927–017; ER10–1950–017; ER19–2398–001; ER10–2006–017; ER18–2246–005; ER18–1771–006; ER16–1872–007; ER10–1970–016; ER10–1972–016; ER16–2506–008; ER18–2224–006; ER13–2461–011; ER17–2270–008; ER12–1660–016; ER13–2458–011; ER10–2078–017; ER11–4462–039; ER10–1951–018; ER17–838–014.

Applicants: Ashtabula Wind II, LLC, Ashtabula Wind III, LLC, Butler Ridge Wind Energy Center, LLC, Crystal Lake Wind Energy I, LLC, Crystal Lake Wind Energy II, LLC, Crystal Lake Wind III, LLC, Endeavor Wind I, LLC, Endeavor Wind II, LLC, Florida Power & Light Company, FPL Energy Mower County, LLC, FPL Energy North Dakota Wind, LLC, FPL Energy North Dakota Wind II, LLC, FPL Energy Oliver Wind I, LLC, FPL Energy Oliver Wind II, LLC, Garden Wind, LLC, Hancock County Wind, LLC, Hawkeye Power Partners, LLC, Heartland Divide Wind Project, LLC, Langdon Renewables, LLC, Marshall Solar, LLC, NextEra Energy Duane Arnold, LLC, NextEra Energy Point Beach, LLC, Oliver Wind III, LLC, Pegasus Wind, LLC, Pheasant Run Wind, LLC, Stuttgart Solar, LLC, Tuscola Bay Wind, LLC, Tuscola Wind II, LLC, White Oak Energy LLC, NEPM II, LLC, NextEra Energy Services Massachusetts, LLC, NextEra Energy Marketing, LLC.

Description: Notice of Change in Status of NextEra Resources Entities.

Filed Date: 1/16/20.

Accession Number: 20200116–5157.

Comments Due: 5 p.m. ET 2/6/20.

Docket Numbers: ER20–842–000.

Applicants: PJM Interconnection, L.L.C.

Description: § 205(d) Rate Filing: Original ISA, SA No. 5550 and ICSA, SA No. 5551; Queue No. AB2–047 to be effective 12/17/2019.

Filed Date: 1/17/20.

Accession Number: 20200117–5108.

Comments Due: 5 p.m. ET 2/7/20.

Docket Numbers: ER20–843–000.

Applicants: Midcontinent Independent System Operator, Inc.

Description: Limited waiver request of Midcontinent Independent System Operator, Inc.

Filed Date: 1/17/20.

Accession Number: 20200117–5118.

Comments Due: 5 p.m. ET 2/7/20.

Docket Numbers: ER20–844–000.

Applicants: Hamilton Projects Acquiror, LLC.

Description: Baseline eTariff Filing: MBR Application to be effective 3/18/2020.

Filed Date: 1/17/20.

Accession Number: 20200117–5126.

Comments Due: 5 p.m. ET 2/7/20.

Docket Numbers: ER20–845–000.

Applicants: Golden Fields Solar II, LLC.

Description: Tariff Cancellation: Notice of Cancellation to be effective 1/17/2020.

Filed Date: 1/17/20.

Accession Number: 20200117–5141.

Comments Due: 5 p.m. ET 2/7/20.

Docket Numbers: ER20–846–000.

Applicants: Duke Energy Carolinas, LLC.

Description: § 205(d) Rate Filing: DEF Revisions to Schedule 2 (Removal of Higgins Units 2–4) to be effective 1/1/2020.

Filed Date: 1/17/20.

Accession Number: 20200117–5143.

Comments Due: 5 p.m. ET 2/7/20.

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

Docket Numbers: ES20–13–000.

Applicants: Union Electric Company.

Description: Application Under Section 204 of the Federal Power Act for Authorization to Issue Securities of Union Electric Company.

Filed Date: 1/17/20.

Accession Number: 20200117–5116.

Comments Due: 5 p.m. ET 2/7/20.

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: January 17, 2020.

Nathaniel J. Davis, Sr.,

Deputy Secretary.

[FR Doc. 2020–01180 Filed 1–23–20; 8:45 am]

BILLING CODE 6717–01–P

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

[Project No. 12449–014]

Wiscons8, LLC; IOWAter Power Corporation; Notice of Application for Transfer of License and Soliciting Comments, Motions To Intervene, and Protests

On December 30, 2019, Wiscons8, LLC (transferor) and IOWAter Power Corporation (transferee) filed an application for the transfer of license of the Big Falls Milldam Project No. 12449. The project is located on the Little Wolf River in Waupaca County, Wisconsin.

The applicants seek Commission approval to transfer the license for the Big Falls Milldam Project from the transferor to the transferee.

Applicants Contact: For transferor: Dwight Bowler, Wiscons8, LLC, 813 Jefferson Hill Road, Nassau, New York 12123, Phone: (518) 766–2753, Email: *dbowler838@aol.com. Copy to:* Joshua A. Sabo, Esq., 287 North Greenbush Road, Troy, New York 12180, Phone: (518) 286–9050, Email: *jsabo@sabolaw.net*

For transferee: Dwight Shanak, IOWAter Power Corporation, N3311 Sunrise Lane, Waupaca, Wisconsin 54981 *Copy to:* Robert W. Zimmerman, Esq., Mallery & Zimmerman, S.C., 500 Third St., Suite 800, P.O. Box 479, Wausau, Wisconsin 54402.

FERC Contact: Anumzziatta Purchiaroni, (202) 502–6191, *Anumzziatta.purchiaroni@ferc.gov.*

Deadline for filing comments, motions to intervene, and protests: 30 days from the date that the Commission issues this notice. 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–12449–014.

Dated: January 17, 2020.

Kimberly D. Bose,

Secretary.

[FR Doc. 2020–01181 Filed 1–23–20; 8:45 am]

BILLING CODE 6717–01–P

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

[Docket No. ER20–820–000]

Blythe Solar IV, LLC; Supplemental Notice That Initial Market-Based Rate Filing Includes Request for Blanket Section 204 Authorization

This is a supplemental notice in the above-referenced Blythe Solar IV, LLC's application for market-based rate authority, with an accompanying rate tariff, noting that such application includes a request for blanket authorization, under 18 CFR part 34, of future issuances of securities and assumptions of liability.

Any person desiring to intervene or to protest should file with the Federal Energy Regulatory Commission, 888 First Street NE, Washington, DC 20426, in accordance with Rules 211 and 214 of the Commission's Rules of Practice and Procedure (18 CFR 385.211 and 385.214). Anyone filing a motion to intervene or protest must serve a copy of that document on the Applicant.

Notice is hereby given that the deadline for filing protests with regard to the applicant's request for blanket authorization, under 18 CFR part 34, of future issuances of securities and assumptions of liability, is February 6, 2020.

The Commission encourages electronic submission of protests and interventions in lieu of paper, using the FERC Online links at *http://www.ferc.gov.* To facilitate electronic service, persons with internet access who will eFile a document and/or be listed as a contact for an intervenor must create and validate an eRegistration account using the eRegistration link. Select the eFiling link to log on and submit the intervention or protests.

Persons unable to file electronically should submit an original and 5 copies of the intervention or protest to the Federal Energy Regulatory Commission, 888 First Street NE, Washington, DC 20426.

The filings in the above-referenced proceeding are accessible in the Commission's eLibrary system by clicking on the appropriate link in the above list. They are also available for electronic review in the Commission's Public Reference Room in Washington, DC. There is an eSubscription link on the website that enables subscribers to receive email notification when a document is added to a subscribed docket(s). For assistance with any FERC Online service, please email *FERCOnlineSupport@ferc.gov.* or call (866) 208–3676 (toll free). For TTY, call (202) 502–8659.

Dated: January 17, 2020.

Nathaniel J. Davis, Sr.,

Deputy Secretary.

[FR Doc. 2020–01187 Filed 1–23–20; 8:45 am]

BILLING CODE 6717–01–P

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

[Docket No. ER20–819–000]

Blythe Solar III, LLC; Supplemental Notice that Initial Market-Based Rate Filing Includes Request for Blanket Section 204 Authorization

This is a supplemental notice in the above-referenced Blythe Solar III, LLC's application for market-based rate authority, with an accompanying rate tariff, noting that such application includes a request for blanket authorization, under 18 CFR part 34, of future issuances of securities and assumptions of liability.

Any person desiring to intervene or to protest should file with the Federal Energy Regulatory Commission, 888 First Street NE, Washington, DC 20426, in accordance with Rules 211 and 214 of the Commission's Rules of Practice and Procedure (18 CFR 385.211 and 385.214). Anyone filing a motion to intervene or protest must serve a copy of that document on the Applicant.

Notice is hereby given that the deadline for filing protests with regard to the applicant's request for blanket authorization, under 18 CFR part 34, of future issuances of securities and assumptions of liability, is February 6, 2020.

The Commission encourages electronic submission of protests and interventions in lieu of paper, using the FERC Online links at *http://www.ferc.gov.* To facilitate electronic service, persons with internet access who will eFile a document and/or be listed as a contact for an intervenor must create and validate an eRegistration account using the eRegistration link. Select the eFiling link to log on and submit the intervention or protests.

Persons unable to file electronically should submit an original and 5 copies of the intervention or protest to the Federal Energy Regulatory Commission, 888 First Street NE, Washington, DC 20426.

The filings in the above-referenced proceeding are accessible in the Commission's eLibrary system by clicking on the appropriate link in the above list. They are also available for electronic review in the Commission's Public Reference Room in Washington, DC. There is an eSubscription link on the website that enables subscribers to receive email notification when a document is added to a subscribed docket(s). For assistance with any FERC Online service, please email *FERCOnlineSupport@ferc.gov.* or call (866) 208–3676 (toll free). For TTY, call (202) 502–8659.

Dated: January 17, 2020.

Nathaniel J. Davis, Sr.,

Deputy Secretary.

[FR Doc. 2020–01184 Filed 1–23–20; 8:45 am]

BILLING CODE 6717–01–P

DEPARTMENT OF ENERGY

Federal Energy Regulatory Commission

[Docket No. CP19–471–000]

Bluewater Gas Storage, LLC; Notice of Availability of the Environmental Assessment for the Proposed Bluewater Compression Project

The staff of the Federal Energy Regulatory Commission (FERC or Commission) has prepared an environmental assessment (EA) for the Bluewater Compression Project (Project), proposed by Bluewater Gas

Storage, LLC (Bluewater) in the above-referenced docket. Bluewater requests authorization to construct, install, own, operate, and maintain a compressor station in Ray Township, Macomb County, Michigan.

The EA assesses the potential environmental effects of the construction and operation of the Project in accordance with the requirements of the National Environmental Policy Act (NEPA). The FERC staff concludes that approval of the proposed project, with appropriate mitigating measures, would not constitute a major federal action significantly affecting the quality of the human environment.

The Project would consist of the following:

- A new 11,150 horsepower natural gas compressor station and ancillary facilities in Macomb County, Michigan;
- Two 105-foot-long, 20-inch-diameter pipeline sections that would tie-in the proposed compressor station to Bluewater's existing 20-inch-diameter pipeline; and
- Abandonment in place of approximately 420 feet of existing 20-inch-diameter pipeline.

The Commission mailed a copy of the *Notice of Availability* to federal, state, and local government representatives and agencies; elected officials; environmental and public interest groups; Native American tribes; potentially affected landowners and other interested individuals and groups; and newspapers and libraries in the project area. The EA is only available in electronic format. It may be viewed and downloaded from the FERC's website (*www.ferc.gov*), on the Environmental Documents page (*https://www.ferc.gov/industries/gas/enviro/eis.asp*). In addition, the EA may be accessed by using the eLibrary link on the FERC's website. Click on the eLibrary link (*https://www.ferc.gov/docs-filing/elibrary.asp*), click on General Search, and enter the docket number in the ''Docket Number'' field, excluding the last three digits (*i.e.* CP19–471). Be sure you have selected an appropriate date range. For assistance, please contact FERC Online Support at *FercOnlineSupport@ferc.gov* or toll free at (866) 208–3676, or for TTY, contact (202) 502–8659.

Any person wishing to comment on the EA may do so. Your comments should focus on the EA's disclosure and discussion of potential environmental effects, reasonable alternatives, and measures to avoid or lessen environmental impacts. The more specific your comments, the more useful they will be. To ensure that the Commission has the opportunity to consider your comments prior to making its decision on this project, it is important that we receive your comments in Washington, DC on or before 5:00 p.m. Eastern Time on February 18, 2020.

For your convenience, there are three methods you can use to file your comments to the Commission. The Commission encourages electronic filing of comments and has staff available to assist you at (866) 208–3676 or *FercOnlineSupport@ferc.gov.* Please carefully follow these instructions so that your comments are properly recorded.

(1) You can file your comments electronically using the *eComment* feature on the Commission's website (*www.ferc.gov*) under the link to *Documents and Filings.* This is an easy method for submitting brief, text-only comments on a project;

(2) You can also file your comments electronically using the *eFiling* feature on the Commission's website (*www.ferc.gov*) under the link to *Documents and Filings.* With eFiling, you can provide comments in a variety of formats by attaching them as a file with your submission. New eFiling users must first create an account by clicking on ''*eRegister.*'' You must select the type of filing you are making. If you are filing a comment on a particular project, please select ''Comment on a Filing''; or

(3) You can file a paper copy of your comments by mailing them to the following address. Be sure to reference the project docket number (CP19- 471–000) with your submission: Kimberly D. Bose, Secretary, Federal Energy Regulatory Commission, 888 First Street NE, Room 1A, Washington, DC 20426.

Any person seeking to become a party to the proceeding must file a motion to intervene pursuant to Rule 214 of the Commission's Rules of Practice and Procedures (18 CFR 385.214). Motions to intervene are more fully described at *http://www.ferc.gov/resources/guides/how-to/intervene.asp.* Only intervenors have the right to seek rehearing or judicial review of the Commission's decision. The Commission may grant affected landowners and others with environmental concerns intervenor status upon showing good cause by stating that they have a clear and direct interest in this proceeding which no other party can adequately represent. Simply filing environmental comments will not give you intervenor status, but you do not need intervenor status to have your comments considered.

Additional information about the project is available from the Commission's Office of External Affairs, at (866) 208–FERC, or on the FERC website (*www.ferc.gov*) using the *eLibrary* link. The eLibrary link also provides access to the texts of all formal documents issued by the Commission, such as orders, notices, and rulemakings.

In addition, the Commission offers a free service called eSubscription which allows you to keep track of all formal issuances and submittals in specific dockets. This can reduce the amount of time you spend researching proceedings by automatically providing you with notification of these filings, document summaries, and direct links to the documents. Go to *www.ferc.gov/docs-filing/esubscription.asp.*

Dated: January 17, 2020.

Kimberly D. Bose,

Secretary.

[FR Doc. 2020–01182 Filed 1–23–20; 8:45 am]

BILLING CODE 6717–01–P

ENVIRONMENTAL PROTECTION AGENCY

[ER–FRL–9049–1]

Environmental Impact Statements; Notice of Availability

Weekly receipt of Environmental Impact Statements

Filed January 13, 2020, 10 a.m. EST, Through January 20, 2020, 10 a.m. EST, Pursuant to 40 CFR 1506.9.

Responsible Agency: Office of Federal Activities, General Information 202–564–5632 or *https://www.epa.gov/nepa/.*

Section 309(a) of the Clean Air Act requires that EPA make public its comments on EISs issued by other Federal agencies. EPA's comment letters on EISs are available at: *https://cdxnodengn.epa.gov/cdx-enepa-public/action/eis/search.*

EIS No. 20200009, Final, BLM, CA, Haiwee Geothermal Leasing Area, Review Period Ends: 02/24/2020, Contact: Gregory Miller 951–697–5216

EIS No. 20200010, Draft, UDOT, UT, Parley's Interchange, I–80/I–215 Eastside, Comment Period Ends: 03/09/2020, Contact: Naomi Kisen 801–965–4005

EIS No. 20200011, Final, USAF, CA, Environmental Impact Statement/Environmental Impact Report for the Edwards AFB Solar Project, Review Period Ends: 02/24/2020, Contact: Andrea Brewer-Anderson 661–277–4948

EIS No. 20200012, Final Supplement, NASA, FL, Supplement

Environmental Impact Statement for the Mars 2020 Mission, Review Period Ends: 02/24/2020, Contact: George Tahu 202–238–0016

EIS No. 20200013, Final, NMFS, REG, Final Regulatory Amendment to Modify Pelagic Longline Bluefin Tuna Area-Based and Weak Hook Management Measures, Review Period Ends: 02/24/2020, Contact: Jennifer Cudney 727–209–5980

EIS No. 20200014, Final, NRCS, ID, ADOPTION—Bruneau-Owyhee Sage-Grouse Habitat Project, Contact: Curtis Elke 208–378–5701

The Natural Resources Conservation Service (NRCS) has adopted the Bureau of Land Management's Final EIS No 20180015, filed 02/02/2018 with the EPA. NRCS was a cooperating agency on this project. Therefore, recirculation of the document is not necessary under Section 1506.3(c) of the CEQ regulations.

EIS No. 20200015, Final, USACE, FL, Central and Southern Florida, Everglades Agricultural Area (EAA), Florida, Review Period Ends: 02/24/2020, Contact: Andrew LoSchiavo 904–232–2077

Amended Notice

EIS No. 20190279, Draft, USACE, CO, Halligan Water Supply Project, Comment Period Ends: 02/26/2020, Contact: Cody Wheeler 720–922–3846. Revision to FR Notice Published 11/22/2019; Extending the Comment Period from 1/27/2020 to 2/26/2020.

EIS No. 20190295, Draft, USFS, ID, Land Management Plan Revision for the Nez Perce-Clearwater National Forests, Comment Period Ends: 04/20/2020, Contact: Zachary Peterson 208–935–4239. Revision to FR Notice Published 12/20/2019; Extending the Comment Period from 03/19/2020 to 04/20/2020.

Dated: January 21, 2020.

Robert Tomiak,

Director, Office of Federal Activities.

[FR Doc. 2020–01186 Filed 1–23–20; 8:45 am]

BILLING CODE 6560–50–P

FEDERAL COMMUNICATIONS COMMISSION

[OMB 3060–1126; FRS 16420]

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 February 24, 2020. 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: 3060–1126.

Title: Testing and Logging Requirements for Wireless Emergency Alerts (WEA).

Form Number: Not applicable.

Type of Review: Extension of a currently approved collection.

Respondents: Business or other for-profit entities.

Number of Respondents and Responses: 76 Participating CMS Providers; 429,020 Responses.

Estimated Time per Response: 0.000694 hours (2.5 seconds) to generate each alert log; 2 hours to respond to each request for alert log data or information about geo-targeting.

Frequency of Response: Monthly and on occasion reporting requirements and recordkeeping requirement.

Obligation to Respond: Required to obtain or retain benefits. Statutory authority for this information collection is contained in 47 U.S.C. 151, 152, 154(i) and (o), 301, 301(r), 303(v), 307, 309, 335, 403, 544(g), 606 and 615 of the Communications Act of 1934, as amended, as well as by sections 602(a), (b), (c), (f), 603, 604 and 606 of the WARN Act.

Total Annual Burden: 119,121 hours.

Total Annual Cost: No cost.

Privacy Act Impact Assessment: No impact(s).

Nature and Extent of Confidentiality: Participating CMS Providers shall make available upon request to the Commission and FEMA, and to emergency management agencies that offer confidentiality protection at least equal to that provided in the federal Freedom of Information Act (FOIA) their alert logs and information about their approach to geo-targeting insofar as the information pertains to alerts initiated by that emergency management agency.

Federal Communications Commission.

Marlene Dortch,

Secretary, Office of the Secretary.

[FR Doc. 2020–01162 Filed 1–23–20; 8:45 am]

BILLING CODE 6712–01–P

FEDERAL COMMUNICATIONS COMMISSION

[OMB 3060–0823; FRS 16421]

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 PRA comments should be submitted on or before March 24, 2020. 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 contact listed below as soon as possible.

ADDRESSES: Direct all PRA comments to Nicole Ongele, FCC, via email *PRA@fcc.gov* and to *Nicole.ongele@fcc.gov.*

FOR FURTHER INFORMATION CONTACT: For additional information about the information collection, contact Nicole Ongele, (202) 418–2991.

SUPPLEMENTARY INFORMATION:

OMB Control Number: 3060–0823.

Title: Part 64, Pay Telephone Reclassification.

Form Number: N/A.

Type of Review: Extension of a currently approved collection.

Respondents: Business or other for-profit.

Number of Respondents and Responses: 400 respondents; 16,820 responses.

Estimated Time per Response: 2.66 hours (average).

Frequency of Response: On occasion, quarterly and monthly reporting requirements and third party disclosure requirements.

Obligation to Respond: Required to obtain or retain benefits. Statutory authority for this information collection is contained in 47 U.S.C. 151, 154, 201–205, 218, 226 and 276.

Total Annual Burden: 44,700 hours.

Total Annual Cost: $768,000.

Privacy Impact Assessment: No impact(s).

Nature and Extent of Confidentiality: Confidentiality concerns are not relevant to these types of disclosures. The Commission is not requesting carriers or providers to submit confidential information to the Commission. If the Commission requests that carriers or providers submit information which they believe is confidential, the carriers or providers may request confidential treatment of their information under 47 CFR 0.459 of the Commission's rules.

Needs and Uses: The Commission established a plan to ensure that payphone service providers (PSPs) were compensated for certain non-coin calls originated from their payphones. As part of this plan, the Commission required that by October 7, 1997, local exchange carriers were to provide payphone-specific coding digits to PSPs, and that PSPs were to provide those digits from their payphones to interexchange carriers. The provision of payphone-specific coding digits was a prerequisite to payphone per-call compensation payments by IXCs to PSPs for subscriber 800 and access code calls. The Commission's Wireline Competition Bureau subsequently provided a waiver until March 9, 1998, for those payphones for which the necessary coding digits were not provided to identify calls. The Bureau also on that date clarified the requirements established in the Payphone Orders for the provision of payphone-specific coding digits and for tariffs that LECs must file pursuant to the Payphone Orders.

Federal Communications Commission.

Marlene Dortch,

Secretary, Office of the Secretary.

[FR Doc. 2020–01163 Filed 1–23–20; 8:45 am]

BILLING CODE 6712–01–P

FEDERAL RESERVE SYSTEM

Change in Bank Control Notices; Acquisitions of Shares of a Bank or Bank Holding Company

The notificants listed below have applied under the Change in Bank Control Act (Act) (12 U.S.C. 1817(j)) and § 225.41 of the Board's Regulation Y (12 CFR 225.41) to acquire shares of a bank or bank holding company. The factors that are considered in acting on the notices are set forth in paragraph 7 of the Act (12 U.S.C. 1817(j)(7)).

The applications listed below, as well as other related filings required by the Board, if any, 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 paragraph 7 of the Act.

Comments regarding each of these applications must be received at the Reserve Bank indicated or the offices of the Board of Governors, Ann E. Misback, Secretary of the Board, 20th and Constitution Avenue NW, Washington, DC 20551–0001, not later than February 6, 2020.

A. Federal Reserve Bank of Chicago (Colette A. Fried, Assistant Vice President) 230 South LaSalle Street, Chicago, Illinois 60690–1414:

1. *The Charles and Lois Welling Family Trust, Hutchinson Island, Florida, Lynnea Kay Gery, La Grange, Illinois, as special voting trustee;* to acquire voting shares of United Bank

Financial Corporation and thereby indirectly acquire voting shares of United Bank of Michigan, both of Grand Rapids, Michigan.

B. Federal Reserve Bank of Kansas City (Dennis Denney, Assistant Vice President) 1 Memorial Drive, Kansas City, Missouri 64198–0001:

1. *The John G. Paterson and Ann P. Paterson Living Trust, John G. Patterson and Ann P. Paterson as co-trustees, all of San Ramon, California; Sharon P. McGuire, Boise, Idaho; Lawrence N. Paterson, Fremont, California; Thomas G. Paterson, San Francisco, California; and Janice L. Selvy, San Carlos, California;* as members of the Paterson Family Group to retain voting shares of Bethany Bankshares, Inc. and thereby indirectly retain voting shares of BTC Bank, both of Bethany, Missouri.

C. Federal Reserve Bank of Minneapolis (Chris P. Wangen, Assistant Vice President), 90 Hennepin Avenue, Minneapolis, Minnesota 55480–0291:

1. *Kelly A. Skalicky, New York, New York; the Norman C. Skalicky 2019 Revocable Trust, St. Cloud, Minnesota, Kelly A. Skalicky and Norman C. Skalicky, St. Cloud, Minnesota, as co-trustees; the Kelly A. Skalicky 2019 GRAT, New York, New York, Kelly A. Skalicky, trustee; and the 2019 Skalicky Family Gift Trust FBO Trenton Dean Skalicky, New York, New York, Kelly A. Skalicky, trustee; to* acquire voting shares of Stearns Financial Services, Inc., St. Cloud, Minnesota, and thereby indirectly acquire voting shares of Stearns Bank NA, St. Cloud, Minnesota; Stearns Bank Holdingford NA, Holdingford, Minnesota; and Stearns Bank NA, Upsala, Minnesota. In addition, Cheryl R. Ryan, Elk River, Minnesota; Jeffery Dean Skalicky, Rosholt, South Dakota; the Cheryl R. Ryan 2019 GRAT, Elk River, Minnesota, Cheryl R. Ryan, trustee; the Jeffery D. Skalicky 2019 GRAT, Jeffery Dean Skalicky, trustee; Jan M. Hanson, Duvall, Washington; Johanna A. Ryan, Brooklyn, New York; and the 2012 Gift Trust FBO Barrett Chelsea Skalicky Doss, Barrett C. Skalicky Doss, trustee, both of Brooklyn, New York; to retain voting shares of Stearns Financial Services, Inc., and thereby indirectly retain voting shares of Stearns Bank NA, Stearns Bank Holdingford NA, and Stearns Bank NA, Upsala, Minnesota.

Board of Governors of the Federal Reserve System, January 17, 2020.

Yao-Chin Chao,

Assistant Secretary of the Board.

[FR Doc. 2020–01123 Filed 1–23–20; 8:45 am]

BILLING CODE 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, if any, 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)).

Comments regarding each of these applications must be received at the Reserve Bank indicated or the offices of the Board of Governors, Ann E. Misback, Secretary of the Board, 20th Street and Constitution Avenue NW, Washington, DC 20551–0001, not later than February 21, 2020.

A. Federal Reserve Bank of Kansas City (Dennis Denney, Assistant Vice President) 1 Memorial Drive, Kansas City, Missouri 64198–0001:

1. *HYS Investments, LLC, Topeka, Kansas;* to acquire additional shares, and thereby increase their ownership from 26.02 percent to 28.55 percent, of BOTS, Inc. parent holding company of VisionBank, both of Topeka, Kansas.

Board of Governors of the Federal Reserve System, January 17, 2020.

Yao-Chin Chao

Assistant Secretary of the Board.

[FR Doc. 2020–01122 Filed 1–23–20; 8:45 am]

BILLING CODE P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Centers for Disease Control and Prevention

Disease, Disability, and Injury Prevention and Control Special Emphasis Panel (SEP)—DP20–001, Assessing the Burden of Diabetes By Type in Children, Adolescents and Young Adults (DiCAYA); Amended Notice of Meeting

Notice is hereby given of a change in the meeting of the Disease, Disability, and Injury Prevention and Control Special Emphasis Panel (SEP)—DP20–001, Assessing the Burden of Diabetes By Type in Children, Adolescents and Young Adults (DiCAYA); March 11, 2019, 10:00 a.m.–6:00 p.m., EDT. Teleconference, Centers for Disease Control and Prevention, Atlanta, Georgia 30341 which was published in the **Federal Register** on January 10, 2020, Volume 85, Number 7, page 1315.

The meeting is being amended to change the meeting date to March 10–11, 2020, from 11:00 a.m.–5:00 p.m., EDT, on March 10, 2020, and 10:00 a.m.–6:00 p.m., EDT, on March 11, 2020.

FOR FURTHER INFORMATION CONTACT: Jaya Raman Ph.D., Scientific Review Officer, CDC, 4770 Buford Highway, Mailstop F80, Atlanta, Georgia 30341; Telephone: (770) 488–6511; *kva5@cdc.gov.*

The Director, Strategic Business Initiatives Unit, Office of the Chief Operating Officer, Centers for Disease Control and Prevention, has been delegated the authority to sign **Federal Register** notices pertaining to announcements of meetings and other committee management activities, for both the Centers for Disease Control and Prevention and the Agency for Toxic Substances and Disease Registry.

Kalwant Smagh,

Director, Strategic Business Initiatives Unit, Office of the Chief Operating Officer, Centers for Disease Control and Prevention.

[FR Doc. 2020–01206 Filed 1–23–20; 8:45 am]

BILLING CODE 4163–18–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Centers for Disease Control and Prevention

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, and the Determination of the Director, Strategic Business Initiatives Unit, Office of the Chief Operating Officer, CDC, pursuant to Public Law 92–463. 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: Disease, Disability, and Injury Prevention and Control Special Emphasis Panel (SEP)-SIP20–002, Improving Cognitive Impairment Detection and Referral to Resources among Older Adults: Applying the KAER Model to Primary Care within a Health Care System.

Date: April 16, 2020.

Time: 11:00 a.m.–6:00 p.m., EDT.

Place: Teleconference.

Agenda: To review and evaluate grant applications.

For Further Information Contact: Jaya Raman Ph.D., Scientific Review Officer, CDC, 4770 Buford Highway, Mailstop F80, Atlanta, Georgia 30341, Telephone: (770) 488–6511, *kva5@cdc.gov.*

The Director, Strategic Business Initiatives Unit, Office of the Chief Operating Officer, Centers for Disease Control and Prevention, has been delegated the authority to sign **Federal Register** notices pertaining to announcements of meetings and other committee management activities, for both the Centers for Disease Control and Prevention and the Agency for Toxic Substances and Disease Registry.

Kalwant Smagh,

Director, Strategic Business Initiatives Unit, Office of the Chief Operating Officer, Centers for Disease Control and Prevention.

[FR Doc. 2020–01208 Filed 1–23–20; 8:45 am]

BILLING CODE 4163–18–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Centers for Disease Control and Prevention

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, and the Determination of the Director, Strategic Business Initiatives Unit, Office of the Chief Operating Officer, CDC, pursuant to Public Law 92–463. 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: Disease, Disability, and Injury Prevention and Control Special Emphasis Panel (SEP)—SIP20–001, Developing and Evaluating Adolescent, Parent, and Provider Resources to Improve Adolescent Use of Sexual Health Services.

Date: April 14, 2020.

Time: 11:00 a.m.–6:00 p.m., EDT.

Place: Teleconference.

Agenda: To review and evaluate grant applications.

FOR FURTHER INFORMATION CONTACT: Jaya Raman Ph.D., Scientific Review Officer, CDC, 4770 Buford Highway, Mailstop F80, Atlanta, Georgia 30341, Telephone: (770) 488–6511, *kva5@cdc.gov.*

The Director, Strategic Business Initiatives Unit, Office of the Chief Operating Officer, Centers for Disease Control and Prevention, has been delegated the authority to sign **Federal Register** notices pertaining to announcements of meetings and other committee management activities, for both the Centers for Disease Control and Prevention and the Agency for Toxic Substances and Disease Registry.

Kalwant Smagh,

Director, Strategic Business Initiatives Unit, Office of the Chief Operating Officer, Centers for Disease Control and Prevention.

[FR Doc. 2020–01207 Filed 1–23–20; 8:45 am]

BILLING CODE 4163–18–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Centers for Medicare & Medicaid Services

[Document Identifier: CMS–10463]

Agency Information Collection Activities: Submission for OMB Review; Comment Request

AGENCY: Centers for Medicare & Medicaid Services, HHS.

ACTION: Notice.

SUMMARY: The Centers for Medicare & Medicaid Services (CMS) is announcing an opportunity for the public to comment on CMS' intention to collect information from the public. Under the Paperwork Reduction Act of 1995 (PRA), federal agencies are required to publish notice in the **Federal Register** concerning each proposed collection of information, including each proposed extension or reinstatement of an existing collection of information, and to allow a second opportunity for public comment on the notice. Interested persons are invited to send comments regarding the burden estimate or any other aspect of this collection of information, including the necessity and utility of the proposed information collection for the proper performance of the agency's functions, the accuracy of the estimated burden, ways to enhance the quality, utility, and clarity of the information to be collected, and the use of automated collection techniques or other forms of information technology to minimize the information collection burden.

DATES: Comments on the collection(s) of information must be received by the OMB desk officer by *February 24, 2020.*

ADDRESSES: When commenting on the proposed information collections, please reference the document identifier or OMB control number. To be assured consideration, comments and recommendations must be received by the OMB desk officer via one of the following transmissions: OMB, Office of Information and Regulatory Affairs, Attention: CMS Desk Officer, Fax Number: (202) 395–5806, *OR,* Email: *OIRA_submission@omb.eop.gov.*

To obtain copies of a supporting statement and any related forms for the proposed collection(s) summarized in this notice, you may make your request using one of following:

1. Access CMS' website address at website address at *https://www.cms.gov/Regulations-and-Guidance/Legislation/PaperworkReductionActof1995/PRA-Listing.html.*

1. Email your request, including your address, phone number, OMB number, and CMS document identifier, to *Paperwork@cms.hhs.gov.*

2. Call the Reports Clearance Office at (410) 786–1326.

FOR FURTHER INFORMATION CONTACT: William Parham at (410) 786–4669.

SUPPLEMENTARY INFORMATION: Under the Paperwork Reduction Act of 1995 (PRA) (44 U.S.C. 3501–3520), federal agencies must obtain approval from the Office of Management and Budget (OMB) for each collection of information they conduct or sponsor. The term ''collection of information'' is defined in 44 U.S.C. 3502(3) and 5 CFR 1320.3(c) 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 publish a 30-day notice in the **Federal Register** concerning each proposed collection of information, including each proposed extension or reinstatement of an existing collection of information, before submitting the collection to OMB for approval. To comply with this requirement, CMS is publishing this notice that summarizes the following proposed collection(s) of information for public comment:

1. *Type of Information Collection Request:* Revision of a currently approved collection; *Title of Information Collection:* Cooperative Agreement to Support Navigators in Federally-facilitated Exchanges; *Use:* Section 1311(i) of the PPACA requires Exchanges to establish a Navigator grant program under which it awards grants to eligible individuals and entities (as described in Section 1311(i)(2) of the PPACA and 45 CFR 155.210(a) and (c)) applying to serve consumers in States with a FFE. Navigators assist consumers by providing education about and facilitating selection of qualified health plans (QHPs) within the Exchanges, as well as other required duties. Entities and individuals cannot serve as federally certified Navigators and carry out the required duties without receiving federal cooperative agreement funding.

As a condition of award, Navigator awardees must agree to cooperate with any Federal evaluation of the program and must provide required weekly, monthly, quarterly, annual, and final (at the end of the cooperative agreement period) reports in a form prescribed by CMS, as well as any additional reports as required. *Form Number:* CMS–10463 (OMB control number: 0938–1215); *Frequency:* Annually, Monthly, Quarterly, Weekly; *Affected Public:* Private sector; *Number of Respondents:* 50; *Total Annual Responses:* 50; *Total Annual Hours:* 20,850. (For questions regarding this collection contact Gian Johnson at 301–492–4323.)

Dated: January 21, 2020.

William N. Parham, III,

Director, Paperwork Reduction Staff, Office of Strategic Operations and Regulatory Affairs.

[FR Doc. 2020–01210 Filed 1–23–20; 8:45 am]

BILLING CODE 4120–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Administration for Children and Families

Submission for OMB Review; Form ACF–196, TANF Quarterly Financial Report (OMB #0970–0247)

AGENCY: Office of Family Assistance; Administration for Children and Families; HHS

ACTION: Request for Public Comment.

SUMMARY: The Administration for Children and Families (ACF) is requesting to renew approval of the ACF–196 Temporary Assistance for Needy Families (TANF) Financial Reporting Form. The ACF–196 is the form used by states to revise expenditure data for fiscal years (FYs) prior to FY 2015. ACF will use the financial data provided by states to assess compliance with statutory and regulatory requirements relating to administrative costs and state matching requirements. No changes are proposed to the form.

DATES: *Comments due within 30 days of publication.* OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this document in the **Federal Register**. Therefore, a comment is best assured of having its full effect if OMB receives it within 30 days of publication.

ADDRESSES: Written comments and recommendations for the proposed information collection should be sent directly to the following: Office of Management and Budget, Paperwork Reduction Project, Email: *OIRA_SUBMISSION@OMB.EOP.GOV*, Attn: Desk Officer for the Administration for Children and Families.

Copies of the proposed collection may be obtained by emailing *infocollection@acf.hhs.gov.* Alternatively, copies can also be obtained by writing to the Administration for Children and Families, Office of Planning, Research, and Evaluation, 330 C Street SW, Washington, DC 20201, Attn: ACF Reports Clearance Officer. All requests, emailed or written, should be identified by the title of the information collection.

SUPPLEMENTARY INFORMATION:

Description: This information collection is authorized under Section 411(a)(3) of the Social Security Act. This request is for renewal of approval to the ACF–196 form for periodic financial reporting under the TANF program. States participating in the TANF program are required by statute to report financial data on the ACF–196 report. The continuation of the ACF–196 is necessary for the states that have open grant awards before FY 2015. This form meets the legal standard and provides essential data on the use of federal funds. Failure to collect the data would seriously compromise ACF's ability to monitor program expenditures, estimate funding needs, and to prepare budget submissions required by Congress. Financial reporting under the TANF program is governed by 45 CFR part 265.

Respondents: TANF Agencies.

ANNUAL BURDEN ESTIMATES

Instrument	Total number of respondents	Number of responses per respondent	Average burden hours per response	Annual burden hours
ACF–196	5	1	5	25

Estimated Total Annual Burden Hours: 25.

Authority: U.S.C. Section 402 of the Social Security Act (42 U.S.C. 602).

Mary B. Jones,

ACF/OPRE Certifying Officer.

[FR Doc. 2020–01124 Filed 1–23–20; 8:45 am]

BILLING CODE 4184–36–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration

[Docket No. FDA–2020–N–0166]

Oncologic Drugs Advisory Committee; Notice of Meeting; Establishment of a Public Docket; Request for Comments

AGENCY: Food and Drug Administration, HHS.

ACTION: Notice; establishment of a public docket; request for comments.

SUMMARY: The Food and Drug Administration (FDA) announces a forthcoming public advisory committee meeting of the Oncologic Drugs Advisory Committee. The general function of the committee is to provide advice and recommendations to FDA on regulatory issues. The meeting will be open to the public. FDA is establishing a docket for public comment on this document.

DATES: The meeting will be held on February 26, 2020, from 8 a.m. to 5 p.m.

ADDRESSES: FDA White Oak Campus, 10903 New Hampshire Ave., Bldg. 31 Conference Center, the Great Room (Rm. 1503), Silver Spring, MD 20993–0002. Entrance for the public meeting participants (non-FDA employees) is through Building 1 where routine security check procedures will be performed. For security information, please refer to *https://www.fda.gov/AboutFDA/WorkingatFDA/BuildingsandFacilities/WhiteOakCampusInformation/ucm241740.htm.* Answers to commonly asked questions including information regarding special accommodations due to a disability, visitor parking, and transportation may be accessed at: *https://www.fda.gov/AdvisoryCommittees/AboutAdvisoryCommittees/ucm408555.htm.*

FDA is establishing a docket for public comment on this meeting. The docket number is Docket No. FDA–2020–N–0166. The docket will close on February 25, 2020. Submit either electronic or written comments on this public meeting by February 25, 2020. Please note that late, untimely filed comments will not be considered. Electronic comments must be submitted on or before February 25, 2020. The *https://www.regulations.gov* electronic filing system will accept comments until 11:59 p.m. Eastern Time at the end of February 25, 2020. Comments received by mail/hand delivery/courier (for written/paper submissions) will be considered timely if they are postmarked or the delivery service acceptance receipt is on or before that date.

Comments received on or before February 19, 2020, will be provided to the committee. Comments received after that date will be taken into consideration by FDA. In the event that the meeting is cancelled, FDA will continue to evaluate any relevant applications or information, and consider any comments submitted to the docket, as appropriate.

You may submit comments as follows:

Electronic Submissions

Submit electronic comments in the following way:

- *Federal eRulemaking Portal: https://www.regulations.gov.* Follow the instructions for submitting comments. Comments submitted electronically, including attachments, to *https://www.regulations.gov* will be posted to the docket unchanged. Because your comment will be made public, you are solely responsible for ensuring that your comment does not include any confidential information that you or a third party may not wish to be posted, such as medical information, your or anyone else's Social Security number, or confidential business information, such as a manufacturing process. Please note that if you include your name, contact information, or other information that identifies you in the body of your comments, that information will be posted on *https://www.regulations.gov.*
- If you want to submit a comment with confidential information that you do not wish to be made available to the public, submit the comment as a written/paper submission and in the manner detailed (see ''Written/Paper Submissions'' and ''Instructions'').

Written/Paper Submissions

Submit written/paper submissions as follows:

- *Mail/Hand Delivery/Courier (for written/paper submissions):* Dockets Management Staff (HFA–305), Food and Drug Administration, 5630 Fishers Lane, Rm. 1061, Rockville, MD 20852.
- For written/paper comments submitted to the Dockets Management Staff, FDA will post your comment, as well as any attachments, except for information submitted, marked and identified, as confidential, if submitted as detailed in ''Instructions.''

Instructions: All submissions received must include the Docket No. FDA–2020–N–0166 for ''Oncologic Drugs Advisory Committee; Notice of Meeting; Establishment of a Public Docket; Request for Comments.'' Received comments, those filed in a timely manner (see **ADDRESSES**), will be placed in the docket and, except for those submitted as ''Confidential Submissions,'' publicly viewable at *https://www.regulations.gov* or at the Dockets Management Staff between 9 a.m. and 4 p.m., Monday through Friday.

- Confidential Submissions—To submit a comment with confidential information that you do not wish to be made publicly available, submit your comments only as a written/paper submission. You should submit two copies total. One copy will include the information you claim to be confidential with a heading or cover note that states ''THIS DOCUMENT CONTAINS CONFIDENTIAL INFORMATION.'' FDA will review this copy, including the claimed confidential information, in its consideration of comments. The second copy, which will have the claimed confidential information redacted/blacked out, will be available for public viewing and posted on *https://www.regulations.gov.* Submit both copies to the Dockets Management Staff. If you do not wish your name and contact information be made publicly available, you can provide this information on the cover sheet and not in the body of your comments and you must identify the information as ''confidential.'' Any information marked as ''confidential'' will not be disclosed except in accordance with 21 CFR 10.20 and other applicable disclosure law. For more information about FDA's posting of comments to public dockets, see 80 FR 56469, September 18, 2015, or access the information at: *https://www.govinfo.gov/content/pkg/FR-2015-09-18/pdf/2015-23389.pdf.*

Docket: For access to the docket to read background documents or the electronic and written/paper comments received, go to *https://www.regulations.gov* and insert the docket number, found in brackets in the heading of this document, into the ''Search'' box and follow the prompts and/or go to the Dockets Management Staff, 5630 Fishers Lane, Rm. 1061, Rockville, MD 20852.

FOR FURTHER INFORMATION CONTACT: Lauren Tesh Hotaki, Center for Drug Evaluation and Research, Food and Drug Administration, 10903 New Hampshire Ave., Bldg. 31, Rm. 2417, Silver Spring, MD 20993–0002, 301–796–9001, Fax: 301–796–8533, email: *ODAC@fda.hhs.gov,* or FDA Advisory Committee Information Line, 1–800–741–8138 (301–443–0572 in the Washington, DC area). A notice in the **Federal Register** about last minute

modifications that impact a previously announced advisory committee meeting cannot always be published quickly enough to provide timely notice. Therefore, you should always check the FDA's website at *https://www.fda.gov/AdvisoryCommittees/default.htm* and scroll down to the appropriate advisory committee meeting link, or call the advisory committee information line to learn about possible modifications before coming to the meeting.

SUPPLEMENTARY INFORMATION:

Agenda: During the morning session, the committee will discuss new drug application 212578 for padeliporfin dipotassium powder for solution for injection, submitted by STEBA Biotech, S.A. The proposed indication (use) for this product is for the treatment of patients with localized prostate cancer, meeting the following criteria: Stage T1–T2a and prostate specific antigen less than or equal to 10 ng/mL and Gleason Grade Group 1 based on transrectal ultrasound guided biopsy or unilateral Gleason Grade Group 2 based on multiparametric magnetic resonance imaging-targeted biopsy with less than 50 percent of cores positive.

During the afternoon session, the committee will discuss supplemental biologics license application 125477/S–034, for CYRAMZA (ramucirumab) injection for intravenous use, submitted by Eli Lilly and Company. The proposed indication (use) for this product is in combination with erlotinib, for first-line treatment of patients with metastatic non-small cell lung cancer whose tumors have epidermal growth factor receptor exon 19 deletions or exon 21 (L858R) substitution mutations.

FDA intends to make background material available to the public no later than 2 business days before the meeting. If FDA is unable to post the background material on its website prior to the meeting, the background material will be made publicly available at the location of the advisory committee meeting, and the background material will be posted on FDA's website after the meeting. Background material is available at *https://www.fda.gov/AdvisoryCommittees/Calendar/default.htm.* Scroll down to the appropriate advisory committee meeting link.

Procedure: Interested persons may present data, information, or views, orally or in writing, on issues pending before the committee. All electronic and written submissions submitted to the Docket (see **ADDRESSES**) on or before February 19, 2020, will be provided to the committee. Oral presentations from the public will be scheduled between approximately 11 a.m. to 11:30 a.m. and 3:30 p.m. to 4 p.m. Those individuals interested in making formal oral presentations should notify the contact person and submit a brief statement of the general nature of the evidence or arguments they wish to present, the names and addresses of proposed participants, and an indication of the approximate time requested to make their presentation on or before February 13, 2020. Time allotted for each presentation may be limited. If the number of registrants requesting to speak is greater than can be reasonably accommodated during the scheduled open public hearing session, FDA may conduct a lottery to determine the speakers for the scheduled open public hearing session. The contact person will notify interested persons regarding their request to speak by February 14, 2020.

Persons attending FDA's advisory committee meetings are advised that FDA is not responsible for providing access to electrical outlets.

For press inquiries, please contact the Office of Media Affairs at *fdaoma@fda.hhs.gov* or 301–796–4540.

FDA welcomes the attendance of the public at its advisory committee meetings and will make every effort to accommodate persons with disabilities. If you require accommodations due to a disability, please contact Lauren Tesh Hotaki (see **FOR FURTHER INFORMATION CONTACT**) at least 7 days in advance of the meeting.

FDA is committed to the orderly conduct of its advisory committee meetings. Please visit our website at *https://www.fda.gov/AdvisoryCommittees/AboutAdvisoryCommittees/ucm111462.htm* for procedures on public conduct during advisory committee meetings.

Notice of this meeting is given under the Federal Advisory Committee Act (5 U.S.C. app. 2).

Dated: January 17, 2020.

Lowell J. Schiller,

Principal Associate Commissioner for Policy.

[FR Doc. 2020–01150 Filed 1–23–20; 8:45 am]

BILLING CODE 4164–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Health Resources and Services Administration

Agency Information Collection Activities: Proposed Collection: Public Comment Request; Information Collection Request Title: Bureau of Health Workforce (BHW) Substance Use Disorder (SUD) Evaluation, OMB No. 0906–xxxx—New

AGENCY: Health Resources and Services Administration (HRSA), Department of Health and Human Services.

ACTION: Notice.

SUMMARY: In compliance with the requirement for opportunity for public comment on proposed data collection projects of the Paperwork Reduction Act of 1995, HRSA announces plans to submit an Information Collection Request (ICR), described below, to the Office of Management and Budget (OMB). Prior to submitting the ICR to OMB, HRSA seeks comments from the public regarding the burden estimate, below, or any other aspect of the ICR.

DATES: Comments on this ICR should be received no later than March 24, 2020.

ADDRESSES: Submit your comments to *paperwork@hrsa.gov* or mail the HRSA Information Collection Clearance Officer, Room 14N136B, 5600 Fishers Lane, Rockville, MD 20857.

FOR FURTHER INFORMATION CONTACT: To request more information on the proposed project or to obtain a copy of the data collection plans and draft instruments, email *paperwork@hrsa.gov* or call Lisa Wright-Solomon, the HRSA Information Collection Clearance Officer at (301) 443–1984.

SUPPLEMENTARY INFORMATION: When submitting comments or requesting information, please include the ICR title for reference.

Information Collection Request Title: Bureau of Health Workforce (BHW) Substance Use Disorder (SUD) Evaluation.

OMB No.: 0906–xxxx—New.

Abstract: In September 2017, HRSA launched a multi-part effort to increase the workforce capacity of the U.S. health care system to prevent and treat the opioid crisis. As a part of this effort, HRSA developed or expanded activities under five programs to help combat the crisis: (1) The National Health Service Corps (NHSC) Loan Repayment Program offers loan repayment to providers focused on Substance Use Disorder treatment (NHSC SUD Workforce LRP), (2) the National Health Service Corps Rural Communities Loan Repayment

Program (NHSC Rural Communities LRP), (3) the Opioid Workforce Expansion Program (OWEP), (4) the Behavioral Health Workforce Education and Training Program (BHWET), and (5) the Graduate Psychology Education (GPE) Program. These programs provide either loan repayment to providers (NHSC SUD Workforce LRP, NHSC Rural Communities LRP) or funding for training programs for behavioral health professionals and paraprofessionals to increase integrated behavioral health into primary care treatment and interprofessional team-based care to high-need areas (OWEP, BHWET, GPE).

The purpose of the planned evaluation is to assess these five programs with respect to their stated goals of increasing access to the number of clinicians delivering evidence-based SUD treatment, enhancing education and training in substance use prevention and treatment for current and future health care professionals and paraprofessionals in rural and underserved communities, and integrating behavioral health into primary care to improve the capacity of the health care delivery system to provide SUD prevention and treatment services.

The evaluation will include data collection through web-based surveys to trainees, recipients of loan repayments, grantee organizations, and training sites participating in BHW's SUD prevention and treatment programs. At the trainee/participant level, questions will focus on educational and professional background, motivation and incentives to join or leave the program, training experiences, perceived readiness to deliver SUD treatment services (where applicable), capacity to engage in prevention strategies, and post-graduation employment (where applicable). At the recipient grantee organization level *(note: This level is not relevant to the NHSC programs),* questions will focus on recruitment and retention of students, how their SUD prevention and treatment training program curriculum was developed, as applicable, collaboration with SUD prevention and treatment training sites, plans for sustainability of SUD prevention and treatment activities, as well as any other benefits that resulted from the program. At the site level, questions will focus on SUD prevention and treatment training such as addressing motivation for the site to participate, whether and what type of integrated care delivery is available, and other organizational factors of the site. At all three levels, and for all programs, we will collect survey SUD prevention and treatment training data on satisfaction with the program and recommendations for improving it.

In total, six survey instruments will be used in this evaluation: (1) NHSC SUD Workforce Loan Repayment Program/NHSC Rural Communities Loan Repayment Program/NHSC Loan Repayment Program—Participant Survey, (2) NHSC Loan Repayment Program—Site Survey, (3) Grantee Training and Educational Programs—Trainee Survey, (4) Grantee Training and Educational Programs—Alumni Survey, (5) Grantee Training and Educational Programs—Site Survey, and (6) Grantee Training and Educational Programs—Grantee Organization Survey. As part of a comprehensive questionnaire design process, questions will be limited and refined to collect information not available through secondary sources. Any data collected will not be duplicative of that collected under progress reports or other BHW grant monitoring. NHSC site and participant survey questions will be drawn from prior NHSC Satisfaction Surveys, which were fielded in 2017 and 2018 but were discontinued. Skip patterns will allow respondents to answer only relevant questions for each of their programs. Participation in all surveys is voluntary, and all surveys will be fielded annually for three years beginning in 2020 and concluding in 2022 to include each annual cohort of trainees and participants. Each trainee, participant, or site will complete their respective surveys one time.

Need and Proposed Use of the Information: The purpose of this effort is to evaluate BHW's SUD prevention and treatment expansion program investments with respect to the following objectives:

- *Objective 1:* What is the impact of the NHSC SUD Workforce LRP and the NHSC Rural Communities LRP on the provision of SUD, services in underserved areas compared to those who participate in the non-SUD NHSC LRP?
- *Objective 2:* How are the activities in the BHWET, GPE, and OWEP programs contributing to the expansion of service delivery for SUD prevention and treatment, at the individual, educational, and service-delivery system level?
- *Objective 3:* To what extent are the BHW's programs successful at increasing access to treatment for SUD, including opioid treatment services?

The survey data will be critical to understanding the factors related to the success of current BHW programs, and assist in the development of future programs and ongoing SUD prevention and treatment workforce policy development.

Likely Respondents: Data will be collected from trainees, grantee organizations, and sites participating in BHW's SUD prevention and treatment expansion programs as described below.

NHSC SUD Workforce Loan Repayment Program/NHSC Rural Communities LRP/NHSC LRP—Participants Survey: All NHSC SUD Workforce LRP participants, NHSC Rural Communities LRP participants, and NHSC traditional LRP participants who have served at an NHSC site for at least nine months will be invited to respond. Respondents will also include those whom have exited a program early to understand reasons for termination.

NHSC Loan Repayment Program—Site Survey: All sites that were approved to receive NHSC resources, regardless if they currently have a participant on staff will be invited to respond.

Grantee Training and Educational Programs—Trainee Survey: All individuals identified by a grantee as currently receiving training as part of one of the grantee training and educational programs will be invited to respond. Respondents will also include those who have exited a program early, to understand reasons for termination.

Grantee Training and Educational Programs—Alumni Survey: All individuals who completed the Grantee Training and Educational Program Trainee Survey but had not completed their training at the time of the participant survey, will be invited to respond to this short survey which will ask about employment since graduation.

Grantee Training and Educational Programs—Site Survey: All sites that were approved to receive BHWET, OWEP, or GPE trainees, regardless of whether they currently have trainees, will be invited to respond.

Grantee Training and Educational Programs—Grantee Organization Survey: All grantee organizations that received awards in fiscal year 2018 for the BHWET program, and received fiscal year 2019 awards for the GPE and OWEP programs will be invited to respond.

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	Number of responses per respondent	Total responses	Average burden per response (in hours)	Total burden hours
NHSC Loan Repayment Programs—Participant Survey	8,000	1	8,000	0.33	2,640
NHSC Loan Repayment Programs—Site Survey	18,000	1	18,000	0.33	5,940
Grantee Programs—Trainee Survey	8,000	1	8,000	0.33	2,640
Grantee Programs—Alumni Survey	2,000	1	2,000	0.16	320
Grantee Programs—Site Survey	5,000	1	5,000	0.33	1,650
Grantee Programs—Grantee Organization Survey	300	1	300	0.33	99
Total	41,300		41,300		13,289

HRSA specifically requests comments on (1) the necessity and utility of the proposed information collection for the proper performance of the agency's functions; (2) the accuracy of the estimated burden; (3) ways to enhance the quality, utility, and clarity of the information to be collected; and (4) the use of automated collection techniques or other forms of information technology to minimize the information collection burden.

Maria G. Button,

Director, Executive Secretariat.

[FR Doc. 2020–01119 Filed 1–23–20; 8:45 am]

BILLING CODE 4165–15–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Health Resources and Services Administration

Solicitation of Nominations for Membership To Serve on the Advisory Committee on Infant Mortality

AGENCY: Health Resources and Services Administration (HRSA), Department of Health and Human Services (HHS).

ACTION: Request for nominations.

SUMMARY: HRSA is seeking nominations of qualified candidates for consideration for appointment as members of the Advisory Committee on Infant Mortality (ACIM). The ACIM provides advice to the Secretary of HHS on Department activities and programs directed at reducing infant mortality and improving the health status of pregnant women and infants. With a focus on life course, ACIM addresses disparities in maternal health to improve maternal health outcomes, including preventing and reducing maternal mortality and severe maternal morbidity. HRSA is seeking nominations of qualified candidates to fill positions on the ACIM.

DATES: Written nominations for membership on the ACIM must be received on or before February 24, 2020.

ADDRESSES: Nomination packages must be submitted electronically as email attachments to David de la Cruz, the ACIM's Designated Federal Official, at: *dcruz@hrsa.gov.*

FOR FURTHER INFORMATION CONTACT: David de la Cruz, Ph.D., MPH. Address: Maternal and Child Health Bureau, HRSA 5600 Fishers Lane, Room 18N25, Rockville, MD 20857; phone number: 301–443–0543; email: *dcruz@hrsa.gov.* A copy of the ACIM charter and list of the current membership can be obtained by accessing the ACIM website at *https://www.hrsa.gov/advisory-committees/Infant-Mortality/index.html.*

SUPPLEMENTARY INFORMATION: The ACIM was established in 1991 and advises the Secretary of HHS on Department activities and programs directed at reducing infant mortality and improving the health status of pregnant women and infants. The ACIM represents a public-private partnership at the highest level to provide guidance and focus attention on the policies and resources required to address the reduction of infant mortality and the improvement of the health status of pregnant women and infants. Women who experience conditions such as hypertension, malnutrition, substance use disorder, and/or diabetes during pregnancy are at an elevated risk of delivering a baby who is low birth weight or premature. These are two of the leading causes of infant mortality. The ACIM provides advice on how best to coordinate a myriad of federal, state, local, and private programs and efforts that are designed to deal with the health and social problems affecting infant mortality and maternal health including implementation of the Healthy Start program and the maternal and infant health objectives from the National Health Promotion and Disease Prevention Objectives.

Nominations: HRSA is requesting nominations for voting members to serve as Special Government Employees (SGEs) on the ACIM. The Secretary appoints up to 21 members for a term of up to 4 years. Nominees should include medical, technical, or scientific professionals with special expertise in the field of maternal and child health, in particular infant mortality and related health disparities; members of the public having special expertise about or concern with infant mortality; and/or representatives from such public health constituencies, consumers, and medical professional societies. Interested applicants may self-nominate or be nominated by another individual or organization.

Members appointed as SGEs receive a stipend and reimbursement for per diem and travel expenses incurred for attending the ACIM meetings and/or conducting other business on behalf of the ACIM, as authorized by 5 U.S.C. 5703 for persons employed intermittently in government service. The ACIM meets approximately twice per year.

The following information must be included in the package of materials submitted for each individual being nominated for consideration: (1) A statement that includes the name and affiliation of the nominee and a clear statement regarding the basis for the nomination, including the area(s) of expertise that may qualify a nominee for service on the ACIM, as described above; (2) confirmation the nominee is willing to serve as a member of the ACIM; (3) the nominee's contact information (please include home address, work address, daytime

telephone number, and an email address); and (4) a current copy of the nominee's curriculum vitae. Nomination packages may be submitted directly by the individual being nominated or by the person/organization recommending the candidate.

HHS endeavors to ensure that the membership of the ACIM is fairly balanced in terms of points of view represented and that individuals from a broad representation of geographic areas, gender, and ethnic and minority groups, as well as individuals with disabilities, are considered for membership. Appointments shall be made without discrimination on the basis of age, ethnicity, gender, sexual orientation, or cultural, religious, or socioeconomic status.

Individuals who are selected to be considered for appointment will be required to provide detailed information regarding their financial holdings, consultancies, and research grants or contracts. Disclosure of this information is necessary in order for HRSA ethics officials to determine whether there is a potential conflict of interest between the SGE's public duties as a member of the ACIM and their private interests, including an appearance of a loss of impartiality as defined by federal laws and regulations, and to identify any required remedial action needed to address the potential conflict.

Authority: The ACIM was established under provisions of section 222 of the Public Health Service Act (42 U.S.C. 217a), as amended. The ACIM is governed by provisions of the Federal Advisory Committee Act (FACA), as amended (5 U.S.C. App.), as well as 41 CFR part 102–3, which set forth standards for the formation and use of Advisory Committees.

Maria G. Button,

Director, Executive Secretariat.

[FR Doc. 2020–01129 Filed 1–23–20; 8:45 am]

BILLING CODE 4165–15–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

National Institutes of Health

National Institute on Drug Abuse; Notice of Closed Meetings

Pursuant to section 10(d) of the Federal Advisory Committee Act, as amended, notice is hereby given of the following meetings.

The meetings 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 Drug Abuse Special Emphasis Panel; PrEP for HIV Prevention among Substance Using Populations (R01 Clinical Trial Optional).

Date: February 12, 2020.

Time: 10:00 a.m. to 4:00 p.m.

Agenda: To review and evaluate grant applications.

Place: National Institutes of Health, Neuroscience Center Building (NSC), 6001 Executive Boulevard, Rockville, MD 20852 (Telephone Conference Call).

Contact Person: Trinh Tran, Ph.D., Scientific Review Officer, Office of Extramural Policy and Review, Division of Extramural Research, National Institute on Drug Abuse, NIH, DHHS, 6001 Executive Boulevard, MSC 9550, Bethesda, MD 20892, *trinh.tran@nih.gov.*

Name of Committee: National Institute on Drug Abuse Special Emphasis Panel; Multi-Site Studies for System-Level Implementation of Substance Use Prevention and Treatment Services (R01; R34).

Date: February 19, 2020.

Time: 12:00 p.m. to 2:00 p.m.

Agenda: To review and evaluate grant applications.

Place: National Institutes of Health, Neuroscience Center Building (NSC), 6001 Executive Boulevard, Rockville, MD 20852 (Telephone Conference Call).

Contact Person: Yvonne Owens Ferguson, Ph.D., Scientific Review Officer, Office of Extramural Policy and Review, Division of Extramural Research, National Institute on Drug Abuse, NIH/DHHS, 6001 Executive Blvd., Rm. 4234, Bethesda, MD 20892, 301–402–7371, *yvonne.ferguson@nih.gov.*

Name of Committee: National Institute on Drug Abuse Special Emphasis; Panel Development of Medications to Prevent and Treat Opioid Use Disorders and Overdose (UG3/UH3 (Clinical Trials Optional).

Date: February 21, 2020.

Time: 9:00 a.m. to 5:00 p.m.

Agenda: To review and evaluate cooperative agreement applications.

Place: Hilton Washington/Rockville, 1750 Rockville Pike, Rockville, MD 20852.

Contact Person: Ivan K Navarro, Ph.D., Scientific Review Officer, Office of Extramural Policy and Review, Division of Extramural Research, National Institute on Drug Abuse, NIH/DHHS, 6001 Executive Blvd., Rm. 4242, MSC 9550, Bethesda, MD 20892, 301–827–5833, *ivan.navarro@nih.gov.*

(Catalogue of Federal Domestic Assistance Program Nos. 93.279, Drug Abuse and Addiction Research Programs, National Institutes of Health, HHS)

Dated: January 17, 2020.

Tyeshia M. Roberson,

Program Analyst, Office of Federal Advisory Committee Policy.

[FR Doc. 2020–01152 Filed 1–23–20; 8:45 am]

BILLING CODE 4140–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

National Institutes of Health

National Institute of Allergy and Infectious Diseases; 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 Allergy and Infectious Diseases Special Emphasis Panel, PAR–16–413: NIAID Investigator Initiated Program Project.

Date: February 11, 2020.

Time: 12:00 p.m. to 3:00 p.m.

Agenda: To review and evaluate grant applications.

Place: National Institutes of Health, 5601 Fishers Lane, Rockville, MD 20892 (Telephone Conference Call).

Contact Person: Annie Walker-Abbey, Ph.D., Scientific Review Officer, Scientific Review Program, National Institute of Allergy and Infectious Diseases, National Institutes of Health, 5601 Fishers Lane, Room 3E70A, Rockville, MD 20852, 240–627–3390, *aabbey@niaid.nih.gov.*

(Catalogue of Federal Domestic Assistance Program Nos. 93.855, Allergy, Immunology, and Transplantation Research; 93.856, Microbiology and Infectious Diseases Research, National Institutes of Health, HHS)

Dated: January 17, 2020.

Tyeshia M. Roberson,

Program Analyst, Office of Federal Advisory Committee Policy.

[FR Doc. 2020–01151 Filed 1–23–20; 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; Delirium & Alzheimer.

Date: February 21, 2020.

Time: 12:30 p.m. to 4:30 p.m.

Agenda: To review and evaluate grant applications.

Place: National Institute on Aging, Gateway Building, 7201 Wisconsin Avenue, Bethesda, MD 20892 (Telephone Conference Call).

Contact Person: Dario Dieguez, Jr, 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) 827–3101, *dario.dieguez@nih.gov.*

(Catalogue of Federal Domestic Assistance Program Nos. 93.866, Aging Research, National Institutes of Health, HHS)

Dated: January 17, 2020.

Miguelina Perez,

Program Analyst, Office of Federal Advisory Committee Policy.

[FR Doc. 2020–01138 Filed 1–23–20; 8:45 am]

BILLING CODE 4140–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

National Institutes of Health

National Institute on Minority Health and Health Disparities; Amended Notice of Meeting

Notice is hereby given of a change in the meeting of the National Advisory Council on Minority Health and Health Disparities, February 3–4, 2020, 1:30 p.m. to 2:00 p.m., National Institutes of Health, 6700B Rockledge Drive, Conference Room A, B, and C, Bethesda, MD 20892, which was published in the **Federal Register** on December 10, 2019, 84 FR 67468.

This meeting notice is amended to update the agenda description for February 4, 2020 to include the NIMHD Re-Organization. The meeting is partially closed to the public.

Dated: January 17, 2020.

Miguelina Perez,

Program Analyst, Office of Federal Advisory Committee Policy.

[FR Doc. 2020–01132 Filed 1–23–20; 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; Hypertension and Cognition.

Date: February 24, 2020.

Time: 12:30 p.m. to 2:30 p.m.

Agenda: To review and evaluate grant applications.

Place: National Institute on Aging, Gateway Building, 7201 Wisconsin Avenue, Bethesda, MD 20892 (Telephone Conference Call).

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: January 17, 2020.

Miguelina Perez,

Program Analyst, Office of Federal Advisory Committee Policy.

[FR Doc. 2020–01133 Filed 1–23–20; 8:45 am]

BILLING CODE 4140–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

National Institutes of Health

National Institute of Diabetes and Digestive and Kidney Diseases; 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 Diabetes and Digestive and Kidney Diseases Special Emphasis Panel; The NIDDK–KUH Fellowship Application SEP.

Date: February 5, 2020.

Time: 8:00 a.m. to 5:00 p.m.

Agenda: To review and evaluate grant applications.

Place: Crystal City Marriott, Conference Room Salon D, 1999 Jefferson Davis Highway, Arlington, VA 22202.

Contact Person: Xiaodu Guo, MD, Ph.D., Scientific Review Officer, Review Branch, DEA, NIDDK, National Institutes of Health, Room 7023, 6707 Democracy Boulevard, Bethesda, MD 20892–5452, (301) 594–4719, *guox@extra.niddk.nih.gov.*

This notice is being published less than 15 days prior to the meeting due to the timing limitations imposed by the review and funding cycle.

(Catalogue of Federal Domestic Assistance Program Nos. 93.847, Diabetes, Endocrinology and Metabolic Research; 93.848, Digestive Diseases and Nutrition Research; 93.849, Kidney Diseases, Urology and Hematology Research, National Institutes of Health, HHS)

Dated: January 17, 2020.

Miguelina Perez,

Program Analyst, Office of Federal Advisory Committee Policy.

[FR Doc. 2020–01134 Filed 1–23–20; 8:45 am]

BILLING CODE 4140–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

National Institutes of Health

Prospective Grant of Exclusive Patent License: Antibody-Based Therapeutics and Chimeric Antigen Receptors Targeting Glypican-2

AGENCY: National Institutes of Health, HHS.

ACTION: Notice.

SUMMARY: The National Cancer Institute (NCI), National Institutes of Health, Department of Health and Human Services, is contemplating the grant of an exclusive, sublicensable patent license to Stanford University, (''Stanford''), a non-profit university located in California, in its rights to the inventions and patents listed in the **SUPPLEMENTARY INFORMATION** section of this notice.

DATES: Only written comments and/or applications for a license which are received by the NCI Technology Transfer Center February 10, 2020 will be considered.

ADDRESSES: Requests for copies of the patent applications, inquiries, and comments relating to the contemplated exclusive patent license should be directed to: Rose M. Freel, Ph.D., Senior Licensing and Patenting Manager, NCI Technology Transfer Center, 8490 Progress Drive, Suite 400, Frederick MD 21701 (for business mail), Telephone: (301) 624–8775; Facsimile: (301) 631–3027; Email: *rose.freel@nih.gov*.

SUPPLEMENTARY INFORMATION: The following and all continuing U.S. and foreign patents/patent applications thereof are the intellectual properties to be licensed under the prospective agreement to Stanford: United States Provisional Patent Application No. 62/844,695, filed May 7, 2019 and entitled ''CHIMERIC ANTIGEN RECEPTORS TARGETING GLYCIPAN–2'' [HHS Reference No. E–064–2019/0–US–01].

The patent rights in these inventions have been assigned to the Government of the United States of America, Stanford University, and Children's Hospital of Philadelphia. The prospective patent license will be for the purpose of consolidating the patent rights to Stanford, one of the co-owners of said rights, for commercial development and marketing. Consolidation of these co-owned rights is intended to expedite development of the invention, consistent with the goals of the Bayh-Dole Act codified as 35 U.S.C. 200–212.

The prospective patent license will be worldwide, exclusive, and may be limited to those fields of use commensurate in scope with the patent rights. It will be sublicensable, and any sublicenses granted by Stanford will be subject to the provisions of 37 CFR part 401 and 404.

The invention pertains to novel antibody binders and chimeric antigen receptors (CARs) that target glypican-2 (GPC–2), a cell surface heparin sulfate proteoglycan with very restricted expression in normal tissue but with expression on many hard-to-treat pediatric and adult solid tumors such as glioblastoma, small cell lung cancer, uterine carcinoma, neuroblastoma, and medulloblastoma. Based on current available data, the intended use for the invention is as a therapeutic for the treatment of GPC–2 expressing solid tumors.

This notice is made pursuant to 35 U.S.C. 209 and 37 CFR part 404. The prospective exclusive patent license will include terms for the sharing of royalty income with NCI from commercial sublicenses of the patent rights and may be granted unless within fifteen (15) days from the date of this published notice the NCI receives written evidence and argument that establishes that the grant of the license would not be consistent with the requirements of 35 U.S.C. 209 and 37 CFR part 404.

Complete applications for a license that are timely filed in response to this notice will be treated as objections to the grant of the contemplated exclusive patent license. In response to this Notice, the public may file comments or objections. Comments and objections, other than those in the form of a license application, will not be treated confidentially, and may be made publicly available.

License applications submitted in response to this Notice will be presumed to contain business confidential information and any release of information from these license applications will be made only as required and upon a request under the *Freedom of Information Act,* 5 U.S.C. § 552.

Dated: January 15, 2020.

Richard U. Rodriguez,

Associate Director, Technology Transfer Center, National Cancer Institute.

[FR Doc. 2020–01154 Filed 1–23–20; 8:45 am]

BILLING CODE 4140–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

National Institutes of Health

Submission for OMB Review; 30-Day Comment Request; Information Program on Clinical Trials: Maintaining a Registry and Results Databank (National Library of Medicine)

AGENCY: National Institutes of Health, HHS.

ACTION: Notice.

SUMMARY: In compliance with the Paperwork Reduction Act of 1995, the National Institutes of Health (NIH) has submitted to the Office of Management and Budget (OMB) a request for review and approval of the information collection listed below.

DATES: Comments regarding this information collection are best assured of having their full effect if received within 30-days of the date of this publication.

ADDRESSES: Written comments and/or suggestions regarding the item(s) contained in this notice, especially regarding the estimated public burden and associated response time, should be directed to the: Office of Management and Budget, Office of Regulatory Affairs, *OIRA_submission@omb.eop.gov* or by fax to 202–395–6974, Attention: Desk Officer for NIH.

FOR FURTHER INFORMATION CONTACT: To request more information on the proposed project or to obtain a copy of the data collection plans and instruments, contact: David Sharlip, Office of Administrative and Management Analysis Services, National Library of Medicine, Building 38A, Room B2N12, 8600 Rockville Pike, Bethesda, MD 20894, or call non-toll-free number (301) 827–6361, or Email your request, including your address to: *sharlipd@mail.nih.gov.*

SUPPLEMENTARY INFORMATION: This proposed information collection was previously published in the **Federal Register** on November 19, 2019, pages 63884–5 (84 FR 63884) and allowed 60 days for public comment. No public comments were received. The purpose of this notice is to allow an additional 30 days for public comment. The National Library of Medicine (NLM), National Institutes of Health, may not conduct or sponsor, and the respondent is not required to respond to, an information collection that has been extended, revised, or implemented on or after October 1, 1995, unless it displays a currently valid OMB control number.

In compliance with Section 3507(a)(1)(D) of the Paperwork

Reduction Act of 1995, the National Institutes of Health (NIH) has submitted to the Office of Management and Budget (OMB) a request for review and approval of the information collection listed below.

Proposed Collection: Information Program on Clinical Trials: Maintaining a Registry and Results Databank, 0925–0586, Expiration Date 02/29/2020—EXTENSION, National Library of Medicine (NLM), National Institutes of Health (NIH).

Need and Use of Information Collection: The National Institutes of Health operates ClinicalTrials.gov, which was established as a clinical trial registry under section 113 of the Food and Drug Administration Modernization Act of 1997 (Pub. L. 105–115) and was expanded to include a results data bank by Title VIII of the Food and Drug Administration Amendments Act of 2007 (FDAAA) and by the Clinical Trials Registration and Results Information Submission regulations at 42 CFR part 11. ClinicalTrials.gov collects registration and results information for clinical trials and other types of clinical studies (*e.g.,* observational studies and patient registries) with the objectives of enhancing patient enrollment and providing a mechanism for tracking subsequent progress of clinical studies to the benefit of public health. It is widely used by patients, physicians, and medical researchers; in particular those involved in clinical research. While many clinical studies are registered and results information submitted voluntarily, 42 CFR part 11 requires the registration and submission of results information for certain applicable clinical trials of drug, biological, and device products whether or not they are approved, licensed, or cleared by the Food and Drug Administration.

OMB approval is requested for 3 years. There are no costs to respondents other than their time. The total estimated annualized burden hours are 1,072,306.

ESTIMATED ANNUALIZED BURDEN HOURS

Submission type	Number of respondents	Number of responses per respondent	Average time per response (in hours)	Total annual burden hours
Registration—attachment 2:				
Initial	7,400	1	8	59,200
Updates	7,400	8	2	118,400
Triggered, voluntary	88	1	8	704
Initial, non-regulated, NIH Policy	657	1	8	5,256
Updates, non-regulated, NIH Policy	657	8	2	10,512
Initial, voluntary and non-regulated	11,244	1	8	89,952
Updates, voluntary and non-regulated	11,244	8	2	179,904
Results Information Submission—attachment 5:				
Initial	7,400	1	40	296,000
Updates	7,400	2	10	148,000
Triggered, voluntary—also attachment 2	30	1	45	1,350
Initial, non-regulated, NIH Policy	657	1	40	26,280
Updates, non-regulated, NIH Policy	657	2	10	13,140
Initial, voluntary and non-regulated	2,000	1	40	80,000
Updates, voluntary and non-regulated	2,000	2	10	40,000
Other:				
Certification to delay results—attachment 6	5,150	1	30/60	2,575
Extension request—attachment 7	250	1	2	500
Initial, expanded access—attachment 3	213	1	2	426
Updates, expanded access—attachment 3	213	2	15/60	107
Total	64,660	210,037	.....	1,072,306

Dated: January 21, 2020.

David H. Sharlip,

Project Clearance Liaison, National Library of Medicine, National Institutes of Health.

[FR Doc. 2020–01157 Filed 1–23–20; 8:45 am]

BILLING CODE 4140–01–P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

National Institutes of Health

National Institute of Diabetes and Digestive and Kidney Diseases; 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 Diabetes and Digestive and Kidney Diseases Special Emphasis Panel; RFA–DK–19–505: Limited Competition for the Accelerating Medicines Partnership (AMP) in Type 2 Diabetes Knowledge Portal (UM1 Clinical Trial Not Allowed).

Date: March 12, 2020.

Time: 11:00 a.m. to 12:30 p.m.

Agenda: To review and evaluate grant applications.

Place: National Institutes of Health, Two Democracy Plaza, 6707 Democracy Boulevard, Bethesda, MD 20892 (Telephone Conference Call).

Contact Person: Dianne Camp, Ph.D., Scientific Review Officer, Review Branch, Division of Extramural Activities, NIDDK, National Institutes of Health, Room 7013, 6707 Democracy Boulevard, Bethesda, MD 20892–2542, (301) 594–7682, *campd@extra.niddk.nih.gov*.

(Catalogue of Federal Domestic Assistance Program Nos. 93.847, Diabetes, Endocrinology and Metabolic Research; 93.848, Digestive Diseases and Nutrition Research; 93.849, Kidney Diseases, Urology and Hematology Research, National Institutes of Health, HHS)

Dated: January 17, 2020.

Miguelina Perez,

Program Analyst, Office of Federal Advisory Committee Policy.

[FR Doc. 2020–01137 Filed 1–23–20; 8:45 am]

BILLING CODE 4140–01–P

DEPARTMENT OF HOMELAND SECURITY

[Docket No. CISA–2019–0017]

Notice of the President's National Infrastructure Advisory Council Meeting

AGENCY: Cybersecurity and Infrastructure Security Agency (CISA), Department of Homeland Security (DHS).

ACTION: Announcement of meeting; request for comments.

SUMMARY: CISA announces a public meeting of the President's National Infrastructure Advisory Council (NIAC). To facilitate public participation, CISA invites public comments on the agenda items and any associated briefing materials to be considered by the council at the meeting.

DATES:

Meeting Registration: Individual registration to attend the meeting in person is required and must be received no later than 5:00 p.m. EST on February 18, 2020.

Speaker Registration: Individuals may register to speak during the meeting's public comment period must be received no later than 5:00 p.m. EST on February 18, 2020.

Written Comments: Written comments must be received no later than 5:00 p.m. EST on February 21, 2020.

NIAC Meeting: The meeting will be held on Friday, February 28, 2020 from 2:00 p.m.–4:00 p.m. HST.

ADDRESSES: The NIAC meeting will be held at 1001 Bishop Street, Honolulu, HI 96813.

Comments: Written comments may be submitted on the issues to be considered by the NIAC as described in the **SUPPLEMENTARY INFORMATION** section below and any briefing materials for the meeting. Any briefing materials that will be presented at the meeting will be made publicly available on Friday, February 21, 2020 at the following website: *https://www.dhs.gov/national-infrastructure-advisory-council.*

Comments identified by docket number ''*CISA–2019–0017*'' may be submitted by any of the following methods:

- *Federal eRulemaking Portal: www.regulations.gov.* Follow the instructions for submitting written comments.
- *Email: NIAC@hq.dhs.gov.* Include docket number *CISA–2019–0017* in the subject line of the message.
- *Fax:* 703–235–9707, ATTN: Ginger K. Norris.
- *Mail:* Ginger K. Norris, Designated Federal Officer, National Infrastructure Advisory Council, Cybersecurity and Infrastructure Security Agency, Department of Homeland Security, 245 Murray Lane, Mail Stop 0612, Arlington, VA 20598–0612.

Instructions: All submissions received must include the agency name and docket number for this notice. All written comments received will be posted without alteration at *www.regulations.gov,* including any personal information provided. For detailed instructions on sending comments and additional information on participating in the upcoming NIAC meeting, see the ''PUBLIC PARTICIPATION'' heading of the **SUPPLEMENTARY INFORMATION** section of this document.

Docket: For access to the docket and comments received by the NIAC, go to *www.regulations.gov.*

FOR FURTHER INFORMATION CONTACT: Ginger K. Norris, 202–441–5885, *ginger.norris@cisa.dhs.gov.*

SUPPLEMENTARY INFORMATION: The NIAC is established under Section 10 of E.O. 13231 issued on October 16, 2001. Notice of this meeting is given under the Federal Advisory Committee Act (FACA), 5 U.S.C. Appendix (Pub. L. 92–463). The NIAC shall provide the President, through the Secretary of Homeland Security, with advice on the security and resilience of the Nation's critical infrastructure sectors.

The NIAC will meet in an open meeting on February 28, 2020, to discuss the following agenda items with DHS leadership.

Agenda

I. Call to Order
II. Opening Remarks
III. Discussion on Previous NIAC Studies
IV. Public Comment
V. New NIAC Business
VI. Closing Remarks
VII. Adjournment

Public Participation

Meeting Registration Information

Due to additional access requirements and limited seating, requests to attend in person will be accepted and processed in the order in which they are received. Individuals may register to attend the NIAC meeting by sending an email to *NIAC@hq.dhs.gov.*

Public Comment

While this meeting is open to the public, participation in FACA deliberations are limited to council members. A public comment period will be held during the meeting from approximately 3:00 p.m.–3:15 p.m. HST. Speakers who wish to comment must register in advance and can do so by emailing *NIAC@hq.dhs.gov* no later than Friday, February 21, 2019, at 5:00 p.m. EST. Speakers are requested to limit their comments to three minutes. Please note that the public comment period may end before the time indicated, following the last call for comments.

Information on Services for Individuals With Disabilities

For information on facilities or services for individuals with disabilities or to request special assistance at the meeting, contact *NIAC@hq.dhs.gov* as soon as possible.

Dated: January 15, 2020.

Ginger K. Norris,

Designated Federal Official National Infrastructure Advisory Council, Cybersecurity and Infrastructure Security Agency, Department of Homeland Security.

[FR Doc. 2020–01192 Filed 1–23–20; 8:45 am]

BILLING CODE 9110–9P–P

DEPARTMENT OF THE INTERIOR

Fish and Wildlife Service

[Docket No. FWS–R3–ES–2019–0100; FXES11130300000–190–FF03E00000]

Endangered and Threatened Wildlife and Plants; Draft Recovery Plan for the Rusty Patched Bumble Bee

AGENCY: Fish and Wildlife Service, Interior.

ACTION: Notice of availability and request for public comment.

SUMMARY: We, the U.S. Fish and Wildlife Service, announce the availability of the draft recovery plan for rusty patched bumble bee for public review and comment. We request review and comment on this draft recovery plan from local, State, and Federal agencies, and the public.

DATES: We must receive comments by February 24, 2020.

ADDRESSES: *Document availability:* The draft recovery plan, along with any comments and other materials that we receive, will be available for public inspection at *http://www.regulations.gov* in Docket No. FWS–R3–ES–2019–0100.

Submitting Comments: You may submit comments by one of the following methods:

- *Internet: http://www.regulations.gov.* Search for and submit comments on Docket No. FWS–R3–ES–2019–0100.
- *U.S. mail or hand-delivery:* Public Comments Processing, Attn: Docket No. FWS–R3–ES–2019–0100; U.S. Fish and Wildlife Service Headquarters, MS: JAO/1N; 5275 Leesburg Pike; Falls Church, VA 22041–3803.

For more information, see Availability of Public Comments under **SUPPLEMENTARY INFORMATION.**

FOR FURTHER INFORMATION CONTACT: Tamara Smith, by phone at 952–252–0092, via email at *tamara_smith@fws.gov,* or via the Federal Relay Service at 800–877–8339.

SUPPLEMENTARY INFORMATION: We, the U.S. Fish and Wildlife Service (Service), announce the availability of the draft recovery plan for the endangered rusty patched bumble bee (*Bombus affinis*) for public review and comment. The draft recovery plan includes objective, measurable criteria and management actions as may be necessary for removal of the species from the Federal List of Endangered and Threatened Wildlife. We request review and comment on this draft recovery plan from local, State, and Federal agencies, and the public.

Recovery Planning

Section 4(f) of the Endangered Species Act of 1973, as amended (Act; 16 U.S.C. 1531 *et seq.*), requires the development of recovery plans for listed species, unless such a plan would not promote the conservation of a particular species. Also pursuant to section 4(f) of the Act, a recovery plan must, to the maximum extent practicable, include (1) a description of site-specific management actions as may be necessary to achieve the plan's goals for the conservation and survival of the species; (2) objective, measurable criteria that, when met, would support a determination under section 4(a)(1) that the species should be removed from the List of Endangered and Threatened Species; and (3) estimates of the time and costs required to carry out those measures needed to achieve the plan's goal and to achieve intermediate steps toward that goal.

Species Background

Historically, the rusty patched bumble bee was broadly distributed across the eastern United States and Upper Midwest, from Maine in the United States and southern Quebec and Ontario in Canada, south to the northeast corner of Georgia, reaching west to the eastern edges of North and South Dakota (Figure 1; USFWS 2016, p. 49). Survival and successful recruitment require floral resources (for food) from early spring through fall, undisturbed nest sites in proximity to foraging resources, and overwintering sites for the next year's queens. Prior to listing (in 2017), the species experienced a widespread and precipitous decline. The cause of the decline is unknown, but evidence suggests a synergistic interaction between an introduced pathogen and exposure to pesticides (specifically, insecticides and fungicides; USFWS 2016, p. 53). The remaining populations of rusty patched bumble bee are exposed to a number of interacting stressors, including pathogens, pesticides, habitat loss and degradation, managed bees, the effects of climate change, and small population biology (USFWS 2016, p. 40). These stressors likely operate independently and in combination, causing synergistic effects. Refer to the Species Status Assessment Report (USFWS 2016) for a full discussion of the species' biology and threats. Under the Act, the Service published a final rule to add the rusty patched bumble bee to the Federal List of Endangered and Threatened Wildlife as an endangered species on January 11, 2017 (82 FR 3186). The final rule took effect on February 10, 2017.

Recovery Criteria

The draft recovery criteria are summarized below. For a complete description of the rationale behind the criteria, the recovery strategy, management actions, and estimated time and costs associated with recovery, refer to the Draft Recovery Plan for Rusty Patched Bumble Bee (see **ADDRESSES** for document availability).

The ultimate recovery goal is to remove the rusty patched bumble bee from the Federal List of Endangered and Threatened Wildlife (''delist'') by ensuring the long-term viability of the species in the wild. In the recovery plan, we define the following criteria for reclassification (''downlisting'' from endangered to threatened) and delisting based on the best available information on the species.

Downlisting Criteria

Criterion 1: A minimum of 159 populations distributed across 5 Conservation Units, as specified in the table below.

Criterion 2: A minimum number of healthy populations within each Conservation Unit, as specified in the table below.

For recovery purposes, a healthy population will be demonstrated by:

2.1 Consistent detection of at least 5 distinct colonies over the most recent 10 years. Individual colonies may be identified through genetic analyses or by using the number of individuals detected (if proven, through research, to be a reliable method). All 5 colonies do not need to be detected in each of the 10 years but must be detected in multiple years.

2.2 Evidence of genetic health over the most recent 10 years. Genetic health must be demonstrated by at least two genetic metrics (*e.g.,* effective population size, heterozygosity, and allelic richness).

2.3 Pathogen and pesticide loads are below levels that could cause meaningful loss of reproductive capacity of the population.

2.4 A high level of certainty—demonstrated via a rigorous analysis—that the population will persist given stressors and environmental variation.

Criterion 3: Population clusters are distributed across a diversity of habitat types, aspects, slopes, elevations, and latitudes within each Conservation Unit. A population cluster is two or more healthy populations that are adjacent to each other.

RUSTY PATCHED BUMBLE BEE CONSERVATION UNITS (CU), TOTAL NUMBER OF HISTORICALLY OCCUPIED POPULATIONS PER CONSERVATION UNIT, MINIMUM NUMBER OF POPULATIONS PER CONSERVATION UNIT (DOWNLISTING CRITERION 1), AND THE MINIMUM NUMBER OF HEALTHY POPULATIONS PER CONSERVATION UNIT (DOWNLISTING CRITERION 2)

Conservation Unit	Number of historically occupied populations per CU	Minimum number of populations per CU (Criterion 1)	Minimum number of healthy populations per CU (Criterion 2)
CU1: Upper West	274	32	16
CU2: Lower West	125	14	7
CU3: Midwest	347	40	20
CU4: Southeast	250	29	14
CU5: Northeast	389	45	22
Total	1,385	159	80

Delisting Criteria

Criterion 1: Downlisting criteria 1, 2, and 3 have been met.

Criterion 2: Mechanisms are in place that provide a high level of certainty that downlisting Criteria 1, 2, and 3 will continue to be met into the foreseeable future.

In achieving delisting Criterion 2, Conservation Unit-specific mechanisms should ensure:

2.1 Population abundance, numbers, and distribution will be maintained at the levels required to meet downlisting criteria,

2.2 Sufficient quality and quantity of suitable habitat will be maintained, and

2.3 The negative effects of the primary threats (including but not limited to pathogens, pesticides, climate change, and managed bees) will be managed.

Availability of Public Comments

Before including your address, phone number, email address, or other personal identifying information in your comment, you should be aware that your entire comment—including your personal identifying information—may be made publicly available at any time. While you can ask us in your comment to withhold your personal identifying information from public review, we cannot guarantee that we will be able to do so.

Authority

The authority for this action is section 4(f) of the Endangered Species Act, 16 U.S.C. 1533(f).

Lori Nordstrom,

Assistant Regional Director, Ecological Services, Midwest Region.

[FR Doc. 2020–01203 Filed 1–23–20; 8:45 am]

BILLING CODE 4333–15–P

DEPARTMENT OF THE INTERIOR

Fish and Wildlife Service

[FWS–R3–ES–2018–N148; FXES11130300000–189–FF03E00000]

Endangered and Threatened Wildlife and Plants; Draft Recovery Plan for the Dakota Skipper

AGENCY: Fish and Wildlife Service, Interior.

ACTION: Notice of availability and request for public comment.

SUMMARY: We, the U.S. Fish and Wildlife Service, announce the availability of the draft recovery plan for the threatened Dakota skipper for public review and comment. We request review and comment on this draft recovery plan from local, State, and Federal agencies, and the public.

DATES: In order to be considered, comments must be received on or before February 24, 2020.

ADDRESSES:

Document availability: You may obtain a copy of the draft recovery plan by one of the following methods:

- *U.S. mail:* U.S. Fish and Wildlife Service; Minnesota-Wisconsin Ecological Services Field Office, Attention: Peter Fasbender; 4101 American Blvd. East, Bloomington, MN 55425.
- *Telephone:* Peter Fasbender, 952–252–0092.
- *internet:* Download the document at the Service's Midwest Region website at *https://www.fws.gov/midwest/Endangered/insects/dask/index.html.*

Comment submission: You may submit comments by one of the following methods:

- *Mail or hand-delivery:* Submit written comments to the above U.S. mail address.
- *Fax:* 952–646–2873, Attention: Peter Fasbender. Please include ''Dakota Skipper DRP'' in the subject line.
- *Email: peter_fasbender@fws.gov.* Please include ''Dakota Skipper DRP'' in the subject line.

For additional information about submitting comments, see Availability of Public Comments in **SUPPLEMENTARY INFORMATION**.

FOR FURTHER INFORMATION CONTACT: Peter Fasbender, by one of the methods in **ADDRESSES**.

SUPPLEMENTARY INFORMATION: We, the U.S. Fish and Wildlife Service (Service), announce the availability of the draft recovery plan for the threatened Dakota skipper (*Hesperia dacotae*) for public review and comment. The draft recovery plan includes objective, measurable criteria and management actions as may be necessary for removal of the species from the Federal List of Endangered and Threatened Wildlife. We request review and comment on this draft recovery plan from local, State, and Federal agencies, and the public.

Recovery Planning

Section 4(f) of the Endangered Species Act of 1973, as amended (Act; 16 U.S.C. 1531 *et seq.*), requires the development of recovery plans for listed species, unless such a plan would not promote the conservation of a particular species. Also pursuant to section 4(f) of the Act, a recovery plan must, to the maximum extent practicable, include (1) a description of site-specific management actions as may be necessary to achieve the plan's goals for the conservation and survival of the species; (2) objective, measurable criteria that, when met, would support a determination under section 4(a)(1) that the species should be removed from the List of Endangered and Threatened Species; and (3) estimates of the time and costs required to carry out those measures needed to achieve the plan's goal and to achieve intermediate steps toward that goal.

The Service has revised its approach to recovery planning. The revised process is intended to reduce the time

needed to develop and implement recovery plans, increase recovery plan relevancy over a longer timeframe, and add flexibility to recovery plans so they can be adjusted to new information or circumstances. A recovery plan will include statutorily required elements (objective, measurable criteria, site-specific management actions, and estimates of time and costs), along with a concise introduction and our strategy for how we plan to achieve species recovery. The recovery plan is supported by a separate Species Status Assessment. The essential component to flexible implementation under this recovery process is producing a separate working document called the Recovery Implementation Strategy (implementation strategy). The implementation strategy steps down from the more general description of actions in the recovery plan to detail the specific, near-term activities needed to implement the recovery plan. The implementation strategy will be adaptable by being able to incorporate new information without having to concurrently revise the recovery plan, unless changes to statutory elements are required. The implementation strategy will be developed following publication of the final recovery plan and will be made available on the Service's website at that time.

Species Background

The Dakota skipper is a small butterfly with a 1-inch wingspan. Like other skippers, it has a thick body and faster, more powerful flight than most butterflies. The Dakota skipper inhabits remnants of tallgrass prairie and mixed-grass prairie in the north-central United States and into southern Saskatchewan and Manitoba Provinces of Canada. Within the native prairie patches where it persists, the species relies on high-quality habitat conditions—diverse native grassland plant communities—and on natural or human disturbances that maintain the integrity of these plant communities while minimizing mortality to vulnerable life stages. Populations may also be influenced significantly at local, landscape, regional, and continental scales by other factors that include activities such as grazing, haying, burning, pesticide use, and lack of management. (Refer to the Species Status Assessment Report (USFWS 2018) for a full discussion of the species' biology and threats.) Under the Act, the Service added the Dakota skipper as a threatened species to the Federal List of Endangered and Threatened Wildlife on October 24, 2014 (79 FR 63672).

Recovery Plan

The draft recovery strategy and criteria are summarized below. For a complete description of these components, as well as the actions and estimated time and costs associate with recovery, refer to the Draft Recovery Plan for the Dakota Skipper (see **ADDRESSES** for document availability).

Recovery Strategy

To recover the Dakota skipper, we will work with our public, private, and tribal partners to design and implement actions that will meet the four goals described below.

1. To ensure that the species' adaptive capacity is preserved, recovery efforts will focus on maintaining Dakota skipper persistence across its current range of adaptive variation. We identified four conservation areas, referred to as Conservation Units (CU), to focus and manage our recovery efforts.

2. To foster the Dakota skipper's ability to withstand environmental stochasticity, stressors, and catastrophes, recovery efforts should ensure that populations are healthy. Those healthy populations need to be supported by native prairie habitats typified by plant communities that reflect historical conditions and that contain a low abundance of non-native species. Recovery actions will also focus on ensuring that healthy populations are distributed across heterogeneous conditions within each CU.

3. Successful recovery requires a better understanding of some fundamental aspects of Dakota skipper ecology. Employing a well-designed adaptive management and monitoring framework for recovery implementation will allow us to better manage for suitable habitat conditions, protect against wide-range and simultaneous population declines due to environmental stochasticity and catastrophes, and respond to adverse effects of climate change.

4. Achieving the above goals is highly dependent on the cooperation and contributions of conservation partners. Specifically, attaining recovery will necessitate the cooperation and dedication of native prairie managers, conservationists, ranchers, farmers, agencies, and those with expertise needed to design and evaluate the effects of land management actions on the species. It will be critical to ensure that recovery goals are met in a manner that is in concert with the missions, objectives, and aspirations of our conservation partners.

Recovery Criteria

The ultimate recovery goal is to remove the Dakota skipper from the Federal List of Endangered and Threatened Wildlife (delist) by ensuring the long-term viability of the species in the wild. In the recovery plan, we define the following delisting criteria based on the best available information on the species:

Criterion 1. A probability of persistence (pP) ≥ 0.95 over 50 years in each CU. Each CU must also have a minimum of five healthy populations.

Criterion 2. A minimum of an additional 29 populations with each having a probability of persistence (pP) ≥ 0.75 over 50 years and distributed across CUs as specified in Table 1.

TABLE 1—THE MINIMUM NUMBER OF POPULATIONS REQUIRED TO MEET CRITERIA 1 AND 2

Conservation unit	Number of populations—Criterion 1	Number of populations—Criterion 2	Number of populations
CU 1: Dry Steppes Ecoregion	5	9	14
CU 2: Steppes Ecoregion	5	6	11
CU 3: Red River Valley Section	5	4	9
CU 4: Prairie Coteau Section	5	10	15

Criterion 3. Each population considered under Criteria 1 and 2 has a written management plan in place that promotes population persistence.

Availability of Public Comments

Before including your address, phone number, email address, or other personal identifying information in your comment, you should be aware that your entire comment—including your personal identifying information—may

be made publicly available at any time. While you can ask us in your comment to withhold your personal identifying information from public review, we cannot guarantee that we will be able to do so.

Authority

The authority for this action is section 4(f) of the Endangered Species Act, 16 U.S.C. 1533(f).

Lori Nordstrom,

Assistant Regional Director, Ecological Services, Midwest Region.

[FR Doc. 2020–01201 Filed 1–23–20; 8:45 am]

BILLING CODE P

DEPARTMENT OF THE INTERIOR

Bureau of Indian Affairs

[DR5B211A000716]

Deadline for Submitting Completed Applications To Begin Participation in the Tribal Self-Governance Program in Fiscal Year 2021 or Calendar Year 2021

AGENCY: Office of Self-Governance, Interior.

ACTION: Notice of application deadline.

SUMMARY: In this notice, the Office of Self-Governance (OSG) establishes a March 1, 2020, deadline for Indian Tribes/consortia to submit completed applications to begin participation in the Tribal self-governance program in fiscal year 2021 or calendar year 2021.

DATES: Completed application packages must be received by the Director, Office of Self-Governance, by March 1, 2020.

ADDRESSES: Application packages for inclusion in the applicant pool should be sent to Sharee M. Freeman, Director, Office of Self-Governance, Department of the Interior, Mail Stop 3624–MIB, 1849 C Street NW, Washington, DC 20240.

FOR FURTHER INFORMATION CONTACT: Dr. Kenneth D. Reinfeld, Office of Self-Governance, Telephone (703) 390–6551.

SUPPLEMENTARY INFORMATION: Under the Tribal Self-Governance Act of 1994 (Pub. L. 103–413), as amended by the Fiscal Year 1997 Omnibus Appropriations Bill (Pub. L. 104–208), and section 1000.15(a) of Title 25 of the Code of Federal Regulations, the OSG Director may select up to 50 additional participating Tribes/consortia per year for the Tribal self-governance program and negotiate and enter into a written funding agreement with each participating Tribe. The Act mandates that the Secretary of the Interior submit copies of the funding agreements at least 90 days before the proposed effective date to the appropriate committees of the Congress and to each Tribe that is served by the Bureau of Indian Affairs' agency that is serving the Tribe that is a party to the funding agreement. Initial negotiations with a Tribe/consortium located in a region and/or agency which has not previously been involved with self-governance negotiations will take approximately 2 months from start to finish. Agreements for an October 1 to September 30 funding year need to be signed and submitted by July 1. Agreements for a January 1 to December 31 funding year need to be signed and submitted by October 1.

Purpose of Notice

The regulations at 25 CFR 1000.10 to 1000.31 will be used to govern the application and selection process for Tribes/consortia to begin their participation in the Tribal self-governance program in fiscal year 2021 and calendar year 2021. Applicants should be guided by the requirements in these subparts in preparing their applications. Copies of these subparts may be obtained from the information contact person identified in this notice.

Tribes/consortia wishing to be considered for participation in the Tribal self-governance program in fiscal year 2021 or calendar year 2021 must respond to this notice, except for those Tribes/consortia which are: (1) Currently involved in negotiations with the Department; or (2) one of the 129 Tribal entities with signed agreements.

Information Collection

This information collection is authorized by OMB Control Number 1076–0143, Tribal Self-Governance Program, which expires June 30, 2022.

Dated: December 18, 2019.

Tara Sweeney,

Assistant Secretary—Indian Affairs.

[FR Doc. 2020–01211 Filed 1–23–20; 8:45 am]

BILLING CODE 4337–15–P

DEPARTMENT OF THE INTERIOR

Bureau of Land Management

[(LLCAD01000.L13400000.DO0000.20X) MO#4500140922]

Notice of Availability of the Final Environmental Impact Statement for the Haiwee Geothermal Leasing Area, California, and the Proposed Amendment to the California Desert Conservation Area Plan

AGENCY: Bureau of Land Management, Interior.

ACTION: Notice of availability.

SUMMARY: In accordance with the National Environmental Policy Act of 1969, as amended (NEPA), and the Federal Land Policy and Management Act of 1976, as amended (FLPMA), the Bureau of Land Management (BLM) has prepared a Final Amendment to the California Desert Conservation Area (CDCA) Plan and a Final Environmental Impact Statement (EIS) for the Haiwee Geothermal Leasing Area (HGLA), Inyo County, California, and by this notice is announcing its availability. The proposed action is to amend the CDCA Plan to allow for geothermal leasing within approximately 22,805 acres. The proposed action also responds to three geothermal lease applications for 4,460 acres of public lands within the HGLA.

DATES: BLM planning regulations state that any person who meets the conditions as described in the regulations may protest the BLM's Proposed Land Use Plan Amendment and Final EIS. A person who meets the conditions and files a protest must file the protest within 30 days of the date that the Environmental Protection Agency publishes its Notice of Availability in the **Federal Register**.

ADDRESSES: The Final EIS and Proposed Land Use Plan Amendment is available on the internet at *https://go.usa.gov/xEnvy*. Hard copies of the Final EIS and Proposed Land Use Plan Amendment are available for public inspection at the BLM-Ridgecrest Field Office at 300 South Richmond Road, Ridgecrest, CA 93555, and at the California Desert District Office, 22835 Calle San Juan De Los Lagos, Moreno Valley, CA 92553. Hard copies of the Final EIS and Proposed Land Use Plan Amendment have been sent to affected Federal, State, local, and tribal government agencies and to other stakeholders. All protests must be in writing and filed with the BLM Director, either as a hard copy or electronically via the BLM's ePlanning project website listed previously. To submit a protest electronically, go to the ePlanning project website and follow the protest instructions highlighted at the top of the home page. If submitting a protest in hard copy, it must be mailed to one of the following addresses:

Regular Mail: BLM Director (210), Attention: Protest Coordinator, P.O. Box 71383, Washington, DC 20024–1383.

Overnight Delivery: BLM Director (210), Attention: Protest Coordinator, 20 M Street SE, Room 2134LM, Washington, DC 20003.

FOR FURTHER INFORMATION CONTACT: Greg Miller, Assistant District Manager—Resources, telephone: 951–697–5216; address: 22835 Calle San Juan De Los Lagos, Moreno Valley, CA 92553; email:

gmiller@blm.gov. Persons who use a telecommunications device for the deaf (TDD) may call the Federal Relay Service (FRS) at 1–800–877–8339 to contact Mr. Miller during normal business hours. FRS is available 24 hours a day, 7 days a week, to leave a message or question. You will receive a reply during normal business hours.

SUPPLEMENTARY INFORMATION: The HGLA Draft EIS and Draft Proposed Amendment to the CDCA published in May 2012 and public meetings were held in June 2012. An Administrative Draft Final EIS was prepared in December 2013 that included public comments and responses to comments, updates to the alternatives descriptions, and internal review comments. As a result of the review of the comments, the BLM conducted a more detailed study to address projected water use by geothermal facilities should they be allowed in the HGLA. Argonne National Laboratories conducted the study and provided BLM a report in January 2016. Additionally, new land use designations approved with the Desert Renewable Energy Conservation Plan amendment to the CDCA Plan in September of 2016 required analysis of a new alternative that considered the new land use designations. Based on these two developments, the BLM has prepared a CDCA Plan Amendment and Draft Supplemental EIS for the project. The Draft Supplemental EIS published on April 19, 2019, for a 90-day public comment period. The Draft Supplemental EIS analyzed the Proposed Action and two action alternatives, in addition to the No Action Alternative.

The BLM received three geothermal lease applications for 4,460 acres of public lands within the HGLA in 2002. In addition, the BLM identified approximately 18,345 acres of public lands, also within the Haiwee Proposed Project Area and adjacent to the three geothermal lease applications, which will be considered for competitive geothermal leasing under 43 CFR 3203.10(e). The proposed action is to amend the CDCA Plan to allow project area lands to be leased under the authority of the Geothermal Steam Act of 1970, as amended (30 U.S.C. 1001 *et seq.*). The leasing of public lands for geothermal resources will require an amendment to the CDCA Plan, which is authorized by FLPMA Section 202 (43 U.S.C. 1712) and 43 CFR 1610.5–5. Total acreage being considered for geothermal leasing is approximately 22,805 acres.

The Draft Supplemental EIS/EIR and Draft Land Use Plan Amendment was available for a 90-day public comment period. The BLM received seven comment letters during the comment period. The BLM considered and incorporated, as appropriate, public comments on the Draft EIS, Draft Supplemental EIS, and Draft Land Use Plan Amendment and internal agency review into the proposed plan amendment. Public comments resulted in the addition of clarifying text but did not significantly change proposed land use plan decisions. A response to substantive comments is included as an appendix to the Final EIS and Proposed Land Use Plan Amendment. The BLM has selected Alternative A, Allow Geothermal Leasing in the Entire HGLA, as the Agency Proposed Alternative in the Final EIS and Proposed Land Use Plan Amendment. Instructions for filing a protest with the Director of the BLM regarding the Final EIS and Proposed Land Use Plan Amendment may be found online at *https://www.blm.gov/programs/planning-and-nepa/public-participation/filing-a-plan-protest* and at 43 CFR 1610.5–2. All protests must be made in writing and mailed to the appropriate address, as set forth in the **ADDRESSES** section listed earlier or submitted electronically through the BLM ePlanning project website as described earlier. Protests submitted electronically by any means other than through the ePlanning project website protest section will be invalid unless a protest is also submitted in hard copy. Protests submitted by fax will also be invalid unless also submitted either through the ePlanning project website protest section or in hard copy.

Before including your phone number, email address, or other personal identifying information in your protest, you should be aware that your entire protest—including your personal identifying information—may be made publicly available at any time. While you can ask us to withhold your personal identifying information from public review, we cannot guarantee that we will be able to do so.

(Authority: 40 CFR 1501.7 and 43 CFR 1610.2)

Joe Stout,

Acting State Director.

[FR Doc. 2020–01178 Filed 1–23–20; 8:45 am]

BILLING CODE 4310–40–P

INTERNATIONAL TRADE COMMISSION

[Investigation No. 731–TA–1143 (Second Review)]

Small Diameter Graphite Electrodes From China; Cancellation of Hearing for Second Full Five-Year Review

AGENCY: United States International Trade Commission.

ACTION: Notice.

DATES: January 16, 2020.

FOR FURTHER INFORMATION CONTACT: Nitin Joshi ((202) 708–1669), Office of Investigations, U.S. International Trade Commission, 500 E Street SW, Washington, DC 20436. Hearing-impaired persons can obtain information on this matter by contacting the Commission's TDD terminal on 202–205–1810. Persons with mobility impairments who will need special assistance in gaining access to the Commission should contact the Office of the Secretary at 202–205–2000. General information concerning the Commission may also be obtained by accessing its internet server (*https://www.usitc.gov*). The public record for this review may be viewed on the Commission's electronic docket (EDIS) at *https://edis.usitc.gov.*

SUPPLEMENTARY INFORMATION: Effective September 23, 2019, the Commission established a schedule for the conduct of this review (84 FR 51619, September 30, 2019). Subsequently, counsel for the domestic interested parties filed a request to appear at the hearing and for consideration of cancellation of the hearing. Counsel indicated a willingness to submit written responses to any Commission questions in lieu of an actual hearing. No other party has entered an appearance in this review. Consequently, the public hearing in connection with this review, scheduled to begin at 9:30 a.m. on Thursday, January 23, 2020, at the U.S. International Trade Commission Building, is cancelled. Parties to this review should respond to any written questions posed by the Commission in their posthearing briefs, which are due to be filed on January 31, 2020.

For further information concerning this review see the Commission's notice cited above and the Commission's Rules of Practice and Procedure, part 201, subparts A through E (19 CFR part 201), and part 207, subparts A and C (19 CFR part 207).

Authority: This review is being conducted under authority of title VII of the Tariff Act of 1930; this notice is published pursuant to section 207.62 of the Commission's rules.

By order of the Commission.

Issued: January 17, 2020.

Lisa Barton,

Secretary to the Commission.

[FR Doc. 2020–01153 Filed 1–23–20; 8:45 am]

BILLING CODE 7020–02–P

DEPARTMENT OF JUSTICE

Foreign Claims Settlement Commission

[F.C.S.C. Meeting and Hearing Notice No. 01–20]

Sunshine Act Meeting

The Foreign Claims Settlement Commission, pursuant to its regulations (45 CFR part 503.25) and the Government in the Sunshine Act (5 U.S.C. 552b), hereby gives notice in regard to the scheduling of open meetings as follows:

TIME AND PLACE: Thursday, January 30, 2020, at 10:00 a.m.

PLACE: All meetings are held at the Foreign Claims Settlement Commission, 441 G St. NW, Room 6234, Washington, DC.

STATUS: Open.

MATTERS TO BE CONSIDERED: 10:00 a.m.—Issuance of Proposed Decisions under the Guam World War II Loyalty Recognition Act, Title XVII, Public Law 114–328.

CONTACT PERSON FOR MORE INFORMATION: Requests for information, or advance notices of intention to observe an open meeting, may be directed to: Patricia M. Hall, Foreign Claims Settlement Commission, 441 G St. NW, Room 6234, Washington, DC 20579. Telephone: (202) 616–6975.

Brian Simkin,

Chief Counsel.

[FR Doc. 2020–01281 Filed 1–22–20; 11:15 am]

BILLING CODE 4410–BA–P

DEPARTMENT OF LABOR

Office of the Secretary

Agency Information Collection Activities; Submission for OMB Review; Comment Request; Program To Prevent Smoking in Hazardous Areas of Underground Coal Mines

ACTION: Notice of availability; request for comments.

SUMMARY: The Department of Labor (DOL) is submitting the Mining Safety and Health Administration (MSHA) sponsored information collection request (ICR) titled, Program to Prevent Smoking in Hazardous Areas of Underground Coal Mines to the Office of Management and Budget (OMB) for review and approval for continued use, without change, in accordance with the Paperwork Reduction Act of 1995 (PRA). Public comments on the ICR are invited.

DATES: The OMB will consider all written comments that agency receives on or before February 24, 2020.

ADDRESSES: A copy of this ICR with applicable supporting documentation; including a description of the likely respondents, proposed frequency of response, and estimated total burden may be obtained free of charge from the RegInfo.gov website at *http://www.reginfo.gov/public/do/PRAViewICR?ref_nbr=* 201910–1219–003 (this link will only become active on the day following publication of this notice) or by contacting Frederick Licari by telephone at 202–693–8073, TTY 202–693–8064, (these are not toll-free numbers) or by email at *DOL_PRA_PUBLIC@dol.gov.*

Submit comments about this request by mail to the Office of Information and Regulatory Affairs, Attn: OMB Desk Officer for DOL–MSHA, Office of Management and Budget, Room 10235, 725 17th Street NW, Washington, DC 20503; by Fax: 202–395–5806 (this is not a toll-free number); or by email: *OIRA_submission@omb.eop.gov.* Commenters are encouraged, but not required, to send a courtesy copy of any comments by mail or courier to the U.S. Department of Labor-OASAM, Office of the Chief Information Officer, Attn: Departmental Information Compliance Management Program, Room N1301, 200 Constitution Avenue NW, Washington, DC 20210; or by email: *DOL_PRA_PUBLIC@dol.gov.*

FOR FURTHER INFORMATION CONTACT: Frederick Licari by telephone at 202–693–8073, TTY 202–693–8064, (these are not toll-free numbers) or by email at *DOL_PRA_PUBLIC@dol.gov.*

SUPPLEMENTARY INFORMATION: This ICR seeks to extend PRA authority for the ''Program to Prevent Smoking in Hazardous Areas of Underground Coal Mines'' information collection. Section 103(h) of the Federal Mine Safety and Health Act of 1977 (Mine Act), 30 U.S.C. 813(h), authorizes MSHA to collect information necessary to carry out its duty in protecting the safety and health of miners. Further, section 101(a) of the Mine Act, 30 U.S.C. 811, authorizes the Secretary of Labor to develop, promulgate, and revise as may be appropriate, improved mandatory health or safety standards for the protection of life and prevention of injuries in coal and metal and nonmetal mines. Section 317(c) of the Mine Act, 30 U.S.C. 877(c), and 30 CFR 75.1702 prohibit persons from smoking or carrying smoking materials underground or in places where there is a fire or explosion hazard. Under the Mine Act, 30 U.S.C. 877(c) and 75.1702, coal mine operators are required to develop programs to prevent persons from carrying smoking materials, matches, or lighters underground and to prevent smoking in hazardous areas, such as in or around oil houses, explosives magazines or other areas where such practice may cause a fire or explosion. Section 75.1702–1 requires a mine operator to submit a smoking prevention plan to MSHA for approval. Section 103(h) of the Mine Act, 30 U.S.C. 813, authorizes MSHA to collect information necessary to carry out its duty in protecting the safety and health of miners. These information collection requirements help to ensure that a fire or explosion hazard does not occur.

This information collection is subject to the PRA. A Federal agency generally cannot conduct or sponsor a collection of information, and the public is generally not required to respond to an information collection, unless the OMB under the PRA approves it and displays a currently valid OMB Control Number. In addition, notwithstanding any other provisions of law, no person shall generally be subject to penalty for failing to comply with a collection of information that does not display a valid Control Number. *See* 5 CFR 1320.5(a) and 1320.6. The DOL obtains OMB approval for this information collection under Control Number 1219–0041.

OMB authorization for an ICR cannot be for more than three (3) years without renewal, and the current approval for this collection is scheduled to expire on January 31, 2020. The DOL seeks to extend PRA authorization for this information collection for three (3) more years, without any change to existing requirements. The DOL notes that existing information collection requirements submitted to the OMB receive a month-to-month extension while they undergo review. For additional substantive information about this ICR, see the related notice published in the **Federal Register** on October 31, 2019 (84 FR 58411).

Interested parties are encouraged to send comments to the OMB, Office of Information and Regulatory Affairs at the address shown in the **ADDRESSES** section within thirty-(30) days of publication of this notice in the **Federal Register**. In order to help ensure

appropriate consideration, comments should mention OMB Control Number 1219–0041. The OMB 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 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.

Agency: DOL–MSHA.

Title of Collection: Program to Prevent Smoking in Hazardous Areas of Underground Coal Mines.

OMB Control Number: 1219–0041.

Affected Public: Private Sector: Businesses or other for-profits.

Total Estimated Number of Respondents: 9.

Total Estimated Number of Responses: 9.

Total Estimated Annual Time Burden: 5 hours.

Total Estimated Annual Other Costs Burden: $0.

Authority: 44 U.S.C. 3507(a)(1)(D).

Dated: January 16, 2020.

Frederick Licari,

Departmental Clearance Officer.

[FR Doc. 2020–01121 Filed 1–23–20; 8:45 am]

BILLING CODE 4510–43–P

DEPARTMENT OF LABOR

Office of Workers' Compensation Programs

Division of Federal Employees Compensation (DFEC); Proposed Extension of Existing Collection; Comment Request

ACTION: Notice.

SUMMARY: The Department of Labor (DOL) is soliciting comments concerning a proposed extension for the authority to conduct the information collection request (ICR) titled, ''Notice of Law Enforcement Officer's Injury or Occupational Disease and Notice of Law Enforcement Officer's Death.'' This comment request is part of continuing Departmental efforts to reduce paperwork and respondent burden in accordance with the Paperwork Reduction Act of 1995 (PRA).

DATES: Consideration will be given to all written comments received by March 24, 2020.

ADDRESSES: A copy of this ICR with applicable supporting documentation, including a description of the likely respondents, proposed frequency of response, and estimated total burden, may be obtained free by contacting Anjanette Suggs by telephone at 202–354–9660 or by email at *suggs.anjanette@dol.gov.*

Submit written comments about, or requests for a copy of, this ICR by mail or courier to the U.S. Department of Labor, Office of Workers' Compensation Program, Room S3323, 200 Constitution Avenue NW, Washington, DC 20210; or by email: *suggs.anjanette@dol.gov.*

FOR FURTHER INFORMATION CONTACT: Anjanette Suggs by telephone at 202–354–9660 or by email at *suggs.anjanette@dol.gov.*

SUPPLEMENTARY INFORMATION: The DOL, as part of continuing efforts to reduce paperwork and respondent burden, conducts a pre-clearance consultation program to provide the general public and Federal agencies an opportunity to comment on proposed and/or continuing collections of information before submitting them to the OMB for final approval. This program helps to ensure requested data can be provided in the desired format, reporting burden (time and financial resources) is minimized, collection instruments are clearly understood, and the impact of collection requirements can be properly assessed.

The Federal Employees' Compensation Act (FECA) provides, under 5 U.S.C. 8191, *et seq.* and 20 CFR 10.735, that non-Federal law enforcement officers injured or killed under certain circumstances are entitled to the benefits of the Act, to the same extent as if they were employees of the Federal Government. The CA–721 and CA–722 forms are used by non-Federal law enforcement officers and their survivors to claim compensation under the FECA. Form CA–721 is used for claims for injury. Form CA–722 is used for claims for death. This information collection is currently approved for use through March 31, 2020. This information collection is subject to the PRA. A Federal agency generally cannot conduct or sponsor a collection of information, and the public is generally not required to respond to an information collection, unless the OMB under the PRA approves it and displays a currently valid OMB control number. In addition, notwithstanding any other provisions of law, no person shall generally be subject to penalty for failing to comply with a collection of information that does not display a valid OMB control number. *See* 5 CFR 1320.5(a) and 1320.6.

Interested parties are encouraged to provide comments to the contact shown in the **ADDRESSES** section. Written comments will receive consideration, and summarized and included in the request for OMB approval of the final ICR. In order to help ensure appropriate consideration, comments should mention 1240–0022.

Submitted comments will also be a matter of public record for this ICR and posted on the internet, without redaction. The DOL encourages commenters not to include personally identifiable information, confidential business data, or other sensitive statements/information in any comments.

The DOL 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 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.

Agency: DOL–OWCP–DFEC.

Type of Review: Extension.

Title of Collection: Notice of Law Enforcement Officer's Injury or Occupational Disease and Notice of Law Enforcement Officer's Death.

Form: Notice of Law Enforcement Officer's Injury or Occupational Disease, CA–722; Notice of Law Enforcement Officer's Death, CA–721.

OMB Control Number: 1240–0022.

Affected Public: Individuals or households; Business or other for-profit; State, Local or Tribal Government.

Estimated Number of Respondents: 6.

Frequency: On occasion.

Total Estimated Annual Responses: 6.

Estimated Average Time per Response: 60–90 minutes.

Estimated Total Annual Burden Hours: 8 hours.

Total Estimated Annual Other Cost Burden: $3.

Anjanette Suggs,

Agency Clearance Officer.

[FR Doc. 2020–01125 Filed 1–23–20; 8:45 am]

BILLING CODE 4510–CH–P

NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

[Notice: 20–003]

National Environmental Policy Act; Mars 2020 Mission

AGENCY: National Aeronautics and Space Administration.

ACTION: Notice of availability for the Final Supplemental Environmental Impact Statement (Supplemental EIS) for implementation of the Mars 2020 mission.

SUMMARY: Pursuant to the National Environmental Policy Act of 1969 (NEPA), as amended, the Council on Environmental Quality Regulations for Implementing the Procedural Provisions of NEPA (CEQ NEPA Regulations), and NASA's procedures for implementing NEPA, NASA announces the availability of the Final Supplemental Environmental Impact Statement for the Mars 2020 Mission (Supplemental EIS). NASA has prepared the Final SEIS which, in accordance with CEQ NEPA Regulations, provides responses to comments and incorporates associated changes resulting from the public and agency review of the Draft SEIS published in October 2019. The Final SEIS provides updated information related to the potential environmental impacts associated with the proposed Mars 2020 mission. The United States Air Force and Department of Energy (DOE) served as Cooperating Agencies.

FOR FURTHER INFORMATION CONTACT: Mr. George Tahu by electronic mail at *mars2020-nepa@lists.nasa.gov* or by telephone at 202–358–0016.

SUPPLEMENTARY INFORMATION: The updated information is pertinent to the consequence and risk analyses of potential accidents which could occur during the launch phases of the mission. Although the probability of such accidents occurring is extremely small, it is possible that under certain conditions an accident could result in a release of plutonium dioxide from the Multi-Mission Radioisotope Thermoelectric Generator (MMRTG) into the environment. The MMRTG is a critical component of the Mars 2020 rover; it would enable the Mars 2020 rover mission to undertake a much broader scope of scientific discovery by providing a continuous supply of electrical power and temperature control to the Mars 2020 rover while on the surface of Mars. The Mars 2020 mission would launch the spacecraft onboard an Atlas V launch vehicle from the Cape Canaveral Air Force Station (CCAFS), Brevard County, Florida during the summer of 2020. Additional information about the mission may be found on the internet at: *https://mars.nasa.gov/mars2020/*.

Per CEQ NEPA Regulations a decision on a course of action will be made after the 30-day Final SEIS waiting period, to conclude 30-days from the date of this **Federal Register** publication. Although NEPA does not require responses to public comments received during this period, comments received will be considered in determining final decisions. Any decision will be documented in a Record of Decision that will be made available to the public. The Final SEIS is available for download at *https://www.nasa.gov/feature/nepa-mars-2020-mission*. Because there were no substantive changes to the document from Draft SEIS to Final SEIS, paper copies will be made available by request only. Comments on, or requests for paper copies of, the Final SEIS may be made by electronic mail at *mars2020-nepa@lists.nasa.gov,* by telephone at 202–358–0016, or in writing to: Mr. George Tahu, Planetary Science Division—Science Mission Directorate, Mail Suite 3E46, NASA Headquarters, Washington, DC 20546–0001. Before including your address, phone number, email address, or other personal identifying information in your comment, be advised that your entire comment—including your personal identifying information—may be publicly available at any time. While you can ask us in your comment to withhold from public review your personal identifying information, we cannot guarantee that we will be able to do so.

NASA's proposed Mars 2020 mission would use the proven design and technology developed for the Mars Science Laboratory mission and rover (Curiosity) that launched from CCAFS in November 2011 and arrived at Mars in August 2012. NASA has selected a high priority, scientifically important landing site based upon data from past and current missions. The rover is equipped with new scientific instrumentation that would: (a) Characterize the geological processes and history of an astrobiologically relevant ancient environment on Mars; (b) within the selected geological environment, assess the past habitability of the landing region and search for evidence of past life; (c) assemble a scientifically selected, well-documented, cache of samples for potential future return to the Earth; (d) further the preparation for future human exploration of Mars; and (e) demonstrate improved technical capabilities for landing and operating on the surface of Mars to benefit future Mars missions.

On September 11, 2013, NASA issued a Notice of Intent to prepare an Environmental Impact Statement (EIS) for the Mars 2020 mission. NASA prepared the EIS and issued the Final in November 2014. NASA evaluated several alternatives related to the Mars 2020 rover's power source. NASA identified use of the MMRTG as its preferred alternative to meet the mission's electrical, thermal, and operational requirements. Waste heat from the MMRTG would be used for temperature control of the rover electronics, science instruments, and other sensitive components. The MMRTG is identical to the power supply that has been used with success on the Mars Curiosity rover. Alternatives to the Proposed Action addressed in the 2014 Final EIS included: (1) The use of alternative sources of on-board power and heat (including solar energy); and (2) the No Action Alternative. The 2014 Mars 2020 Final EIS also addressed the purpose and need for the proposed Mars 2020 mission and the environmental impacts associated with its implementation. The environmental impacts associated with the normal launch of the mission were addressed, as were the potential consequences of launch related accidents. NASA issued its Record of Decision (ROD) for the Mars 2020 mission on January 27, 2015. The ROD adopted Alternative 1 as the preferred alternative. Alternative 1 required NASA to complete preparation for and implement the proposed Mars 2020 mission during July—August 2020, or during the next available launch opportunity in August through September 2022, and to operate the mission using a MMRTG that would continually provide heat and electrical power to the rover's battery. Since 2015, NASA has significantly advanced preparations for the Mars 2020 mission and selected the Atlas V as the launch vehicle. The Mars 2020 Final EIS discussed Incomplete and Unavailable Information which would be addressed

in the future through more detailed risk analyses conducted as part of NASA's and the DOE's ongoing radiological safety review programs. These analyses were completed in 2019 and accounted for the Atlas V as the chosen launch vehicle (that was selected on August 25, 2016, after the Mars 2020 Record of Decision on January 27, 2015), up-to-date safety test information, and updated analytical models.

NASA policy for implementation of NEPA is found in NASA Procedural Requirements 8580.1A (NPR). The NPR requires preparation of a supplemental NEPA document when significant new information relevant to environmental concerns that bear on the proposed action or its impacts is discovered. Since NASA issued the 2014 Final EIS and 2015 ROD, the updated results from the risk and consequence modeling have become available for NASA's consideration. NASA has determined that the purposes of NEPA will be furthered by preparation and issuance of a SEIS.

Calvin F. Williams,

Associate Administrator, Office of Strategic Infrastructure, Mission Support Directorate.

[FR Doc. 2020–01179 Filed 1–23–20; 8:45 am]

BILLING CODE 7510–13–P

NUCLEAR REGULATORY COMMISSION

Advisory Committee on the Medical Uses of Isotopes: Meeting Notice

AGENCY: U.S. Nuclear Regulatory Commission.

ACTION: Notice of meeting.

SUMMARY: The U.S. Nuclear Regulatory Commission (NRC) will convene a teleconference meeting of the Advisory Committee on the Medical Uses of Isotopes (ACMUI) on March 11, 2020, to discuss the draft report of the ACMUI Regulatory Guide 8.39 Subcommittee. A phased approach is being conducted by the NRC staff to comprehensively update Regulatory Guide 8.39, ''Release of Patients Administered Radioactive Material.'' Phase 1 of the revision provides licensees with more detailed instructions to patients before and after they have been administered radioactive material than what is currently provided in Regulatory Guide 8.39. The ACMUI subcommittee's report will include its comments and recommendations on the draft final Phase 1 revisions to Regulatory Guide 8.39. Meeting information, including a copy of the agenda and handouts, will be available at *http://www.nrc.gov/reading-rm/doc-collections/acmui/meetings/2020.html.* The agenda and handouts may also be obtained by contacting Ms. Kellee Jamerson using the information below.

DATES: The teleconference meeting will be held on Wednesday, March 11, 2020, 2:00 p.m. to 4:00 p.m. Eastern Time.

FOR FURTHER INFORMATION CONTACT: Kellee Jamerson, email: *Kellee.Jamerson@nrc.gov,* telephone: (301) 415–7408.

SUPPLEMENTARY INFORMATION:

Public Participation: Any member of the public who wishes to participate in the teleconference should contact Ms. Jamerson using the contact information in **FOR FURTHER INFORMATION CONTACT**.

Conduct of the Meeting

Dr. Darlene Metter, ACMUI Chairman, will preside over the meeting. Dr. Metter will conduct the meeting in a manner that will facilitate the orderly conduct of business. The following procedures apply to public participation in the meeting:

1. Persons who wish to provide a written statement should submit an electronic copy to Ms. Jamerson at the contact information listed above. All written statements must be received by March 6, 2020, three business days prior to the meeting, and must pertain to the topic on the agenda for the meeting.

2. Questions and comments from members of the public will be permitted during the meeting at the discretion of the ACMUI Chairman.

3. The draft transcript and meeting summary will be available on ACMUI's website *http://www.nrc.gov/reading-rm/doc-collections/acmui/meetings/2020.html* on or about April 22, 2020.

This meeting will be held in accordance with the Atomic Energy Act of 1954, as amended (primarily Section 161a); the Federal Advisory Committee Act (5 U.S.C. App); and the Commission's regulations in 10 CFR part 7.

Dated: January 17, 2020.

Russell E. Chazell,

Federal Advisory Committee Management Officer.

[FR Doc. 2020–01127 Filed 1–23–20; 8:45 am]

BILLING CODE 7590–01–P

POSTAL REGULATORY COMMISSION

[Docket Nos. CP2017–232; CP2017–242; CP2017–249; CP2017–251; CP2017–254; CP2017–255; CP2019–50; CP2019–70; CP2019–110]

New Postal Products

AGENCY: Postal Regulatory Commission.

ACTION: Notice.

SUMMARY: The Commission is noticing a recent Postal Service filing for the Commission's consideration concerning negotiated service agreements. This notice informs the public of the filing, invites public comment, and takes other administrative steps.

DATES: *Comments are due:* January 27, 2020.

ADDRESSES: Submit comments electronically via the Commission's Filing Online system at *http://www.prc.gov.* Those who cannot submit comments electronically should contact the person identified in the **FOR FURTHER INFORMATION CONTACT** section by telephone for advice on filing alternatives.

FOR FURTHER INFORMATION CONTACT: David A. Trissell, General Counsel, at 202–789–6820.

SUPPLEMENTARY INFORMATION:

Table of Contents

I. Introduction

The Commission gives notice that the Postal Service filed request(s) for the Commission to consider matters related to negotiated service agreement(s). The request(s) may propose the addition or removal of a negotiated service agreement from the market dominant or the competitive product list, or the modification of an existing product currently appearing on the market dominant or the competitive product list.

Section II identifies the docket number(s) associated with each Postal Service request, the title of each Postal Service request, the request's acceptance date, and the authority cited by the Postal Service for each request. For each request, the Commission appoints an officer of the Commission to represent the interests of the general public in the proceeding, pursuant to 39 U.S.C. 505 (Public Representative). Section II also establishes comment deadline(s) pertaining to each request.

The public portions of the Postal Service's request(s) can be accessed via the Commission's website (*http://www.prc.gov*). Non-public portions of the Postal Service's request(s), if any, can be accessed through compliance with the requirements of 39 CFR 3007.301.[1]

The Commission invites comments on whether the Postal Service's request(s)

[1] *See* Docket No. RM2018–3, Order Adopting Final Rules Relating to Non-Public Information, June 27, 2018, Attachment A at 19–22 (Order No. 4679).

in the captioned docket(s) are consistent with the policies of title 39. For request(s) that the Postal Service states concern market dominant product(s), applicable statutory and regulatory requirements include 39 U.S.C. 3622, 39 U.S.C. 3642, 39 CFR part 3010, and 39 CFR part 3020, subpart B. For request(s) that the Postal Service states concern competitive product(s), applicable statutory and regulatory requirements include 39 U.S.C. 3632, 39 U.S.C. 3633, 39 U.S.C. 3642, 39 CFR part 3015, and 39 CFR part 3020, subpart B. Comment deadline(s) for each request appear in section II.

II. Docketed Proceeding(s)

1. *Docket No(s).:* CP2017–232; *Filing Title:* Notice of the United States Postal Service of Filing Modification Six to a Global Plus 1D Negotiated Service Agreement; *Filing Acceptance Date:* January 16, 2020; *Filing Authority:* 39 CFR 3015.5; *Public Representative:* Kenneth R. Moeller; *Comments Due:* January 27, 2020.

2. *Docket No(s).:* CP2017–242; *Filing Title:* Notice of the United States Postal Service of Filing Modification Six to a Global Plus 1D Negotiated Service Agreement; *Filing Acceptance Date:* January 16, 2020; *Filing Authority:* 39 CFR 3015.5; *Public Representative:* Kenneth R. Moeller; *Comments Due:* January 27, 2020.

3. *Docket No(s).:* CP2017–249; *Filing Title:* Notice of the United States Postal Service of Filing Modification Five to a Global Plus 3 Negotiated Service Agreement; *Filing Acceptance Date:* January 16, 2020; *Filing Authority:* 39 CFR 3015.5; *Public Representative:* Katalin K. Clendenin; *Comments Due:* January 27, 2020.

4. *Docket No(s).:* CP2017–251; *Filing Title:* Notice of the United States Postal Service of Filing Modification Seven to a Global Plus 1D Negotiated Service Agreement; *Filing Acceptance Date:* January 16, 2020; *Filing Authority:* 39 CFR 3015.5; *Public Representative:* Kenneth R. Moeller; *Comments Due:* January 27, 2020.

5. *Docket No(s).:* CP2017–254; *Filing Title:* Notice of the United States Postal Service of Filing Modification Five to a Global Plus 1D Negotiated Service Agreement; *Filing Acceptance Date:* January 16, 2020; *Filing Authority:* 39 CFR 3015.5; *Public Representative:* Kenneth R. Moeller; *Comments Due:* January 27, 2020.

6. *Docket No(s).:* CP2017–255; *Filing Title:* Notice of the United States Postal Service of Filing Modification Four to Global Plus 1D Negotiated Service Agreement; *Filing Acceptance Date:* January 16, 2020; *Filing Authority:* 39 CFR 3015.5; *Public Representative:* Kenneth R. Moeller; *Comments Due:* January 27, 2020.

7. *Docket No(s).:* CP2019–50; *Filing Title:* Notice of the United States Postal Service of Filing Modification Three to Global Plus 4 Negotiated Service Agreement; *Filing Acceptance Date:* January 16, 2020; *Filing Authority:* 39 CFR 3015.5; *Public Representative:* Curtis E. Kidd; *Comments Due:* January 27, 2020.

8. *Docket No(s).:* CP2019–70; *Filing Title:* Notice of the United States Postal Service of Filing Modification Two to Global Plus 6 Negotiated Service Agreement; *Filing Acceptance Date:* January 16, 2020; *Filing Authority:* 39 CFR 3015.5; *Public Representative:* Katalin K. Clendenin; *Comments Due:* January 27, 2020.

9. *Docket No(s).:* CP2019–110; *Filing Title:* Notice of the United States Postal Service of Filing Modification Two to Global Plus 4 Negotiated Service Agreement; *Filing Acceptance Date:* January 16, 2020; *Filing Authority:* 39 CFR 3015.5; *Public Representative:* Curtis E. Kidd; *Comments Due:* January 27, 2020.

This Notice will be published in the **Federal Register**.

Ruth Ann Abrams,

Acting Secretary.

[FR Doc. 2020–01131 Filed 1–23–20; 8:45 am]

BILLING CODE 7710–FW–P

SECURITIES AND EXCHANGE COMMISSION

[Investment Company Act Release No. 33748; 812–15007]

Blackstone Alternative Investment Funds and Blackstone Alternative Investment Advisors LLC; Notice of Application

January 21, 2020.

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

ACTION: Notice of an application under Section 6(c) of the Investment Company Act of 1940 (''Act'') for an exemption from Section 15(c) of the Act.

APPLICANTS: Blackstone Alternative Investment Funds (''Trust''), a Massachusetts business trust registered under the Act as an open-end management investment company with multiple series and Blackstone Alternative Investment Advisors LLC (''Adviser''), a Delaware limited liability company registered as an investment adviser under the Investment Advisers Act of 1940 (''Advisers Act'') that serves an investment adviser to such series (collectively the ''Applicants'').

SUMMARY OF APPLICATION: The requested exemption would permit the Trust's board of trustees (the ''Board'') to approve new sub-advisory agreements and material amendments to existing sub-advisory agreements for the Subadvised Series (as defined below), without complying with the in-person meeting requirement of Section 15(c) of the Act.

FILING DATES: The application was filed on March 4, 2019, and amended on March 29, 2019, June 24, 2019, September 25, 2019, and January 10, 2020.

HEARING OR NOTIFICATION OF HEARING: An order granting the application will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the Commission's Secretary and serving Applicants with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on February 18, 2020, and should be accompanied by proof of service on the Applicants, in the form of an affidavit or, for lawyers, a certificate of service. Pursuant to rule 0–5 under the Act, hearing requests should state the nature of the writer's interest, any facts bearing upon the desirability of a hearing on the matter, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Commission's Secretary.

ADDRESSES: Secretary, U.S. Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090. Applicants: James Hannigan, Esq., Blackstone Alternative Investment Advisors LLC, 345 Park Avenue, 29th Floor, New York, NY 10154.

FOR FURTHER INFORMATION CONTACT: Jean E. Minarick, Senior Counsel, at (202) 551–6811, or Kaitlin C. Bottock, Branch Chief, at (202) 551–6821 (Division of Investment Management, Chief Counsel's Office).

SUPPLEMENTARY INFORMATION: The following is a summary of the application. The complete application may be obtained via the Commission's website by searching for the file number or an Applicant using the ''Company'' name box, at *http://www.sec.gov/search/search.htm* or by calling (202) 551–8090.

I. Requested Exemptive Relief

1. Applicants request an exemption from Section 15(c) of the Act to permit

the Board,[1] including the Independent Trustees,[2] to approve an agreement (each a ''Sub-Advisory Agreement'') pursuant to which a sub-adviser manages all or a portion of the assets of one or more of the series, or a material amendment thereof (a ''Sub-Adviser Change''), without complying with the in-person meeting requirement of Section 15(c).[3] Under the requested relief, the Independent Trustees could instead approve a Sub-Adviser Change at a meeting at which members of the Board participate by any means of communication that allows them to hear each other simultaneously during the meeting.

2. Applicants request that the relief apply to Applicants, as well as to any future series of the Trust and any other existing or future registered open-end management investment company or series thereof that intends to rely on the requested order in the future and that: (i) Is advised by the Adviser; [4] (ii) uses the multi-manager structure described in the application; and (iii) complies with the terms and conditions of the application (each, a ''Subadvised Series'').[5]

II. Management of the Subadvised Series

3. The Adviser will serve as the investment adviser to each Subadvised Series pursuant to an investment advisory agreement with the Trust (each an ''Investment Management Agreement''). The Adviser, subject to the oversight of the Board, will provide continuous investment management services to each Subadvised Series. Applicants are not seeking an exemption from the Act with respect to the Investment Management Agreements.

4. Applicants state that the Subadvised Series may seek to provide exposure to multiple strategies across various asset classes, thus allowing investors to more easily access such strategies without the additional transaction costs and administrative burdens of investing in multiple funds to seek to achieve comparable exposures.

5. To that end, the Adviser may achieve its desired exposures to specific strategies by allocating discrete portions of the Subadvised Series' assets to various sub-advisers. Consistent with the terms of each Investment Management Agreement and subject to the Board's approval,[6] the Adviser would delegate management of all or a portion of the assets of a Subadvised Series to a sub-adviser.[7] Each sub-adviser would be an ''investment adviser'' to the Subadvised Series within the meaning of Section 2(a)(20) of the Act.[8] The Adviser would retain overall responsibility for the management and investment of the assets of each Subadvised Series.

III. Applicable Law

6. Section 15(c) of the Act prohibits a registered investment company having a board from entering into, renewing or performing any contract or agreement whereby a person undertakes regularly to act as an investment adviser (including a sub-adviser) to the investment company, unless the terms of such contract or agreement and any renewal thereof have been approved by the vote of a majority of the investment company's board members who are not parties to such contract or agreement, or interested persons of any such party, cast in person at a meeting called for the purpose of voting on such approval.

7. Section 6(c) of the Act provides that the Commission may exempt any person, security, or transaction or any class or classes of persons, securities, or transactions from any provisions of the Act, or any rule thereunder, if such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act. Applicants state that the requested relief meets this standard for the reasons discussed below.

IV. Arguments in Support of the Requested Relief

8. Applicants assert that boards of registered investment companies, including the Board, typically hold in-person meetings on a quarterly basis. Applicants state that during the three to four month period between board meeting dates, market conditions may change or investment opportunities may arise such that the Adviser may wish to make a Sub-Adviser Change. Applicants also state that at these moments it may be impractical and costly to hold an additional in-person Board meeting, especially given the geographic diversity of Board members and the additional cost of holding in-person meetings.

9. As a result, Applicants believe that the requested relief would allow the Subadvised Series to operate more efficiently. In particular, Applicants assert that without the delay inherent in holding in-person Board meetings (and the attendant difficulty of obtaining the necessary quorum for, and the additional costs of, an unscheduled in-person Board meeting), the Subadvised Series would be able to act quicker and with less expense to add or replace sub-advisers when the Board and the Adviser believe that a Sub-Adviser Change would benefit the Subadvised Series.

10. Applicants also note that the in-person meeting requirement in Section 15(c) of the Act was designed to prohibit absentee approval of advisory agreements. Applicants state that condition 1 to the requested relief is designed to avoid such absentee approval by requiring that the Board approve a Sub-adviser Change at a meeting where all participating Board members can hear each other and be heard by each other during the meeting.[9]

11. Applicants, moreover, represent that the Board would conduct any such non-in-person consideration of a Sub-

[1] The term ''Board'' also includes the board of trustees or directors of a future Subadvised Series (as defined below).

[2] The term ''Independent Trustees'' means the members of the Board who are not parties to the Sub-Advisory Agreement (as defined below), or ''interested persons'', as defined in Section 2(a)(19) of the Act, of any such party.

[3] Applicants do not request relief that would permit the Board and the Independent Trustees to approve renewals of Sub-Advisory Agreements at non-in-person meetings.

[4] The term ''Adviser'' includes (i) the Adviser or its successors, and (ii) any entity controlling, controlled by or under common control with, the Adviser or its successors. For the purposes of the requested order, ''successor'' is limited to an entity or entities that result from a reorganization into another jurisdiction or a change in the type of business organization.

[5] The term ''Subadvised Series'' also includes a wholly-owned subsidiary, as defined in the Act, of a Subadvised Series (each a ''Subsidiary'') and the term ''Sub-Adviser'' includes any Sub-Adviser to a Subsidiary. All registered open-end investment companies that currently intend to rely on the requested order are named as applicants. Any entity that relies on the requested order will do so only in accordance with the terms and conditions contained in the application.

[6] A Sub-Advisory Agreement may also be subject to approval by a Subadvised Series' shareholders. Applicants currently rely on a multi-manager exemptive order to enter into and materially amend Sub-Advisory Agreements without obtaining shareholder approval. *See* Blackstone Alternative Investment Funds, et al., Investment Company Act Release Nos. 32481 (Feb. 16, 2017) (notice) and 32530 (Mar. 13, 2017) (order).

[7] A sub-adviser may manage the assets of a Subadvised Series directly or provide the Adviser with model portfolio or investment recommendation(s) that would be utilized in connection with the management of a Subadvised Series.

[8] Each sub-adviser would be registered with the Commission as an investment adviser under the Advisers Act or not subject to such registration.

[9] Applicants state that technology that includes visual capabilities will be used unless unanticipated circumstances arise. Applicants also state that the Board could not rely upon the relief to approve a Sub-Advisory Agreement by written consent or another form of absentee approval by the Board.

Advisory Agreement in accordance with its typical process for approving Sub-Advisory Agreements. Consistent with Section 15(c) of the Act, the Board would request and evaluate such information as may reasonably be necessary to evaluate the terms of any Sub-Advisory Agreement, and the Adviser and sub-adviser would provide such information.

12. Finally, Applicants note that that if one or more Board members request that a Sub-Adviser Change be considered in-person, then the Board would not be able to rely on the relief and would have to consider the Sub-Adviser Change at an in-person meeting.

13. The Commission continues to believe that a board's decision-making process may benefit from the directors' having the opportunity to interact in person, as a group and individually. We recognize, however, that under the circumstances described by Applicants, the need to act promptly for the benefit of the Fund may justify the Board's meeting on a non-in-person basis, and that technological advances enable directors to hold such meetings in a manner where the directors can be personally present and able to assure themselves that they are informed as to the matter that requires action by the Board. Accordingly, the requested relief would meet the applicable standard for relief under the Act.

V. Applicants' Conditions

Applicants agree that any order granting the requested relief will be subject to the following conditions:

1. The Independent Trustees will approve a Sub-Adviser Change at a non-in-person meeting in which Board members may participate by any means of communication that allows those Board members participating to hear each other simultaneously during the meeting.

2. Management will represent that the materials provided to the Board for the non-in-person meeting include the same information the Board would have received if a Sub-Adviser Change were sought at an in-person Board meeting.

3. The notice of the non-in-person meeting will explain the need for considering the Sub-Adviser Change at a non-in-person meeting. Once notice of the non-in-person meeting to consider a Sub-Adviser Change is sent, Board members will be given the opportunity to object to considering the Sub-Adviser Change at a non-in-person Board meeting. If a Board member requests that the Sub-Adviser Change be considered in-person, the Board will consider the Sub-Adviser Change at an in-person meeting, unless such request is rescinded.

4. A Subadvised Series' ability to rely on the requested relief will be disclosed in the Subadvised Series' registration statement.

By the Commission.

J. Matthew DeLesDernier,

Assistant Secretary.

[FR Doc. 2020–01191 Filed 1–23–20; 8:45 am]

BILLING CODE 8011–01–P

SMALL BUSINESS ADMINISTRATION

[Disaster Declaration #16253 and #16254; PUERTO RICO Disaster Number PR–00034]

Presidential Declaration of a Major Disaster for the Commonwealth of Puerto Rico

AGENCY: U.S. Small Business Administration.

ACTION: Notice.

SUMMARY: This is a Notice of the Presidential declaration of a major disaster for the Commonwealth of Puerto Rico (FEMA–4473–DR), dated 01/16/2020.

Incident: Earthquakes.

Incident Period: 12/28/2019 and continuing.

DATES: Issued on 01/16/2020.

Physical Loan Application Deadline Date: 03/16/2020.

Economic Injury (EIDL) Loan Application Deadline Date: 10/16/2020.

ADDRESSES: Submit completed loan applications to: U.S. Small Business Administration, Processing and Disbursement Center, 14925 Kingsport Road, Fort Worth, TX 76155.

FOR FURTHER INFORMATION CONTACT: A. Escobar, Office of Disaster Assistance, U.S. Small Business Administration, 409 3rd Street SW, Suite 6050, Washington, DC 20416, (202) 205–6734.

SUPPLEMENTARY INFORMATION: Notice is hereby given that as a result of the President's major disaster declaration on 01/16/2020, applications for disaster loans may be filed at the address listed above or other locally announced locations.

The following areas have been determined to be adversely affected by the disaster:

Primary Municipalities (Physical Damage and Economic Injury Loans): Guanica, Guayanilla, Penuelas, Ponce, Utuado, Yauco.

Contiguous Municipalities (Economic Injury Loans Only):

Puerto Rico: Adjuntas, Arecibo, Ciales, Hatillo, Jayuya, Juana Diaz, Lajas, Lares, Maricao, Sabana Grande.

The Interest Rates are:

	Percent
For Physical Damage:	
Homeowners with Credit Available Elsewhere	3.000
Homeowners without Credit Available Elsewhere	1.500
Businesses with Credit Available Elsewhere	7.750
Businesses without Credit Available Elsewhere	3.875
Non-Profit Organizations with Credit Available Elsewhere	2.750
Non-Profit Organizations without Credit Available Elsewhere	2.750
For Economic Injury:	
Businesses & Small Agricultural Cooperatives without Credit Available Elsewhere	3.875
Non-Profit Organizations without Credit Available Elsewhere	2.750

The number assigned to this disaster for physical damage is 162532 and for economic injury is 162540.

(Catalog of Federal Domestic Assistance Number 59008)

James Rivera,

Associate Administrator for Disaster Assistance.

[FR Doc. 2020–01169 Filed 1–23–20; 8:45 am]

BILLING CODE 8026–03–P

SMALL BUSINESS ADMINISTRATION

[Disaster Declaration #16242; Mississippi Disaster Number MS–00119 Declaration of Economic Injury]

Administrative Declaration of an Economic Injury Disaster for the State of Mississippi

AGENCY: U.S. Small Business Administration.

ACTION: Notice.

SUMMARY: This is a notice of an Economic Injury Disaster Loan (EIDL) declaration for the State of Mississippi, dated 01/16/2020.

Incident: Blue-Green Algae on the Gulf Coast of Mississippi.

Incident Period: 06/22/2019 through 10/05/2019.

DATES: Issued on 01/16/2020.

Economic Injury (EIDL) Loan Application Deadline Date: 10/16/2020.

ADDRESSES: Submit completed loan applications to: U.S. Small Business Administration, Processing and Disbursement Center, 14925 Kingsport Road, Fort Worth, TX 76155.

FOR FURTHER INFORMATION CONTACT: A. Escobar, Office of Disaster Assistance, U.S. Small Business Administration,

409 3rd Street SW, Suite 6050, Washington, DC 20416, (202) 205–6734.

SUPPLEMENTARY INFORMATION: Notice is hereby given that as a result of the Administrator's EIDL declaration, applications for economic injury disaster loans may be filed at the address listed above or other locally announced locations.

The following areas have been determined to be adversely affected by the disaster:

Primary Counties: Hancock, Harrison, Jackson.

Contiguous Counties:

Mississippi: George, Pearl River, Stone

Alabama: Mobile

Louisiana: Saint Tammany

The Interest Rates are:

	Percent
Businesses and Small Agricultural Cooperatives without Credit Available Elsewhere	4.000
Non-Profit Organizations without Credit Available Elsewhere	2.750

The number assigned to this disaster for economic injury is 162420.

The States which received an EIDL Declaration # are Mississippi, Alabama, Louisiana.

(Catalog of Federal Domestic Assistance Number 59008)

Dated: January 16, 2020.

Jovita Carranza,

Administrator.

[FR Doc. 2020–01194 Filed 1–23–20; 8:45 am]

BILLING CODE 8026–03–P

SMALL BUSINESS ADMINISTRATION

Military Reservist Economic Injury Disaster Loans; Interest Rate for Second Quarter FY 2020

AGENCY: U.S. Small Business Administration.

ACTION: Notice.

SUMMARY: This is a notice of the Military Reservist Economic Injury Disaster Loans interest rate for loans approved on or after January 17, 2020.

DATES: Issued on 01/17/2020.

FOR FURTHER INFORMATION CONTACT: A. Escobar, Office of Disaster Assistance, U.S. Small Business Administration, 409 3rd Street SW, Suite 6050, Washington, DC 20416, (202) 205–6734.

SUPPLEMENTARY INFORMATION: The Small Business Administration publishes an interest rate for Military Reservist Economic Injury Disaster Loans (13 CFR 123.512) on a quarterly basis. The interest rate will be 3.750 for loans approved on or after January 17, 2020.

James Rivera,

Associate Administrator for Disaster Assistance.

[FR Doc. 2020–01170 Filed 1–23–20; 8:45 am]

BILLING CODE 8026–03–P

SMALL BUSINESS ADMINISTRATION

[Disaster Declaration #16255 and #16256; VERMONT Disaster Number VT–00039]

Presidential Declaration of a Major Disaster for Public Assistance Only for the State of Vermont

AGENCY: U.S. Small Business Administration.

ACTION: Notice.

SUMMARY: This is a Notice of the Presidential declaration of a major disaster for Public Assistance Only for the State of Vermont (FEMA–4474–DR), dated 01/17/2020.

Incident: Severe Storm and Flooding.

Incident Period: 10/31/2019 through 11/01/2019.

DATES: Issued on 01/17/2020.

Physical Loan Application Deadline Date: 03/17/2020.

Economic Injury (EIDL) Loan Application Deadline Date: 10/19/2020.

ADDRESSES: Submit completed loan applications to: U.S. Small Business Administration, Processing And Disbursement Center, 14925 Kingsport Road, Fort Worth, TX 76155.

FOR FURTHER INFORMATION CONTACT: A. Escobar, Office of Disaster Assistance, U.S. Small Business Administration, 409 3rd Street SW, Suite 6050, Washington, DC 20416, (202) 205–6734.

SUPPLEMENTARY INFORMATION: Notice is hereby given that as a result of the President's major disaster declaration on 01/17/2020, Private Non-Profit organizations that provide essential services of a governmental nature may file disaster loan applications at the address listed above or other locally announced locations.

The following areas have been determined to be adversely affected by the disaster:

Primary Counties: Addison, Chittenden, Essex, Franklin, Lamoille, Orange, Orleans, Washington.

The Interest Rates are:

	Percent
For Physical Damage:	
Non-Profit Organizations With Credit Available Elsewhere	2.750
Non-Profit Organizations Without Credit Available Elsewhere	2.750
For Economic Injury:	
Non-Profit Organizations Without Credit Available Elsewhere	2.750

The number assigned to this disaster for physical damage is 16255B and for economic injury is 162560.

(Catalog of Federal Domestic Assistance Number 59008)

Cynthia Pitts,

Acting Associate Administrator for Disaster Assistance.

[FR Doc. 2020–01171 Filed 1–23–20; 8:45 am]

BILLING CODE 8026–03–P

SURFACE TRANSPORTATION BOARD

[Docket No. AB 541 (Sub-No. 2X)]

Portland & Western Railroad, Inc.—Discontinuance of Service Exemption—in Clatsop County, Or.

Portland & Western Railroad, Inc. (PNWR), has filed a verified notice of exemption under 49 CFR part 1152 subpart F—*Exempt Abandonments and Discontinuances of Service* to discontinue service over an approximately 22.58-mile rail line extending between milepost 96.88 near Tongue Point/Astoria and milepost 74.3 near Wauna, in Clatsop County, Or. (the Line).[1] The Line traverses U.S. Postal Service Zip Code 97103.

PNWR has certified that: (1) No local traffic has moved over the Line for at least two years; (2) because the Line is stub-ended, it has not handled any overhead traffic in at least two years, and there is no potential overhead traffic that would need to be rerouted; (3) no formal complaint filed by a user of rail service on the Line (or by a state or local government entity acting on behalf of such user) regarding cessation of service over the Line is pending either with the Surface Transportation Board (Board) or with any U.S. District Court or has been decided in favor of complainant within the two-year period; and (4) the requirements at 49 CFR 1105.12 (newspaper publication) and 49

[1] PNWR initially submitted its verified notice on December 6, 2019, and supplemented it on December 10 and December 16, 2019. By letter filed December 26, 2019, PNWR notified the Board that it had included an incorrect Zip Code in its notice and requested that the proceeding be held in abeyance. The Board granted PNWR's request to allow it to submit supplemental information, and on January 6, 2020, PNWR submitted amendments to its notice. Therefore, January 6, 2020 is considered the filing date and the basis for all dates in this notice.

CFR 1152.50(d)(1) (notice to governmental agencies) have been met.[2]

As a condition to this exemption, any employee adversely affected by the discontinuance of service shall be protected under *Oregon Short Line Railroad—Abandonment Portion Goshen Branch Between Firth & Ammon, in Bingham & Bonneville Counties, Idaho,* 360 I.C.C. 91 (1979). To address whether this condition adequately protects affected employees, a petition for partial revocation under 49 U.S.C. 10502(d) must be filed.

Provided no formal expression of intent to file an offer of financial assistance (OFA) [3] to subsidize continued rail service has been received, this exemption will be effective on February 23, 2020, unless stayed pending reconsideration. Petitions to stay that do not involve environmental issues and formal expressions of intent to file an OFA to subsidize continued rail service under 49 CFR 1152.27(c)(2) [4] must be filed by February 3, 2020.[5] Petitions for reconsideration must be filed by February 13, 2020, with the Surface Transportation Board, 395 E Street SW, Washington, DC 20423–0001.

A copy of any petition filed with Board should be sent to PNWR's representative, Justin J. Marks, Clark Hill PLC, 1001 Pennsylvania Ave. NW, Suite 1300 South, Washington, DC 20004.

If the verified notice contains false or misleading information, the exemption is void ab initio.

Board decisions and notices are available at *www.stb.gov.*

Decided: January 16, 2020.

By the Board, Allison C. Davis, Director, Office of Proceedings.

Kenyatta Clay,

Clearance Clerk.

[FR Doc. 2020–01199 Filed 1–23–20; 8:45 am]

BILLING CODE 4915–01–P

[2] PNWR filed a corrected notice of newspaper publication and corrected letters providing notice to governmental entities on January 6, 2020.

[3] Persons interested in submitting an OFA to subsidize continued rail service must first file a formal expression of intent to file an offer, indicating the intent to file an OFA for subsidy and demonstrating that they are preliminarily financially responsible. *See* 49 CFR 1152.27(c)(2)(i).

[4] The filing fee for OFAs can be found at 49 CFR 1002.2(f)(25).

[5] Because this is a discontinuance proceeding and not an abandonment, trail use/rail banking and public use conditions are not appropriate. Because there will be an environmental review during abandonment, this discontinuance does not require environmental review.

DEPARTMENT OF TRANSPORTATION

Federal Railroad Administration

[Docket Number FRA–2020–0004]

Notice of Application for Approval of Discontinuance or Modification of a Railroad Signal System

Under part 235 of title 49 of the Code of Federal Regulations (CFR) and 49 U.S.C. 20502(a), this provides the public notice that on January 7, 2020, WATCO Companies, LLC (WATCO) petitioned the Federal Railroad Administration (FRA) seeking approval to discontinue or modify a signal system. FRA assigned the petition Docket Number FRA–2020–0004.

Applicant: WATCO Companies, LLC, Mr. Scott Adams, Vice President of Engineering, 420 Hansen Street S, Twin Falls, ID 83301.

Specifically, WATCO requests permission to discontinue the automatic interlocking signal system at Chrisman, IL, where the Decatur Subdivision, milepost (MP) BD 209.3, crosses the Danville Subdivision, MP QSD 104.6.

Upon discontinuance of the automatic interlocking signal system the railroad crossing-at-grade will be protected by lighted STOP signs placed in each quadrant and General Code of Operating Rules 6.16, *Approaching Railroad Crossings, Drawbridges, and End of Multiple Main Track,* will be in effect.

A copy of the petition, as well as any written communications concerning the petition, is available for review online at *www.regulations.gov* and in person at the U.S. Department of Transportation's (DOT) Docket Operations Facility, 1200 New Jersey Ave. SE, W12–140, Washington, DC 20590. The Docket Operations Facility is open from 9 a.m. to 5 p.m., Monday through Friday, except Federal Holidays.

Interested parties are invited to participate in these proceedings by submitting written views, data, or comments. FRA does not anticipate scheduling a public hearing in connection with these proceedings since the facts do not appear to warrant a hearing. If any interested parties desire an opportunity for oral comment and a public hearing, they should notify FRA, in writing, before the end of the comment period and specify the basis for their request.

All communications concerning these proceedings should identify the appropriate docket number and may be submitted by any of the following methods:

- *Website: http://www.regulations.gov.* Follow the online instructions for submitting comments.
- *Fax:* 202–493–2251.
- *Mail:* Docket Operations Facility, U.S. Department of Transportation, 1200 New Jersey Ave. SE, W12–140, Washington, DC 20590.
- *Hand Delivery:* 1200 New Jersey Ave. SE, Room W12–140, Washington, DC 20590, between 9 a.m. and 5 p.m., Monday through Friday, except Federal Holidays.

Communications received by March 9, 2020 will be considered by FRA before final action is taken. Comments received after that date will be considered if practicable.

Anyone can search the electronic form of any written communications and comments received into any of our dockets by the name of the individual submitting the comment (or signing the document, if submitted on behalf of an association, business, labor union, etc.). Under 5 U.S.C. 553(c), DOT solicits comments from the public to better inform its processes. 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.dot.gov/privacy.* See also *http://www.regulations.gov/#!privacyNotice* for the privacy notice of *regulations.gov*.

Issued in Washington, DC.

John Karl Alexy,

Associate Administrator for Railroad Safety, Chief Safety Officer.

[FR Doc. 2020–01115 Filed 1–23–20; 8:45 am]

BILLING CODE 4910–06–P

DEPARTMENT OF TRANSPORTATION

Federal Transit Administration

FY 2020 Competitive Funding Opportunity: Low or No Emission Grant Program

AGENCY: Federal Transit Administration (FTA), DOT.

ACTION: Notice of funding opportunity (NOFO).

SUMMARY: The Federal Transit Administration (FTA) announces the opportunity to apply for $130 million in competitive grants under the fiscal year (FY) 2020 Low or No Emission Grant Program (Low-No Program) (Catalog of Federal Domestic Assistance number: 20.526). As required by Federal public transportation law, funds will be awarded competitively for the purchase or lease of low or no emission vehicles that use advanced technologies for transit revenue operations, including related equipment or facilities. Projects

may include costs incidental to the acquisition of buses or to the construction of facilities, such as the costs of related workforce development and training activities, and project administration expenses. FTA may award additional funding that is made available to the program prior to the announcement of project selections.

DATES: Complete proposals must be submitted electronically through the *GRANTS.GOV* ''APPLY'' function by 11:59 p.m. Eastern time on March 17, 2020. Prospective applicants should initiate the process by registering on the *GRANTS.GOV* website promptly to ensure completion of the application process before the submission deadline. Instructions for applying can be found on FTA's website at *http://transit.dot.gov/howtoapply* and in the ''FIND'' module of *GRANTS.GOV.* The funding opportunity ID is FTA–2020–005–LowNo. Mail and fax submissions will not be accepted.

FOR FURTHER INFORMATION CONTACT: Victor Waldron, FTA Office of Program Management, 202–366–5183, or *victor.waldron@dot.gov.*

SUPPLEMENTARY INFORMATION:

Table of Contents

A. Program Description

Federal public transportation law (49 U.S.C. 5339(c)) authorizes FTA to award grants for low or no emission buses through a competitive process, as described in this notice. The Low-No Program provides funding to State and local governmental authorities for the purchase or lease of zero-emission and low-emission transit buses, including acquisition, construction, and leasing of required supporting facilities such as recharging, refueling, and maintenance facilities. FTA recognizes that a significant transformation is occurring in the transit bus industry, with the increasing availability of low and zero emission bus vehicles for transit revenue operations.

In FY 2020, FTA is encouraging applicants to propose projects that introduce innovative technologies or practices in support of FTA's Accelerating Innovative Mobility (AIM) initiative. FTA is focused on the introduction of new technology not commonly found within U.S. transit systems such as integrated fare payment systems permitting complete trips or advancements to propulsion systems. Innovation can also include practices such as new public transportation operational models, financial or procurement arrangements, or value capture.

B. Federal Award Information

Federal public transportation law (49 U.S.C. 5338(a)(2)(M)) authorizes $55,000,000 in FY 2020 for the Low-No Program. The Further Consolidated Appropriations Act, 2020 appropriated an additional $75,000,000 for the Low-No Program for a total $130,000,000 available in FY 2020.

In FY 2019, the program received applications for 157 projects requesting a total of $500 million. Thirty-eight projects were funded at a total of $84.95 million. FTA may cap the amount a single recipient or State may receive as part of the selection process. In FY 2019, for example, the largest amount awarded to a single applicant was $3 million and no State received more than 3.5 percent of the total funding available.

FTA will grant pre-award authority to incur costs for selected projects beginning on the date FY 2020 project selections are announced on FTA's website. Funds are available for obligation three fiscal years after the fiscal year in which the competitive awards are announced. Funds are only available for projects that have not incurred costs prior to the announcement of project selections.

C. Eligibility Information

1. Eligible Applicants

Eligible applicants include designated recipients, States, local governmental authorities, and Indian Tribes. Proposals for funding projects in rural (non-urbanized) areas may be submitted as part of a consolidated State proposal. To be considered eligible, applicants must be able to demonstrate the requisite legal, financial, and technical capabilities to receive and administer Federal funds under this program. States and other eligible applicants may submit consolidated proposals for projects in urbanized areas. Proposals may contain projects to be implemented by the recipient or its eligible subrecipients. Eligible subrecipients are entities that are otherwise eligible recipients under this program.

As permitted by the Further Consolidated Appropriations Act, 2020, applicants to the Low-No Program may submit applications that include partnerships with other entities that intend to participate in the implementation of the project, including, but not limited to, specific vehicle manufacturers, equipment vendors, owners or operators of related facilities, or project consultants. If an application that involves such a partnership is selected for funding, the competitive selection process will be deemed to satisfy the requirement for a competitive procurement under 49 U.S.C. 5325(a) for the named entities. Applicants are advised that any changes to the proposed partnership will require FTA written approval, must be consistent with the scope of the approved project, and may necessitate a competitive procurement.

2. Cost Sharing or Matching

The maximum Federal share for projects that involve leasing or acquiring transit buses (including clean fuel or alternative fuel vehicles) for purposes of complying with or maintaining compliance with the Clean Air Act is 85 percent of the net project cost.

The maximum Federal share for the cost of acquiring, installing, or constructing vehicle-related equipment or facilities (including clean fuel or alternative fuel vehicle-related equipment or facilities) for purposes of complying with or maintaining compliance with the Clean Air Act is 90 percent of the net project cost of such equipment or facilities that are attributable to compliance with the Clean Air Act. The award recipient must itemize the cost of specific, discrete, vehicle-related equipment associated with compliance with the Clean Air Act to be eligible for the maximum 90 percent Federal share for these costs.

Eligible sources of local match include the following: Cash from non-Government sources other than revenues from providing public transportation services; revenues derived from the sale of advertising and concessions; amounts received under a service agreement with a State or local social service agency or private social service organization; revenues generated from value capture financing mechanisms; funds from an undistributed cash surplus; replacement or depreciation cash fund or reserve; new capital; or in-kind contributions. Transportation development credits or in-kind match may be used for local match if identified and documented in the application.

3. Eligible Projects

Under the Low-No Program (49 U.S.C. 5339(c)(1)(B)), eligible projects include

projects or programs of projects in an eligible area for: (1) Purchasing or leasing low or no emission buses; (2) acquiring low or no emission buses with a leased power source; (3) constructing or leasing facilities and related equipment for low or no emission buses; (4) constructing new public transportation facilities to accommodate low or no emission buses; (5) or rehabilitating or improving existing public transportation facilities to accommodate low or no emission buses. As required by Federal public transportation law (49 U.S.C. 5339(c)(5)), FTA will only consider eligible projects relating to the acquisition or leasing of low or no emission buses or bus facilities that make greater reductions in energy consumption and harmful emissions than comparable standard buses or other low or no emission buses and are part of the recipient's long-term integrated fleet management plan.

A low or no-emission bus is defined as a passenger vehicle used to provide public transportation that significantly reduces energy consumption or harmful emissions, including direct carbon emissions, when compared to a standard vehicle. The statutory definition includes zero-emission transit buses, which are defined as buses that produce no direct carbon emissions and no particulate matter emissions under any and all possible operational modes and conditions. Examples of zero emission bus technologies include, but are not limited to, hydrogen fuel-cell buses and battery-electric buses. All new transit bus models must successfully complete FTA bus testing for production transit buses pursuant to FTA's Bus Testing regulation (49 CFR part 665) in order to be procured with funds awarded under the Low-No Program. All transit vehicles must be procured from certified transit vehicle manufacturers in accordance with the Disadvantaged Business Enterprise (DBE) regulations (49 CFR part 26). The development or deployment of prototype vehicles is not eligible for funding under the Low-No Program.

Recipients are permitted to use up to 0.5 percent of their requested grant award for workforce development activities eligible under Federal public transportation law (49 U.S.C. 5314(b)) and an additional 0.5 percent for costs associated with training at the National Transit Institute. Applicants must identify the proposed use of funds for these activities in the project proposal and identify them separately in the project budget.

If a single project proposal involves multiple public transportation providers, such as when an agency acquires vehicles that will be operated by another agency, the proposal must include a detailed statement regarding the role of each public transportation provider in the implementation of the project.

D. Application and Submission Information

1. Address To Request Application

Applications must be submitted electronically through *GRANTS.GOV.* General information for submitting applications through *GRANTS.GOV* can be found at *www.fta.dot.gov/howtoapply* along with specific instructions for the forms and attachments required for submission. Mail and fax submissions will not be accepted. A complete proposal submission consists of two forms: The SF–424 Application for Federal Assistance (available at *GRANTS.GOV*) and the supplemental form for the FY 2020 Low-No Program (downloaded from *GRANTS.GOV* or the FTA website at *https://www.transit.dot.gov/funding/grants/lowno*). Failure to submit the information as requested can delay review or disqualify the application.

2. Content and Form of Application Submission

A strong transportation network is critical to the functioning and growth of the American economy. The nation's industry depends on the transportation network to move the goods that it produces, and facilitate the movements of the workers who are responsible for that production. When the nation's highways, railways, and ports function well, that infrastructure connects people to jobs, increases the efficiency of delivering goods and thereby cuts the costs of doing business, reduces the burden of commuting, and improves overall well-being.

Rural transportation networks play a vital role in supporting our national economic vitality. Addressing the deteriorating conditions and disproportionately high fatality rates on our rural transportation infrastructure is of critical interest to the Department, as rural transportation networks face unique challenges in safety, infrastructure condition, and passenger and freight usage. Consistent with the R.O.U.T.E.S. Initiative, the Department encourages applicants to consider how the project will address the challenges faced by rural areas.

a. Proposal Submission

A complete proposal submission consists of two forms: (1) The SF–424 Application for Federal Assistance; and (2) the supplemental form for the FY 2020 Low-No Program. The supplemental form and any supporting documents must be attached to the ''Attachments'' section of the SF–424. The application must include responses to all sections of the SF–424 Application for Federal Assistance and the supplemental form, unless indicated as optional. The information on the supplemental form will be used to determine applicant and project eligibility for the program, and to evaluate the proposal against the selection criteria described in part E of this notice.

FTA will accept only one supplemental form per SF–424 submission. FTA encourages States and other applicants to consider submitting a single supplemental form that includes multiple activities to be evaluated as a consolidated proposal. If a State or other applicant chooses to submit separate proposals for individual consideration by FTA, each proposal must be submitted using a separate SF–424 and supplemental form.

Applicants may attach additional supporting information to the SF–424 submission, including but not limited to letters of support, project budgets, fleet status reports, or excerpts from relevant planning documents. Any supporting documentation must be described and referenced by file name in the appropriate response section of the supplemental form, or it may not be reviewed.

Information such as applicant name, Federal amount requested, local match amount, description of areas served, etc. may be requested in varying degrees of detail on both the SF–424 and supplemental form. Applicants must fill in all fields unless stated otherwise on the forms. If information is copied into the supplemental form from another source, applicants should verify that pasted text is fully captured on the supplemental form and has not been truncated by the character limits built into the form. Applicants should use both the ''Check Package for Errors'' and the ''Validate Form'' validation buttons on both forms to check all required fields on the forms, and ensure that the Federal and local amounts specified are consistent.

b. Application Content

The SF–424 Application for Federal Assistance and the supplemental form will prompt applicants for the required information, including:

i. Applicant name

ii. Dun and Bradstreet (D&B) Data Universal Numbering System (DUNS) number
iii. Key contact information (including contact name, address, email address, and phone)
iv. Congressional district(s) where project will take place
v. Project information (including title, an executive summary, and type)
vi. A detailed description of the need for the project
vii. A detailed description on how the project will support the Low-No Program objectives
viii. Evidence that the project is consistent with local and regional planning documents
ix. Evidence that the applicant can provide the local cost share
x. A description of the technical, legal, and financial capacity of the applicant
xi. A detailed project budget
xii. An explanation of the scalability of the project
xiii. Details on the local matching funds
xiv. A detailed project timeline
xv. Whether the project impacts an Opportunity Zone

3. Unique Entity Identifier and System for Award Management (SAM)

Each applicant is required to: (1) Be registered in SAM before submitting an application; (2) provide a valid unique entity identifier in its application; and (3) continue to maintain an active SAM registration with current information at all times during which the applicant has an active Federal award or an application or plan under consideration by FTA. These requirements do not apply if the applicant has an exemption approved by FTA under Federal grants and agreements law (2 CFR 25.110(d)). FTA may not make an award until the applicant has complied with all applicable unique entity identifier and SAM requirements. If an applicant has not fully complied with the requirements by the time FTA is ready to make an award, FTA may determine that the applicant is not qualified to receive an award and use that determination as a basis for making a Federal award to another applicant. All applicants must provide a unique entity identifier provided by SAM. Registration in SAM may take as little as 3–5 business days, but since there could be unexpected steps or delays (for example, if there is a need to obtain an Employer Identification Number), FTA recommends allowing ample time, up to several weeks, for completion of all steps. For additional information on obtaining a unique entity identifier, please visit *www.sam.gov.*

4. Submission Dates and Times

Project proposals must be submitted electronically through *GRANTS.GOV* by 11:59 p.m. Eastern time on March 17, 2020. *GRANTS.GOV* attaches a time stamp to each application at the time of submission. Proposals submitted after the deadline will only be considered under extraordinary circumstances not under the applicant's control. Mail and fax submissions will not be accepted.

Within 48 hours after submitting an electronic application, the applicant should receive an email message from *GRANTS.GOV* with confirmation of successful transmission to *GRANTS.GOV.* If a notice of failed validation or incomplete materials is received, the applicant must address the reason for the failed validation, as described in the email notice, and *resubmit before the submission deadline.* If making a resubmission for any reason, include all original attachments regardless of which attachments were updated and check the box on the supplemental form indicating this is a resubmission.

FTA urges applicants to submit applications at least 72 hours prior to the due date to allow time to receive the validation messages and to correct any problems that may have caused a rejection notification. *GRANTS.GOV* scheduled maintenance and outage times are announced on the *GRANTS.GOV* website. Deadlines will not be extended due to scheduled website maintenance.

Applicants are encouraged to begin the process of registration on the *GRANTS.GOV* site well in advance of the submission deadline. Registration is a multi-step process, which may take several weeks to complete before an application can be submitted. Registered applicants may still be required to take steps to keep their registration up to date before submissions can be made successfully: (1) Registration in SAM is renewed annually, and (2) persons making submissions on behalf of the Authorized Organization Representative (AOR) must be authorized in *GRANTS.GOV* by the AOR to make submissions.

5. Restrictions

Funds under this NOFO cannot be used to reimburse applicants for otherwise eligible expenses incurred prior to FTA award of a grant agreement until FTA has issued pre-award authority for selected projects.

6. Other Submission Requirements

Applicants are encouraged to identify scaled funding options in case insufficient funding is available to fund a project at the full requested amount. If an applicant indicates that a project is scalable, the applicant must provide an appropriate minimum funding amount that will fund an eligible project that achieves the objectives of the program and meets all relevant program requirements. The applicant must provide a clear explanation of how the project budget would be affected by a reduced award. FTA may award a lesser amount regardless of whether a scalable option is provided.

E. Application Review Information

1. Criteria

Projects will be evaluated primarily on the responses provided in the supplemental form. Additional information may be provided to support the responses; however, any additional documentation must be directly referenced on the supplemental form, including the file name where the additional information can be found. FTA will evaluate proposals for the Low-No Program based on the criteria described in this notice.

Consistent with the Department's R.O.U.T.E.S. Initiative (*https://www.transportation.gov/rural*), the Department recognizes that rural transportation networks face unique challenges. To the extent that those challenges are reflected in the merit criteria listed in this section, the Department will consider how the activities proposed in the application will address those challenges, regardless of the geographic location of those activities.

a. Demonstration of Need

Since the purpose of this program is to fund vehicles and facilities, applications will be evaluated based on the quality and extent to which they demonstrate how the proposed project will address an unmet need for capital investment in vehicles and/or supporting facilities. For example, an applicant may demonstrate that it requires additional or improved charging or maintenance facilities for low or no emission vehicles, that it intends to replace existing vehicles that have exceeded their minimum useful life, or that it requires additional vehicles to meet current ridership demands.

FTA will consider an applicant's responses to the following criteria when assessing the need for capital investment underlying the proposed project:

i. Consistency with Long-Term Fleet Management Plan: As required by

Federal public transportation law (49 U.S.C. 5339(c)(5)(b)), all project proposals must demonstrate that they are part of the intended recipient's long-term integrated fleet management plan, as demonstrated through an existing transit asset management program, fleet procurement plan, or similarly documented program or policy. These plans must be attached to the application. FTA will evaluate the consistency of the proposed project with the applicant's long-term fleet management plan, as well as the applicant's previous experience with the relevant low or no emissions vehicle technologies.

ii. For low or no emission bus projects (replacement and/or or expansion): Applicants must provide information on the age, condition, and performance of the vehicles to be replaced by the proposed project. Vehicles to be replaced must have met their minimum useful life at the time of project completion. For service expansion requests, applicants must provide information on the proposed service expansion and the benefits for transit riders and the community from the new service. For all vehicle projects, the proposal must address whether the project conforms to FTA's spare ratio guidelines. Low or no emission vehicles funded under this program are not exempted from FTA's standard spare ratio requirements, which apply to and are calculated on the agency's entire fleet.

iii. For bus facility and equipment projects (replacement, rehabilitation, and/or expansion): Applicants must provide information on the age and condition of the asset to be rehabilitated or replaced relative to its minimum useful life.

b. Demonstration of Benefits

Applicants must demonstrate how the proposed project will support the statutory requirements of the Low-No Program (49 U.S.C. 5339(c)(5)(A)). In particular, FTA will consider the quality and extent to which applications demonstrate how the proposed project will: (1) Reduce Energy Consumption; (2) Reduce Harmful Emissions; and (3) Reduce Direct Carbon Emissions. FTA will also evaluate the potential of the proposed project to accelerate innovation.

i. Reduce Energy Consumption: Applicants must describe how the proposed project will reduce energy consumption. FTA will evaluate applications based on the degree to which the proposed technology reduces energy consumption as compared to more common vehicle propulsion technologies.

ii. Reduce Harmful Emissions: Applicants must demonstrate how the proposed vehicles or facility will reduce the emission of particulates that create local air pollution, which leads to local environmental health concerns, smog, and unhealthy ozone concentrations. FTA will evaluate the rate of particulate emissions by the proposed vehicles or vehicles to be supported by the proposed facility, compared to the emissions from the vehicles that will be replaced or moved to the spare fleet as a result of the proposed project, as well as comparable standard buses.

iii. Reduce Direct Carbon Emissions: Applicants should demonstrate how the proposed vehicles or facility will reduce emissions of greenhouse gases from transit vehicle operations. FTA will evaluate the rate of direct carbon emissions by the proposed vehicles or vehicles to be supported by the proposed facility, compared to the emissions from the vehicles that will be replaced or moved to the spare fleet as a result of the proposed project, as well as comparable standard buses.

iv. Accelerating Innovation: Applicants may also demonstrate how the project will accelerate the introduction of innovative technologies or practices such as integrated fare payment systems permitting complete trips or advancements to propulsion systems. Innovation can also include practices such as new public transportation operational models, financial or procurement arrangements, or value capture.

c. Planning and Local/Regional Prioritization

Applicants must demonstrate how the proposed project is consistent with local and regional long-range planning documents and local government priorities. FTA will evaluate applications based on the quality and extent to which they assess whether the project is consistent with the transit priorities identified in the long-range plan; and/or contingency/illustrative projects included in that plan; or the locally developed human services public transportation coordinated plan. Applicants may submit copies of the relevant pages of such plans to support their application. FTA will consider how the project will support regional goals and applicants may submit support letters from local and regional planning organizations attesting to the consistency of the proposed project with these plans.

Evidence of additional local or regional prioritization may include letters of support for the project from local government officials, public agencies, and non-profit or private sector partners.

d. Local Financial Commitment

Applicants must identify the source of the local cost share and describe whether such funds are currently available for the project or will need to be secured if the project is selected for funding. FTA will consider the availability of the local cost share as evidence of local financial commitment to the project. Applicants should submit evidence of the availability of funds for the project; for example, by including a board resolution, letter of support from the State, or other documentation of the source of local funds such as a budget document highlighting the line item or section committing funds to the proposed project. In addition, an applicant may propose a local cost share that is greater than the minimum requirement or provide documentation of previous local investments in the project, which cannot be used to satisfy local matching requirements, as evidence of local financial commitment. Additional consideration will be given to those projects that propose a larger local cost share. FTA will also note if an applicant proposes to use grant funds only for the incremental cost of new technologies over the cost of replacing vehicles with standard propulsion technologies.

e. Project Implementation Strategy

FTA will rate projects higher if grant funds can be obligated within 12 months of selection and the project can be implemented within a reasonable time frame. In assessing when funds can be obligated, FTA will consider whether the project qualifies for a Categorical Exclusion (CE), or whether the required environmental work has been initiated or completed for projects that require an Environmental Assessment (EA) or Environmental Impact Statement (EIS) under the National Environmental Policy Act of 1969 (NEPA), as amended. As such, applicants should submit information describing the project's anticipated path and timeline through the environmental review process. The proposal must state when grant funds can be obligated and indicate the timeframe under which the Metropolitan Transportation Improvement Program (TIP) and/or Statewide Transportation Improvement Program (STIP) can be amended to include the proposed project.

In assessing whether the proposed implementation plans are reasonable and complete, FTA will review the

proposed project implementation plan, including all necessary project milestones and the overall project timeline. For projects that will require formal coordination, approvals, or permits from other agencies or project partners, the applicant must demonstrate coordination with these organizations and their support for the project, such as through letters of support.

For project proposals that involve a partnership with a manufacturer, vendor, consultant, or other third party, applicants must identify by name any project partners, including, but not limited to, other transit agencies, bus manufacturers, owners or operators of related facilities, or any expert consultants. FTA will evaluate the experience and capacity of the named project partners to successfully implement the proposed project based on the partners' experience and qualifications. Applicants are advised to submit information on the partners' qualifications and experience as a part of the application. Entities involved in the project that are not named in the application will be required to be selected through a competitive procurement.

f. Technical, Legal, and Financial Capacity

Applicants must demonstrate that they have the technical, legal, and financial capacity to undertake the project. FTA will review relevant oversight assessments and records to determine whether there are any outstanding legal, technical, or financial issues with the applicant that would affect the outcome of the proposed project.

2. Review and Selection Process

In addition to other FTA staff that may review the proposals, a technical evaluation committee will evaluate proposals based on the published evaluation criteria. Members of the technical evaluation committee and other FTA staff may request additional information from applicants, if necessary. Based on the findings of the technical evaluation committee, the FTA Administrator will determine the final selection of projects for program funding. In determining the allocation of program funds, FTA may consider geographic diversity, diversity in the size of the transit systems receiving funding, projects located in or that support public transportation service in a qualified opportunity zone designated pursuant to 26 U.S.C. 1400Z–1, the applicant's receipt of other competitive awards, the percentage of the local share provided, and whether the project includes an innovative technology or practice. FTA may consider capping the amount a single applicant may receive and prioritizing investments in rural areas. Projects that have a higher local financial commitment may also be prioritized.

After applying the above criteria, the FTA Administrator will consider the following key Departmental objectives:

a. Supporting economic vitality at the national and regional level;

b. Utilizing alternative funding sources and innovative financing models to attract non-Federal sources of infrastructure investment;

c. Accounting for the life-cycle costs of the project to promote the state of good repair;

d. Using innovative approaches to improve safety and expedite project delivery; and,

e. Holding grant recipients accountable for their performance and achieving specific, measurable outcomes identified by grant applicants.

Prior to making an award, FTA is required to review and consider any information about the applicant that is in the Federal Award Performance and Integrity Information System accessible through SAM . An applicant may review and comment on any information about itself that a Federal awarding agency previously entered. FTA will consider any comments by the applicant, in addition to the other information in the designated integrity and performance system, in making a judgment about the applicant's integrity, business ethics, and record of performance under Federal awards when completing the review of risk posed by applicants as described in the Office of Management and Budget's Uniform Requirements for Federal Awards (2 CFR 200.205).

F. Federal Award Administration Information

The FTA Administrator will announce the final project selections on the FTA website. Recipients should contact their FTA Regional Offices for additional information regarding allocations for projects under the Low-No Program. At the time the project selections are announced, FTA will extend pre-award authority for the selected projects. There is no blanket pre-award authority for these projects before announcement.

1. Federal Award Notices

Funds under the Low-No Program are available to States, designated recipients, local governmental authorities, and Indian Tribes. There is no minimum or maximum grant award amount; however, FTA intends to fund as many meritorious projects as possible. Only proposals from eligible recipients for eligible activities will be considered for funding. Due to funding limitations, applicants that are selected for funding may receive less than the amount originally requested. In those cases, applicants must be able to demonstrate that the proposed projects are still viable and can be completed with the amount awarded.

2. Administrative and National Policy Requirements

a. Pre-Award Authority

FTA will issue specific guidance to recipients regarding pre-award authority at the time of selection. FTA does not provide pre-award authority for competitive funds until projects are selected, and even then, there are Federal requirements that must be met before costs are incurred. For more information about FTA's policy on pre-award authority, please see the FY 2019 Apportionment Notice published on July 3, 2019. *https://www.govinfo.gov/content/pkg/FR-2019-07-03/pdf/2019-14248.pdf*.

b. Grant Requirements

If selected, awardees will apply for a grant through FTA's Transit Award Management System (TrAMS). All Low-No Program recipients are subject to the grant requirements of the Urbanized Area Formula Grant program (49 U.S.C. 5307), including those of FTA Circular ''Urbanized Area Formula Program: Program Guidance and Application Instructions'' (FTA.C.9030.1E). All recipients must also follow the Award Management Requirements (FTA.C.5010.1) and the labor protections required by Federal public transportation law (49 U.S.C. 5333(b)). Technical assistance regarding these requirements is available from each FTA regional office.

c. Buy America

FTA requires that all capital procurements meet FTA's Buy America requirements (49 U.S.C. 5323(j)), which require that all iron, steel, or manufactured products be produced in the United States. Federal public transportation law provides for a phased increase in the domestic content for rolling stock between FY 2016 and FY 2020. For FY 2020 and beyond, the cost of components and subcomponents produced in the United States must be more than 70 percent of the cost of all components. There is no change to the requirement that final assembly of rolling stock must occur in the United

States. FTA issued guidance on the implementation of the phased increase in domestic content on September 1, 2016 (81 FR 60278). Applicants should read the policy guidance carefully to determine the applicable domestic content requirement for their project. Any proposal that will require a waiver must identify in the application the items for which a waiver will be sought. Applicants should not proceed with the expectation that waivers will be granted. Consistent with Executive Order 13858 *Strengthening Buy-American Preferences for Infrastructure Projects,* signed by President Trump on January 31, 2019, applicants should maximize the use of goods, products, and materials produced in the United States, in Federal procurements and through the terms and conditions of Federal financial assistance awards.

d. Disadvantaged Business Enterprise

FTA requires that its recipients receiving planning, capital, and/or operating assistance that will award prime contracts exceeding $250,000 in FTA funds in a Federal fiscal year comply with Department of Transportation Disadvantaged Business Enterprise (DBE) program regulations (49 CFR part 26). Applicants should expect to include any funds awarded, excluding those to be used for vehicle procurements, in setting their overall DBE goal. Note, however, that projects including vehicle procurements remain subject to the DBE program regulations. The rule requires that, prior to bidding on any FTA-assisted vehicle procurement, entities that manufacture vehicles, or perform post-production alterations or retrofitting, must submit a DBE program plan and goal methodology to FTA. Further, to the extent that a vehicle remanufacturer is responding to a solicitation for new or remanufactured vehicles with a vehicle to which the remanufacturer has provided post-production alterations or retrofitting (*e.g.,* replacing major components such as an engine to provide a ''like new'' vehicle), the vehicle remanufacturer is considered a transit vehicle manufacturer and must also comply with the DBE regulations.

FTA will then issue a transit vehicle manufacturer (TVM) concurrence/certification letter. Grant recipients must verify each entity's compliance with these requirements before accepting its bid. A list of compliant, certified TVMs is posted on FTA's web page at *https://www.transit.dot.gov/regulations-and-guidance/civil-rights-ada/eligible-transit-vehicle-manufacturers.* Please note that this list is nonexclusive, and recipients must contact FTA before accepting bids from entities not listed on this web-posting. Recipients may also establish project-specific DBE goals for vehicle procurements. FTA will provide additional guidance as grants are awarded. For more information on DBE requirements, please contact Scheryl Portee, Office of the Chief Counsel, 202–366–0840, email: *scheryl.portee@dot.gov.*

e. Planning

FTA encourages applicants to notify the appropriate State Departments of Transportation and metropolitan planning organizations in areas likely to be served by the project funds made available under these initiatives and programs. Selected projects must be incorporated into the long-range plans and transportation improvement programs of States and metropolitan areas before they are eligible for FTA funding. As described under the evaluation criteria, FTA may consider whether a project is consistent with or already included in these plans when evaluating a project.

f. Standard Assurances

The applicant assures that it will comply with all applicable Federal statutes, regulations, executive orders, directives, FTA circulars, and other Federal administrative requirements in carrying out any project supported by the FTA grant. The applicant acknowledges that it is under a continuing obligation to comply with the terms and conditions of the grant agreement issued for its project with FTA. The applicant understands that Federal laws, regulations, policies, and administrative practices might be modified from time to time and may affect the implementation of the project. The applicant agrees that the most recent Federal requirements will apply to the project, unless FTA issues a written determination otherwise. The applicant must submit the Certifications and Assurances before receiving a grant if it does not have current certifications on file.

3. Reporting

Post-award reporting requirements include the electronic submission of Federal Financial Reports and Milestone Progress Reports in FTA's electronic grants management system. Recipients of funds made available through this NOFO are also required to regularly submit data to the National Transit Database.

G. Technical Assistance and Other Program Information

This program is not subject to Executive Order 12372, ''Intergovernmental Review of Federal Programs.'' FTA will consider applications for funding only from eligible recipients for eligible projects listed in Section C. Complete applications must be submitted through *GRANTS.GOV* by 11:59 p.m. Eastern time on March 17, 2020. For issues with *GRANTS.GOV,* please contact GRANTS.GOV by phone at 1–800–518–4726 or by email at *support@grants.gov.* Contact information for FTA's regional offices can be found on FTA's website at *www.fta.dot.gov.*

H. Federal Awarding Agency Contacts

For further information concerning this notice, please contact the Low-No Program manager, Victor Waldron, by phone at 202–366–5183, or by email at *victor.waldron@dot.gov.* A TDD is available for individuals who are deaf or hard of hearing at 800–877–8339. In addition, FTA will post answers to questions and requests for clarifications on FTA's website at *https://www.transit.dot.gov/funding/grants/lowno.* To ensure applicants receive accurate information about eligibility or the program, applicants are encouraged to contact FTA directly, rather than through intermediaries or third parties, with questions. FTA staff may also conduct briefings on the FY 2020 competitive grants selection and award process upon request.

K. Jane Williams,

Acting Administrator.

[FR Doc. 2020–01140 Filed 1–23–20; 8:45 am]

BILLING CODE P

DEPARTMENT OF TRANSPORTATION

Maritime Administration

Voluntary Intermodal Sealift Agreement/Joint Planning Advisory Group Meeting

AGENCY: Maritime Administration, Department of Transportation.

ACTION: Notice.

SUMMARY: The Voluntary Intermodal Sealift Agreement (VISA) program requires that a notice of the time, place, and nature of each VISA Joint Planning Advisory Group (JPAG) meeting be published in the **Federal Register.** On January 14, 2020, the Maritime Administration (MARAD) and the U.S. Transportation Command (USTRANSCOM) co-hosted a classified VISA JPAG meeting at Scott Air Force

Base, Illinois. The JPAG is co-chaired by MARAD and USTRANSCOM and is convened jointly. The U.S. Department of Justice and Federal Trade Commission were informed of the JPAG meeting prior to its occurrence, in accordance with VISA program requirements.

Participants in the JPAG meeting were required to possess a secret clearance due to the classified nature of the event and attendance at the meeting was by invitation only. MARAD and USTRANSCOM invited participating VISA carriers and representatives of maritime labor organizations to attend the meeting. In addition, representatives from the U.S. Department of Transportation, MARAD, the U.S. Department of Homeland Security, the U.S. Coast Guard, the Joint Chiefs of Staff, and the Department of Defense (DOD) to include the Office of the Secretary of Defense, USTRANSCOM, the U.S. Navy, the Military Sealift Command, and the Surface Deployment and Distribution Command, as well as operational elements of Geographic Combatant Commands, were in attendance.

FOR FURTHER INFORMATION CONTACT: William G. McDonald, Director, Office of Sealift Support, U.S. Department of Transportation, Maritime Administration, 1200 New Jersey Avenue SE, Washington, DC 20590; Telephone (202) 366–0688 or electronic mail to: *william.g.mcdonald@dot.gov.*

SUPPLEMENTARY INFORMATION: Vice Admiral (VADM) Dee L. Mewbourne, Deputy Commander, USTRANSCOM, and Mr. Kevin Tokarski, Associate Administrator for Strategic Sealift, MARAD, welcomed the participants. Mr. Tokarski thanked the industry participants for their continued support. He spoke of the unique value of the JPAG in maximizing the effective use of joint resources to meet deployment and sustainment requirements and expressed confidence that JPAG meetings would serve to prepare attendees for what could occur during a VISA activation. VADM Mewbourne discussed the current operational picture and said JPAG operations are crucial to development of concepts of operations focused on VISA participants' ability to meet DOD requirements for moving contingency cargo from CONUS Sea Ports of Embarkation to designated OCONUS Ports of Debarkation and onward to operational areas.

The purpose of the JPAG meeting was to: (1) Brief members on current strategic and operational developments; (2) affirm industry's readiness, ability, and resilience to meet DOD contingency transport requirements, and; (3) discuss planning assumptions for potential deployment scenarios. The meeting was rated a success by industry participants, who offered informed and useful information on the provision of capacity and resources to meet DOD requirements.

VISA is a USDOT/DoD Emergency Preparedness Program (EPP) administered by MARAD in partnership with USTRANSCOM. The program is designed to provide DoD with assured access to vessels and intermodal capacity to meet contingency requirements in the event of national emergency. On September 30, 2019, MARAD published a notice in the **Federal Register**/Vol. 84, No. 189, 51710, announcing extension of the VISA program until October 1, 2024.

The following ocean carriers are VISA participants:

American International Shipping, LLC
American President Lines, Ltd.
American Roll-On Roll-Off Carrier, LLC
APL Marine Services, Ltd.
APL Maritime, Ltd.
Argent Marine Operations, Inc.
Beyel Brothers Inc.
Columbia Coastal Transport, LLC
Crimson Shipping Co., Inc.
Crowley Marine Services, Inc.
Crowley Puerto Rico Services, Inc.
Curtin Maritime, Corporation
Dann Marine Towing, LC
Dann Ocean Towing, Inc.
Dunlap Towing Company
Farrell Lines Incorporated
Fidelio Limited Partnership
Foss International, Inc.
Foss Maritime Company
Hapag-Lloyd USA, LLC
JM Ships, LLC
Laborde Marine, LLC
Liberty Global Logistics, LLC
Liberty Glory Corporation
Lynden Incorporated & Affiliates
Maersk Line, Limited
Matson Navigation Company, Inc.
McAllister Towing and Transportation Co., Inc.
McCulley Marine Services, Inc.
Moran Towing Corporation
National Shipping of America, LLC
Northcliffe Ocean Shipping & Trading Company, Inc.
Pacific Maritime Freight, Inc.
Pasha Hawaii Holdings LLC
Patriot Shipping, LLC
Resolve Towing & Salvage, Inc.
Samson Tug & Barge Co., Inc.
Schuyler Lines Navigation Company, LLC
Seabridge, Inc.
Sealift, Inc.
SeaTac Marine Services, LLC
Smith Maritime, Inc.
Stevens Towing Company, Inc.
Stevens Transportation, LLC
Superior Maritime Services, Inc.
TOTE Maritime Alaska, Inc.
TOTE Maritime Puerto Rico, LLC
Trailer Bridge, Inc.
Waterman Steamship Corporation
Waterman Transport, Inc.
Weeks Marine, Inc.
Western Towboat Company
Young Brothers, Limited

(Authority: 49 CFR 1.93(l), 44 CFR part 332)

* * *

Dated: January 21, 2020.

By Order of the Maritime Administrator.

T. Mitchell Hudson, Jr.,

Secretary, Maritime Administration .

[FR Doc. 2020–01200 Filed 1–23–20; 8:45 am]

BILLING CODE 4910–81–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

Proposed Collection; Comment Request for Form 8453–R

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice and request for comments.

SUMMARY: The Internal Revenue Service (IRS), as part of its continuing effort to reduce paperwork and respondent burden, invites the general public and other Federal agencies to take this opportunity to comment on information collections, as required by the Paperwork Reduction Act of 1995. The IRS is soliciting comments concerning Electronic Filing Declaration for Form 8963.

DATES: Written comments should be received on or before March 24, 2020 to be assured of consideration.

ADDRESSES: Direct all written comments to Dr. Philippe Thomas, Internal Revenue Service, Room 6526, 1111 Constitution Avenue NW, Washington, DC 20224.

FOR FURTHER INFORMATION: Requests for additional information or copies of the form and instructions should be directed to Martha R. Brinson, at (202)317–5753, or at Internal Revenue Service, Room 6526, 1111 Constitution Avenue NW, Washington, DC 20224, or through the internet at *Martha.R.Brinson@irs.gov*.

SUPPLEMENTARY INFORMATION:

Title: Electronic Filing Declaration for Form 8963.

OMB Number: 1545–2253.

Form Number: 8453–R.

Abstract: The purpose of the form is to authenticate the electronic filing of Form 8963, Report of Health Insurance Provider Information.

Current Actions: There are no changes being made to the form at this time.

Type of Review: Extension of a currently approved collection.

Affected Public: Businesses and other for-profit organizations and Not-for-profit organizations.

Estimated Number of Respondents: 2,550.

Estimated Time per Respondent: 1 hour 37 minutes.

Estimated Total Annual Burden Hours: 4,131.

The following paragraph applies to all of 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 as long as 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.

Request for Comments: Comments submitted in response to this notice will be summarized and/or included in the request for OMB approval. All comments will become a matter of public record.

Comments are invited on: (a) Whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility; (b) the accuracy of the agency's estimate of the burden of the collection of information; (c) ways to enhance the quality, utility, and clarity of the information to be collected; (d) ways to minimize the burden of the collection of information on respondents, including through the use of automated collection techniques or other forms of information technology; and (e) estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

Approved: January 14, 2020.

Philippe Thomas,

Supervisory Tax Analyst.

[FR Doc. 2020–01173 Filed 1–23–20; 8:45 am]

BILLING CODE 4830–01–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

Proposed Collection; Comment Request for Form 8316

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 general 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 8316, Information Regarding Request for Refund of Social Security Tax Erroneously Withheld on Wages Received by a Nonresident Alien on an F, J, or M Type Visa.

DATES: Written comments should be received on or before March 24, 2020 to be assured of consideration.

ADDRESSES: Direct all written comments to Dr. Philippe Thomas, Internal Revenue Service, Room 6526, 1111 Constitution Avenue NW, Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Requests for additional information or copies of the form should be directed to LaNita Van Dyke at Internal Revenue Service, Room 6526, 1111 Constitution Avenue NW, Washington, DC 20224, or through the internet at *Lanita.VanDYke@irs.gov@irs.gov*.

SUPPLEMENTARY INFORMATION:

Title: Information Regarding Request for Refund of Social Security Tax Erroneously Withheld on Wages Received by a Nonresident Alien on an F, J, or M Type Visa.

OMB Number: 1545–1862.

Form Number: 8316.

Abstract: Certain foreign students and other nonresident visitors are exempt from FICA tax for services performed as specified in the Immigration and Naturalization Act. Applicants for refund of this FICA tax withheld by their employer must complete Form 8316 to verify that they are entitled to a refund of the FICA, that the employer has not paid back any part of the tax withheld and that the taxpayer has attempted to secure a refund from his/her employer.

Current Actions: There are no changes being made to the form at this time.

Type of Review: Extension of a currently approved collection.

Affected Public: Individuals.

Estimated Number of Respondents: 22,000.

Estimated Time per Respondent: 15 minutes.

Estimated Total Annual Burden Hours: 5,500.

The following paragraph applies to all of 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 as long as 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.

Request for Comments: Comments submitted in response to this notice will be summarized and/or included in the request for OMB approval. All comments will become a matter of public record. Comments are invited on: (a) Whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility; (b) the accuracy of the agency's estimate of the burden of the collection of information; (c) ways to enhance the quality, utility, and clarity of the information to be collected; (d) ways to minimize the burden of the collection of information on respondents, including through the use of automated collection techniques or other forms of information technology; and (e) estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

Approved: January 15, 2020.

Philippe Thomas,

Supervisory Tax Analyst.

[FR Doc. 2020–01172 Filed 1–23–20; 8:45 am]

BILLING CODE 4830–01–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

Proposed Collection; Comment Request on Capitalization of Interest

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 general 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 TD 8584, capitalization of interest.

DATES: Written comments should be received on or before March 24, 2020 to be assured of consideration.

ADDRESSES: Direct all written comments to Dr. Philippe Thomas, Internal Revenue Service, Room 6526, 1111 Constitution Avenue NW, Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Requests for additional information or copies of the information collection should be directed to LaNita Van Dyke (202) 317–6009, or at Internal Revenue Service, Room 6526, 1111 Constitution Avenue NW, Washington, DC 20224, or through the internet, at *Lanita.VanDyke@irs.gov.*

SUPPLEMENTARY INFORMATION:

Title: Capitalization of Interest.

OMB Number: 1545–1265.

Regulation Project Number: TD 8584.

Abstract: Internal Revenue Code section 263A(f) requires taxpayers to estimate the length of the production period and total cost of tangible personal property to determine if Interest capitalization is required. This regulation requires taxpayers to maintain contemporaneous written records of production period estimates, to file a ruling request to segregate activities in applying the interest capitalization rules, and to request the consent of the Commissioner to change their methods of accounting for the capitalization of interest.

Current Actions: There is no change to this existing regulation.

Type of Review: Extension of a currently approved approval.

Affected Public: Individuals or households, and business or other for-profit organizations.

Estimated Number of Respondents: 500,050.

Estimated Time per Respondent: 14 Minutes.

Estimated Total Annual Burden Hours: 116,767 Hours.

The following paragraph applies to all of 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 as long as 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.

Request for Comments: Comments submitted in response to this notice will be summarized and/or included in the request for OMB approval. All comments will become a matter of public record. Comments are invited on: (a) Whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility; (b) the accuracy of the agency's estimate of the burden of the collection of information; (c) ways to enhance the quality, utility, and clarity of the information to be collected; (d) ways to minimize the burden of the collection of information on respondents, including through the use of automated collection techniques or other forms of information technology; and (e) estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

Approved: January 15, 2020.

Philippe Thomas,

Supervisory Tax Analyst.

[FR Doc. 2020–01176 Filed 1–23–20; 8:45 am]

BILLING CODE 4830–01–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

Proposed Collection; Comment Request

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 general 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 the Tip Reporting Alternative Commitment Agreement (TRAC) for Use in the Food and Beverage Industry; the Tip Rate Determination Agreement (TRDA) for industries other than the food and beverage industry and the gaming industry.

DATES: Written comments should be received on or before March 24, 2020 to be assured of consideration.

ADDRESSES: Direct all written comments to Dr. Philippe Thomas, Internal Revenue Service, Room 6526, 1111 Constitution Avenue NW, Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Requests for additional information or copies of the collection tools should be directed to LaNita Van Dyke, Internal Revenue Service, Room 6526, 1111 Constitution Avenue NW, Washington, DC 20224, or through the internet at *LaNita.VanDyke@irs.gov*.

SUPPLEMENTARY INFORMATION: Currently, the IRS is seeking comments concerning the following information collection tools, reporting, and record-keeping requirements:

Title: Tip Reporting Alternative Commitment Agreement (TRAC) for Use in the Food and Beverage Industry.

OMB Number: 1545–1549.

Form Number: N/A.

Abstract: Announcement 2000–22, 2000–19 I.R.B. 987, and Announcement 2001–1, #2001–2 I.R.B. p.277, contain Information required by the Internal Revenue Service in its compliance efforts to assist employers and their employees in understanding and complying with Internal Revenue Code section 6053(a), which requires employees to report all their tips monthly to their employers.

Current Actions: There is no change in the paperwork burden previously approved by OMB.

Type of Review: Extension of a currently approved collection.

Affected Public: Business or other for-profit organizations.

Estimated Number of Respondents: 41,800.

Estimated Time per Respondent: 7 hrs., 6 min.

Estimated Total Annual Burden Hours: 296,916.

The following paragraph applies to all of 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 as long as 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.

Request For Comments: Comments submitted in response to this notice will be summarized and/or included in the request for OMB approval. All comments will become a matter of public record.

Comments are invited on: (a) Whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility; (b) the accuracy of the agency's estimate of the burden of the collection of information; (c) ways to enhance the quality, utility, and clarity of the information to be collected; (d) ways to minimize the burden of the collection of information on respondents, including through the use of automated collection techniques or other forms of information technology; and (e) estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

Approved: January 15, 2020.

Philippe Thomas,

Supervisory Tax Analyst.

[FR Doc. 2020–01175 Filed 1–23–20; 8:45 am]

BILLING CODE 4830–01–P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

Proposed Collection; Comment Request for Form 1098–E

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice and request for comments.

SUMMARY: The Internal Revenue Service (IRS), as part of its continuing effort to reduce paperwork and respondent burden, invites the general public and other Federal agencies to take this opportunity to comment on information collections, as required by the Paperwork Reduction Act of 1995. The IRS is soliciting comments concerning Student Loan Interest Statement.

DATES: Written comments should be received on or before March 24, 2020 to be assured of consideration.

ADDRESSES: Direct all written comments to Dr. Philippe Thomas, Internal Revenue Service, Room 6526, 1111 Constitution Avenue NW, Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Requests for additional information or copies of the form and instructions should be directed to Martha R. Brinson, at (202) 317–5753, or at Internal Revenue Service, Room 6526, 1111 Constitution Avenue NW, Washington, DC 20224, or through the internet at *Martha.R.Brinson@irs.gov*.

SUPPLEMENTARY INFORMATION:

Title: Student Loan Interest Statement.

OMB Number: 1545–1576.

Form Number: 1098–E.

Abstract: Section 6050S(b)(2) of the Internal Revenue Code requires persons (financial institutions, governmental units, etc.) to report $600 or more of interest paid on student loans to the IRS and the students. Form 1098–E is used for this purpose.

Current Actions: There are no changes being made to the form at this time.

Type of Review: Extension of a currently approved collection.

Affected Public: Business or other for-profit organizations, not-for-profit institutions, and State, local or tribal governments.

Estimated Number of Respondents: 22,148,234.

Estimated Time per Respondent: 7 mins.

Estimated Total Annual Burden Hours: 2,657,789.

The following paragraph applies to all of 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 as long as 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.

Request for Comment: Comments submitted in response to this notice will be summarized and/or included in the request for OMB approval. All comments will become a matter of public record. Comments are invited on: (a) Whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility; (b) the accuracy of the agency's estimate of the burden of the collection of information; (c) ways to enhance the quality, utility, and clarity of the information to be collected; (d) ways to minimize the burden of the collection of information on respondents, including through the use of automated collection techniques or other forms of information technology; and (e) estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

Approved: January 14, 2020.

Philippe Thomas,

Supervisory Tax Analyst.

[FR Doc. 2020–01174 Filed 1–23–20; 8:45 am]

BILLING CODE 4830–01–P

DEPARTMENT OF VETERANS AFFAIRS

[OMB Control No. 2900–0020]

Agency Information Collection Activity: Designation of Beneficiary Government Life Insurance and Supplemental Designation of Beneficiary Government Life Insurance

AGENCY: Veterans Benefits Administration, Department of Veterans Affairs.

ACTION: Notice.

SUMMARY: Veterans Benefits Administration, Department of Veterans Affairs (VA), is announcing an opportunity for public comment on the proposed collection of certain information by the agency. Under the Paperwork Reduction Act (PRA) of 1995, Federal agencies are required to publish notice in the **Federal Register** concerning each proposed collection of information, including each proposed revision of a currently approved collection, and allow 60 days for public comment in response to the notice.

DATES: Written comments and recommendations on the proposed collection of information should be received on or before March 24, 2020.

ADDRESSES: Submit written comments on the collection of information through Federal Docket Management System (FDMS) at *www.Regulations.gov* or to Nancy J. Kessinger, Veterans Benefits Administrations (20M33), Department of Veterans Affairs, 810 Vermont Avenue NW, Washington, DC 20420 or email to *nancy.kessinger@va.gov*. Please refer to ''OMB Control No. 2900–0020'' in any correspondence. During the comment period, comments may be viewed online through FDMS.

FOR FURTHER INFORMATION CONTACT: Danny S. Green at (202) 421–1354.

SUPPLEMENTARY INFORMATION: Under the PRA of 1995, Federal agencies must obtain approval from the Office of Management and Budget (OMB) for each collection of information they conduct or sponsor. This request for comment is being made pursuant to Section 3506(c)(2)(A) of the PRA. With respect to the following collection of information, VBA invites comments on: (1) Whether the proposed collection of information is necessary for the proper performance of VBA's functions, including whether the information will have practical utility; (2) the accuracy of VBA's estimate of the burden of the proposed collection of information; (3) ways to enhance the quality, utility, and clarity of the information to be collected; and (4) ways to minimize the

burden of the collection of information on respondents, including through the use of automated collection techniques or the use of other forms of information technology.

Authority: Public Law 104–13; 44 U.S.C. 3501–3521.

Title: Designation of Beneficiary Government Life Insurance VA Form 29–336 and Supplemental Designation of Beneficiary Government Life Insurance VA Form 29–336a.

OMB Control Number: 2900–0020.

Type of Review: Revision of a currently approved collection.

Abstract: These forms are used by the insured to designate beneficiaries and select an optional settlement to be used when the insurance matures by death. The information is required to determine the claimant's eligibility to receive the proceeds. The information on the form is required by law, 38 U.S.C. Sections 1917, 1949 and 1952.

Affected Public: Individuals and households.

Estimated Annual Burden: 13,917 hours.

Estimated Average Burden per Respondent: 10 minutes.

Frequency of Response: On occasion.

Estimated Number of Respondents: 83,500.

By direction of the Secretary.

Danny S. Green,

VA Clearance Officer, Office of Quality, Performance and Risk, Department of Veterans Affairs.

[FR Doc. 2020–01197 Filed 1–23–20; 8:45 am]

BILLING CODE 8320–01–P

FEDERAL REGISTER

Vol. 85 Friday,

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Part II

Department of the Treasury

Office of the Comptroller of the Currency

12 CFR Parts 3 and 32

Federal Reserve System

12 CFR Part 217

Federal Deposit Insurance Corporation

12 CFR Parts 324 and 327

Standardized Approach for Calculating the Exposure Amount of Derivative Contracts; Final Rule

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Parts 3 and 32

[Docket ID OCC–2018–0030]

RIN 1557–AE44

FEDERAL RESERVE SYSTEM

12 CFR Part 217

[Docket No. R–1629]

RIN 7100–AF22

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Parts 324 and 327

RIN 3064–AE80

Standardized Approach for Calculating the Exposure Amount of Derivative Contracts

AGENCY: The Office of the Comptroller of the Currency, Treasury; the Board of Governors of the Federal Reserve System; and the Federal Deposit Insurance Corporation.

ACTION: Final rule.

SUMMARY: The Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation are issuing a final rule to implement a new approach—the standardized approach for counterparty credit risk (SA–CCR)—for calculating the exposure amount of derivative contracts under these agencies' regulatory capital rule. Under the final rule, an advanced approaches banking organization may use SA–CCR or the internal models methodology to calculate its advanced approaches total risk-weighted assets, and must use SA–CCR, instead of the current exposure methodology, to calculate its standardized total risk-weighted assets. A non-advanced approaches banking organization may use the current exposure methodology or SA–CCR to calculate its standardized total risk-weighted assets. The final rule also implements SA–CCR in other aspects of the capital rule. Notably, the final rule requires an advanced approaches banking organization to use SA–CCR to determine the exposure amount of derivative contracts included in the banking organization's total leverage exposure, the denominator of the supplementary leverage ratio. In addition, the final rule incorporates SA–CCR into the cleared transactions framework and makes other amendments, generally with respect to cleared transactions.

DATES: *Effective date:* April 1, 2020. *Mandatory compliance date:* January 1, 2022, for advanced approaches banking organizations.

FOR FURTHER INFORMATION CONTACT:

OCC: Margot Schwadron, Director or Guowei Zhang, Risk Expert, Capital Policy, (202) 649–7106; Kevin Korzeniewski, Counsel, or Ron Shimabukuro, Senior Counsel, Chief Counsel's Office, (202) 649–5490; or, for persons who are deaf or hearing impaired, TTY, (202) 649–5597.

Board: Constance M. Horsley, Deputy Associate Director, (202) 452–5239; David Lynch, Deputy Associate Director, (202) 452–2081; Elizabeth MacDonald, Manager, (202) 475–6316; Michael Pykhtin, Manager, (202) 912–4312; Mark Handzlik, Lead Financial Institutions Policy Analyst, (202) 475–6636; Sara Saab, Senior Financial Institutions Policy Analyst II, (202) 872–4936; or Cecily Boggs, Senior Financial Institutions Policy Analyst II, (202) 530–6209; Division of Supervision and Regulation; or Mark Buresh, Senior Counsel, (202) 452–5270; Gillian Burgess, Senior Counsel (202) 736–5564; or Andrew Hartlage, Counsel, (202) 452–6483; Legal Division, Board of Governors of the Federal Reserve System, 20th and C Streets NW, Washington, DC 20551. For the hearing impaired only, Telecommunication Device for the Deaf, (202) 263–4869.

FDIC: Bobby R. Bean, Associate Director, *bbean@fdic.gov;* Irina Leonova, Senior Policy Analyst, *ileonova@fdic.gov;* Peter Yen, Senior Policy Analyst, *pyen@fdic.gov,* Capital Markets Branch, Division of Risk Management Supervision, (202) 898–6888; or Michael Phillips, Counsel, *mphillips@fdic.gov;* Catherine Wood, Counsel, *cawood@fdic.gov;* Supervision Branch, Legal Division, Federal Deposit Insurance Corporation, 550 17th Street NW, Washington, DC 20429.

SUPPLEMENTARY INFORMATION:

Table of Contents

I. Introduction and Overview of the Proposal

A. Overview of Derivative Contracts

In general, derivative contracts represent agreements between parties either to make or receive payments or to buy or sell an underlying asset on a certain date (or dates) in the future. Parties generally use derivative contracts to mitigate risk, although such transactions may serve other purposes. For example, an interest rate derivative contract allows a party to manage the risk associated with a change in interest rates, while a commodity derivative contract allows a party to fix commodity prices in the future and thereby minimize any exposure attributable to unfavorable movements in those prices.

The value of a derivative contract, and thus a party's exposure to its counterparty, changes over the life of the contract based on movements in the value of the reference rates, assets, indicators or indices underlying the contract (reference exposures). A party with a positive current exposure expects to receive a payment or other beneficial transfer from the counterparty and is considered to be ''in the money.'' A party that is in the money is subject to the risk that the counterparty will default on its obligations and fail to pay the amount owed under the transaction, which is referred to as counterparty credit risk. In contrast, a party with a zero or negative current exposure does not expect to receive a payment or beneficial transfer from the counterparty

and is considered to be ''at the money'' or ''out of the money.'' A party that has no current exposure to counterparty credit risk may have exposure to counterparty credit risk in the future if the derivative contract becomes ''in the money.''

Parties to a derivative contract often exchange collateral to mitigate counterparty credit risk. If a counterparty defaults, the non-defaulting party can sell the collateral to offset its exposure. In the derivatives context, collateral may include variation margin and initial margin (also known as independent collateral). Parties exchange variation margin on a periodic basis during the term of a derivative contract, as typically specified in a variation margin agreement or by regulation.[1] Variation margin offsets changes in the market value of a derivative contract and thereby covers the potential loss arising from the default of a counterparty. Variation margin may not always be sufficient to cover a party's positive exposure (*e.g.,* due to delays in receiving collateral), and thus parties may exchange initial margin. Parties typically exchange initial margin at the outset of the derivative contract and in amounts that are expected to reduce the likelihood of a positive exposure amount for the derivative contract in the event of the counterparty's default, resulting in overcollateralization.

To facilitate the exchange of collateral, parties may enter into variation margin agreements that typically provide for a threshold amount and a minimum transfer amount. The threshold amount is the maximum amount by which the market value of the derivative contract can change before a party must collect or post variation margin (in other words, the threshold amount specifies an acceptable amount of under-collateralization). The minimum transfer amount is the smallest amount of collateral that a party must transfer when it is required to exchange collateral under the variation margin agreement. Parties generally apply a discount (also known as a haircut) to non-cash collateral to account for a potential reduction in the value of the collateral during the period between the last exchange of collateral before the close out of the derivative contract (as in the case of default of the counterparty) and replacement of the contract on the market. This period is known as the margin period of risk (MPOR).

Two parties often will enter into a large number of derivative contracts together. In such cases, the parties may enter into a netting agreement to allow for the offsetting of the derivative contracts under the agreement in the event that one of the parties default and to streamline certain aspects of the transactions, including the exchange of collateral. Netting multiple contracts against each other can substantially reduce the exposure if one of the parties were to default. A netting set reflects those derivative contracts that are subject to the same master netting agreement.[2]

Parties to a derivative contract may also clear their derivative contract through a central counterparty (CCP). The use of central clearing is designed to reduce the risk of engaging in derivative transactions through the multilateral netting of exposures, establishment and enforcement of collateral requirements, and the promotion of market transparency. A party engages with a CCP either as a clearing member or as a clearing member client. A clearing member is a member of, or a direct participant in, a CCP that has authority to enter into transactions with the CCP. A clearing member may act as a financial intermediary with respect to the clearing member client and either take one position with the client and an offsetting position with the CCP (the principal model of clearing) or guarantee the performance of the clearing member client to the CCP (the agency model of clearing). With respect to the latter type of clearing, the clearing member generally is responsible for fulfilling initial and variation margin calls from the CCP on behalf of its client, irrespective of the client's ability to post such collateral.

The capital rule of the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC) (together, the agencies) requires a banking organization to hold regulatory capital based on the exposure amount of its derivative contracts.[3] The capital rule prescribes different approaches for measuring the exposure amount of derivative contracts based on the size and risk profile of a banking organization. All banking organizations are currently required to use the current exposure method (CEM) to determine the exposure amount of a derivative contract for purposes of calculating standardized total risk-weighted assets.[4] Certain large banking organizations may use CEM or the internal models methodology (IMM) to determine the exposure amount of a derivative contract for advanced approaches risk-weighted assets. In contrast to CEM, IMM is an internal-models-based approach that requires supervisory approval. The capital rule also requires certain large banking organizations to meet a supplementary leverage ratio, measured as the banking organization's tier 1 capital relative to its total leverage exposure.[5] The total leverage exposure measure captures both on- and off-balance sheet assets, including the exposure amount of a banking organization's derivative contracts as determined under CEM.[6]

[1] *See, e.g.,* 12 CFR part 45 (OCC); 12 CFR part 237 (Board); and 12 CFR part 349 (FDIC).

[2] ''Qualifying master netting agreement'' is defined in §§ __.2 and __.3(d) of the capital rule. *See* 12 CFR 3.2 and 3.3(d) (OCC); 12 CFR 217.2 and 217.3(d) (Board); and 12 CFR 324.2 and 324.3(d) (FDIC).

[3] 12 CFR part 3 (OCC); 12 CFR part 217 (Board); 12 CFR part 324 (FDIC). The agencies have codified the capital rule in different parts of title 12 of the CFR, but the internal structure of the sections within each agency's rule are identical. All references to sections in the capital rule or the proposal are intended to refer to the corresponding sections in the capital rule of each agency. Banking organizations subject to the agencies' capital rule include national banks, state member banks, insured state nonmember banks, savings associations, and top-tier bank holding companies and savings and loan holding companies domiciled in the United States, but exclude banking organizations subject to the Board's Small Bank Holding Company and Savings and Loan Holding Company Policy Statement (12 CFR part 225, appendix C), and certain savings and loan holding companies that are substantially engaged in insurance underwriting or commercial activities or that are estate trusts, and bank holding companies and savings and loan holding companies that are employee stock ownership plans. The agencies recently adopted a final rule to implement a community bank leverage ratio framework that is applicable, on an optional basis to depository institutions and depository institution holding companies with less than $10 billion in total consolidated assets and that meet certain other criteria. Such banking organizations that opt into the community bank leverage ratio framework will be deemed compliant with the capital rule's generally applicable requirements and are not required to calculate risk-based capital ratios. *See* 84 FR 61776 (November 13, 2019).

[4] CEM and IMM are also applied in other parts of the capital rule. For example, advanced approaches banking organizations must use CEM to determine the exposure amount of derivative contracts included in total leverage exposure, the denominator of the supplementary leverage ratio. In addition, the capital rule incorporates CEM into the cleared transactions framework and makes other amendments, generally with respect to cleared transactions. *See* section II.C. of this **SUPPLEMENTARY INFORMATION** for further discussion.

[5] *See infra* note 23. Banking organizations subject to Category I, Category II, or Category III standards are subject to the supplementary leverage ratio.

[6] *See* 12 CFR 3.10(c)(4) (OCC); 12 CFR 217.10(c)(4) (Board); and 12 CFR 324.10(c)(4) (FDIC).

B. The Basel Committee Standard on SA–CCR

In 2014, the Basel Committee on Banking Supervision released a new approach for calculating the exposure amount of a derivative contract called the standardized approach for counterparty credit risk (SA–CCR) (the Basel Committee standard).[7] Under the Basel Committee standard, a banking organization calculates the exposure amount of its derivative contracts at the netting set level, meaning, those contracts that the standard permits to be netted against each other because they are subject to the same qualifying master netting agreement (QMNA), which must meet certain operational requirements.[8] The exposure amount of a derivative contract not subject to a QMNA is calculated individually, and thus the derivative contract constitutes a netting set of one.

The exposure amount of each netting set is equal to an alpha factor of 1.4 multiplied by the sum of the replacement cost of the netting set and the potential future exposure (PFE) of the netting set:

exposure amount = 1.4 * (replacement cost + PFE)

For netting sets that are not subject to a variation margin agreement, replacement cost reflects a banking organization's current on-balance-sheet credit exposure to its counterparty measured as the maximum of the fair value of the derivative contracts within the netting set less the applicable collateral or zero. For netting sets that are subject to a variation margin agreement, the replacement cost of a netting set reflects the maximum possible unsecured exposure amount of the netting set that would not trigger a variation margin call. For the replacement cost calculation, a banking organization recognizes the collateral amount on a dollar-for-dollar basis, subject to any applicable haircuts.

PFE reflects a measure of potential changes in a banking organization's counterparty exposure for a netting set over a specified period. The PFE calculation allows a banking organization to fully or partially offset derivative contracts within the same netting set that share similar risk factors, based on the concept of hedging sets. Under the Basel Committee standard, derivative contracts form a hedging set if they share the same primary risk factor, and therefore, are within the same asset class—interest rate, exchange rate, credit, equity, or commodities. As derivatives within the same asset class are highly correlated and thus have an economic relationship,[9] under the Basel Committee standard, derivative contracts within the same hedging set may be able to fully or partially offset each other.

To obtain the PFE for each netting set, a banking organization sums the adjusted derivative contract amount of all hedging sets within the netting set using an asset-class specific aggregation formula and multiples that amount by the PFE multiplier. The PFE multiplier decreases exponentially from a value of one as the value of the financial collateral held by the banking organization exceeds the net fair value of the derivative contracts within the netting set, subject to a floor of five percent. Thus, the PFE multiplier accounts for both over-collateralization and the negative fair value amount of the derivative contracts within the netting set.

For purposes of calculating the hedging set amount, a banking organization calculates the adjusted notional amount of a derivative contract and multiplies that amount by a corresponding supervisory factor, maturity factor, and supervisory delta to determine a conservative estimate of effective expected positive exposure (EEPE), assuming zero fair value and zero collateral.[10] The Basel Committee standard uses supervisory factors that reflect the volatilities observed in the derivatives markets during the financial crisis. The supervisory factors reflect the potential variability of the primary risk factor of the derivative contract over a one-year horizon. The maturity factor scales down the default one-year risk horizon of the supervisory factor to the risk horizon appropriate for the derivative contract. For the supervisory delta adjustment, a banking organization applies a positive sign to the derivative contract amount if the derivative contract is long the risk factor and a negative sign if the derivative contract is short the risk factor. A derivative contract is long the primary risk factor if the fair value of the instrument increases when the value of the primary risk factor increases. A derivative contract is short the primary risk factor if the fair value of the instrument decreases when the value of the primary risk factor increases. The assumptions of zero fair value and zero collateral allow for recognition of offsetting and diversification benefits between derivative contracts that share similar risk factors (*i.e.,* long and short derivative contracts within the same hedging set could fully or partially offset one another).

C. Overview of the Proposal

On October 30, 2018, the agencies published a notice of proposed rulemaking (proposal) to implement SA–CCR[11] in order to provide important improvements to risk sensitivity and calibration relative to CEM.[12] In particular, the implementation of SA–CCR is responsive to concerns that CEM has not kept pace with certain market practices that have been adopted, particularly by large banking organizations that are

[7] *See* ''The standardized approach for measuring counterparty credit risk exposures,'' Basel Committee on Banking Supervision (March 2014, rev. April 2014), *https://www.bis.org/publ/bcbs279.pdf.*

[8] *See e.g. supra* note 2.

[9] Derivative contracts within the same asset class share the same primary risk factor, which implies a closer alignment between all of the underlying risk factors and a higher correlation factor. For a directional portfolio, greater alignment between the risk factors would result in a more concentrated risk, leading to a higher exposure amount. For a balanced portfolio, greater alignment between the risk factors would result in more offsetting of risk, leading to a lower exposure amount.

[10] Under IMM, an advanced approaches banking organization uses its own internal models to determine the exposure amount of its derivative contracts. The exposure amount under IMM is calculated as the product of the EEPE for a netting set, which is the time-weighted average of the effective expected exposures (EE) profile over a one-year horizon, and an alpha factor. For the purposes of regulatory capital calculations, the resulting exposure amount is treated as a loan equivalent exposure, which is the amount effectively loaned by the banking organization to the counterparty under the derivative contract. A banking organization arrives at the exposure amount by first determining the EE profile for each netting set. In general, EE profile is determined by computing exposure distributions over a set of future dates using Monte Carlo simulations, and the expectation of exposure at each date is the simple average of all positive Monte Carlo simulated exposures for each date. The expiration of short-term trades can cause the EE profile to decrease, even though a banking organization is likely to replace short-term trades with new trades (*i.e.,* rollover). To account for rollover, a banking organization converts the EE profile for each netting set into an effective EE profile by applying a nondecreasing constraint to the corresponding EE profile over the first year. The nondecreasing constraint prevents the effective EE profile from declining with time by replacing the EE amount at a given future date with the maximum of the EE amounts across this and all prior simulation dates. The EEPE for a netting set is the time-weighted average of the effective EE profile over a one-year horizon. EEPE would be the appropriate loan equivalent exposure in a credit risk capital calculation if the following assumptions were true: There is no concentration risk, systematic market risk, and wrong-way risk (*i.e.,* the size of an exposure is positively correlated with the counterparty's probability of default). However, these conditions nearly never exist with respect to a derivative contract. Thus, to account for these risks, IMM requires a banking organization to multiply EEPE by 1.4.

[11] *See* 83 FR 64660 (December 17, 2018).

[12] The **SUPPLEMENTARY INFORMATION** set forth in the proposal includes a description of CEM. *See id.* at 64664.

active in the derivatives market.[13] The agencies also proposed SA–CCR to provide a method that is less complex and involves less discretion than IMM, which allows banking organizations to use their own internal models to determine the exposure amount of their derivative contracts.[14] Although IMM is more risk-sensitive than CEM, IMM is significantly more complex and requires prior supervisory approval.[15] The agencies based the core elements of the proposal on the Basel Committee SA–CCR standard.[16]

The agencies received approximately 58 comments on the proposal from interested parties, including banking organizations, trade groups, members of Congress, and advocacy organizations. Banking organizations and trade groups offered widespread support for the implementation of SA–CCR although they also suggested modifications to various components of the proposal largely to address concerns regarding its calibration. Commenters who supported the proposal also expressed concerns with its proposed implementation schedule and potential interaction with certain other U.S. laws and regulations. Other commenters, including some commercial entities that use derivative contracts to manage risks arising from their business operations (commercial end-users), opposed the proposal or elements of the proposal. Specifically, these commenters expressed concern that the proposal could indirectly increase the fees they pay to enter into derivative transactions to manage commercial risks in order to help offset the regulatory capital costs of such derivative contracts for banking organizations. The commenters asserted that any such effect would be in contravention of separate public policy objectives designed to support the ability of commercial end-users to engage in derivative transactions for risk-management purposes.[17] By contrast, other commenters that opposed the proposal expressed concerns that it could reduce capital held against derivative contracts.

As discussed in detail below, the agencies are finalizing the proposal with some modifications to address certain concerns raised by commenters. In particular, the final rule removes the alpha factor of 1.4 from the exposure amount calculation for derivative contracts with commercial end-user counterparties. This change will reduce the exposure amount of such derivative contracts by roughly 29 percent, in comparison to similar derivative contracts with a counterparty that is not a commercial end-user.

Commenters also raised concerns regarding the proposed netting treatment for settled-to-market derivative contracts.[18] The final rule allows a banking organization to elect, at the netting set level, to treat all such contracts within the same netting set as collateralized-to-market, thus allowing netting of settled-to-market derivative contracts with collateralized-to-market derivative contracts within the same netting set. In order to make the election, a banking organization must treat the settled-to-market derivative contracts as collateralized-to-market derivative contracts for all purposes under the SA–CCR calculation, including by applying the MPOR treatment applicable to collateralized-to-market derivative transactions.[19]

Commenters also criticized the proposal's approach to the recognition of collateral provided to support a derivative contract for purposes of the supplementary leverage ratio. In response to commenters' concerns, and consistent with changes to the Basel Committee leverage ratio standard that occurred during the comment period, the final rule allows for greater recognition of collateral in the calculation of total leverage exposure relating to client-cleared derivative contracts.[20]

II. Overview of the Final Rule

Figure 1 below provides a high-level overview of SA–CCR under the Final Rule.

FIGURE 1—OVERVIEW OF SA–CCR UNDER THE FINAL RULE

Purpose	• The final rule implements the standardized approach for counterparty-credit risk, in a manner consistent with the core elements of the Basel Committee standard. • A banking organization uses SA–CCR (either on a mandatory or an optional basis) to determine the capital requirements for its derivative contracts.
SA–CCR Mechanics	Under the final rule, a banking organization using SA–CCR determines the exposure amount for a netting set of derivative contracts as follows: *Exposure amount = alpha factor × (replacement cost + potential future exposure)*
Key Elements of the SA–CCR Formula	
Replacement Cost	The *replacement cost* of a derivative contract reflects the amount that it would cost a banking organization to replace the derivative contract if the counterparty were to immediately default. Under SA–CCR, replacement cost is based on the fair value of a derivative contract under U.S. GAAP, with adjustments to reflect the exchange of collateral for margined transactions.

[13] The agencies initially adopted CEM in 1989. *See* 54 FR 4168 (January 27, 1989) (Board and OCC); 54 FR 11500 (March 21, 1989) (FDIC). The last significant update to CEM was in 1995. *See* 60 FR 46170 (September 5, 1995).

[14] The **SUPPLEMENTARY INFORMATION** set forth in the proposal includes a description of IMM. *See* 83 FR at 64665.

[15] *See* 12 CFR 3.122 (OCC); 12 CFR 217.122 (Board); and 12 CFR 324.122 (FDIC).

[16] *See supra* note 7.

[17] *See, e.g.,* The Commodity Exchange Act and the Securities Exchange Act of 1934, as amended by sections 731 and 764, respectively, of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376, 1703–12, 1784–96 (2010), require the agencies to, in establishing capital and margin requirements for non-cleared swaps, provide an exemption for certain types of counterparties (*e.g.,* counterparties that are not financial entities and are using swaps to hedge or mitigate commercial risks) from the mandatory clearing requirement. *See* 7 U.S.C. 6s(e)(3)(C); 15 U.S.C. 78o–10(e)(3)(C); *see also* 12 CFR part 45 (OCC); 12 CFR part 237 (Board); and 12 CFR part 349 (FDIC) (swap margin rule).

[18] Settled-to-market derivatives contracts are those entered into between a central counterparty and a banking organization, under which the central counterparty's rulebook considers daily payments of variation margin as a settlement payment for the exposure that arises from marking the derivative contract to fair value. These payments are similar to traditional exchanges of variation margin, except that the receiving party takes title to the payment from the transferring party rather than holding the assets as collateral, and thus effectively settles the contract.

[19] Banking organizations that make such an election would apply the maturity factor applicable to margined transactions under the final rule. *See also* section III.D.4. of this **SUPPLEMENTARY INFORMATION.**

[20] *See* ''Leverage ratio treatment of client cleared derivatives,'' Basel Committee on Banking Supervision, June 2019, *https://www.bis.org/bcbs/publ/d467.pdf. See also* section V of this **SUPPLEMENTARY INFORMATION.**

[21] A counterparty's maximum exposure to a netting set subject to a varation margin agreement equals the threshold amount plus minimum transfer amount.

[22] Net independent collateral amount (NICA), as described in section III. B of this **SUPPLEMENTARY INFORMATION.**

FIGURE 1—OVERVIEW OF SA–CCR UNDER THE FINAL RULE—Continued

	For un-margined transactions: RC = max{V − C; 0}, where replacement cost (RC) equals the maximum of the fair value of the derivative contract (after excluding any valuation adjustments) (V) less the net amount of any collateral (C) received from the counterparty and zero. *For margined transactions: RC = max{V − C; TH + MTA − NICA; 0}, where* replacement cost equals the maximum of (1) the sum of the fair values (after excluding any valuation adjustments) of the derivative contracts within the netting set less the net amount of collateral applicable to such derivative contracts; (2) the counterparty's maximum exposure to the netting set under the variation margin agreement (TH + MTA),[21] less the net collateral amount applicable to such derivative contracts (NICA[22]); or (3) zero.
Potential Future Exposure	The *potential future exposure* of a derivative contract reflects the possibility of changes in the value of the derivative contract over a specified period. Under SA–CCR, the potential future exposure amount is based on the notional amount and maturity of the derivative contract, volatilities observed during the financial crisis for different classes of derivative contracts (*i.e.,* interest rate, exchange rate, credit, equity, and commodity), the exchange of collateral, and full or partial offsetting among derivative contracts that share an economic relationship. *PFE = multiplier × aggregated amount, where* the PFE multiplier decreases exponentially from a value of 1 to recognize the amount of any excess collateral and the negative fair values of derivative contracts within the netting set. The aggregated amount accounts for full or partial offsetting among derivative contracts within a hedging set that share an economic relationship, as well as observed volatilities in the reference asset, the maturity of the derivative contract, and the correlation between the derivative contract and the reference exposure (*i.e.,* long or short).
Alpha Factor	The *alpha factor* is a measure of conservatism that is designed to address risks that are not directly captured under SA–CCR, and to ensure that the capital requirement for a derivative contract under SA–CCR is generally not lower than the one produced under IMM. For most derivative contracts, the alpha factor equals 1.4; however, no alpha factor applies to derivative contracts with commercial end-user counterparties.

A. Scope and Application of the Final Rule

1. Scoping Criteria

The capital rule provides two methodologies for determining total risk-weighted assets: The standardized approach, which applies to all banking organizations, and the advanced approaches, which apply only to ''advanced approaches banking organizations,'' (or banking organizations subject to Category I or Category II standards)[23] as defined under the capital rule.[24] Both the standardized approach and the advanced approaches require a banking organization to determine the exposure amount for derivative contracts transacted through a central counterparty (*i.e.,* cleared transactions) and derivative contracts that are not cleared transactions (*i.e.,* noncleared derivative contracts, otherwise known as over-the-counter derivative contracts).[25] As part of the cleared transactions framework, a banking organization also must determine the risk-weighted asset amounts of any contributions or commitments it may have to mutualized loss sharing agreements with central counterparties (*i.e.,* default fund contributions).[26]

The proposal would have replaced CEM with SA–CCR in the capital rule for advanced approaches banking organizations. Thus, for purposes of the advanced approaches, an advanced approaches banking organization would have been required to use either SA–CCR or IMM to calculate the exposure amount of its noncleared and cleared derivative contracts and to use SA–CCR to determine the risk-weighted asset amount of its default fund contributions. For purposes of the standardized approach, an advanced approaches banking organization would have been required to use SA–CCR (instead of CEM) to calculate the exposure amount of its noncleared and cleared derivative contracts and to determine the risk-weighted asset amount of its default fund contributions. The proposal also would have revised the total leverage exposure measure of the supplementary leverage ratio by replacing CEM with a modified version of SA–CCR.

Banking organizations that are not advanced approaches banking organizations[27] would have had to choose either CEM or SA–CCR to calculate the exposure amount of

[23] The agencies recently adopted a final rule to revise the criteria for determining the applicability of regulatory capital and liquidity requirements for large U.S. and foreign banking organizations (tailoring final rule). Under the tailoring final rule, an advanced approaches banking organization means a banking organization subject to Category I or Category II standards. Category I standards apply to U.S. global systemically important bank holding companies (U.S. GSIBs) and their depository institution subsidiaries, as identified based on the methodology in the Board's U.S. GSIB surcharge rule. Category II standards apply to banking organizations that are not subject to Category I standards and that have $700 billion or more in total consolidated assets or $75 billion or more in cross-jurisdictional activity and to their depository institution subsidiaries. Category III standards apply to banking organizations that are not subject to Category I or II standards and that have $250 billion or more in total consolidated assets or $75 billion or more in any of nonbank assets, weighted short-term wholesale funding, or off-balance-sheet exposure. Category III standards also apply to depository institution subsidiaries of any holding company subject to Category III standards. Category IV standards apply to banking organizations with total consolidated assets of $100 billion or more, and their depositiory institution subsidiaries, that do not meet any of the criteria for a higher category of standards. *See* ''Changes to Applicabiltiy Thresholds for Regulatory Capital and Liquidity Requirements,'' 84 FR 59230 (November 1, 2019).

[24] Standardized total risk-weighted assets serve as a floor for advanced approaches total risk-weighted assets. Advanced approaches banking organizations must therefore calculate total risk-weighted assets under both approaches and use the result that produces a more binding capital requirement. Total risk-weighted assets are the denominator of the risk-based capital ratios; regulatory capital is the numerator.

[25] Under the standardized approach, the risk-weighted asset amount for a derivative contract currently is the product of the exposure amount of the derivative contract calculated under CEM and the risk weight for the type of counterparty as set forth in the capital rule. *See generally* 12 CFR 3.35 (OCC); 12 CFR 217.35 (Board); and 12 CFR 324.35 (FDIC). Under the advanced approaches, the risk-weighted asset amount for a derivative contract currently is derived using either CEM or the internal models methodology, which multiplies the exposure amount (or exposure at default amount) of the derivative contract by a models-based formula that uses risk parameters determined by a banking organization's internal methodologies. *See generally* 12 CFR 3.132 (OCC); 12 CFR 217.132 (Board); and 12 CFR 324.132 (FDIC).

[26] *See* 12 CFR 3.35(d) and 3.133(d) (OCC); 12 CFR 217.35(d) and 217.133(d) (Board); and 12 CFR 324.35(d) and 324.133(d) (FDIC).

[27] Under this final rule, banking organizations that are not advanced approaches banking organizations (*i.e.,* banking organizations subject to Category III or Category IV standards) are permitted to choose either CEM or SA–CCR for purposes of determining standardized risk-weighted assets. *See supra* note 23.

noncleared and cleared derivative contracts and to determine the risk-weighted asset amount of default fund contributions under the standardized approach.

Some commenters raised concerns with the proposal's use of multiple methods—CEM, SA–CCR, and IMM—to determine the exposure amount of derivative contracts. Specifically, commenters stated that including multiple approaches for calculating the exposure amount of derivative contracts in the capital rule creates regulatory burden and increases the potential for competitive inequalities. The commenters asked the agencies to adopt one methodology that all banking organizations would be required to use to determine the exposure amount of derivative contracts or, short of that, to allow all banking organizations (*i.e.,* both advanced approaches and non-advanced approaches banking organizations) to elect to use any approach—CEM, SA–CCR, or IMM—to determine the exposure amount for all derivative contracts, as long as the approach is permitted or required under any of the agencies' rules to calculate the exposure amount of derivative contracts. Other commenters, however, supported allowing advanced approaches banking organizations the option to use IMM for noncleared and cleared derivative contracts to facilitate closer alignment with internal risk-management practices of banking organizations because, according to the commenters, SA–CCR may not adapt dynamically to changes in market conditions.

Some commenters also requested changes to the applicability criteria for a particular methodology under the capital rule. Specifically, commenters asked the agencies to allow advanced approaches banking organizations to use IMM to calculate the exposure amount of derivative contracts under the standardized approach. Some of these commenters also asked the agencies to tailor the application of SA–CCR based on the composition of a banking organization's derivatives portfolio, rather than solely based on whether the banking organization meets the definition of an advanced approaches banking organization.

Limiting all banking organizations to a single methodology would be inconsistent with the agencies' efforts to tailor the application of the capital rule to the risk profiles of banking organizations.[28] In particular, while SA–CCR offers several improvements to the regulatory capital treatment for derivative contracts relative to CEM, it also requires internal systems enhancements and other operational modifications that could be particularly burdensome for smaller, less complex banking organizations. Moreover, allowing banking organizations to use IMM for purposes of determining standardized total risk-weighted assets would be inconsistent with an intended purpose of the standardized approach, which is to serve as a floor to model-derived outcomes under the advanced approaches.

The proposal to require advanced approaches banking organizations to use either SA–CCR or IMM to determine the exposure amount of their noncleared and cleared derivative contracts under the advanced approaches provides meaningful flexibility, promotes consistency for banking organizations that have substantial operations in multiple jurisdictions, and facilitates regulatory reporting and the supervisory assessment of an advanced approaches banking organization's capital management program. An approach that tailors the applicability of SA–CCR based solely on the composition of a banking organization's derivatives portfolio, as suggested by commenters, would be inconsistent with these objectives.

Consistent with the proposal, the final rule includes CEM, SA–CCR, and IMM as methodologies for banking organizations to use to determine the exposure amount of derivative contracts and prescribes which approach a banking organization must use based on the category of standards applicable to the banking organization.[29] As under the capital rule currently, the final rule does not permit advanced approaches banking organizations to use IMM to calculate the exposure amount of derivative contracts under the standardized approach.

Under the final rule and as reflected further in Table 1, an advanced approaches banking organization generally may use SA–CCR or IMM for purposes of determining advanced approaches total risk-weighted assets,[30] and must use SA–CCR for purposes of determining standardized total risk-weighted assets as well as the supplementary leverage ratio. A non-advanced approaches banking organization may continue to use CEM or elect to use SA–CCR for purposes of the standardized approach and supplementary leverage ratio (as applicable).[31] Where a banking organization has the option to choose among the approaches applicable to such banking organization under the capital rule, it must use the same approach for all purposes. As discussed in section II.C of this **SUPPLEMENTARY INFORMATION**, the agencies will continue to consider the extent to which SA–CCR should be incorporated into areas of the regulatory framework that are not addressed under this final rule in the context of separate rulemakings.

TABLE 1—SCOPE AND APPLICABILITY OF THE FINAL RULE

	Noncleared derivative contracts	Cleared transactions framework	Default fund contribution
Advanced approaches banking organizations, advanced approaches total risk-weighted assets.	Option to use SA–CCR or IMM	Must use the same approach selected for purposes of noncleared derivative contracts.	Must use SA–CCR.
Advanced approaches banking organizations, total risk-weighted assets under the standardized approach.	Must use SA–CCR	Must use SA–CCR	Must use SA–CCR.

[28] *See id.*

[29] *Id.*

[30] As reflected in Table 1, an advanced approaches banking organization must use SA–CCR to determine its exposure to default fund contributions under the advanced approaches.

[31] The tailoring final rule revised the scope of applicability of the supplementary leverage ratio, such that it applies to U.S. and foreign banking organizations subject to Category I, Category II, or Category III standards. *See supra* notes 5 and 23. The use of SA–CCR for purposes of the supplementary leverage ratio is discussed in greater detail in section V of this **SUPPLEMENTARY INFORMATION.**

TABLE 1—SCOPE AND APPLICABILITY OF THE FINAL RULE—Continued

	Noncleared derivative contracts	Cleared transactions framework	Default fund contribution
Non-advanced approaches banking organizations, total risk-weighted assets under the standardized approach.	Option to use CEM or SA–CCR ...	Must use the same approach selected for purposes of non-cleared derivative contracts.	Must use the same approach selected for purposes of non-cleared derivative contracts.
Advanced approaches banking organizations, supplementary leverage ratio.	Must use SA–CCR to determine the exposure amount of derivative contracts for total leverage exposure.		
Banking organizations subject to Category III capital standards, supplementary leverage ratio.	Option to use CEM or SA–CCR to determine the exposure amount of derivative contracts for total leverage exposure. A banking organization must use the same approach, CEM or SA–CCR, for purposes of both standardized total risk-weighted assets and the supplementary leverage ratio.		

2. Applicability to Certain Derivative Contracts

The proposal would have required a banking organization to calculate the exposure amount for all derivative contracts to which the banking organization has an exposure. Commenters raised concerns regarding the treatment of certain derivative contracts under the proposal. Specifically, several commenters asked the agencies to exclude from banking organizations' regulatory capital calculations derivative contracts with commercial end-user counterparties, while other commenters suggested that the final rule should exclude physically settled forward contracts. Other commenters requested that the agencies allow advanced approaches banking organizations to continue to use CEM to calculate the exposure amount of their derivative contracts with commercial end-user counterparties.

Excluding certain derivative contracts from the application of the capital rule, as suggested by commenters, would exclude a material source of credit risk from a banking organization's regulatory capital requirements. Moreover, requiring a banking organization to use the same approach for its entire derivative portfolio when calculating either its standardized or advanced approaches total risk-weighted assets promotes consistency in the regulatory capital treatment of derivative contracts, and facilitates the supervisory assessment of a banking organization's capital management program.[32] Therefore, consistent with the proposal, the final rule does not provide an exclusion for specific types of derivative contracts nor does it permit the use of different methodologies based on the type of derivative contract or counterparty.

3. Application to New Derivative Contracts and Immaterial Exposures

Under the current capital rule, an advanced approaches banking organization can use CEM for a period of 180 days for material portfolios of new derivative contracts and without time limitations for immaterial portfolios of new derivative contracts to satisfy the requirement that the total exposure amount calculated under IMM must be at least equal to the greater of the expected positive exposure amount under either the modelled stress scenario or the modelled un-stressed scenario multiplied by 1.4.[33] Some commenters noted that the proposal did not replace CEM with SA–CCR for these purposes and suggested providing advanced approaches banking organizations the option to consider SA–CCR, in place of CEM, to satisfy the same conservatism requirements. The agencies recognize that an advanced approaches banking organization may need time to develop systems and collect sufficient data to appropriately model the exposure amount for material portfolios of new derivatives under IMM. Therefore, under the final rule, an advanced approaches banking organization that elects to use IMM to calculate the exposure amount of its derivative contracts under the advanced approaches may use SA–CCR for a period of 180 days for material portfolios of new derivative contracts and for immaterial portfolios of such contracts without time limitations.[34] This treatment is consistent with the current capital rule.

B. Effective Date and Compliance Deadline

The proposal included a transition period, until July 1, 2020, by which time all advanced approaches banking organizations would have been required to implement SA–CCR; however, both advanced approaches and non-advanced approaches banking organizations would have been able to adopt SA–CCR as of the effective date of the final rule.

Several commenters asked the agencies to delay adoption of the final rule. Specifically, some of these commenters asked that the agencies delay adoption until completion of a comprehensive study on the effect of the proposal, including the effect of SA–CCR on commercial end-user counterparties. Other commenters also asked the agencies to delay adoption of SA–CCR, or alternatively, the mandatory compliance date, in order to align its implementation with potential forthcoming changes to the U.S. regulatory capital framework that might be implemented through separate rulemakings.[35] These commenters expressed concern that the interaction between SA–CCR and related aspects of the U.S. regulatory capital framework could result in increased capital requirements for banking organizations that are not reflective of underlying risk. In addition, some of these commenters specifically urged the agencies to pair the adoption of SA–CCR with the implementation of the Basel Committee's revised comprehensive approach for securities financing transactions.[36] These commenters argued that banking organizations could use derivative transactions as a substitute for securities financing

[32] The final rule does not revise the FR Y–15 report to reflect SA–CCR, as discussed further in section II.C of this **SUPPLEMENTARY INFORMATION**.

[33] *See* 12 CFR 3.132(d)(10) (OCC); 12 CFR 217.132(d)(10) (Board); and 12 CFR 324.132(d)(10) (FDIC).

[34] Similar to CEM, as a standardized framework, SA–CCR is designed to produce sufficiently conservative exposure amounts, compared to those calculated under IMM, that satisfy the conservatism requirement under § __.132(d)(10)(i). The final rule also makes similar conforming changes elsewhere in § __.132(d) and (e) to incorporate SA–CCR in the place of CEM.

[35] For example, the commenters noted potential changes to the regulatory framework as a result of the Basel Committee's December 2017 release. *See* ''Basel III: Finalising post-crisis reforms,'' Basel Committee on Banking Supervision, December 2017, *https://www.bis.org/bcbs/publ/d424.pdf.*

[36] *Id.*

transactions and, therefore, adopting SA–CCR without implementing the revised comprehensive approach for securities financing transactions could lead to further concentration in the derivatives market and decreases in the liquidity of the securities financing transactions market. Alternatively, other commenters urged the agencies to set the mandatory compliance date as of January 2022 to align with other anticipated changes to the U.S. regulatory capital framework, and supported allowing banking organizations to adopt SA–CCR or portions of SA–CCR as early as the issuance of the final rule.

Additionally, several commenters asked the agencies to align U.S. implementation of SA–CCR with its implementation schedule in other jurisdictions, so as not to disadvantage U.S. banking organizations and their U.S. clients relative to foreign firms. These commenters argued that a mandatory compliance date of January 2022 would ensure internationally consistent implementation of SA–CCR across jurisdictions and allow banking organizations ample time to implement SA–CCR for purposes of both existing regulatory capital requirements and any anticipated forthcoming changes to the U.S. regulatory capital framework. Other commenters suggested extending the mandatory compliance date to January 2022 for banking organizations that use CEM currently and do not have extensive derivatives portfolios.

Conversely, several commenters asked the agencies to adopt the proposal as a final rule without delay and to retain the proposed July 2020 mandatory compliance date. Of these, some commenters suggested that the effective date for implementation of SA–CCR should be earlier than July 2020 for the entirety or portions of the SA–CCR rule. These commenters also asked the agencies to provide interim relief through a reduction in risk weights for certain financial products, such as options, if the implementation of SA–CCR is delayed.

The agencies anticipate that the final rule will not materially change the amount of capital in the banking system, and that any change in a particular banking organization's capital requirements, through either an increase or a decrease in regulatory capital, would reflect the enhanced risk sensitivity of SA–CCR relative to CEM, as well as market conditions.[37] In addition, SA–CCR provides important improvements to risk sensitivity and calibration relative to CEM and is responsive to concerns that CEM has not kept pace with market practices used by large banking organizations that are active in the derivatives market. Therefore, the agencies are not delaying adoption of the final rule. The agencies intend to monitor the implementation of SA–CCR as part of their ongoing assessment of the effectiveness of the overall U.S. regulatory capital framework to determine whether there are opportunities to reduce burden and improve its efficiency in a manner that continues to support the safety and soundness of banking organizations and U.S. financial stability.

However, the agencies recognize that the implementation of SA–CCR requires advanced approaches banking organizations to augment existing systems or develop new ones, as all such banking organizations must adopt SA–CCR for the standardized approach even if they plan to continue using IMM under the advanced approaches. Accordingly, the final rule includes a mandatory compliance date for advanced approaches banking organizations of January 1, 2022, to permit these banking organizations additional time to adjust their systems, as needed, to implement SA–CCR. The final rule also includes an effective date shortly after publication that permits any banking organization to elect to adopt SA–CCR prior to the mandatory compliance date. For this reason, the agencies do not believe that it is necessary to provide any interim adjustments to the current framework.

Advanced approaches and non-advanced approaches banking organizations that adopt SA–CCR prior to the mandatory compliance date must notify their appropriate Federal supervisor. Non-advanced approaches banking organizations that adopt SA–CCR after the mandatory compliance date also must notify their appropriate Federal supervisor. As the final rule does not allow banking organizations to use SA–CCR for a material subset of derivative exposures under either the standardized or advanced approaches, a banking organization cannot early adopt SA–CCR on a partial basis.[38] In addition, the technical revisions in the final rule, as described in section VI of this **SUPPLEMENTARY INFORMATION**, are effective as of the effective date of the final rule.

C. Final Rule's Interaction With Agency Requirements and Other Proposals

The implementation of SA–CCR affects other parts of the regulatory framework. Commenters asked that the agencies clarify the interaction between SA–CCR and other existing aspects of the framework that would be affected by the adoption of SA–CCR, including the FDIC's deposit insurance assessment methodology, the Banking Organization Systemic Risk Report (FR Y–15), the stress test projections in the Board's Comprehensive Capital Analysis and Review (CCAR) process, and the OCC's lending limits. Commenters also asked that the agencies clarify the interaction between SA–CCR and potential future revisions to the U.S. regulatory capital framework, including potential implementation of the December 2017 Basel Committee release, *Basel III: Finalising post-crisis reforms* (Basel III finalization standard),[39] and the Board's stress capital buffer proposal.

1. FDIC Deposit Insurance Assessment Methodology

Some commenters noted that the adoption of SA–CCR could affect the FDIC assessment methodology. In response to this comment, the FDIC notes that a lack of historical data on derivative exposure using SA–CCR makes the FDIC unable to incorporate the SA–CCR methodology into the deposit insurance assessment pricing methodology for highly complex institutions[40] upon the effective date of this rule. The FDIC plans to review derivative exposure data reported using SA–CCR, and then consider options for addressing the use of SA–CCR in the deposit insurance assessment system. In the meantime, for purposes of reporting counterparty exposures on Schedule RC–O, memorandum items 14 and 15,

[37] The estimated impact of the final rule is described in greater detail in section VII of this **SUPPLEMENTARY INFORMATION**.

[38] The final rule allows banking organizations that elect to use SA–CCR to continue to use method 1 or method 2 under CEM to calculate the risk-weighted asset amount for default fund contributions until January 1, 2022. *See* section IV.B. of this **SUPPLEMENTARY INFORMATION** for a more detailed discussion on the treatment of default fund contributions under the final rule.

[39] *See supra* note 35.

[40] A ''highly complex institution'' is defined as: (1) An insured depository institution (IDI) (excluding a credit card bank) that has had $50 billion or more in total assets for at least four consecutive quarters that either is controlled by a U.S. parent holding company that has had $500 billion or more in total assets for four consecutive quarters, or is controlled by one or more intermediate U.S. parent holding companies that are controlled by a U.S. holding company that has had $500 billion or more in assets for four consecutive quarters; or (2) a processing bank or trust company. A processing bank or trust company is an IDI whose last three years' non-lending interest income, fiduciary revenues, and investment banking fees, combined, exceed 50 percent of total revenues (and its last three years fiduciary revenues are non-zero), whose total fiduciary assets total $500 billion or more and whose total assets for at least four consecutive quarters have been $10 billion or more. *See* 12 CFR 327.8(g) and (s).

highly complex institutions must continue to calculate derivative exposures using CEM (as set forth in 12 CFR 324.34(b) under the final rule), but without any reduction for collateral other than cash collateral that is all or part of variation margin and that satisfies the requirements of 12 CFR 324.10(c)(4)(ii)(C)(1)(ii) and (iii) and 324.10(c)(4)(ii)(C)(3)–(7) (as amended under the final rule). Similarly, highly complex institutions must continue to report the exposure amount associated with securities financing transactions, including cleared transactions that are securities financing transactions, using the standardized approach set forth in 12 CFR 324.37(b) or (c) (as amended under the final rule). The FDIC is making technical amendments to its assessment regulations to update cross-references to CEM and cash collateral requirements in 12 CFR part 324.

2. The Banking Organization Systemic Risk Report (FR Y–15)

Some commenters noted that the adoption of SA–CCR could affect reporting on the Banking Organization Systemic Risk Report (FR Y–15), which must be filed by U.S. bank holding companies and certain savings and loan holding companies with $100 billion or more in total consolidated assets and foreign banking organizations with $100 billion or more in combined U.S. assets.[41] In particular, these commenters requested that the agencies exclude the alpha factor from the exposure amount calculation under SA–CCR for purposes of the interconnectedness indicator under the FR Y–15. The Board expects to address the use of SA–CCR for purposes of the FR Y–15 in a separate process. Until such time, banking organizations that must report the FR Y–15 should continue to use CEM to determine the potential future exposure of their derivative contracts for purposes of completing line 11(b) of Schedule B, consistent with the current instructions to the form.

3. Stress Test Projections in CCAR

Commenters asked the Board to clarify how the implementation of SA–CCR will interact with the supervisory stress-testing program. In particular, some commenters asked the Board to clarify when a banking organization must incorporate SA–CCR into any stress test projections made for purposes of the Comprehensive Capital Analysis and Review (CCAR) exercise relative to the timing of its implementation for regulatory capital purposes. Consistent with past capital planning practice, the Board expects to make revisions so as to not require a banking organization to use SA–CCR for purposes of the CCAR exercise prior to adopting SA–CCR to calculate its risk-based and supplementary leverage capital requirements (as applicable) under the capital rule. To promote comparability of stress test results across banking organizations, for the 2020 stress test cycle all banking organizations would continue to use CEM for the CCAR exercise. However, a banking organization that has elected to adopt SA–CCR in 2020 would be required to use SA–CCR for the CCAR exercise beginning with the 2021 stress test cycle, and those who adopt in 2021 must use SA–CCR for the CCAR exercise beginning with 2022 stress test cycle.[42] Finally, a banking organization that does not adopt SA–CCR until the mandatory compliance date in 2022 would not be required to use SA–CCR for the CCAR exercise until the 2023 and all subsequent stress test cycles. Prior to the time of adoption in stress testing, the Board expects to update the Form FR Y–14 to implement these changes and to provide any necessary information on how to incorporate SA–CCR into a banking organization's stress test results.[43]

Commenters also suggested aligning certain aspects of the CCAR exercise with SA–CCR. Specifically, commenters asked the Board to revise the CCAR methodology for estimating losses under the largest single counterparty default scenario to distinguish between margined and unmargined counterparty relationships in a manner consistent with SA–CCR. The methodologies for measuring counterparty exposure under SA–CCR and supervisory stress testing are designed to capture different types of risks. In particular, the largest single counterparty default exercise seeks to ensure that a banking organization can absorb losses associated with the default of any counterparty, in addition to losses associated with adverse economic conditions, in an environment of economic uncertainty. The Board regularly reviews its stress testing models, and will continue to evaluate the appropriateness of assumptions related to the largest counterparty default component.

4. Swap Margin Rule

Commenters noted that the agencies' margin and capital requirements for covered swap entities rule (swap margin rule) uses a methodology similar to CEM to quantify initial margin requirements for non-cleared swaps and non-cleared security-based swaps.[44] This final rule does not affect the swap margin rule or the calculation of appropriate margin and, therefore, the implementation of SA–CCR will not require a banking organization to change the way it complies with those requirements.

5. OCC Lending Limits

In the proposal, the OCC proposed to revise its lending limit rule at 12 CFR part 32, to update cross-references to CEM in the standardized approach and to permit SA–CCR as an option for calculation of exposures under lending limits. Commenters generally supported the OCC's proposal to align measurement of counterparty credit risk across regulatory requirements. The OCC agrees with the commenters and therefore the final rule adopts revisions to the lending limits rule as proposed.

6. Single Counterparty Credit Limit (SCCL)

As noted in the proposal, the Board's single counterparty credit limit (SCCL) rule authorizes a banking organization subject to the SCCL to use any methodology that such a banking organization is authorized to use under the capital rule to determine the credit exposure associated with a derivative contract for purposes of the SCCL rule.[45] Thus, as under the proposal, as of the mandatory compliance date for SA–CCR, to determine the credit exposure associated with a derivative contract under the SCCL rule, an advanced approaches banking organization must use SA–CCR or IMM and a banking organization subject to Category III standards, which include the SCCL rule, must use whichever of CEM or SA–CCR

[41] *See* Reporting Form FR Y–15, Instructions for Preparation of Banking Organization Systemic Risk Report (reissued December 2016). The Board recently finalized modifications the reporting panel and certain substantive requirements of Form FR Y–15 in connection with the tailoring final rule adopted by the agencies. *See* 84 FR 59032 (November 1, 2019) (Board-only final rule to establish risk-based categories for determining prudential standards to large U.S. and foreign banking organizations (Board-only tailoring final rule)); *see also supra* note 23.

[42] For banking organizations subject to Category IV supervisory stress test requirements, 2022 is an on-cycle year.

[43] Banking organizations that report information on the FR Y–14 under SA–CCR must do so for all schedules, including DFAST and CCAR. The anticipated standards described in this section would apply equally for purposes of DFAST and CCAR.

[44] *See supra* note 17.

[45] *See* 83 FR 38460 (August 6, 2018). The Board-only tailoring final rule revised the scope of applicability of the SCCL rule, such that it applies to U.S. and foreign banking organizations subject to Category I, II, or III standards, as applicable, and foreign banking organizations with global consolidated assets of $250 billion or more. *See supra* note 41.

that it uses to calculate its standardized total risk-weighted assets.

7. Potential Future Revisions to the Agencies' Rules

Commenters requested additional information on the interaction of SA–CCR with other potential revisions that the agencies may make to their respective regulatory capital rules. Potential revisions identified by commenters included the implementation of the Basel III finalization standard and the Board's proposal to integrate the capital rule and CCAR and stress test rules published in April 2018.[46] In addition, the proposed net stable funding ratio rule would cross-reference netting provisions of the agencies' supplementary leverage ratio that are amended under the final rule.[47] The agencies will consider the calibration and operation of SA–CCR for purposes of any such potential revisions through the rulemaking process.

III. Mechanics of the Standardized Approach for Counterparty Credit Risk

A. Exposure Amount

Under the proposal, the exposure amount of a netting set would have been equal to an alpha factor of 1.4 multiplied by the sum of the replacement cost of the netting set and the PFE of the netting set. The purposes of the alpha factor were to address certain risks that are not captured under SA–CCR and to ensure that exposure amounts produced under SA–CCR generally would not be lower than those under IMM, in support of its use as a broadly applicable and standardized methodology. In addition, the proposal would have set the exposure amount at zero for a netting set that consists of only sold options in which the counterparty to the options paid the premiums up front and that the options within the netting set are not subject to a variation margin agreement.

Commenters stated that the proposal would increase the exposure amount of derivative contracts with commercial end-users, relative to CEM, because commercial end-users often have directional, unmargined derivative portfolios, which would not receive the benefits of collateral recognition and netting under SA–CCR in the form of a reduction to the replacement cost and PFE amounts. As a result, commenters expressed concern that banking organizations would pass the costs of higher capital to commercial end-users in the form of higher fees or, alternatively, that banking organizations could be less willing to engage in derivative contracts with commercial end-users who may lack the capability and scale to provide financial collateral recognized under the capital rule. Commenters also expressed concern that any increase in hedging costs for commercial end-users could have an adverse impact on the broader economy.

Commenters generally suggested that the agencies address these issues through changes to the alpha factor, either by removing it for all derivative contracts with commercial end-user counterparties, or only for such contracts that are unmargined. Commenters asserted that providing relief for derivative contracts with commercial end-user counterparties would not undermine the goals of the proposal because these transactions comprise a small percentage of outstanding derivatives and may present less risk than other directional, unmargined derivatives. In support of this assertion, commenters argued that commercial end-users typically provide collateral that is not recognized as financial collateral under the capital rule but nonetheless reduces the counterparty credit risk of the underlying transaction.[48] Commenters also argued that removing or reducing the alpha factor for such derivative contracts would be consistent with congressional and regulatory efforts designed to facilitate the ability of such counterparties to enter into derivative contracts to manage commercial risks.[49]

Some commenters argued that applying the alpha factor to derivative contracts with commercial end-user counterparties is misaligned with the risks that the alpha factor was intended to address under IMM, such as wrong-way risk.[50] Some commenters recommended reducing the alpha factor to 0.65 for derivative contracts with investment grade commercial end-user counterparties, or with non-investment grade commercial end-user counterparties that are supported by a letter of credit or provide a first-priority lien on assets that do not present wrong-way risk with respect to the underlying derivative contract. These commenters argued that reducing the alpha factor to 0.65 would improve risk sensitivity and more closely align with the treatment of investment-grade corporate exposures under the revised Basel III finalization standard.[51]

The agencies recognize that derivative contracts between banking organizations and commercial end-users may include credit risk mitigants that do not qualify as financial collateral under the capital rule.[52] In addition, and in contrast to derivative contracts with financial end-users, derivative contracts with commercial end-users have heightened potential to present right-way risk.[53] The final rule removes the alpha factor from the exposure amount formula for derivative contracts with commercial end-user counterparties. The agencies intend for this treatment to better align with the counterparty credit risk presented by such exposures due to the presence of credit risk mitigants and the potential for such transactions to present right-way risk. In particular, the agencies recognize that derivative exposures to commercial end-user counterparties may be less likely to present the types of risks that the alpha factor was designed to address, as discussed previously, and therefore believe that removing the alpha factor for such exposures improves the calibration of SA–CCR. The agencies note that this approach also may mitigate the concerns of commenters regarding the potential effects of the proposal relative to congressional and other regulatory actions designed to mitigate the effect that post-crisis derivatives market reforms have on the ability of these parties to enter into derivative contracts to manage commercial risks. The agencies intend to monitor the implementation of SA–CCR as part of their ongoing assessment of the effectiveness of the overall U.S. regulatory capital framework to determine whether there are opportunities to improve the ability of commercial end-users to enter into derivative contracts with banking organizations in a manner that continues to support the safety and soundness of banking organizations and U.S. financial stability.

Beyond the concerns related to commercial end-users, commenters

[46] *See* 83 FR 18160 (April 25, 2018).

[47] *See* 81 FR 35124 (June 1, 2016).

[48] The types of collateral that commercial end-users provide that do not qualify as financial collateral under the capital rule are discussed in further detail in section III.B. of this **SUPPLEMENTARY INFORMATION.**

[49] *See supra* note 17.

[50] Wrong way risk means that the size of an exposure is positively correlated with the counterparty's probability of default—that is, the exposure amount of the derivative contract increases as the counterparty's probability of default increases.

[51] *See supra* note 3555.

[52] Under § __.2 of the capital rule, financial collateral means cash or liquid and readily marketable securities, in which a banking organization has a perfected first-priority security interest in the collateral. *See* 12 CFR 3.2 (OCC); 12 CFR 217.2 (Board); and 12 CFR 324.2 (FDIC).

[53] Right way risk means that the size of an exposure is negatively correlated with the counterparty's probability of default—that is, the exposure amount of the derivative contract decreases as the counterparty's probability of default increases.

recommended other changes to the alpha factor. Several commenters suggested removing the alpha factor from the SA–CCR methodology altogether, whereas other commenters suggested that the alpha factor should apply only to the PFE component. Some commenters supported reducing or eliminating the alpha factor as it applies to all or a subset of derivative contracts.

Commenters that recommended removing the alpha factor argued that the rationale for adopting the alpha factor for purposes of IMM does not apply in the context of SA–CCR because, in contrast to IMM, SA–CCR is a non-modelled approach and does not require an adjustment to account for model risk. Similarly, other commenters noted that the alpha factor is less meaningful in the United States because, under the capital rule, the standardized approach serves as a floor to the advanced approaches for total risk-weighted assets. Some of these commenters also stated that the potential elimination of the advanced approaches in connection with the U.S. implementation of the Basel III finalization standard would eliminate use of IMM and undermine the need for the alpha factor. Other commenters argued that because IMM incorporates relatively higher stressed-volatility inputs while the supervisory factors under SA–CCR are static, attempts to have SA–CCR yield a more conservative exposure amount than IMM in all cases could result in SA–CCR producing excessive capital requirements that are disconnected from the actual risk of the underlying exposures. Alternatively, other commenters recommended only applying the alpha factor to PFE. These commenters argued that applying the alpha factor to replacement cost would be inappropriate as the fair value of on-balance sheet derivatives are not subject to model uncertainty.

Commenters that supported reducing the alpha factor recommended revising the calibration to reflect the derivatives market reforms that followed the financial crisis, such as mandatory clearing requirements promulgated by the Commodity Futures Trading Commission (CFTC) [54] and the swap margin rule.[55] Of these, some commenters supported applying a lower alpha factor to heavily over-collateralized portfolios in order to provide greater collateral recognition.

Additionally, some commenters expressed concern that the alpha factor could adversely affect custody banking organizations. In particular, the commenters asserted that custody banking organizations do not maintain large portfolios of derivative contracts across a broad range of tenors (*i.e.,* the amount of time remaining before the end date of the derivative contract) and asset classes and that the foreign exchange derivative portfolio of a custody banking organization is intended to serve the investment needs of the custody banking organization's clients rather than to take on economic risk.

In contrast, some commenters who supported the alpha factor suggested that concerns regarding its impact on the exposure amount calculated under SA–CCR are overstated. Specifically, these commenters argued that banking organizations have incentives to minimize estimates of risk for regulatory capital purposes and that internal models failed to account properly for risk during the crisis and have been criticized in analyses conducted since then. In addition, these commenters stated that although SA–CCR uses estimates of volatility for individual positions that are based on observed, crisis period volatilities, greater recognition of netting and margin under SA–CCR may fully offset any conservatism resulting from the use of updated volatility estimates.

As noted in the proposal, the alpha factor helps to instill an appropriate level of conservatism and further support the use of SA–CCR as a broadly applicable and standardized methodology. Additionally, the alpha factor serves to capture certain risks (*e.g.,* wrong-way risk, non-granular risk exposures, etc.) that are not fully reflected under either IMM or SA–CCR. Adopting commenters' recommendations could reduce the efficacy of SA–CCR as a standardized approach that serves a floor to internal models-based approaches. For large, internationally active banking organizations, consistency with the Basel Committee standard also helps to reduce operational burden and minimize any incentives such banking organizations may have to book activities in legal entities located in jurisdictions that provide relatively more favorable regulatory capital treatment.

Accordingly, the final rule incorporates an alpha factor of 1.4 in the exposure amount formula, except as it applies to derivative contracts with commercial end-user counterparties for which the alpha factor is removed under the final rule. The exposure amount formulas are represented as follows:

exposure amount = 1.4 * (*replacement cost* + *PFE*).

However, for a derivative contract with a commercial end-user counterparty, the exposure amount is represented as follows:

exposure amount = (*replacement cost* + *PFE*).

To operationalize the exposure amount formula for derivative contracts with commercial end-user counterparties, the final rule provides a definition of commercial end-user. Under the final rule, a commercial end-user means a company that is using derivatives to hedge or mitigate commercial risk, and is not a financial entity listed in section 2(h)(7)(C)(i)(I) through (VIII) of the Commodity Exchange Act [56] or is not a financial entity listed in section 3C(g)(3)(A)(i) through (viii) of the Securities Exchange Act.[57] The definition also includes an entity that qualifies for the exemption from clearing under section 2(h)(7)(A) of the Commodity Exchange Act by virtue of section 2(h)(7)(D) of the Commodity Exchange Act, including entities that are exempted from the definition of financial entity under section 2(h)(7)(C)(iii) of the Commodity Exchange Act; [58] or qualifies for the exemption from clearing under section 3C(g)(1) of the Securities Exchange Act by virtue of section 3C(g)(4) of the Securities Exchange Act.[59] Including these entities within the commercial end-user definition permits affiliates that hedge commercial risks on behalf of a parent entity that is not a financial entity to qualify as a commercial end-user, which would accommodate business organizations that hedge commercial risks through transactions conducted by affiliates rather than directly by the parent company. Overall, the definition covers commercial end-users and generally excludes financial entities.

This definition has the advantage of being generally consistent with other regulations promulgated by the agencies, including the swap margin rule.[60] Referencing provisions of the Commodities Exchange Act or Securities Exchange Act promotes consistency with other regulations and offers a significant compliance benefit to

[54] *See* 17 CFR part 50.

[55] *See supra* note 17.

[56] 7 U.S.C. 2(h)(7)(C)(i)(I) through (VIII). The commercial end-user definition also applies to transactions with affiliates of entities that enter into derivative contracts on behalf of those entities that meet the criteria under section 2(h)(7)(D) of the Commodity Exchange Act.

[57] 15 U.S.C. 78c–3(g)(3)(A)(i) through (viii).

[58] 7 U.S.C. 2(h)(7)(A), (C)(iii), and (D).

[59] 15 U.S.C. 78c–3(g)(1) and (4).

[60] *See supra* note 17.

institutions subject to the final rule.[61] In addition, in the swap margin rule context, the agencies observed that differences in risk profiles justified distinguishing between financial end-users and non-financial end-users, on the grounds that financial firms present a higher level of risk than other types of counterparties and are more likely to default during a period of financial stress, thus posing greater risk to the safety and soundness of the counterparty and systemic risk.[62] While some commenters requested an exemption for entities that was slightly narrower or broader than the definition the agencies are adopting in the final rule, as noted above, the distinction drawn by this definition is appropriate to differentiate derivative transactions that have the potential to present right-way risk from those that do not.[63]

Other commenters asked the agencies to clarify that the proposal would apply an exposure amount of zero to sold options in which the counterparty to the options has paid the premiums up front and that are not subject to a variation margin agreement. Consistent with the proposal, under the final rule, an exposure amount of zero applies to sold options that are not subject to a variation margin agreement and for which the counterparty has paid the premiums up front.[64] This treatment is appropriate because the counterparty to the option has no future payment obligation under the derivative contract and the banking organization, as the option seller, has no exposure to counterparty credit risk.

B. Definition of Netting Sets and Treatment of Financial Collateral

Under the capital rule, a netting set is currently defined as a group of transactions with a single counterparty that are subject to a qualifying master netting agreement (QMNA) or a qualifying cross-product master netting agreement. The proposal would have revised the definition of netting set to mean either one derivative contract between a banking organization and a single counterparty, or a group of derivative contracts between a banking organization and a single counterparty that are subject to the same qualifying master netting agreement or the same qualifying cross-product master netting agreement. The proposal would have allowed a banking organization to calculate the exposure amount of multiple derivative contracts under the same netting set so long as each derivative contract is subject to the same QMNA.

Some commenters raised concerns with the proposal's reliance on netting to reduce exposure amounts on a point-in-time basis instead of on a dynamic basis and suggested revising the proposal to account for situations that may arise during stress periods that could disrupt the availability of netting. As an example, the commenters noted that during the financial crisis some banking organizations requested to novate their ''in-the-money'' derivative contracts with another counterparty, while leaving the banking organization's ''out-of-the-money'' positions with the initial counterparty. The agencies believe it is appropriate to allow for the netting of derivative contracts under SA–CCR on a point-in-time basis, as allowing for netting on a point-in-time basis under SA–CCR is consistent with U.S. generally accepted accounting principles (U.S. GAAP) and facilitates implementation of the final rule. The capital rule relies significantly on banking organizations' U.S. GAAP balance sheets and thus requires banking organizations to determine capital ratios on a point-in-time basis. The risks related to stress events identified by the commenters may be further addressed in the context of stress testing and resolution planning. Thus, the agencies are adopting as final the netting treatment under the proposal, with the exception of the availability of netting among collateralized-to-market and settled-to-market derivative contracts, which is discussed below in section III.D.4. of this **SUPPLEMENTARY INFORMATION**.

Under the final rule, a group of derivative contracts subject to the same QMNA are part of the same netting set.[65] In general, a QMNA means a netting agreement that permits a banking organization to terminate, close-out on a net basis, and promptly liquidate or set off collateral upon an event of default of the counterparty.[66] To qualify as a QMNA, the netting agreement must satisfy certain operational requirements under § __.3 of the capital rule.[67]

Some commenters expressed concern that the proposed definition of netting set could inadvertently affect the treatment for repo-style transactions under other provisions of the capital rule. The proposed definition was intended to reflect that under SA–CCR a banking organization would determine the exposure amount for a derivative contract at the netting set level, which would have included a single derivative contract. However, to address the commenters' concern, the agencies have revised the definition of netting set under the final rule to mean a group of transactions with a single counterparty that are subject to a QMNA and, with respect to derivative contracts only, also includes a single derivative contract between a banking organization and a counterparty.[68] With respect to repo-style transactions, this definition is consistent with the current capital rule.

The proposal set forth definitions for variation margin, variation margin amount, independent collateral, and net independent collateral amount. The proposal would have defined variation margin as financial collateral that is subject to a collateral agreement and provided by one party to its counterparty to meet the performance of the first party's obligations under one or more derivative contracts between the parties as a result of a change in value of such obligations since the last exchange of such collateral. The variation margin amount would have been equal to the fair value amount of the variation margin that a counterparty to a netting set has posted to a banking organization less the fair value amount of the variation margin posted by the banking organization to the counterparty.

The proposal would have required the variation margin amount to be adjusted by the existing standard supervisory haircuts under § __.132(b)(2)(ii)(A)(*1*) of the capital rule. The standard supervisory haircuts reflect potential

[61] The definition of a commercial end-user in the final rule does not extend to an organization exempted by the CFTC pursuant to section 2(h)(7)(C)(ii) of the Commodity Exchange Act (7 U.S.C. 2(h)(7)(C)(ii)) or exempted by the Securities and Exchange Commission pursuant to section 3C(g)(3)(B) of the Securities Exchange Act of 1934 (15 U.S.C. 78c–3(g)(3)(B)).

[62] *See* 80 FR 74839, 74853 (April 1, 2016).

[63] *Id.*

[64] *See* § __.132(c)(5)(iii) of the final rule.

[65] The definition of netting set also clarifies that a netting set can be composed of a single derivative contract and retains certain components of the definition that are specific to IMM.

[66] *See supra* note 2. In 2017, the agencies adopted a final rule that requires GSIBs and the U.S. operations of foreign GSIBs to amend their qualified financial contracts to prevent their immediate cancellation or termination if such a banking organization enters bankruptcy or a resolution process. Qualified financial contracts include derivative contracts, securities lending, and short-term funding transactions such as repurchase agreements. Under the 2017 final rule, the agencies revised the definition of QMNA under the capital rule such that qualified financial contracts could be subject to a QMNA (notwithstanding other operational requirements). *See* 82 FR 42882 (September 12, 2017).

[67] *See supra* note 2.

[68] Consistent with the current definition of netting set, for purposes of the internal models methodology in § __.132(d) of the capital rule, netting set also includes a qualifying cross-product master netting agreement. *See* 12 CFR 3.132(d) (OCC); 12 CFR 217.132(d) (Board); and 12 CFR 324.132(d) (FDIC).

future changes in the value of the financial collateral by adjusting for any potential decrease in the value of the financial collateral received by a banking organization and any potential increase in the value of the financial collateral posted by the banking organization over supervisory-provided holding periods. The standard supervisory haircuts are based on a ten-business-day holding period, and the capital rule requires a banking organization to adjust, as applicable, the standard supervisory haircuts to align with the associated derivative contract (or repo-style transaction) according to the formula in § __.132(b)(2)(ii)(A)(4).[69]

The proposal would have defined independent collateral as financial collateral, other than variation margin, that is subject to a collateral agreement, or in which a banking organization has a perfected, first-priority security interest or, outside of the United States, the legal equivalent thereof (with the exception of cash on deposit and notwithstanding the prior security interest of any custodial agent or any prior security interest granted to a CCP in connection with collateral posted to that CCP), and the amount of which does not change directly in response to the change in value of the derivative contract or contracts that the financial collateral secures.

Net independent collateral amount would have been defined as the fair value amount of the independent collateral that a counterparty to a netting set has posted to a banking organization less the fair value amount of the independent collateral posted by the banking organization to the counterparty, excluding such amounts held in a bankruptcy-remote manner,[70] or posted to a qualifying central counterparty (QCCP) [71] and held in conformance with the operational requirements in § __.3 of the capital rule. As with the variation margin amount, the independent collateral amount would have been subject to the standard supervisory haircuts under § __.132(b)(2)(ii)(A)(*1*) of the capital rule.

The agencies did not receive comment on the proposed definitions of variation margin, variation margin amount, independent collateral, and independent collateral amount. Several commenters, however, advocated for recognition of alternative collateral arrangements under SA–CCR to address the potential impact of the proposal on derivative contracts with certain counterparties, including commercial end-users. As noted above, the commenters argued that SA–CCR could unduly increase capital requirements for derivative exposures to commercial end-user counterparties because they often do not provide collateral in the form of cash or liquid and readily marketable securities. Commenters stated that companies, including commercial end-users, regularly use alternative security arrangements, such as liens on assets, a letter of credit, or a parent company guarantee, to offset the counterparty credit risk of their derivative contracts, and that banking organizations should be able to recognize the credit risk-mitigating benefits of such arrangements under SA–CCR.

In support of their recommendation, commenters noted that a line of credit functions similarly to the exchange of margin because the line of credit is available to be drawn upon by the banking organization in advance of default as the counterparty's creditworthiness deteriorates. Moreover, the line of credit can be structured so that its amount may increase over the life of the derivative contract based on certain credit quality metrics. Commenters added that common industry practice allows banking organizations to accept these forms of collateral from counterparties and to reflect their credit risk-mitigating benefits when they calculate the exposure amount under IMM. Commenters also argued that derivative contracts with commercial end-users may present right-way risk for banking organizations, in contrast to derivative contracts with financial institution counterparties, and that this feature of these transactions supports recognition of alternative forms of collateral.

The capital rule only recognizes certain forms of collateral that qualify as ''financial collateral,'' as defined under the rule.[72] In general, the items that qualify as financial collateral under the capital rule exhibit sufficient liquidity and asset quality to serve as credit risk mitigants for risk-based capital purposes. Consistent with the capital rule, the final rule does not recognize the alternative collateral arrangements suggested by commenters. Liens and asset pledges, by contrast, may not be rapidly available to support losses in an event of default because the assets they attach to can be illiquid and thus difficult to value and sell for cash after enforcement of a security interest in the collateral or foreclosure, which is inconsistent with the principle that derivatives should be able to be closed out easily and quickly in an event of default.[73] In addition, recognizing letters of credit would add significant complexity to the capital rule. In particular, recognition of letters of credit as financial collateral would require the introduction of appropriate qualification criteria, as well as a framework for considering the counterparty credit risk of institutions providing the letters of credit. The agencies also believe that the removal of the alpha factor for derivative contract exposures to commercial end-users helps to address commenters' concerns that the proposal would have resulted in unduly high risk-weighted asset amounts for derivative contracts with commercial end-user counterparties.

Accordingly, the agencies are adopting without change the proposed definitions for variation margin, independent collateral, variation margin amount, and independent collateral amount, as well as the proposed application of the standard supervisory haircuts under the capital rule.

C. Replacement Cost

The proposal would have provided separate formulas to determine replacement cost that apply depending on whether the counterparty to a banking organization is required to post variation margin. Specifically, the replacement cost for a netting set that is not subject to a variation margin agreement would have equaled the greater of (1) the sum of the fair values (after excluding any valuation adjustments) of the derivative contracts within the netting set, less the net independent collateral amount applicable to such derivative contracts, or (2) zero.[74]

[69] As described in section III.D. of this **SUPPLEMENTARY INFORMATION**, the final rule applies a five-day holding period for the purpose of the margin period of risk to all derivative contracts subject to a variation margin agreement that are client-facing derivative transactions, as defined in the final rule, regardless of the method the banking organization uses to calculate the exposure amount of the derivative contract. As described in section VI.E. of this **SUPPLEMENTARY INFORMATION**, the collateral haircuts for such transactions similarly reflect a five-business-day holding period under the final rule.

[70] ''Bankruptcy remote'' is defined in § __.2 of the capital rule. *See* 12 CFR 3.2 (OCC); 12 CFR 217.2 (Board); and 12 CFR 324.2 (FDIC).

[71] ''Qualifying central counterparty'' is defined in § __.2 of the capital rule. *See* 12 CFR 3.2 (OCC); 12 CFR 217.2 (Board); and 12 CFR 324.2 (FDIC).

[72] *See supra* note 52.

[73] The Board and OCC issued the capital rule as a joint final rule on October 11, 2013 (78 FR 62018) and the FDIC issued the capital rule as a substantially identical interim final rule on September 10, 2013 (78 FR 53340). In April 14, 2014, the FDIC issued the interim final rule as a final rule with no substantive changes (79 FR 20754).

[74] Replacement cost is calculated based on the assumption that the counterparty has defaulted. Therefore, this calculation cannot include valuation adjustments based on counterparty's credit quality,

For a netting set that is subject to a variation margin agreement where the counterparty is required to post variation margin, replacement cost would have equaled the greater of (1) the sum of the fair values (after excluding any valuation adjustments) of the derivative contracts within the netting set, less the sum of the net independent collateral amount and the variation margin amount applicable to such derivative contracts; (2) the sum of the variation margin threshold and the minimum transfer amount applicable to the derivative contracts within the netting set, less the net independent collateral amount applicable to such derivative contracts; or (3) zero. As noted in the proposal, the formula to determine the replacement cost of a netting set subject to a variation margin agreement would have accounted for the maximum possible unsecured exposure amount of the netting set that would not trigger a variation margin call. For example, a netting set with a high variation margin threshold has a higher replacement cost compared to an equivalent netting set with a lower variation margin threshold. Therefore, the proposal would have provided definitions for variation margin threshold and the minimum transfer amount.

Under the proposal, the variation margin threshold would have meant the maximum amount of a banking organization's credit exposure to its counterparty that, if exceeded, would require the counterparty to post variation margin to the banking organization. The minimum transfer amount would have meant the smallest amount of variation margin that may be transferred between counterparties to a netting set. The proposal included this treatment to address transactions for which the variation margin agreement includes a variation margin threshold that is set at a level high enough to make the netting set effectively unmargined. In such a case, the variation margin threshold would result in an inappropriately high replacement cost, because it is not reflective of the risk associated with the derivative contract but rather the terms of the variation margin agreement. To address this issue, the proposal would have provided that the exposure amount of a netting set subject to a variation margin agreement could not exceed the exposure amount of the same netting set calculated as if the netting set were not subject to a variation margin agreement.[75]

In addition, the proposal would have provided adjustments for determining the replacement cost of a netting set that is subject to multiple variation margin agreements or a hybrid netting set, which is a netting set composed of at least one derivative contract subject to a variation margin agreement under which the counterparty must post variation margin and at least one derivative contract that is not subject to such a variation margin agreement, and for multiple netting sets subject to a single variation margin agreement.

Some commenters supported the proposed replacement cost calculation and, in particular, the cap based on the margin exposure threshold and minimum transfer amount. The commenters argued that the unmargined exposure amount more accurately reflects the exposure amount for short-dated trades subject to a higher MPOR, as the close-out period reflected in MPOR cannot be increased beyond the maturity of the transactions. Other commenters advocated subtracting incurred CVA from the exposure amount of a netting set. In support of their recommendation, the commenters noted that IMM allows incurred CVA to be subtracted from EAD, and that the agencies previously extended such treatment to advanced approaches banking organizations that use CEM to calculate advanced approaches risk-weighted assets.

The final rule adopts the proposed replacement cost formulas and related definitions, with one modification. The agencies recognize that in determining the fair value of a derivative on a banking organization's balance sheet, the recognized CVA on the netting set of OTC derivative contracts is intended to reflect the credit quality of the counterparty. The final rule permits advanced approaches banking organizations to reduce EAD, calculated according to SA–CCR, by the recognized CVA on the balance sheet, for the purposes of calculating advanced approaches total risk-weighted assets. This treatment is consistent with the recognition of CVA under CEM as it applies to advanced approaches banking organizations that use CEM for purposes of determining advanced approaches total risk-weighted assets.[76]

The final rule otherwise adopts without change the proposed replacement cost formulas and related definitions, as well as the proposed treatment to cap the exposure amount for a margined netting set at the maximum exposure amount for an unmargined, but otherwise identical, netting set.

Under § __.132(c)(6)(ii) of the final rule, the replacement cost of a netting set that is not subject to a variation margin agreement is represented as follows:

$$replacement\ cost = max\{V - C; 0\},$$

Where:

V is the fair values (after excluding any valuation adjustments) of the derivative contracts within the netting set; and

C is the net independent collateral amount applicable to such derivative contracts.

The same requirement applies to a netting set that is subject to a variation margin agreement under which the counterparty is not required to post variation margin. For such a netting set, C also includes the negative amount of the variation margin that the banking organization posted to the counterparty (thus increasing replacement cost).

For netting sets subject to a variation margin agreement under which the counterparty must post variation margin, the replacement cost formula is provided under § __.132(c)(6)(i) of the final rule and is represented as follows:

$$replacement\ cost = max\{V - C; VMT + MTA - NICA; 0\},$$

Where:

V is the fair values (after excluding any valuation adjustments) of the derivative contracts within the netting set;

such as CVA, which reflect the discounted present value of losses if the counterparty were to default in the future.

[75] There could be a situation unrelated to the value of the variation margin threshold in which the exposure amount of a margined netting set is greater than the exposure amount of an equivalent unmargined netting set. For example, in the case of a margined netting set composed of short-term transactions with a residual maturity of ten business days or less, the risk horizon equals the MPOR, which under the final rule is set to a minimum floor of ten business days. The risk horizon for an equivalent unmargined netting set also is set to ten business days because this is the floor for the remaining maturity of such a netting set. However, the maturity factor for the margined netting set is greater than the one for the equivalent unmargined netting set because of the application of a factor of 1.5 to margined derivative contracts. In such an instance, the exposure amount of a margined netting set is more than the exposure amount of an equivalent unmargined netting set by a factor of 1.5, thus triggering the cap. In addition, in the case of margin disputes, the MPOR of a margined netting set is doubled, which could further increase the exposure amount of a margined netting set comprised of short-term transactions with a residual maturity of ten business days or less above an equivalent unmargined netting set. The agencies believe, however, that such instances rarely occur and thus would have minimal effect on banking organizations' regulatory capital. Therefore, the final rule limits the exposure amount of a margined netting set to no more than the exposure amount of an equivalent unmargined netting set. However, the agencies expect to monitor the application of this treatment under the final rule.

[76] *See* 80 FR 41409 (July 15, 2015).

C is the sum of the net independent collateral amount and the variation margin amount applicable to such derivative contracts;

VMT is the variation margin threshold applicable to the derivative contracts within the netting set; and

MTA is the minimum transfer amount applicable to the derivative contracts within the netting set.

NICA is the net independent collateral amount applicable to such derivative contracts.

For a netting set that is subject to multiple variation margin agreements, or a hybrid netting set, a banking organization must determine replacement cost using the methodology described in § __.132(c)(11)(i) of the final rule. Under this paragraph, a banking organization must use the standard replacement cost formula (described in § __.132(c)(6)(i) for a netting set subject to a variation margin agreement), except that the variation margin threshold equals the sum of the variation margin thresholds of all the variation margin agreements within the netting set and the minimum transfer amount equals the sum of the minimum transfer amounts of all the variation margin agreements within the netting set.

For multiple netting sets subject to a single variation margin agreement, a banking organization must assign a single replacement cost to the multiple netting sets according to the following formula, as provided under § __.132(c)(10)(i) of the final rule:

$$Replacement\ Cost = max\{\Sigma_{NS}\ max\{V_{NS};\ 0\} - max\{C_{MA};\ 0\};\ 0\} + max\{\Sigma_{NS}\ min\{V_{NS};\ 0\} - min\{C_{MA};\ 0\};\ 0\},$$

Where:

NS is each netting set subject to the variation margin agreement MA;

V_{NS} is the sum of the fair values (after excluding any valuation adjustments) of the derivative contracts within the netting set NS; and

C_{MA} is the sum of the net independent collateral amount and the variation margin amount applicable to the derivative contracts within the netting sets subject to the single variation margin agreement.

The component $max\{\Sigma_{NS}\ max\{V_{NS};\ 0\} - max\{C_{MA};\ 0\};\ 0\}$ reflects the exposure amount produced by netting sets that have current positive market value. Variation margin and independent collateral collected from the counterparty to the transaction can offset the current positive market value of these netting sets (*i.e.,* this component contributes to replacement cost only in instances when C_{MA} is positive). However, netting sets that have current negative market value are not allowed to offset the exposure amount. The component $max\{\Sigma_{NS}\ min\{V_{NS};\ 0\} - min\{C_{MA};\ 0\};\ 0\}$ reflects the exposure amount produced when the banking organization posts variation margin and independent collateral to its counterparty (*i.e.,* this component contributes to replacement cost only in instances when C_{MA} is negative).

D. Potential Future Exposure

Under the proposal, the PFE for a netting set would have equaled the product of the PFE multiplier and the aggregated amount. To determine the aggregated amount, a banking organization would have been required to determine the hedging set amounts for the derivative contracts within a netting set, where a hedging set is comprised of derivative contracts that share similar risk factors based on asset class (*i.e.,* interest rate, exchange rate, credit, equity, and commodity). The aggregated amount would have equaled the sum of all hedging set amounts within a netting set.

Under the proposal, a banking organization would have used a two-step process to determine the hedging set amount for an asset class. First, a banking organization would have determined the composition of a hedging set using the asset class definitions set forth in the proposal. Second, the banking organization would have determined hedging set amount using asset class specific formulas. The hedging set amount formulas require a banking organization to determine an adjusted derivative contract amount for each derivative contract, and to aggregate those amounts to arrive at the hedging set amount for an asset class.[77]

The final rule adopts the formula for determining PFE as proposed. Under § __.132(c)(7) of the final rule, the PFE of a netting set equals the product of the PFE multiplier and the aggregated amount. The final rule defines the aggregated amount as the sum of all hedging set amounts within the netting set. This formula is represented in the final rule as follows:

$$PFE = PFE\ multiplier * aggregated\ amount,$$

Where aggregated amount is the sum of each hedging set amount within the netting set.

1. Hedging Set Amounts

Under the proposal, a banking organization would have determined the hedging set amount by asset class. To specify each asset class, the proposal would have maintained the existing definitions in the capital rule for interest rate, exchange rate, credit, equity, and commodity derivative contracts. The proposal would have provided hedging set definitions for each asset class and sought comment on an alternative approach for the definition and treatment of exchange rate derivative contracts to recognize the economic relationships of exchange rate chains (*i.e.,* when more than one currency pair can offset the risk of another). For example, a Yen/Dollar forward contract and a Dollar/Euro forward contract, taken together, may be economically equivalent, with properly set notional amounts, to a Yen/Euro forward contract when they are subject to the same QMNA. The proposal also would have included separate treatments for volatility derivative contracts and basis derivative contracts.

Some commenters recommended that the agencies revise the definitions for interest rate, exchange rate, equity, and commodity derivative contracts for SA–CCR. In particular, the commenters noted that there could be instances in which the existing definitions in the capital rule are not aligned with the primary risk factor for a derivative contract, and therefore would differ from the classifications used under SA–CCR. To address this concern, commenters requested allowing banking organizations to use the primary risk factor for the derivative contract instead of one based on the asset class definitions set forth in the proposal.

The final rule maintains the definitions of interest rate, exchange rate, equity, and commodity derivative contracts, as the definitions are largely aligned with existing derivative products and market practices. In addition to being sufficiently broad to capture the various types of derivative contracts, the existing asset class definitions are well-established, well-understood, and generally have functioned as intended in the capital rule. The final rule preserves the ability of the primary Federal regulator to address derivative contracts with multiple risk factors by requiring them to be included in multiple hedging sets under § __.132(c)(2)(iii)(H).[78]

[77] Section III.D.1. of this **SUPPLEMENTARY INFORMATION** discusses the methodology for determining the composition of a hedging set using the asset class distinctions set forth in the final rule. Section III.D.2. of this **SUPPLEMENTARY INFORMATION** discusses the methodology for determining the adjusted derivative contract amount for each derivative contract. Section III.D.3. of this **SUPPLEMENTARY INFORMATION** discusses the PFE multiplier. Section III.D.4. of this **SUPPLEMENTARY INFORMATION** discusses the PFE calculation for nonstandard margin agreements.

[78] The Board is the primary Federal regulator for bank holding companies, savings and loan holding companies, intermediate holding companies of foreign banks, and state member banks; the OCC is the primary Federal regulator for all national banks

Some commenters supported the alternative treatment for recognizing the economic relationships of exchange rate chains described in the proposal, but only if modified to address any potential overstatement in the exposure amounts produced when creating separate hedging sets for each foreign currency. The agencies believe that the alternative treatment described in the proposal, if modified to incorporate correlation parameters as suggested by commenters, would add a level of complexity to the alternative treatment that would make it inappropriate for use in a standardized framework that is intended for potential implementation by all banking organizations. The agencies further believe that the alternative treatment described in the proposal, if modified to require the maximum of long or short risk positions, would not add meaningful risk sensitivity by not taking into account the correlations between currency risk factors. Therefore, the agencies are adopting as final the asset class and hedging set definitions as proposed.

To determine each hedging set amount, a banking organization first must group into separate hedging sets derivative contracts that share similar risk factors based on the following asset classes: Interest rate, exchange rate, credit, equity, and commodity. Basis derivative contracts and volatility derivative contracts require separate hedging sets. A banking organization then must determine each hedging set amount using asset-class specific formulas that allow for full or partial offsetting. If the risk of a derivative contract materially depends on more than one risk factor, whether interest rate, exchange rate, credit, equity, or commodity risk factor, a banking organization's primary Federal regulator may require the banking organization to include the derivative contract in each appropriate hedging set. Under the final rule, the hedging set amount of a hedging set composed of a single derivative contract equals the absolute value of the adjusted derivative contract amount of the derivative contract.

Section __.132(c)(2)(iii) of the final rule provides the respective hedging set definitions. As noted, an exchange rate hedging set means all exchange rate derivative contracts within a netting set that reference the same currency pair. Thus, there could be as many exchange rate hedging sets within a netting set as distinct currency pairs referenced by the exchange rate derivative contracts. An interest rate hedging set means all interest rate derivative contracts within a netting set that reference the same reference currency. Thus, there could be as many interest rate hedging sets in a netting set as distinct currencies referenced by the interest rate derivative contracts in the netting set. A credit hedging set would mean all credit derivative contracts within a netting set. Similarly, an equity hedging set means all equity derivative contracts within a netting set. Consequently, there could be at most one equity hedging set and one credit hedging set within a netting set. A commodity hedging set means all commodity derivative contracts within a netting set that reference one of the following commodity categories: Energy, metal, agricultural, or other commodities. Therefore, there could be no more than four commodity derivative contract hedging sets within a netting set.

Consistent with the proposal, the final rule sets forth separate treatments for volatility derivative contracts and basis derivative contracts. A basis derivative contract is a non-foreign exchange derivative contract (*i.e.,* the contract is denominated in a single currency) in which the cash flows of the derivative contract depend on the difference between two risk factors that are attributable solely to one of the following derivative asset classes: Interest rate, credit, equity, or commodity. A basis derivative contract hedging set means all basis derivative contracts within a netting set that reference the same pair of risk factors and are denominated in the same currency. In contrast, a volatility derivative contract means a derivative contract in which the payoff of the derivative contract explicitly depends on a measure of volatility for the underlying risk factor of the derivative contract. Examples of volatility derivative contracts include variance and volatility swaps and options on realized or implied volatility. A volatility derivative contract hedging set means all volatility derivative contracts within a netting set that reference one of interest rate, exchange rate, credit, equity, or commodity risk factors, separated according to the requirements under § __.132(c)(2)(iii)(A)–(E) of the final rule.

a. Interest Rate Derivative Contracts

Under the proposal, the hedging set amount for a hedging set of interest rate derivative contracts would have recognized that interest rate derivative contracts with close tenors (*i.e.,* the amount of time remaining before the end date of the derivative contract) are generally highly correlated, and thus would have provided a greater offset relative to interest rate derivative contracts that do not have close tenors. In particular, the proposed formula for determining the hedging set amount for interest rate derivative contracts would have permitted full offsetting within a tenor category and partial offsetting across tenor categories, with tenor categories of less than one year, between one and five years, and more than five years. The proposal would have applied a correlation factor of 70 percent across adjacent tenor categories and a correlation factor of 30 percent across nonadjacent tenor categories. The tenor of a derivative contract would have been based on the period between the present date and the end date of the derivative contract, where end date would have meant the last date of the period referenced by the derivative contract, or if the derivative contract references another instrument, the period referenced by the underlying instrument.

Some commenters asked the agencies to allow banking organizations to recognize interest rate derivative contracts within the same QMNA as belonging to the same interest rate hedging set, even if such derivative contracts reference different currencies. According to the commenters, such an approach would allow banking organizations to recognize the diversification benefits of multi-currency interest rate derivative portfolios. Some of these commenters also suggested potential ways to implement this approach. Under one approach, a banking organization would calculate the maximum exposure for the interest rate derivative contracts within the QMNA under two scenarios using a single-factor model. The first scenario would receive a correlation factor of zero percent across interest rate exposures in different currencies, while the second scenario would receive a correlation factor of 70 percent. The former scenario would produce the largest amount for portfolios balanced across net short and net long currency exposures, while the latter scenario would produce the largest amount for portfolios that primarily consist of net long or net short currency positions. The second approach would use a single-factor model to aggregate interest rate derivative contracts per currency type to recognize correlations across currencies. Alternatively, other commenters stated that yield curve correlations across major currencies could be used to establish correlation

and Federal savings associations; and the FDIC is the primary Federal regulatory for all state nonmember banks and savings associations.

factors for interest rate derivative contracts that reference different currencies. These commenters noted that the Basel Committee's standard on minimum capital requirements for market risk incorporates a correlation parameter to reflect diversification benefits across multi-currency interest rate portfolios.[79] These commenters also stated that studies regarding the Basel Committee standard suggest that, by not recognizing any hedging or diversification benefits across currencies, the proposed method to calculate the hedging set amount for interest rate derivatives under SA–CCR is overly conservative. Other commenters criticized the proposal as not providing a sufficient justification for the requirement that interest rate hedging sets must be settled in the same currency to be included within the same hedging set, in contrast to the proposed treatment for credit, commodity, and equity derivative contracts.

The fact that a set of derivative contracts are subject to the same QMNA is not determinative of whether hedging benefits across derivative contracts actually exist. Interest rates in different currencies can move in different directions, rendering correlations unstable. In addition, adopting the commenters' recommendations could add significant complexity to the final rule. The agencies therefore are adopting as final the proposed treatment for determining the hedging set amount of interest rate derivative contracts. Under § __.132(c)(8)(i) of the final rule, a banking organization must calculate the hedging set amount for interest rate derivative contracts according to the following formula:

$$Hedging\ set\ amount = [(AddOn_{TB1}^{IR})^2 + (AddOn_{TB2}^{IR})^2 + (AddOn_{TB3}^{IR})^2 + 1.4 * AddOn_{TB1}^{IR} * AddOn_{TB2}^{IR} + 1.4 * AddOn_{TB2}^{IR} * AddOn_{TB3}^{IR} + 0.6 * AddOn_{TB1}^{IR} * AddOn_{TB3}^{IR})]^{\frac{1}{2}},$$

Where:

$AddOn_{TB1}{}^{IR}$ equals the sum of the adjusted derivative contract amounts within the hedging set with an end date of less than one year from the present date;

$AddOn_{TB2}{}^{IR}$ equals the sum of the adjusted derivative contract amounts within the hedging set with an end date of one to five years from the present date; and

$AddOn_{TB3}{}^{IR}$ equals the sum of the adjusted derivative contract amounts within the hedging set with an end date of more than five years from the present date.

Consistent with the proposal, the final rule also includes a simpler formula that does not provide an offset across tenor categories. Under this approach, the hedging set amount for interest rate derivative contracts equals the sum of the absolute amounts of each tenor category, which is the sum of the adjusted derivative contract amounts within each respective tenor category. The simpler formula always results in a more conservative measure of the hedging set amount for interest rate derivative contracts of different tenor categories, but may be less burdensome for banking organizations with smaller interest rate derivative contract portfolios. A banking organization may use this simpler formula for some or all of its interest rate derivative contracts.

b. Exchange Rate Derivative Contracts

Exchange rate derivative contracts that reference the same currency pair generally are driven by the same market factor (*i.e.,* the exchange spot rate between these currencies) and thus are highly correlated. Therefore, under the proposal, the formula for determining the hedging set amount for exchange rate derivative contracts would have allowed for full offsetting within the exchange rate derivative contract hedging set. The agencies did not receive comment regarding the formula for determining the hedging set amount for exchange rate derivative contracts, and are adopting it as proposed. Under § __.132(c)(8)(ii) of the final rule, the hedging set amount for exchange rate derivative contracts equals the absolute value of the sum of the adjusted derivative contract amounts within the hedging set.

c. Credit Derivative Contracts and Equity Derivative Contracts

Under the proposal, a banking organization would have used the same formula to determine the hedging set amount for both its credit derivative contracts and equity derivative contracts. The formula would allow full offsetting for credit or equity contracts that reference the same entity, and partial offsetting when aggregating across distinct reference entities. In addition, the proposal would have provided supervisory correlation parameters for credit derivative contracts and equity derivative contracts based on whether the derivative contract referenced a single-name entity or an index.

A single-name derivative would have received a correlation factor of 50 percent, while an index derivative contract would have received a correlation factor of 80 percent to reflect partial diversification of idiosyncratic risk within an index. As noted in the proposal, the pairwise correlation between two entities is the product of the corresponding correlation factors, so that the pairwise correlation between two single-name derivatives is 25 percent, between one single-name and one index derivative is 40 percent, and between two index derivatives is 64 percent. The application of a higher correlation factor does not necessarily result in a higher exposure amount because the proposal generally would have yielded a lower exposure amount for balanced portfolios relative to directional portfolios.

Several commenters asked the agencies to allow banking organizations to decompose indices within credit and equity asset classes to reflect the exposure of highly correlated net long and short positions within an index. Under § __.132(c)(5)(vi) of the final rule, a banking organization may elect to decompose indices within credit and equity asset classes, such that a banking organization would treat each component of the index as a separate single-name derivative contract. Thus, under this election, a banking organization would apply the SA–CCR methodology to each component of the index as if it were a separate single-name derivative contract instead of applying the SA–CCR methodology to

[79] *See* ''Minimum capital requirements for market risk,'' Basel Committee on Banking Supervision (January 2019, rev. February 2019), *https://www.bis.org/bcbs/publ/d457.pdf.*

the index derivative contract. This approach provides enhanced risk sensitivity to the SA–CCR framework by allowing for recognition of the hedging benefits provided by the components of an index. In addition, this approach is similar to other aspects of the capital rule.[80] The agencies will monitor the application of the decomposition approach, including the correlation assumptions between an index and its components, to ensure that the approach is functioning as intended.

Under the final rule, a banking organization must determine the hedging set amount for its credit and equity derivative contracts set forth in § __.132(c)(8)(iii) of the final rule, as follows:

$$Hedging\ set\ amount = \left[\left(\sum_{k=1}^{K} \rho_k * AddOn(Ref_k)\right)^2 + \sum_{k=1}^{K}(1 - (\rho_k)^2) * (AddOn(Ref_k))^2\right]^{\frac{1}{2}},$$

Where:

k is each reference entity within the hedging set;

K is the number of reference entities within the hedging set;

$AddOn(Ref_k)$ equals the sum of the adjusted derivative contract amounts for all derivative contracts within the hedging set that reference reference entity k; and

ρ_k equals the applicable supervisory correlation factor, as provided in Table 2.

d. Commodity Derivative Contracts

The proposal would have required a banking organization to determine the hedging set amount for commodity derivative contracts based on the following four commodity categories: Energy, metal, agricultural and other. The proposal would have permitted full offsetting for all derivative contracts within the same commodity category (*i.e.,* within a hedging set) that reference the same commodity type, and partial offsetting for all derivative contracts within the same commodity category that reference different commodity types.

Under the proposal, a commodity type would have referred to a specific commodity within one of the four commodity categories. Additionally, the proposal would not have provided separate supervisory factors for different commodity types within the energy commodity category.[81] For example, under the proposal, a hedging set could have been composed of crude oil derivative contracts and electricity derivative contracts, with each subject to the same supervisory factor. A banking organization would have been able to fully offset all crude oil derivative contracts against each other and all electricity derivative contracts against each other (as they reference the same commodity type). In addition, a banking organization would not have been able to offset commodity derivative contracts that are included in different commodity categories (*i.e.,* a forward contract on crude oil cannot hedge a forward contract on corn).

Several commenters asked the agencies to clarify the offsetting treatment among the different types of contracts within the energy category (*e.g.,* electricity and oil/gas derivative contracts). Some commenters asked the agencies to allow banking organizations to decompose derivative contracts that reference commodity indices, such that a banking organization would treat each component of the index as a separate single-name derivative contract.

Consistent with the proposal, the final rule permits full offsetting for all derivative contracts within a hedging set that reference the same commodity type, and partial offsetting for all derivative contracts within a hedging set that reference different commodity types within the same commodity category.[82] This treatment applies consistently to each of the four commodity categories, including energy. For example, electricity derivative contracts within the same hedging set may fully offset each other, whereas electricity derivative contracts and non-electricity derivate contracts (*e.g.,* oil derivative contracts) within the same hedging set may only partially offset each other because they are different commodity types within the same commodity category.

In an attempt to appropriately balance risk sensitivity with operational burden, consistent with the proposal, the final rule allows banking organizations to recognize commodity types without regard to characteristics such as location or quality. For example, a banking organization may recognize crude oil as a commodity type, and would not need to distinguish further between West Texas Intermediate and Saudi Light crude oil.

In response to comments, § __.132(c)(5)(vi) of the final rule allows a banking organization to elect to decompose commodity indices, such that a banking organization would treat each component of the index as a separate, single-name derivative contract. Thus, under this election, a banking organization would apply the SA–CCR methodology to each component of the index as if it were a separate, single-name derivative contract, instead of applying the SA–CCR methodology to the index derivative contract. This approach provides enhanced risk sensitivity to the SA–CCR framework by allowing for better recognition of hedging benefits provided by the components of an index. In addition, this approach is similar to other aspects of the capital rule.[83]

The agencies recognize that specifying separate commodity types is operationally difficult; indeed, it is likely infeasible to sufficiently specify all relevant distinctions between commodity types in order to capture all basis risk. Therefore, the agencies will monitor the commodity-type distinctions made within the industry for purposes of both the full offset treatment for commodity derivative contracts of the same type and the decomposition approach for commodity indices, to ensure that they are being applied and functioning as intended.

Consistent with the proposal, a banking organization must assign a derivative contract to the ''other'' commodity category if the derivative contract does not meet the criteria for the energy, metal or agricultural commodity categories.

The hedging set amount for commodity derivative contracts would

[80] *See e.g.,* 12 CFR 3.53 (OCC); 12 CFR 217.53 (Board); and 12 CFR 324.53 (FDIC).

[81] *See* section III.D.2.b. of this **SUPPLEMENTARY INFORMATION** for a more detailed discussion on supervisory factors under the final rule.

[82] The final rule provides separate supervisory factors for electricity derivative contracts and other types of commodity derivative contracts within the energy category as discussed further in section III.D.2.b.iii. of this **SUPPLEMENTARY INFORMATION**.

[83] *See supra* note 80.

be determined under § __.132(c)(8)(iv) of the final rule, as follows:

$$\textit{Hedging set amount} = \left[\left(\rho * \sum_{k=1}^{K} AddOn(Type_k)\right)^2 + (1-(\rho)^2) * \sum_{k=1}^{K} (AddOn(Type_k))^2\right]^{\frac{1}{2}},$$

Where:

k is each commodity type within the hedging set;

K is the number of commodity types within the hedging set;

$AddOn(Type_k)$ equals the sum of the adjusted derivative contract amounts for all derivative contracts within the hedging set that reference commodity type k; and

ρ equals the applicable supervisory correlation factor, as provided in Table 2 of the preamble.

2. Adjusted Derivative Contract Amount

Under the proposal, the adjusted derivative contract amount would have represented a conservative estimate of effective expected positive exposure (EEPE) [84] for a netting set consisting of a single derivative contract, assuming zero market value and zero collateral, that is either positive (if a long position) or negative (if a short position). A banking organization would have calculated the adjusted derivative contract amount as a product of four components: The adjusted notional amount, the applicable supervisory factor, the applicable supervisory delta adjustment, and the applicable maturity factor. The adjusted derivative contact amount for each asset class would have been aggregated under the hedging set amount formulas for each asset class, as described above. The agencies received no comments on this aspect of the proposal, and are finalizing the formula for determining the adjusted derivative contract amount as proposed under § __.132(c)(9) of the final rule.

The formula to determine the adjusted derivative contract amount is represented as follows:

$$\textit{adjusted derivative contract amount} = d_i * \delta_i * MF_i * SF_i.$$

Where:

d_i is the adjusted notional amount;

δ_i is the applicable supervisory delta adjustment;

MF_i is the applicable maturity factor; and

SF_i is the applicable supervisory factor.

The adjusted notional amount accounts for the size of the derivative contract and reflects the attributes of the most common derivative contracts in each asset class. The supervisory factor converts the adjusted notional amount of the derivative contract into an EEPE based on the measured volatility specific to each asset class over a one-year horizon.[85] The supervisory delta adjustment accounts for the sensitivity of a derivative contract (scaled to unit size) to the underlying primary risk factor, including the correct sign (positive or negative) to account for the direction of the derivative contract amount relative to the primary risk factor.[86] Finally, the maturity factor scales down, if necessary, the derivative contract amount from the standard one-year horizon used for supervisory factor calibration to the risk horizon relevant for a given contract.

a. Adjusted Notional Amount

i. Interest Rate and Credit Derivative Contracts

Under the proposal, a banking organization would have applied the same formula to interest rate derivative contracts and credit derivative contracts to arrive at the adjusted notional amount. For such contracts, the adjusted notional amount would have equaled the product of the notional amount of the derivative contract, as measured in U.S. dollars, using the exchange rate on the date of the calculation, and the supervisory duration. The supervisory duration would have incorporated measures of the number of business days from the present day until the start date for the derivative contract (S), and the number of business days from the present day until the end date for the derivative contract (E).

Some commenters argued that the standard notional definition would not produce reasonably accurate exposure estimates of a banking organization's closeout risk for all types of derivative contracts. These commenters recommended allowing banking organizations to use internal methodologies to determine the adjusted notional amount for derivative contracts that are not specifically covered under the formulas and methodologies set forth in the proposal.

The final rule maintains the formulas and methodologies for determining the adjusted notional amount for interest rate and credit derivative contracts, as generally one of these will be applicable for most derivative contracts. However, the agencies recognize that such approaches may not be applicable to all types of derivative contracts, and that a different approach may be necessary to determine the adjusted notional amount of a derivative contract. In such a case, a banking organization must consult with its primary Federal regulator prior to using an alternative approach to the formulas or methodologies set forth in the final rule.

Some commenters suggested revising the proposal to provide a separate measure of S for fixed-to-floating interest rate derivative contracts where the floating rate is determined at the beginning of the reset period and paid at the end, defined as the time period until the earliest reset date, measured in years.

According to the commenters, the proposal could overestimate the duration for such derivative contracts, as it would include the time period for which the floating rate (and, therefore, the floating leg payment) is captured in the supervisory duration. The commenters also noted that such

[84] *See supra* note 10.

[85] Specifically, the supervisory factors are intended to reflect the EEPE of a single at-the-money linear trade of unit size, zero market value and one-year maturity referencing a given risk factor in the absence of collateral. *See supra* note 10.

[86] Sensitivity of a derivative contract to a risk factor is the ratio of the change in the market value of the derivative contract caused by a small change in the risk factor to the value of the change in the risk factor. In a linear derivative contract, the payoff of the derivative contract moves at a constant rate with the change in the value of the underlying risk factor. In a nonlinear contract, the payoff of the derivative contract does not move at a constant rate with the change in the value of the underlying risk factor. The sensitivity is positive if the derivative contract is long the risk factor and negative if the derivative contract is short the risk factor.

treatment could significantly affect the adjusted notional amount for a short-dated interest rate derivative portfolio.

Other commenters recommended changes to the measure of *S* for basis derivative contracts, for which the floating rates on the reference exposure are set at the beginning of the payment period. Some of these commenters recommended measuring *S* as the period (in years) as the earliest reset date of the two floating-rate components of the contract, if the reset dates are different.

The treatment recommended by the commenters cannot be made applicable to all interest rate derivatives; for example, it would not be appropriate for in arrears swaps, in which the rate is set at the end of the reset period instead of the beginning, and for forward rate agreements. In addition, adopting the commenters' recommendations could add significant complexity to the final rule because it would require additional parameters in the adjusted notional amount formula that would be used only in certain circumstances. Such an approach would create additional burden for banking organizations that adopt SA–CCR and could adversely affect the agencies' ability to use SA–CCR to assess comparability across banking organizations. The agencies therefore are adopting as final the proposed treatment for determining the adjusted notional amount of interest rate and credit derivative contracts.

Some commenters requested changes to address forward-settling mortgage-backed securities traded in the to-be-announced (TBA) market. Specifically, these commenters asked the agencies to recalibrate the adjusted notional amount for TBA derivative contracts to account for the term of the mortgage loans underlying the securities. Other commenters recommended measuring *S* for TBA derivative contracts as the time-weighted average term of the mortgages underlying the securities. In response to commenter concerns, the agencies are clarifying that for an interest rate derivative contract or credit derivative contract that is a variable notional swap, including mortgage-backed securities traded in the TBA market, the notional amount is equal to the time-weighted average of the contractual notional amounts of such a swap over the remaining life of the swap.

Other commenters recommended measuring the adjusted notional amount for basis derivative contracts as the product of the absolute value of the spread between the two underlying risk factors (positive or negative) and the number of units. According to these commenters, such an approach would better reflect the risk of such transactions because SA–CCR requires the use of floating notional values, and the notional value may change after execution based on increases or decreases in the spread. The commenters also argued that such an approach would be consistent with guidance released by the CFTC regarding the notional amount for locational basis derivative contracts.[87] The final rule does not incorporate the commenters' suggestion, as the purpose of the proposed treatment is to obtain the absolute volatility of the contract price, which is related to each risk factor rather than the spread.

The final rule adopts without change the proposed treatment for determining the adjusted notional amount for credit and interest rate derivative contracts. Under § __.132(c)(9)(ii)(A) of the final rule, the adjusted notional amount for such contracts equals the product of the notional amount of the derivative contract, as measured in U.S. dollars using the exchange rate on the date of the calculation, and the supervisory duration. The formula to determine the supervisory duration is as follows:

$$Supervisory\ duration = \ max\left\{\frac{e^{-0.05*\left(\frac{S}{250}\right)}-e^{-0.05*\left(\frac{E}{250}\right)})}{0.05}, 0.04\right\},$$

Where:

S is the number of business days from the present day until the start date for the derivative contract, or zero if the start date has already passed; and

E is the number of business days from the present day until the end date for the derivative contract.

A banking organization must calculate the supervisory duration for the period that starts at *S* and ends at *E,* where *S* equals the number of business days between the present date and the start date for the derivative contract, or zero if the start date has passed, and *E* equals the number of business days from the present date until the end date for the derivative contract. The supervisory duration recognizes that interest rate derivative contracts and credit derivative contracts with a longer tenor have a greater degree of variability than an identical derivative contract with a shorter tenor for the same change in the underlying risk factor (interest rate or credit spread), and is based on the assumption of a continuous stream of equal payments and a constant continuously compounded interest rate of 5 percent. The exponential function provides discounting for *S* and *E* at 5 percent continuously compounded. In all cases, the supervisory duration is floored at ten business days (or 0.04, based on an average of 250 business days per year).

For an interest rate derivative contract or a credit derivative contract that is a variable notional swap, the notional amount equals the time-weighted average of the contract notional amounts of such a swap over the remaining life of the swap. For an interest rate derivative contract or a credit derivative contract that is a leveraged swap, in which the notional amounts of all legs of the derivative contract are divided by a factor and all rates of the derivative contract are multiplied by the same factor, the notional amount equals the notional amount of an equivalent unleveraged swap.

ii. Exchange Rate Derivative Contracts

Under the proposal, the adjusted notional amount for an exchange rate derivative contract would have equaled the notional amount of the non-U.S. denominated currency leg of the derivative contract, as measured in U.S. dollars using the exchange rate on the date of the calculation. In general, the non-U.S. dollar denominated currency leg is the source of exchange rate volatility. If both legs of the exchange rate derivative contract are denominated in currencies other than U.S. dollars, the adjusted notional amount of the derivative contract would have been the largest leg of the derivative contract, measured in U.S. dollars. For an exchange rate derivative contract with multiple exchanges of principal, the notional amount would have equaled

[87] *See* CFTC, Division of Swap Dealer and Intermediary Oversight, FAQs About Swap Entities (Oct. 12, 2012), at 1.

the notional amount of the derivative contract multiplied by the number of exchanges of principal under the derivative contract. The agencies received no comments on the proposed adjusted notional amount for exchange rate derivative contracts, and are adopting it as final under § __.132(c)(9)(ii)(B) of the final rule.

iii. Equity and Commodity Derivative Contracts

Under the proposal, a banking organization would have applied the same single-factor formula to equity derivative contracts and commodity derivative contracts. For such contracts, the adjusted notional amount would have equaled the product of the fair value of one unit of the reference instrument underlying the derivative contract and the number of such units referenced by the derivative contract. By design, the proposed treatment would have reflected the current price of the underlying reference instrument. For example, if a banking organization has a derivative contract that references 15,000 pounds of frozen concentrated orange juice currently priced at $0.0005 a pound then the adjusted notional amount would be $7.50. For an equity derivative contract or a commodity derivative contract that is a volatility derivative contract, a banking organization would have been required to replace the unit price with the underlying volatility referenced by the volatility derivative contract and replace the number of units with the notional amount of the volatility derivative contract. By design, the proposed treatment would have reflected that the payoff of a volatility derivative contract generally is determined based on a notional amount and the realized or implied volatility (or variance) referenced by the derivative contract and not necessarily the unit price of the underlying reference instrument. The agencies received no comments on the proposed adjusted notional amount for equity and commodity derivative contracts, including instances in which such a contract is a volatility derivative contract, and are adopting it without change under § __.132(c)(9)(ii)(C) of the final rule.

b. Supervisory Factor

i. Credit Derivative Contracts

In contrast to the Basel Committee standard, the proposal would not have provided for the use of credit ratings to determine the supervisory factor for credit derivative contracts due to section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which prohibits the use of credit ratings in Federal regulations.[88] As an alternative, the proposal would have introduced an approach that satisfies section 939A of the Dodd-Frank Act while allowing for a level of granularity among the supervisory factors applicable to single-name credit derivatives that would have been generally consistent with the Basel Committee standard.[89] Under the proposal for single-name credit derivative contracts, investment grade derivative contracts would have received a supervisory factor of 0.5 percent, speculative grade derivative contracts would have received a supervisory factor of 1.3 percent, and sub-speculative grade derivative contracts would have received a supervisory factor of 6.0 percent. For credit derivative contracts that reference an index, investment grade derivative contracts would have received 0.38 percent and speculative grade derivative contracts would have received 1.06 percent. The proposal would have revised the capital rule to include definitions for speculative grade and sub-speculative grade (the capital rule already includes a definition for investment grade). The agencies received several comments on the supervisory factors for credit derivative contracts, but no comments on the proposed definitions of speculative grade and sub-speculative grade.

Several commenters encouraged the agencies to reconsider the proposed methodology for determining the supervisory factors for single-name credit derivative contracts. As an alternative, the commenters recommended an approach that maps probability of default (PD) bands to the credit rating categories and the corresponding supervisory factors set forth in the Basel Committee standard for single-name credit derivatives, consistent with the approach used to assign a counterparty risk weight under the simple CVA approach in the advanced approaches.[90] According to the commenters, this approach would more closely align with the granularity and the supervisory factors provided under the Basel Committee standard, while meeting the requirements of section 939A of the Dodd-Frank Act. Alternatively, if the agencies declined to adopt the PD band-based approach for purposes of the final rule, the commenters suggested lowering the proposed supervisory factor for investment grade single-name credit derivatives from 0.5 percent to 0.46 percent, to eliminate the impact of rounding (to the nearest tenth) that was conducted for purposes of the proposal. Other commenters suggested aligning the supervisory factor for investment grade single-name credit derivatives to the lowest supervisory factor under the Basel Committee standard, 0.38 percent, based on the view that the most creditworthy issuers in the United States are no more prone to default than the most creditworthy issuers in other jurisdictions.

SA–CCR is a standardized approach, and the use of PD bands to assign supervisory factors to single-name credit derivatives would require the use of internal models, which generally are not appropriate for a standardized approach that is intended to be implementable by banking organizations of all sizes. In addition, providing such treatment as an option in SA–CCR could introduce more risk sensitivity solely for more sophisticated banking organizations that currently determine PD for purposes of the advanced approaches, and potentially provide a competitive advantage to such firms and adversely affect the use of SA–CCR to assess comparability across banking organizations. In addition, lowering the supervisory factor for single-name investment grade credit derivatives to 0.38 percent would fail to recognize the meaningful differences in the risks captured by the investment grade category under the proposal and the final rule, relative to the category and supervisory factor that correspond solely to an AAA credit rating under the Basel Committee standard. In response to comments, however, the final rule applies a 0.46 percent supervisory factor to investment grade single-name credit derivative contracts. This change will enhance the precision and risk sensitivity of the final rule, without introducing undue complexity or materially affecting the amount of regulatory capital a banking organization must hold for such derivative contracts relative to the proposal.

Therefore, the final rule adopts the supervisory factors for credit derivative contracts, as proposed, with one modification to the supervisory factor for investment grade single-name credit derivative contracts as described above. In addition, the final rule maintains the current definition of investment grade

[88] *See* Public Law 111–203, 124 Stat. 1376 (2010), section 939A. This provision is codified as part of the Securities Exchange Act of 1934 at 15 U.S.C. 78o–7.

[89] Specifically, the supervisory factors in the Basel Committee's SA–CCR standard are as follows (in percent): AAA and AA–0.38, A–0.42; BBB–0.54; BB–1.06; B–1.6; CCC–6.0.

[90] *See* 12 CFR 3.132(e)(5) (OCC); 12 CFR 217.132(e)(5) (Board); and 12 CFR 324.132(e)(5) (FDIC).

in the capital rule, and adopts the proposed definitions for ''speculative grade'' and ''sub-speculative grade.'' The supervisory factors are reflected in Table 2 of this **SUPPLEMENTARY INFORMATION**.

The investment grade category generally captures single-name credit derivative contracts consistent with the three highest supervisory factor categories under the Basel Committee standard. The capital rule defines investment grade to mean that the entity to which the banking organization is exposed through a loan or security, or the reference entity with respect to a credit derivative contract, has adequate capacity to meet financial commitments for the projected life of the asset or exposure. Such an entity or reference entity has adequate capacity to meet financial commitments, as the risk of its default is low and the full and timely repayment of principal is expected.[91]

The speculative grade category generally captures single-name credit derivative contracts consistent with the next two lower supervisory factor categories under the Basel Committee standard. The final rule defines the term speculative grade to mean that the reference entity has adequate capacity to meet financial commitments in the near term, but is vulnerable to adverse economic conditions, such that should economic conditions deteriorate, the reference entity would present elevated default risk. The sub-speculative grade category corresponds to the lowest supervisory factor category under the Basel Committee standard, with the term sub-speculative grade defined under the final rule to mean that the reference entity depends on favorable economic conditions to meet its financial commitments, such that should economic conditions deteriorate, the reference entity likely would default on its financial commitments. Each of these categories includes exposures that perform largely in accordance with the performance criteria that define each category under the final rule, and therefore result in capital requirements that are broadly equivalent to those resulting from application of the supervisory factors under the Basel Committee standard.[92]

The agencies expect that banking organizations would conduct their own due diligence to determine the appropriate category for a single-name credit derivative, in view of the performance criteria in the definitions for each category under the final rule. A banking organization may consider the credit rating for a single-name credit derivative in making that determination as part of a multi-factor analysis. In addition, the agencies expect a banking organization to have and retain support for its analysis and assignment of the respective credit categories.

ii. Equity Derivative Contracts

Under the proposal, single-name equity derivative contracts would have received a supervisory factor of 32 percent and equity derivative contracts that reference an index would have received a supervisory factor of 20 percent. The agencies received several comments regarding the proposed supervisory factors for equity derivative contracts. In general, the commenters recommended various approaches to distinguish among the risks of single-name equity derivative contracts and thereby provide additional granularity in the supervisory factors that correspond to such exposures. The approaches offered by the commenters would distinguish among (1) investment grade and non-investment grade issuers; (2) issuers in advanced and emerging markets; (3) issuers with large market capitalizations and those with small market capitalizations; and (4) issuers in different industry sectors. Some of the approaches suggested by commenters align with the Basel Committee market risk standard.[93] Commenters also suggested various permutations of these approaches (*e.g.,* use of sector differentiation in combination with a distinction for advanced and emerging markets). Some commenters provided analysis suggesting that each of these approaches could offer additional granularity and allow for lower supervisory factors for investment grade, advanced markets, and large cap issuers, relative to the supervisory factors under the proposal and the Basel Committee standard. Commenters also suggested incorporating one of the above distinctions into the supervisory factors for equity indices.

The agencies acknowledge that certain aspects of the proposal could be revised to enhance its risk sensitivity; however, any such revisions must be balanced against the objectives of simplicity and ensuring comparability among banking organizations that implement SA–CCR. Attempting to define different categories of market types or allocating exposures across the various alternate categories posed by commenters, and then calibrating supervisory factors associated with each of those sub-categories, would increase the complexity of applying SA–CCR and reduce comparability among banking organizations. Further adjustments to the supervisory factor for equity derivative contracts to align with the revised Basel III market risk standard, as recommended by commenters, potentially could be considered if that standard is implemented in the United States in a future rulemaking. Therefore, the final rule adopts as proposed the supervisory factors for equity derivative contracts, as reflected in Table 2 of the final rule.

iii. Commodity Derivative Contracts

The proposal would have established four commodity categories: Energy, metals, agriculture, and other. Energy derivative contracts would have received a supervisory factor of 40 percent, whereas derivative contracts in the non-energy commodity categories (*i.e.,* metal, agricultural, and other) each would have received a supervisory factor of 18 percent.

The agencies received a number of comments on the proposed supervisory factors for commodity derivative contracts. Several commenters encouraged the agencies to recalibrate the supervisory factors for commodity derivative contracts to reflect the market price of forward contracts, stating that this would better reflect the actual volatility of the commodity derivatives market compared to the market price of spot contracts. According to these commenters, such an approach would reflect the widespread use of commodity derivative contracts in the market, as a way to hedge commodity price risk for months or years into the future. As an alternative to this recommendation, commenters suggested full alignment with the supervisory factors for commodity derivative contracts in the Basel Committee standard, which applies a 40 percent supervisory factor to electricity derivative contracts and an 18 percent supervisory factor to oil/gas derivative contracts, each within the energy category.

Other commenters expressed concern that the proposed supervisory factors for commodity derivative contracts were not sufficiently granular. These commenters argued that each of the commodity categories set forth in the proposal would include a wide range of commodity types that present different levels of risk. As a result, the commenters expressed concern that the

[91] ''Investment grade'' is defined in § __.2 of the capital rule. *See* 12 CFR 3.2 (OCC); 12 CFR 217.2 (Board); and 12 CFR 324.2 (FDIC).

[92] An empirical analysis for the supervisory factors applied to the investment grade and speculative grade categories is set forth in the **SUPPLEMENTARY INFORMATION** section of the proposal. *See* 83 FR 64660, 64675 (December 17, 2018).

[93] *See supra* note 79.

proposal would overstate the amount of capital that must be held for certain lower-risk commodities, particularly natural gas and certain types of agricultural commodities.[94] Several commenters expressed concern that the proposed supervisory factors for commodity derivative contracts would indirectly increase the cost of such contracts for commercial end-user counterparties, who may use commodity derivative contracts to manage commercial risk.

In response to comments, the final rule adopts a separate supervisory factor of 18 percent for all energy derivative contracts except for electricity derivative contracts, which receive a supervisory factor of 40 percent. This treatment enhances the risk sensitivity of the supervisory factors for derivative contract types within the energy commodity category in a manner that aligns with the Basel Committee standard.[95] The final rule does not revise the other supervisory factors proposed for commodity derivatives, or provide for more granularity in the supervisory factors. In addition to presenting significant challenges and materially increasing the complexity of the framework (as noted in section III.D.1.d. of this **SUPPLEMENTARY INFORMATION**), revising the proposal to include additional commodity categories for specific commodity types could limit the full offset treatment available to commodity types within the same category. Recalibrating the supervisory factors for commodity derivative contracts to reflect the volatility driven by forward prices also would not be appropriate for all commodity derivative contracts because the value of short-term derivative contracts—which also are prevalent within the market—is driven by spot prices rather than forward prices. Moreover, such an approach would materially deviate from the Basel Committee standard and could create material inconsistencies in the international treatment of derivative contracts across jurisdictions. Any such inconsistencies could create regulatory compliance burdens for large, internationally active banking organizations required to determine capital requirements for derivative contracts under multiple regulatory regimes, and could provide incentives for such banking organizations to book commodity derivatives in an entity located in the jurisdiction that provides for the most favorable treatment from a regulatory capital perspective.

Other commenters recommended revising the proposal to provide separate recognition for derivative contracts that reference commodity indices. According to these commenters, diversification across different commodities significantly lowers the volatility of a diversified index when compared to the undiversified volatilities of the index constituents. The final rule does not include a specific treatment for commodity indices because they are typically highly heterogeneous depending on their compositions and maturities and, as a result, a single calibration for such a broad asset class will not provide for the risk sensitivity intended by SA–CCR.

Under the proposal, a banking organization would have been required to treat a gold derivative contract as a commodity derivative contract rather than an exchange rate derivative contract, and apply a supervisory factor of 18 percent. Several commenters argued for revising the proposal to recognize gold derivative contracts as a type of exchange rate derivative contract. According to the commenters, such treatment would be consistent with CEM, IMM, the Basel Committee's Basel II accord issued in 2004 (Basel II),[96] and industry practice. The commenters also asserted that, similar to currencies, gold serves as a macroeconomic hedge to dynamic market conditions including declining equity prices, inflationary pressures, and political crises.

Based on an analysis of price data for gold, silver, nickel and platinum from January 2001 to January 2019, gold exhibits historical volatility levels that are generally consistent with those observed for other metals, and are nearly identical to the historical volatility levels observed for platinum over the same period. Accordingly, treating a gold derivative contract as an exchange rate derivative contract would significantly understate the risk associated with such exposures, notwithstanding their treatment under either Basel II, IMM or CEM. Moreover, the supervisory factors under SA–CCR are calibrated to volatilities observed in the primary risk factor, and are not based on the purpose for which such a derivative contract may be entered into. Therefore, consistent with the proposal, under the final rule a banking organization must treat a gold derivative contract as a commodity derivative contract, with a supervisory factor of 18 percent.

The final rule adopts the supervisory factors for commodity derivative contracts, as proposed, with one modification to the supervisory factor for energy derivative contracts that are not electricity derivative contracts as discussed above. The supervisory factors are reflected in Table 2 of this **SUPPLEMENTARY INFORMATION** and Table 2 to § __.132 of the final rule.

iv. Interest Rate Derivative Contracts

Under the proposal, interest rate derivative contracts would have received a supervisory factor of 0.5 percent. The agencies did not receive comments on this aspect of the proposal, and are adopting it as proposed, as reflected in Table 2 of this **SUPPLEMENTARY INFORMATION**.

v. Exchange Rate Derivative Contracts

Under the proposal, exchange rate derivative contracts would have received a supervisory factor of 4 percent. As noted in the discussion on supervisory factors for commodity derivative contracts, several commenters supported treating gold derivative contracts as a type of exchange rate derivative contract. However, as noted previously, treating a gold derivative as an exchange rate derivative contract would significantly understate the risk associated with such exposures. The agencies are therefore adopting as final the proposal to treat a gold derivative contract as a commodity derivative contract. The agencies did not receive comments on other aspects of the proposed supervisory factors for exchange rate derivative contracts, and are adopting them as final, as reflected in Table 2 of this **SUPPLEMENTARY INFORMATION**.

vi. Volatility Derivative Contracts and Basis Derivative Contracts

For volatility derivative contracts, the proposal would have required a banking organization to multiply the applicable supervisory factor based on the asset class related to the volatility measure by a factor of five. This treatment would have recognized that volatility derivative contracts are inherently subject to more price volatility than the underlying asset classes they reference.

For basis derivative contracts, the proposal would have required a banking

[94] *See* section III.D.1.d. of this **SUPPLEMENTARY INFORMATION**.

[95] As described in section III.D.1.d. of this **SUPPLEMENTARY INFORMATION**, for purposes of calculating the hedging set amount, the final rule permits full offsetting for all derivative contracts within a hedging set that reference the same commodity type, and partial offsetting for all derivative contracts within a hedging set that reference different commodity types within the same commodity category.

[96] *See* ''International Convergence of Capital Measurement and Capital Standards: A Revised Framework,'' Basel Committee on Banking Supervision (June 2004), *https://www.bis.org/publ/bcbs107.pdf.*

organization to multiply the applicable supervisory factor based on the asset class related to the basis measure by a factor of one half. This treatment would have reflected that the volatility of a basis derivative contract is based on the difference in volatilities of highly correlated risk factors, which would have resulted in a lower volatility than a derivative contract that is not a basis derivative contract. The agencies did not receive comments on the proposed supervisory factors for volatility derivative contracts and basis derivative contracts, and the final rule adopts this aspect of the proposal without change.

TABLE 2—SUPERVISORY OPTION VOLATILITY AND SUPERVISORY FACTORS FOR DERIVATIVE CONTRACTS

Asset class	Category	Type	Supervisory option volatility (percent)	Supervisory correlation factor (percent)	Supervisory factor [1] (percent)
Interest rate	N/A	N/A	50	N/A	0.50
Exchange rate	N/A	N/A	15	N/A	4.0
Credit, single name	Investment grade	N/A	100	50	0.46
	Speculative grade	N/A	100	50	1.3
	Sub-speculative grade	N/A	100	50	6.0
Credit, index	Investment Grade	N/A	80	80	0.38
	Speculative Grade	N/A	80	80	1.06
	N/A	N/A	120	50	32
Equity, index	N/A	N/A	75	80	20
Commodity	Energy	Electricity	150	40	40
		Other	70	40	18
	Metals	N/A	70	40	18
	Agricultural	N/A	70	40	18
	Other	N/A	70	40	18

[1] The applicable supervisory factor for basis derivative contract hedging sets is equal to one-half of the supervisory factor provided in Table 2, and the applicable supervisory factor for volatility derivative contract hedging sets is equal to 5 times the supervisory factor provided in Table 2.

c. Supervisory Delta Adjustment

Under the proposal, a banking organization would have applied the supervisory delta adjustment to account for the sensitivity of a derivative contract to the underlying primary risk factor, including the correct sign (positive for long and negative for short) to account for the direction of the derivative contract amount relative to the primary risk factor. Because option contracts are nonlinear, the proposal would have required a banking organization to use the Black-Scholes Model to determine the supervisory delta adjustment.

Some commenters argued that use of the Black-Scholes Model is not appropriate for certain path-dependent options, because their price is not determined by a single price but instead is determined by the path of the price for the underlying asset during the option's tenor. For such path-dependent options, the commenters asked that banking organizations instead be allowed to use existing internal models. Similarly, other commenters requested allowing banking organizations to use modeled volatilities for purposes of the supervisory delta adjustment, rather than the volatilities prescribed by the proposal. Conversely, other commenters supported the agencies' proposal with respect to the calibration of supervisory deltas.

As generally noted above, SA–CCR is a standardized framework, and the use of internal models to determine option volatility would generally not be appropriate for a standardized approach that is intended to be implementable by all banking organizations and used to facilitate supervisory assessments of comparability across banking organizations. Allowing banking organizations to use internal models for purposes of the final rule would not support these objectives. The agencies note that advanced approaches banking organizations may continue to use IMM, which is a model-based approach, to determine the exposure amount of derivative contracts for purposes of calculating advanced approaches total risk-weighted assets.[97]

The final rule adopts the supervisory delta adjustment as proposed. Under § __.132(c)(9)(iii) of the final rule, the supervisory delta adjustment for derivative contracts that are not options or collateralized debt obligation tranches must account only for the direction of the derivative contract (positive or negative) with respect to the underlying risk factor, as such contracts are considered to be linear in the primary risk factor. Accordingly, the supervisory delta adjustment equals one if such a derivative contract is long the primary risk factor and negative one if it is short the primary risk factor.

As noted above, because options contracts are nonlinear, a banking organization must use the Black-Scholes Model to determine the supervisory delta adjustment for options contracts. However, because the Black-Scholes Model assumes that the underlying risk factor is greater than zero, consistent with the proposal, the final rule incorporates a parameter, lambda (λ), so that the Black-Scholes Model may be used where the underlying risk factor has a negative value. In particular, the Black Scholes formula provides a ratio, P/K, as an input to the natural logarithm function. P is the fair value of the underlying instrument and K is the strike price. The natural logarithm function can be defined only for amounts greater than zero, and therefore, a reference risk factor with a negative value (*e.g.,* negative interest rates) would make the supervisory delta adjustment inoperable.

[97] *See supra* note 25.

[98] Under the final rule, a banking organization must represent binary options with strike K as the combination of one bought European option and one sold European option of the same type as the original option (put or call) with the strike prices set equal to 0.95 * K and 1.05 * K. The size of the position in the European options must be such that the payoff of the binary option is reproduced exactly outside the region between the two strikes. The absolute value of the sum of the adjusted derivative contract amounts of the bought and sold options is capped at the payoff amount of the binary option.

Table 3 – Supervisory Delta Adjustment for Options[98]

	Bought	Sold
Call Options	$\Phi\left(\frac{\ln\left(\frac{P+\lambda}{K+\lambda}\right)+0.5*\sigma^2*T/250}{\sigma*\sqrt{T/250}}\right)$	$-\Phi\left(\frac{\ln\left(\frac{P+\lambda}{K+\lambda}\right)+0.5*\sigma^2*T/250}{\sigma*\sqrt{T/250}}\right)$
Put Options	$-\Phi\left(-\frac{\ln\left(\frac{P+\lambda}{K+\lambda}\right)+0.5*\sigma^2*T/250}{\sigma*\sqrt{T/250}}\right)$	$\Phi\left(-\frac{\ln\left(\frac{P+\lambda}{K+\lambda}\right)+0.5*\sigma^2*T/250}{\sigma*\sqrt{T/250}}\right)$

Where:

Φ is the standard normal cumulative distribution function;

P equals the current fair value of the instrument or risk factor, as applicable, underlying the option;

K equals the strike price of the option;

T equals the number of business days until the latest contractual exercise date of the option; and

λ equals zero for all derivative contracts, except that for interest rate options that reference currencies currently associated with negative interest rates λ must be equal to max $\{-L + 0.1\%; 0\}$;[99] and

σ equals the supervisory option volatility, determined in accordance with Table 2 of the preamble.

Consistent with the proposal, under the final rule, for a derivative contract that can be represented as a combination of standard option payoffs (such as collar, butterfly spread, calendar spread, straddle, and strangle),[100] a banking organization must treat each standard option component as a separate derivative contract. For a derivative contract that includes multiple-payment options (such as interest rate caps and floors),[101] a banking organization must represent each payment option as a combination of effective single-payment options (such as interest rate caplets and floorlets). A banking organization cannot decompose linear derivative contracts (such as swaps) into components.

For a derivative contract that is a collateralized debt obligation tranche, a banking organization must determine the supervisory delta adjustment according to the following formula:

$$\text{Supervisory delta adjustment} = \frac{15}{(1+14*A)*(1+14*D)},$$

Where:

A is the attachment point, which equals the ratio of the notional amounts of all underlying exposures that are subordinated to the banking organization's exposure to the total notional amount of all underlying exposures, expressed as a decimal value between zero and one;[102] and

D is the detachment point, which equals one minus the ratio of the notional amounts of all underlying exposures that are senior to the banking organization's exposure to the total notional amount of all underlying exposures, expressed as a decimal value between zero and one.

The final rule applies a positive sign to the resulting amount if the banking organization purchased the collateralized debt obligation tranche and applies a negative sign if the banking organization sold the collateralized debt obligation tranche.

d. Maturity Factor

The proposal would have provided separate maturity factors based on whether a derivative contract is subject to a variation margin agreement. For derivative contracts subject to a variation margin agreement, the maturity factor would have been based on the ratio of the supervisory-provided MPOR applicable to the type of derivative contract and 250 business days. The proposal would have defined MPOR as the period from the most recent exchange of collateral under a variation margin agreement with a defaulting counterparty until the

[99] The same value of λ_i must be used for all interest rate options that are denominated in the same currency. The value of λ_i for a given currency would be equal to the lowest value L of P_i and K_i of all interest rate options in a given currency that the banking organization has with all counterparties.

[100] A collar is a combination of a long position in the stock, a long put option and a short call option, in which the investor gives up the upside on the stock (by selling the call option) to obtain downside protection (through the purchase of the put option).

A butterfly spread consists of a long put (call) with a low exercise price, a long put (call) with a high exercise price, and two short puts (calls) with an intermediate exercise price, in which the investor earns a profit if the underlying asset equals the intermediate exercise price of two short puts (calls) but has limited their potential loss to no more than the low exercise price of the long put (call).

A calendar spread consists of a short call (put) option and a long call (put) option on the same underlying stock and with the same exercise price, but with different maturities. If the investor expects limited price movement on the stock in the near-term but a significant longer-term price increase, the investor will sell the short-dated call option and purchase the long-dated call option.

A straddle consists of a long (short) call option and long (short) put option on the same underlying stock, with the same exercise price and with the same maturity, in which the investor pays (receives) two option premiums upfront. In a long straddle, the investor pays two premiums upfront for the options in order to hedge against expected large future stock price moves regardless of direction. In a short straddle, the investor receives two option premiums upfront based on their expectation of low future price volatility.

A strangle consists of a call and put option on the same underlying stock and with the same exercise date, but with different exercise prices. The strategy is similar to the straddle, but the investor is purchasing (selling) out-of-the-money options in a strangle, while in a straddle, the investor is purchasing (selling) at-the-money options.

[101] An interest rate cap is a series of interest rate call options (''caplets'') in which the option seller pays the option buyer when the reference rate exceeds the predetermined level in the contract. An interest rate floor is a series of interest rate put options (''floorlets'') in which the option seller pays the options buyer when the reference rate falls below the contractual floor.

[102] In the case of a first-to-default credit derivative, there are no underlying exposures that are subordinated to the banking organization's exposure and A = 0. In the case of a second-or-subsequent-to-default credit derivative, the smallest (n − 1) notional amounts of the underlying exposures are subordinated to the banking organization's exposure.

derivative contracts are closed out and the resulting market risk is re-hedged. For derivative contracts subject to a variation margin agreement that are not cleared transactions, MPOR would have been floored at ten business days. For derivative contracts subject to a variation margin agreement and that are cleared transactions, MPOR would have been floored at five business days. For derivative contracts not subject to a variation margin agreement, the maturity factor would have been based on the ratio of the remaining maturity of the derivative contract, capped at 250 business days, with the numerator floored at ten business days.

Several commenters asked the agencies to clarify whether a five-business-day MPOR floor would apply to the exposure of a clearing member banking organization to its client that arises when the clearing member banking organization is acting as a financial intermediary and enters into an offsetting derivative contract with a CCP or when the clearing member banking organization provides a guarantee to the CCP on the performance of the client on a derivative contract with the CCP. In response to comments, the final rule applies a five-business-day MPOR floor to the exposure of a clearing member banking organization to its client that arises when the clearing member banking organization is acting as a financial intermediary and enters into an offsetting derivative contract with a QCCP or when the clearing member banking organization provides a guarantee to the QCCP on the performance of the client on a derivative contract with the QCCP (defined under this final rule as a ''client-facing derivative transaction,'' as described below).[103]

Some commenters noted that the criteria for doubling the MPOR under the proposal is different from the existing criteria under the IMM. Under the proposal, a banking organization would have been required to double the applicable MPOR floor if the derivative contract is subject to an outstanding dispute over margin. Under the IMM, a banking organization must double the applicable MPOR only if over the two previous quarters more than two margin disputes in a netting set have occurred and lasted longer than the MPOR. The agencies are aligning the treatment in the final rule with this approach. Therefore, a banking organization must double the applicable MPOR only if over the two previous quarters more than two margin disputes in a netting set have occurred, and each margin dispute lasted longer than the MPOR.[104] This approach is consistent with the treatment under IMM, which has generally functioned as intended. In addition, alignment with IMM will reduce operational burden for firms that are required to use SA–CCR for calculating standardized risk-weighted assets, but have received prior supervisory approval to use IMM to calculate risk-weighted assets under the advanced approaches.

Other commenters requested revising the proposal to allow banking organizations to treat all derivative contracts with a commercial end-user counterparty as subject to a variation margin agreement and apply a holding period of no more than ten business days, regardless of whether the derivative contract is subject to a variation margin agreement. The reasons provided by commenters for this request were to help address the types of concerns raised by commenters regarding exposures to commercial end-user counterparties, as discussed previously. The final rule does not provide maturity factors based on the type of counterparty to the derivative contract because the agencies intend for the maturity factor to capture the time period to close out a defaulted counterparty and the degree of legal certainty with respect to such close-out period. With respect to comments regarding the MPOR for exposures to commercial end-user counterparties, removing the alpha factor for derivative contracts with such counterparties should help to address the commenters' concerns.

Some commenters asked the agencies to replace the term ''exotic derivative contracts'' [105] under the proposal with ''derivative contracts that are not easily replaceable'' in order to allow banking organizations to rely on existing operational processes rather than requiring the establishment of new ones to identify ''exotic derivative contracts.'' These commenters noted that banking organizations have already established the operational processes necessary for identifying derivative contracts as ''not easily replaceable'' to comply with other aspects of the capital rule. In response to commenters' concerns, the agencies are replacing the term ''exotic derivative contract'' with ''derivative contract that cannot be easily replaced.''

For the reasons described above, the agencies are adopting as final the proposed maturity factor adjustment under § __.132(c)(9)(iv) of the final rule, subject to the clarifications and revisions discussed above. Under the final rule, for derivative contracts not subject to a variation margin agreement, or derivative contracts subject to a variation margin agreement under which the counterparty to the variation margin agreement is not required to post variation margin to the banking organization, a banking organization must determine the maturity factor using the following formula:

$$\text{Maturity factor} = \sqrt{\frac{\min\{M, 250\}}{250}},$$

Where M equals the greater of ten business days and the remaining maturity of the contract, as measured in business days.

For derivative contracts subject to a variation margin agreement under which the counterparty must post variation margin, a banking organization must determine the maturity factor using the following formula:

[103] Section 132(c)(9)(iv)(A)(2)(ii) of the proposed rule text would have applied a five-business-day MPOR floor to cleared transactions subject to a variation margin agreement. In order to capture the longer close-out period required in the event of a central counterparty failure, the final rule text at section 132(c)(9)(iv)(A)(1) provides that MPOR cannot be less than ten business days for transactions subject to a variation margin agreement that are not client-facing derivative transactions.

The final rule is consistent with the Basel Committee standard regarding capital requirements for bank exposures to central counterparties and with the treatment of these transactions under the agencies' implementation of CEM. *See infra* note 116.

[104] The adopted treatment is also consistent with the application of the standard supervisory haircuts under § __.132(b)(2)(ii)(A)(*4*) of the final rule.

[105] Under the proposal, a banking organization would have been required to use a MPOR of 20 business days for a derivative contract that is within a netting set that is composed of more than 5,000 derivative contracts that are not cleared transactions, or if a netting set contains one or more trades involving illiquid collateral or exotic derivative contracts.

$$\text{Maturity factor} = \frac{3}{2}\sqrt{\frac{MPOR}{250}},$$

Where MPOR refers to the period from the most recent exchange of collateral under a variation margin agreement with a defaulting counterparty until the derivative contracts are closed out and the resulting market risk is re-hedged.

The final rule introduces the term ''client-facing derivative transactions'' to describe the exposure of a clearing member banking organization to its client that arises when the clearing member banking organization is either acting as a financial intermediary and enters into an offsetting derivative contract with a QCCP or when the clearing member banking organization provides a guarantee to the QCCP on the performance of the client for a derivative contract with the QCCP. Under the final rule, the agencies are clarifying that the MPOR is floored at five business days for derivative contracts subject to a variation margin agreement that are client-facing derivative transactions. For all other derivative contracts subject to a variation margin agreement, the MPOR is floored at ten business days. If over the previous two quarters a netting set is subject to two or more outstanding margin disputes that lasted longer than the MPOR, the applicable MPOR is twice the MPOR provided for those transactions in the absence of such disputes.[106] For a derivative contract that is within a netting set that is composed of more than 5,000 derivative contracts that are not cleared transactions, or if a netting set contains one or more transactions involving illiquid collateral or a derivative contract that cannot be easily replaced, the MPOR is floored at 20 business days.

For a cleared derivative contract in which on specified dates any outstanding exposure of the derivative contract is settled and the fair value of the derivative contract is reset to zero, the remaining maturity of the derivative contract is the period until the next reset date.[107] In addition, derivative contracts with daily settlement would be treated as unmargined derivative contracts. However, as discussed in section III.D.4. of this **SUPPLEMENTARY INFORMATION**, a banking organization may elect to treat settled-to-market derivative contracts as collateralized-to-market derivative contracts subject to a variation margin agreement and apply the maturity factor for derivative contracts subject to a variation margin agreement.

3. PFE Multiplier

Under the proposal, the PFE multiplier would have recognized, if present, the amount of excess collateral available and the negative fair value of the derivative contracts within the netting set. Specifically, the PFE multiplier would have decreased exponentially from a value of one as the value of the financial collateral held exceeds the net fair value of the derivative contracts within the netting set, subject to a floor of 5 percent. This function accounted for the fact that the proposed aggregated amount formula would not have recognized financial collateral and would have assumed a zero market value for all derivative contracts.

Several commenters argued that the PFE multiplier is too conservative and does not appropriately account for the risk-reducing effects of collateral. Some commenters argued that the calibration of the aggregated amount for a netting set would result in an overly conservative PFE multiplier amount, and that the aggregated amount in the PFE multiplier should be divided by at least two to mitigate such conservatism. Other commenters argued that because other factors under SA–CCR already contribute to the conservative recognition of initial margin (*e.g.,* the calibration of the add-on, use of an exponential function, and reflection of collateral volatility through haircuts that do not allow any diversification across collateral), the agencies should decrease the floor to 1 percent because initial margin requirements for uncleared swaps under the swap margin rule generally are calibrated to a 99 percent confidence level. Additionally, these commenters argued that the floor should not be a component of the PFE multiplier function but instead should act as an independent floor to the recognition of collateral under the PFE function. According to these comments, while these changes would result in more risk-sensitive initial margin recognition for heavily overcollateralized netting sets, the overall impact would remain conservative due to the overcalibration of the add-on. Other commenters asked the agencies to recognize the effect of collateral on a dollar-for-dollar basis, subject to haircuts, similar to the recognition of collateral under the replacement cost component of SA–CCR.

Relative to CEM, SA–CCR is more sensitive to the risk-reducing benefits of collateral. However, the agencies recognize that as a standardized framework, SA–CCR may not appropriately capture risks in all cases (*e.g.,* collateral haircuts may be less than those realized in stress periods) and therefore believe it is appropriate to instill conservatism. The combination of the exponential function and the floor provides adequate recognition of collateral while maintaining a sufficient level of conservatism by limiting decreases in PFE due to large amounts of collateral and preventing PFE from reaching zero for any amount of margin. This ensures that some amount of capital will be maintained even in situations where the transaction is overcollateralized. The commenters' recommendations could, in certain circumstances, undermine these objectives. Therefore, the final rule adopts the PFE multiplier as proposed.

Under the final rule, a banking organization must calculate the PFE multiplier using the formula set forth in §__.132(c)(7)(i) of the final rule, as follows:

$$PFE\ multiplier = min\left\{1; 0.05 + 0.95 * e^{\left(\frac{V-C}{1.9*A}\right)}\right\},$$

Where:

V is the sum of the fair values (after excluding any valuation adjustments) of the derivative contracts within the netting set;

[106] In general, a party will not have violated its obligation to collect or post variation margin from or to a counterparty if: The counterparty has refused or otherwise failed to provide or accept the required variation margin to or from the party; and the party has made the necessary efforts to collect or post the required variation margin, including the timely initiation and continued pursuit of formal dispute resolution mechanisms; or has otherwise demonstrated that it has made appropriate efforts to collect or post the required variation margin; or commenced termination of the derivative contract with the counterparty promptly following the applicable cure period and notification requirements.

[107] *See* 12 CFR 3.2 (OCC); 12 CFR 217.2 (Board); and 12 CFR 324.2 (FDIC).

C is the sum of the net independent collateral amount and the variation margin amount applicable to the derivative contracts within the netting set; and

A is the aggregated amount of the netting set.

The PFE multiplier decreases as the net fair value of the derivative contracts within the netting set less the amount of collateral decreases below zero. Specifically, when the component $V - C$ is greater than zero, the multiplier is equal to one. When the component $V - C$ is less than zero, the multiplier is equal to an amount less than one and decreases exponentially in value as the absolute value of $V - C$ increases. The PFE multiplier approaches a floor of 5 percent as the absolute value of $V - C$ becomes very large as compared with the aggregated amount of the netting set.

4. PFE Calculation for Nonstandard Margin Agreements

When a single variation margin agreement covers multiple netting sets, the parties exchange variation margin based on the aggregated market value of the netting sets—*i.e.,* netting sets with positive and negative market values can offset one another to reduce the amount of variation margin that the parties are required to exchange. This can result, however, in a situation in which margin exchanged between the parties will be insufficient relative to the banking organization's exposure amount for the netting sets.[108] To address such a situation, the proposal would have required a banking organization to assign a single PFE to each netting set covered by a single variation margin agreement, calculated as if none of the derivative contracts within the netting set are subject to a variation margin agreement. The agencies did not receive comments on this aspect of the proposal, and are adopting it as proposed under § __.132(c)(10)(ii) of the final rule.

The proposal also would have provided a separate calculation to determine PFE for a situation in which a netting set is subject to more than one variation margin agreement, or for a hybrid netting set. Under the proposal, a banking organization would have divided the netting set into sub-netting sets and calculated the aggregated amount for each sub-netting set. In particular, all derivative contracts within the netting set that are not subject to a variation margin agreement or that are subject to a variation margin agreement under which the counterparty is not required to post variation margin would have formed a single sub-netting set. A banking organization would have been required to calculate the aggregated amount for this sub-netting set as if the netting set were not subject to a variation margin agreement. All derivative contracts within the netting set that are subject to variation margin agreements under which the counterparty must post variation margin and that share the same MPOR value would have formed another sub-netting set. A banking organization would have been required to calculate the aggregated amount for this sub-netting set as if the netting set were subject to a variation margin agreement, using the MPOR value shared by the derivative contracts within the netting set.

Several commenters asked the agencies to allow banking organizations to net based solely on whether a QMNA that provides for closeout netting per applicable law in the event of default is in place. These commenters asserted that netting should not be limited to derivative contracts with the same MPOR because the purpose of the MPOR is to capture the risks associated with an extended closeout period upon a counterparty's default and that differences in MPOR are unrelated to the legal ability to net upon closeout, which should be based only on legal certainty which is established under U.S. law if the netting agreement is a QMNA. In particular, commenters were concerned that the proposal would prohibit banking organizations from being able to net settled-to-market[109] derivative contracts with collateralized-to-market derivative contracts,[110] as well as futures-style options and options with equity-style margining,[111] even if such contracts are within the same netting set.

The proposal's distinction between margined and unmargined derivative contracts would not have fully captured the relationship between settled-to-market derivative contracts and collateralized-to-market derivative contracts that are cleared transactions as defined under § __.2 of the capital rule. In particular, under both cleared settled-to-market and cleared collateralized-to-market derivative transactions a banking organization must either make a settlement payment or exchange collateral to support its outstanding credit obligation to the counterparty on a periodic basis. Such contracts are functionally and economically similar from a credit risk perspective, and therefore, the final rule allows a banking organization to elect, at the netting set level, to treat all the settled-to-market derivative contracts within the netting set that are cleared transactions as subject to a variation margin agreement and receive the benefits of netting with cleared collateralized-to-market derivative contracts. That is, a banking organization that makes such election will treat such cleared settled-to-market derivative contracts as cleared collateralized-to-market derivative contracts, using the higher maturity factor applicable to collateralized-to-market derivative contracts.[112]

Similarly, for listed options, the agencies are clarifying that a banking organization may elect to treat listed options on securities or listed options on futures with equity-style margining that are cleared transactions as margined derivatives. Under the final rule, a banking organization may elect to treat all such transactions within the same netting set as being subject to a variation margin agreement with a zero threshold amount and a zero minimum transfer amount, given that the daily net option value credits and debits are economically equivalent to an exchange of variation margin under a zero threshold and a zero minimum transfer amount. Consistent with the treatment described above for settled-to-market derivative contracts that are treated as collateralized-to-market, a banking

[108] For example, consider a variation margin agreement with a zero threshold amount that covers two separate netting sets, one with a positive market value of 100 and the other with a market value of negative 100. The aggregate market value of the netting sets would be zero and thus no variation margin would be exchanged. However, the banking organization's aggregate exposure amount for these netting sets would be equal to 100 because the negative market value of the second netting set would not be available to offset the positive market value of the first netting set. In the event of default of the counterparty, the banking organization would pay the counterparty 100 for the second netting set and would be exposed to a loss of 100 on the first netting set.

[109] *See supra* note 18.

[110] In general, in a collateralized-to-market derivative contract, title of transferred collateral stays with the posting party.

[111] In general, for margining for options, the buyer of the option pays a premium upfront to the seller and there is no exchange of variation margin. The buyer, however, may credit the net value of the option against its initial margin requirements. The seller, in turn, receives a debit against its initial margin requirement in the amount of the net option value. The option is subject to daily revaluation with increases and decreases to the net option value resulting in adjustments to the buyer's and the seller's net option value credits and debits. In addition, under U.S. GAAP, the option is an asset and the banking organization could use it in the event of a client's default to offset any other losses the buyer may have.

[112] § __.132(c)(9)(iv)(A) of the final rule. Similar to the treatment under CEM, SA–CCR provides a lower maturity factor for cleared settled-to-market derivative contracts that meet certain criteria. *See* ''Regulatory Capital Treatment of Certain Centrally-cleared Derivative Contracts Under Regulatory Capital Rules'' (August 14, 2017), OCC Bulletin: 2017–27; Board SR letter 07–17; and FDIC Letter FIL–33–2017.

organization that elects to apply this treatment must apply the maturity factor applicable to margined derivative contracts.

Except for the changes described above, the agencies are adopting the proposed approach for netting sets subject to more than one variation margin agreement, or for a hybrid netting set.[113]

IV. Revisions to the Cleared Transactions Framework

Under the capital rule, a banking organization must maintain regulatory capital for its exposure to, and certain collateral posted in connection with, a derivative contract that is a cleared transaction (as defined under § __.2 of the capital rule). A clearing member banking organization also must hold risk-based capital for its default fund contributions.[114] The proposal would have revised the cleared transactions framework under the capital rule by replacing CEM with SA–CCR for advanced approaches banking organizations in both the advanced approaches and standardized approach. Non-advanced approaches banking organizations would have been permitted to elect to use SA–CCR or CEM for noncleared and cleared derivative contracts, but would have been required to use the same approach for both.[115] In addition, the proposal would have simplified the formula that a clearing member banking organization must use to determine the risk-weighted asset amount for its default fund contributions. The proposed revisions were consistent with standards developed by the Basel Committee.[116]

A. Trade Exposure Amount

Under the proposal, an advanced approaches banking organization that elected to use SA–CCR for purposes of determining the exposure amount of a noncleared derivative contract under the advanced approaches would have been required to also use SA–CCR (instead of IMM) to determine the trade exposure amount for a cleared derivative contract under the advanced approaches. In addition, an advanced approaches banking organization would have been required to use SA–CCR to determine the exposure amount for both its cleared and noncleared derivative contracts under the standardized approach. A non-advanced approaches banking organization that elected to use SA–CCR for purposes of determining the exposure amount of a non-cleared derivative contract would have been required to use SA–CCR (instead of CEM) to determine the trade exposure amount for a cleared derivative contract.

Several commenters recommended providing advanced approaches banking organizations the option to use SA–CCR or IMM for purposes of the cleared transactions framework, regardless of the banking organization's election to use SA–CCR or IMM to determine the exposure amount of noncleared derivative contracts under the advanced approaches. As discussed in section II.A. of this **SUPPLEMENTARY INFORMATION**, the agencies believe that requiring an advanced approaches banking organization to use one of either SA–CCR or IMM for both cleared and noncleared derivative contracts under the advanced approaches promotes consistency in the regulatory capital treatment of derivative contracts and facilitates the supervisory assessment of a banking organization's capital management program.

Some commenters asked the agencies to remove from the calculation of trade exposure amount the requirement to include non-cash initial margin posted to a CCP that is not held in a bankruptcy-remote manner. According to commenters, this requirement would overstate the banking organization's exposure to such collateral, because collateral posted to a CCP remains on the balance sheet of the banking organization and must be reflected in risk-weighted assets under the capital rule. Collateral held in a manner that is not bankruptcy remote exposes a banking organization to risk of loss should the CCP fail and the banking organization is unable to recover its collateral. This counterparty credit risk is separate from, and in addition to, the risk inherent to the collateral itself. Thus, the final rule does not remove from the calculation of trade exposure amount the requirement to include non-cash initial margin posted to a CCP that is not held in a bankruptcy remote manner.

Other commenters asked for clarification regarding the scope of transactions that would be subject to the cleared transactions framework. In particular, the commenters asked the agencies to clarify the treatment of an exposure between a banking organization and a clearing member where the banking organization acts as agent for its client for a cleared transaction by providing a guarantee to the clearing member of the QCCP for the performance of the client. The final rule clarifies that, in such a situation, the banking organization may treat its exposure to the transaction as if the banking organization were the clearing member and directly facing the QCCP (*i.e.,* the banking organization would have no exposure to the clearing member or the QCCP as long as it does not provide a guarantee to the client on the performance of the clearing member or QCCP).[117] Furthermore, in such a situation, the banking organization may treat the exposure resulting from the guarantee of the client's performance obligations with respect to the underlying derivative contract as a client-facing derivative transaction.[118] Similarly, under CEM, the banking organization may adjust the exposure amount for the client-facing derivative transaction by applying a scaling factor of the square root of ½ (which equals 0.707107) to such exposure or higher if the banking organization determines a longer holding period is appropriate.[119]

Some commenters asked the agencies to clarify how a clearing member banking organization that acts as agent on behalf of a client should reflect its temporary exposure to the client for the

[113] § __.132(c)(11)(ii) of the final rule.

[114] A default fund contribution means the funds contributed or commitments made by a clearing member banking organization to a CCP's mutualized loss-sharing arrangement. *See* 12 CFR 3.2 (OCC); 12 CFR 217.2 (Board); and 12 CFR 324.2, (FDIC).

[115] At the time of the proposal, an advanced approaches banking organization meant a banking organization that has at least $250 billion in total consolidated assets or if it has consolidated on-balance sheet foreign exposures of at least $10 billion, or if it is a subsidiary of a depository institution, bank holding company, savings and loan holding company or intermediate holding company that is an advanced approaches banking organization. Under the tailoring proposals adopted by the agencies, the supplementary leverage ratio also would have applied to banking organizations subject to Category III. Banking organizations subject to Category III standards would have been permitted to use CEM or a modified version of SA–CCR for purposes of the supplementary leverage ratio, but consistent with the proposal to implement SA–CCR, they would have been required to use the same approach (CEM or SA–CCR) for all purposes under the capital rule. *See* ''Proposed Changes to the Applicability Thresholds for Regulatory Capital and Liquidity Requirements,'' 83 FR 66024 (December 21, 2018) and ''Changes to Applicability Thresholds for Regulatory Capital Requirements for Certain U.S. Subsidiaries of Foreign Banking Organizations and Application of Liquidity Requirements to Foreign Banking Organizations, Certain U.S. Depository Instititution Holding Companies, and Certain Depository Institution Subsidiaries,'' 84 FR 24296 (May 24, 2019).

[116] *See* ''Capital requirements for bank exposures to central counterparties,'' Basel Committee on Banking Supervision (April 2014), *https://www.bis.org/publ/bcbs282.pdf.*

[117] *See* 12 CFR 3.3(a) (OCC); 12 CFR 217.3(a) (Board); and 12 CFR 324.3(a) (FDIC).

[118] As described in section III.D.2.d. of this **SUPPLEMENTARY INFORMATION**, for the client-facing derivative transaction (*i.e.,* the banking organization's exposure to the client due to the guarantee), the banking organization would treat the exposure as a non-cleared derivative contract using the five-business-day minimum MPOR.

[119] *See* 12 CFR 3.34(e) (OCC); 12 CFR 217.34(e) (Board); and 12 CFR 324.34(e) (FDIC).

collateral posted by the clearing member banking organization to the CCP, which the client subsequently will post to the clearing member banking organization. The commenters stated that the collateral advanced by the clearing member banking organization on behalf of the client creates a receivable under U.S. GAAP until the clearing member banking organization receives the collateral from the client. Accordingly, the commenters sought clarification on whether the amount of such receivables should be reflected in exposure amount of the client-facing derivative transaction or treated as a separate exposure to the client. Such receivables expose the clearing member banking organization to risk of loss should the client fail to subsequently post the collateral to the clearing member banking organization. This credit risk is separate from, and in addition to, the counterparty credit risk of the exposure arising from the client-facing derivative transaction, which represents the guarantee the clearing member banking organization provides for the client's performance on the underlying derivative transaction. Thus, consistent with U.S. GAAP, a clearing member banking organization must treat such a receivable as a credit exposure to the client for purposes of the capital rule, separate from the treatment applicable to the client-facing derivative transaction under this final rule.

For the reasons discussed above, the agencies are adopting as final under § __.133(b) of the final rule the proposal to replace CEM with SA–CCR for advanced approaches banking organizations in the capital rule, with one modification to introduce the defined term ''client-facing derivative transactions'' and clarify that such exposures receive a five-business-day minimum MPOR under SA–CCR, as discussed above. An advanced approaches banking organization that elects to use SA–CCR for purposes of determining the exposure amount of its noncleared derivative contracts under the advanced approaches must also use SA–CCR (instead of IMM) to determine the trade exposure amount for its cleared derivative contracts under the advanced approaches.[120]

A non-advanced approaches banking organization may continue to use CEM to determine the trade exposure amount for its cleared derivative contracts under the standardized approach. However, a non-advanced approaches banking organization that elects to use SA–CCR to calculate the exposure amount for its noncleared derivative contracts must use SA–CCR to calculate the trade exposure amount for its cleared derivative contracts.

B. Treatment of Default Fund Contributions

The proposal would have revised certain of the approaches that a banking organization could use to determine the risk-weighted asset amount for its default fund contributions. Specifically, the proposal would have eliminated method one and method two under section 133(d)(3) of the capital rule, either of which may be used by a clearing member banking organization to determine the risk-weighted asset amount for its default fund contributions to a QCCP.[121] In its place, the proposal would have implemented a single approach for a clearing member banking organization to determine the risk-weighted asset amount for its default fund contributions to a QCCP, which would have been less complex than method one but also more granular than method two. The proposal would have maintained the approach by which a clearing member banking organization determines its risk-weighted asset amount for its default fund contributions to a CCP that is not a QCCP.[122]

Some commenters asked the agencies to clarify that a banking organization's commitment to enter into reverse repurchase agreements with a CCP are not default fund contributions. Certain CCPs may require clearing members to provide funding in the form of reverse repurchase agreements in the event of a clearing member's default in order to support the liquidity needs of the CCP. The capital rule defines default fund contributions as the funds contributed to or commitments made by a clearing member to a CCP's mutualized loss sharing arrangements. The proposal did not contemplate changes to the definition of default fund contributions and the final rule does not revise this definition. Whether or not a particular arrangement meets the definition in the regulation depends on the facts and circumstances of the particular arrangement. The agencies may consider whether revisions to the definition are necessary in connection with future rulemakings if the definition is not functioning as intended.

Other commenters asked the Board to revise Regulation HH[123] to require QCCPs regulated by the Board to make available to clearing member banking organizations the information required to calculate the QCCP's hypothetical capital requirement. The commenters raised concerns that while domestic QCCPs will likely be prepared to provide the requisite data to calculate the hypothetical capital requirement, no regulation requires them to do so, and that foreign QCCPs are not subject to U.S. regulation and may not be prepared to provide the requisite data. The commenters also encouraged the agencies to work with the SEC and the CFTC to make similar revisions to their regulations applicable to domestic QCCPs and with international standard setters and foreign regulators to ensure that foreign QCCPs will be capable of providing U.S. banking organizations with the data required for the hypothetical capital calculations under the proposal. Lastly, the commenters asked that the agencies clarify that banking organizations may rely on the amount of a foreign QCCP's hypothetical capital requirement produced under a Basel-compliant SA–CCR regime.

The proposal did not contemplate changes to Regulation HH and thus the agencies view these comments as out of scope for this rulemaking. In addition, the Board's Regulation HH serves a different purpose than the capital rule and covers a different set of entities. However, the agencies recognize the concerns raised by the commenters with respect to potential difficulties for banking organizations in calculating the hypothetical capital requirement of a QCCP and intend to monitor whether banking organizations experience difficulties obtaining the hypothetical capital requirement (or the requisite information required to calculated it) from the QCCP to perform this calculation.[124] In recognition of these

[120] As discussed in section II.A. of this **SUPPLEMENTARY INFORMATION**, an advanced approaches banking organization must use SA–CCR to determine the trade exposure amount for its cleared derivative contracts and the exposure amount for its noncleared derivative contracts under the standardized approach.

[121] Method one is a complex three-step approach that compares the default fund of the QCCP to the capital the QCCP would be required to hold if it were a banking organization and provides a method to allocate the default fund deficit or excess back to the clearing member. Method two is a simplified approach in which the risk-weighted asset amount for a default fund contribution to a QCCP equals 1,250 percent multiplied by the default fund contribution, subject to a cap.

[122] In that case, the risk-weighted asset amount is the sum of the clearing member banking organization's default fund contributions multiplied by 1,250 percent.

[123] *See* 12 CFR part 234. Regulation HH relates to the regulation of designated financial market utilities by the Board.

[124] Under the capital rule, if a CCP does not provide the hypothetical capital requirement (or, alternatively, the required data) the CCP is not a QCCP and a banking organization must apply a risk weight of 1250 percent to its default fund

Continued

concerns, the final rule allows banking organizations that elect to use SA–CCR to continue to use method 1 or method 2 under CEM to calculate the risk-weighted asset amount for default fund contributions until January 1, 2022.[125] This is intended to provide sufficient time for clearing member banking organizations to coordinate with CCPs to obtain the hypothetical capital requirement produced under SA–CCR (or the requisite information to calculate it) from the CCPs, in order for such entities to qualify as QCCPs after the mandatory compliance date. The agencies are also clarifying that after January 1, 2022, the mandatory compliance date, a banking organization that is using SA–CCR may only consider a foreign CCP to be a QCCP for purposes of the capital rule if the foreign CCP produces its hypothetical capital requirement under SA–CCR (as implemented by the CCP's home country in a manner consistent with the Basel Committee standard). The agencies intend to monitor whether banking organizations experience difficulties obtaining the hypothetical capital requirement (or alternatively, the required data) after the January 1, 2022, mandatory compliance date. If, after January 2022, significant obstacles remain after a banking organization has made best efforts to obtain the necessary information from CCPs (*e.g.,* due to delays in the implementation of the Basel Committee standard in other jurisdictions), its primary Federal regulator may permit the banking organization to use method 2 of CEM to calculate risk-weighted asset amounts for default fund contributions for a specified period.

The agencies otherwise are generally adopting without change the proposed revisions to the risk-weighted asset calculation for default fund contributions under § __.133(d) of the final rule.[126] Thus, to determine the capital requirement for a default fund contribution to a QCCP, a clearing member banking organization first calculates the hypothetical capital requirement of the QCCP (K_{CCP}), unless the QCCP has already disclosed it, in which case the banking organization must rely on that disclosed figure. In either case, a banking organization may choose to use a higher amount of K_{CCP} than the minimum calculated under the formula or disclosed by the QCCP if the banking organization has concerns about the nature, structure, or characteristics of the QCCP. In effect, K_{CCP} serves as a consistent measure of a QCCP's default fund amount.

Under the final rule, a clearing member banking organization must calculate K_{CCP} according to the following formula:

$$K_{CCP} = \Sigma_{CM_i} EAD_i * 1.6 \textit{ percent,}$$

Where:

CM_i is each clearing member of the QCCP; and

EAD_i is the exposure amount of the QCCP to each clearing member of the QCCP, as determined under § __.133(d)(6).[127]

The component EAD_i includes both the clearing member banking organization's own transactions, the client transactions guaranteed by the clearing member, and all values of collateral held by the QCCP (including the clearing member banking organization's pre-funded default fund contribution) against these transactions. The 1.6 percent amount represents the product of a capital ratio of 8 percent and a 20 percent risk weight of a clearing member banking organization.

Subject to the transitional provisions described above, as of January 1, 2022, a banking organization that is required or elects to use SA–CCR to determine the exposure amount for its derivative contracts under the standardized approach must use a K_{CCP} calculated using SA–CCR for both the standardized approach and the advanced approaches.[128] For purposes of calculating K_{CCP}, the PFE multiplier includes collateral held by a QCCP in which the QCCP has a legal claim in the event of the default of the member or client, including default fund contributions of that member. In addition, the QCCP must use a MPOR of ten business days in the maturity factor adjustment. A banking organization that elects to use CEM to determine the exposure amount of its derivative contracts under the standardized approach must use a K_{CCP} calculated using CEM.

EAD must be calculated separately for each clearing member banking organization's sub-client accounts and sub-house account (*i.e.,* for the clearing member's proprietary activities). If the clearing member banking organization's collateral and its client's collateral are held in the same account, then the EAD of that account would be the sum of the EAD for the client-related transactions within the account and the EAD of the house-related transactions within the account. In such a case, for purposes of determining such EADs, the independent collateral of the clearing member banking organization and its client must be allocated in proportion to the respective total amount of independent collateral posted by the clearing member banking organization to the QCCP. This treatment protects against a clearing member banking organization recognizing client collateral to offset the QCCP's exposures to the clearing member banking organization's proprietary activity in the calculation of K_{CCP}.

In addition, if any account or sub-account contains both derivative contracts and repo-style transactions, the EAD of that account is the sum of the EAD for the derivative contracts within the account and the EAD of the repo-style transactions within the account. If independent collateral is held for an account containing both derivative contracts and repo-style transactions, then such collateral must be allocated to the derivative contracts and repo-style transactions in proportion to the respective product-specific exposure amounts. The respective product specific exposure amounts must be calculated, excluding the effects of collateral, according to § __.132(b) of the capital rule for repo-style transactions and to § __.132(c)(5) for derivative contracts.

A clearing member banking organization also must calculate its capital requirement (K_{CM_i}), which is the capital requirement for its default fund contribution, subject to a floor equal to a 2 percent risk weight multiplied by the clearing member banking

contributions to the CCP. *See* definition of ''qualifying central counterparty'' under § __.2 of the capital rule, 12 CFR 3.2 (OCC); 12 CFR 217.2 (Board); and 12 CFR 324.2 (FDIC).

[125] In cases where a banking organization uses method 1 to calculate the risk-weighted asset amount for a default fund contribution, a QCCP that provides the banking organization its hypothetical capital requirement produced using CEM would still qualify as a QCCP until January 1, 2022.

[126] In a nonsubstantive change, the agencies moved paragraphs (i) and (ii) of § __.133(d)(3) of the proposed rule text to paragraphs (iv) and (v) under § __.133(d)(6) of the final rule text. The agencies made this change because these sections provide instruction on calculating EAD for default fund contribution accounts, which are covered under § __.133(d)(6). In addition, the agencies changed the reference to (e)(4) in § __.133(d)(3) of the proposed rule text to (d)(4).

[127] Section 133(d)(6) of the proposed rule text would have required a banking organization to sum the exposure amount of all underlying transactions, the collateral held by the CCP, and any prefunded default contributions. In a technical correction to the proposal, and to recognize that collateral held by the QCCP and any prefunded default fund contributions serve to mitigate this exposure, the final rule text at section 133(d)(6) clarifies that banking organizations under the final rule must subtract from the exposure amount the value of collateral held by the QCCP and any prefunded default contributions. The final rule is consistent with the Basel Committee standard regarding capital requirements for bank exposures to central counterparties. *See supra* note 116.

[128] The final rule does not revise the calculations for determining the exposure amount of repo-style transactions for purposes of determining the risk-weighted asset amount of a banking organization's default fund contributions.

organization's prefunded default fund contribution to the QCCP and an 8 percent capital ratio. This calculation allocates K_{CCP} on a pro rata basis to each clearing member based on the clearing member's share of the overall default fund contributions. Thus, a clearing member banking organization's capital requirement increases as its contribution to the default fund increases relative to the QCCP's own prefunded amounts and the total prefunded default fund contributions from all clearing members to the QCCP. In all cases, a clearing member banking organization's capital requirement for its default fund contribution to a QCCP may not exceed the capital requirement that would apply if the same exposure were calculated as if it were to a CCP that is not a QCCP.

A clearing member banking organization calculates according to the following formula: [129]

$$K_{CM_i} = max\left(K_{CCP} * \left(\frac{DF^{pref}}{DF_{CCP}+DF_{CM}^{pref}}\right); 0.16\% * DF^{pref}\right),$$

Where:

K_{CCP} is the hypothetical capital requirement of the QCCP;

DF^{pref} is the prefunded default fund contribution of the clearing member banking organization to the QCCP;

DF_{CCP} is the QCCP's own prefunded amounts (*e.g.,* contributed capital, retained earnings) that are contributed to the default fund waterfall and are junior or pari passu to the default fund contribution of the members; and

DF_{CM}^{pref} is the total prefunded default fund contributions from clearing members of the QCCP.

V. Revisions to the Supplementary Leverage Ratio

Under the capital rule, advanced approaches banking organizations and banking organizations subject to Category III standards must satisfy a minimum supplementary leverage ratio requirement of 3 percent.[130] The supplementary leverage ratio is the ratio of tier 1 capital to total leverage exposure, where total leverage exposure includes both on-balance sheet assets and certain off-balance sheet exposures.[131]

The proposal would have revised the capital rule to require advanced approaches banking organizations to use a modified version of SA–CCR, instead of CEM, to determine the on- and off-balance sheet amounts of derivative contracts for purposes of calculating total leverage exposure. The modified version of SA–CCR would have limited the recognition of collateral to certain cash variation margin [132] in the replacement cost calculation, but would not have allowed for recognition of any financial collateral in the PFE component.[133]

The proposal sought comment on whether the agencies should broaden the recognition of collateral in the supplementary leverage ratio to also include collateral provided by a client to a clearing member banking organization in connection with a cleared transaction (client collateral), in recognition of recent policy efforts to support migration of derivative transactions to CCPs, including an October 2018 consultative release by the Basel Committee on the treatment of client collateral in the international leverage ratio standard.[134] Several commenters urged the agencies to recognize greater amounts of client collateral, including margin, in either PFE or in both replacement cost and PFE. Other commenters, however, argued that the agencies should not recognize greater amounts of client collateral, including cash or non-cash initial and variation margin, in connection with cleared transactions entered into on behalf of clients or any amount of margin collateral within the supplementary leverage ratio. In addition, some commenters urged the agencies to assess the effectiveness of collateral in offsetting the operational risks arising from the provision of client clearing services.

Commenters that supported greater recognition of client collateral argued that such an approach would be consistent with the G20 mandate to establish policies that support the use of central clearing for derivative transactions,[135] as it could decrease the regulatory capital cost of providing clearing services and thereby improve access to clearing services for clients, reduce concentration among clearing member banking organizations, and improve the portability of client positions to other clearing members, particularly in times of stress. Other commenters argued that allowing an advanced approaches banking organization to use the same SA–CCR methodology as proposed for the risk-based framework would simplify the capital rule for advanced approaches banking organizations.

Some commenters urged the agencies to consider the risk to financial stability if implementation of SA–CCR further exacerbates the trend towards concentration among clearing service providers or leads to a reduction in access to clearing for non-clearing-member entities. Of these, some commenters also argued that the proposed SA–CCR methodology could

[129] The agencies are clarifying that K_{CM_i} must be multiplied by 12.5 to arrive at the risk-weighted asset amount for a default fund contribution.

[130] *See* 12 CFR 3.10(a)(5) (OCC); 12 CFR 217.10(a)(5) (Board); and 12 CFR 324.10(a)(5) (FDIC).

[131] *See supra* note 6.

[132] Consistent with CEM, the proposal would have permitted an advanced approaches banking organization to recognize cash variation margin in the on-balance component calculation only if (1) the cash variation margin met the conditions under § __.10(c)(4)(ii)(C)(*3*) through (*7*) of the proposed rule; and (2) it had not been recognized in the form of a reduction in the fair value of the derivative contracts within the netting set under the advanced approaches banking organization's operative accounting standard.

[133] To determine the carrying value of derivative contracts, U.S. GAAP provides a banking organization with the option to reduce any positive fair value of a derivative contract by the amount of any cash collateral received from the counterparty, provided the relevant GAAP criteria for offsetting are met (the GAAP offset option). Similarly, under the GAAP offset option, a banking organization has the option to offset the negative mark-to-fair value of a derivative contract with a counterparty. *See* Accounting Standards Codification paragraphs 815–10–45–1 through 7 and 210–20–45–1. Under the capital rule, a banking organization that applies the GAAP offset option to determine the carrying value of its derivative contracts would be required to reverse the effect of the GAAP offset option for purposes of determining total leverage exposure, unless the collateral is cash variation margin recognized as settled with the derivative contract as a single unit of account for balance sheet presentation and satisfies the conditions under § __.10(c)(4)(ii)(C)(*1*)(*ii*) through (*iii*) and § __.10(c)(4)(ii)(C)(*3*) through (*7*) of the capital rule.

[134] *See* ''Consultative Document: Leverage ratio treatment of client cleared derivatives,'' Basel Committee on Banking Supervision (October 2018), *https://www.bis.org/bcbs/publ/d451.pdf.*

[135] The Group of Twenty (G20) was established in 1999 to bring together industrialized and developing economies to discuss key issues in the global economy. Members include finance ministers and central bank governors from Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, Republic of Korea, Turkey, the United Kingdom, and the United States and the European Union. *See* ''Leaders' Statement: The Pittsburgh Summit,'' G–20 (September 24–25, 2009), *https://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh_summit_leaders_statement_250909.pdf.*

indirectly adversely affect clearing member clients with directional and long-dated portfolios, such as pension funds, mutual funds, life insurance companies and other end-users that use derivatives largely for risk management purposes. Specifically, these commenters argued that such entities have already experienced difficulty in obtaining and maintaining access to central clearing from banking organizations due to the treatment of client margin, which substantially increases the capital requirements under the supplementary leverage ratio for banking organizations that provide clearing services.

Other commenters argued that limiting the recognition of client collateral in the supplementary leverage ratio could have pro-cyclical effects that undermine the core objectives of the clearing framework. These commenters asserted that CCPs typically increase collateral requirements during stress periods, and therefore can cause clearing member banking organizations to be bound, or further bound, by the supplementary leverage ratio during that time. According to the commenters, procyclicality in the capital requirements for a clearing member could undermine the client-account portability objective of the central clearing framework if the clearing member is unable to acquire a book of cleared derivatives from another failing clearing member due to the regulatory capital costs of such acquisition.

Furthermore, some commenters posited that greater recognition of the risk-reducing effects of client collateral for purposes of the supplementary leverage ratio would be appropriate due to the manner in which clearing member banking organizations collect such collateral and the protections such collateral receives under existing regulations. Specifically, these commenters noted that CFTC regulations prohibit rehypothecation of client collateral, and explicitly limit a clearing member banking organization's use of collateral received from a client to purposes that fulfil the clearing member's obligations to the CCP or to cover losses in the event of that client's default.

By contrast, commenters who opposed greater recognition of the risk-reducing effects of client collateral under the supplementary leverage ratio expressed concern that such an approach would decrease capital levels among clearing member banking organizations and therefore could increase risks to both safety and soundness and U.S. financial stability. In particular, some commenters noted that solvency of clearing member banking organizations is critical to the stability of CCPs and that broadening the recognition of client collateral under the supplementary leverage ratio could undermine the advances made by central clearing mandates in stabilizing global financial markets. These commenters added that higher levels of regulatory capital at clearing member banking organizations could improve their ability to assume client positions from a defaulted clearing member in stress, and that the agencies have authority to provide temporary relief to leverage capital requirements if doing so would be necessary to allow a banking organization to absorb the client positions of an insolvent clearing member. With respect to concentration concerns, these commenters argued that lowering capital requirements for clearing member banking organizations would not reduce concentration in the provision of clearing services; rather, any further reduction in capital requirements for clearing member banking organizations would only benefit banking organizations that already provide these services. In addition, these commenters expressed concern regarding the introduction of risk mitigants into the leverage capital requirements, and stated that such a revision could blur the distinction between leverage and risk-based capital requirements.

The final rule allows a clearing member banking organization to recognize the risk-reducing effect of client collateral in replacement cost and PFE for purposes of calculating total leverage exposure under certain circumstances.[136] This treatment applies to a banking organization's exposure to its client-facing derivative transactions. For such exposures, the banking organization would use SA–CCR, as applied for risk-based capital purposes, which permits recognition of both cash and non-cash margin received from a client in replacement cost and PFE. The agencies believe that this treatment appropriately recognizes recent developments in the use of central clearing and maintains levels of capital consistent with safe and sound operations of banking organizations engaged in these activities. Although there are some risks associated with CCPs, the agencies believe that central clearing through CCPs generally reduces the effective exposure of derivative contracts through the multilateral netting of exposures, establishment and enforcement of collateral requirements, and promotion of market transparency. Also, this treatment is consistent with the G20 mandate to establish policies that support the use of central clearing, and recent developments by the Basel Committee. Specifically, on June 26, 2019, the Basel Committee released a standard that revises the leverage ratio treatment of client-cleared derivatives contracts to generally align with the measurement of such exposures under SA–CCR as used for risk-based capital purposes.[137] The standard was designed to balance the robustness of the supplementary leverage ratio as a non-risk-based safeguard against unsustainable sources of leverage with the policy objective set by G20 leaders to promote central clearing of standardized derivative contracts as part of mitigating systemic risk and making derivative markets safer. The final rule similarly maintains the complementary purpose of risk-based and leverage capital requirements, in a manner that is expected to have minimal impact on overall capital levels, will reduce burden by reducing the number of separate calculations required, and will not impede important policy objectives regarding central clearing.

Banking organizations subject to the supplementary leverage ratio under Category III that continue to use CEM to determine the total leverage exposure measure are not permitted to recognize the risk-reducing effects of client collateral other than with respect to certain transfers of cash variation margin in replacement cost. Relative to CEM, SA–CCR is more sensitive to the recognition of collateral, and therefore the commenters' concerns are more pronounced in that context. Moreover, most clearing member banking organizations are advanced approaches banking organizations that are required to use SA–CCR or IMM for the cleared transactions framework, and extending such treatment to CEM would have limited impact, if any, in the aggregate.

Some commenters noted that section 34 of the capital rule allows a banking organization subject to the supplementary leverage ratio to exclude the PFE of all credit derivatives or other similar instruments through which it provides credit protection, but without regard to credit risk mitigation, provided that it does not adjust the net-to-gross ratio. Under the capital rule, a banking organization subject to the supplementary leverage ratio that chooses to exclude the PFE of credit derivatives or other similar instruments through which it provides credit

[136] The recognition of client collateral provided under the final rule only applies in the context of SA–CCR, not CEM.

[137] *See supra* note 20.

protection must do so consistently over time for the calculation of the PFE for all such instruments. The agencies are clarifying that the same treatment would apply under SA–CCR for purposes of the supplementary leverage ratio.[138] In particular, a banking organization subject to the supplementary leverage ratio may choose to exclude from the PFE component of the exposure amount calculation the portion of a written credit derivative that is not offset according to § __.10(c)(4)(ii)(D)(*1*)–(*2*) and for which the effective notional amount of the written credit derivative is included in total leverage exposure.

The agencies generally are adopting as final the proposed requirement that a banking organization that is required to use SA–CCR or elects to use SA–CCR to calculate the exposure amount of its derivative contracts for purposes of the supplementary leverage ratio must use the modified version of SA–CCR described in § __.10(c)(4)(ii) of the final rule, with a few revisions.[139] For a client-facing derivative transaction, however, the banking organization calculates the exposure amount under § __.132(c)(5).

Consistent with the proposal, written options must be included in total leverage exposure even though the final rule allows certain written options to receive an exposure amount of zero for risk-based capital purposes.[140]

VI. Technical Amendments

The proposal would have made several technical corrections and clarifications to the capital rule to address certain provisions that warrant revision based on questions presented by banking organizations and further review by the agencies. The agencies did not receive comment on these technical amendments, and are finalizing them as proposed. The agencies did receive several suggestions for other clarifications and technical changes to the proposal. The agencies are adopting many of these suggestions in the final rule. These changes are described below.

A. Receivables Due From a QCCP

The final rule revises § __.32 of the capital rule to clarify that cash collateral posted by a clearing member banking organization to a QCCP, and which could be considered a receivable due from the QCCP under U.S. GAAP, should not be risk-weighted as a corporate exposure. Instead, for a client-cleared trade the cash collateral posted to a QCCP receives a risk weight of 2 percent, if the cash associated with the trade meets the requirements under § __.35(b)(3)(i)(A) or § __.133(b)(3)(i)(A) of the capital rule, or 4 percent, if the collateral does not meet the requirements necessary to receive the 2 percent risk weight. For a trade made on behalf of the clearing member's own account, the cash collateral posted to a QCCP receives a 2 percent risk weight. The agencies intend for this amendment to maintain incentives for banking organizations to post cash collateral and recognize that a receivable from a QCCP that arises in the context of a trade exposure should not be treated as equivalent to a receivable that would arise if, for example, a banking organization made a loan to a CCP.

B. Treatment of Client Financial Collateral Held by a CCP

Under § __.2 of the capital rule, financial collateral means, in part, collateral in which a banking organization has a perfected first-priority security interest in the collateral. However, when a banking organization is acting on behalf of a client, it generally is required to post any client collateral to the CCP, in which case the CCP establishes and maintains a perfected first-priority security interest in the collateral instead of the clearing member. As a result, the capital rule does not permit a clearing member banking organization to recognize client collateral posted to a CCP as financial collateral.

Client collateral posted to a CCP remains available to mitigate the risk of a credit loss on a derivative contract in the event of a client default. Specifically, when a client defaults the CCP will use the client collateral to offset its exposure to the client, and the clearing member banking organization would be required to cover only the amount of any deficiency between the liquidation value of the collateral and the CCP's exposure to the client. However, were the clearing member banking organization to enter into the derivative contract directly with the client, the clearing member would establish and maintain a perfected first-priority security interest in the collateral, and the exposure of the clearing member to the client would similarly be mitigated only to the extent the collateral is sufficient to cover the exposure amount of the transaction at the time of default. Therefore, the final rule revises the definition of financial collateral to allow clearing member banking organizations to recognize as financial collateral noncash client collateral posted to a CCP. In this situation, the clearing member banking organization is not required to establish and retain a first-priority security interest in the collateral for it to qualify as financial collateral under § __.2 of the capital rule.

C. Clearing Member Exposure When CCP Performance Is Not Guaranteed

The final rule revises § __.35(c)(3) of the capital rule to align the capital requirements under the standardized approach for client-cleared transactions with the treatment under § __.133(c)(3) of the advanced approaches. Specifically, the final rule allows a clearing member banking organization that does not guarantee the performance of the CCP to the clearing member's client to apply a zero percent risk weight to the CCP-facing portion of the transaction. The agencies previously implemented this treatment for purposes of the advanced approaches.[141]

D. Bankruptcy Remoteness of Collateral

The final rule removes the requirement in § __.35(b)(4)(i) of the standardized approach and § __.133(b)(4)(i) of the advanced approaches that collateral posted by a clearing member client banking organization to a clearing member banking organization must be bankruptcy remote from a custodian in order for the client banking organization to avoid the application of risk-based capital requirements related to the collateral, and clarifies that a custodian must be acting in its capacity as a custodian for this treatment to apply.[142]

[138] *See* 79 FR 57725, 57731–57732 (Sept. 26, 2014).

[139] Some commenters requested clarification regarding the items to be summed under § __.10(c)(4)(ii)(C)(*1*) of the proposed rule. The agencies are clarifying that the items to be summed under this paragraph (now located at § __.10(c)(4)(ii)(C)(*2*)(*i*) of the final rule) are the replacement cost of each derivative contract or single product netting set of derivative contracts to which the advanced approaches banking organization is a counterparty, as described under 10(c)(4)(ii)(C)(*2*)(i) of the final rule. Section __.10(c)(4)(ii)(C)(*2*)(*ii*) of the final rule serves to adjust, under certain situations, the items to be summed under § __.10(c)(4)(ii)(C)(*2*)(*i*). In addition, these commenters requested clarification of the application of § __.10(c)(4)(ii)(C)(*2*) in the proposal. The agencies are removing § __.10(c)(4)(ii)(C)(*2*) from the final rule, as this provision is captured under the definition of the cash variation margin terms in the formula described under § __.10(c)(4)(ii)(C)(*2*)(*i*).

[140] Under the final rule, the exposure amount of a netting set that consists of only sold options in which the premiums have been fully paid by the counterparty to the options and where the options are not subject to a variation margin agreement is zero. *See* section III.A. of this **SUPPLEMENTARY INFORMATION** for further discussion.

[141] *See* 80 FR 41411 (July 15, 2015).

[142] *See* 12 CFR 3.35(b)(4) and 3.133(b)(4) (OCC); 12 CFR 217.35(b)(4) and 217.133(b)(4) (Board); and 12 CFR 324.35(b)(4) and 324.133(b)(4) (FDIC).

The agencies believe this revision is appropriate because the collateral would generally be considered to be bankruptcy remote if the custodian is acting in its capacity as a custodian with respect to the collateral. Therefore, this revision applies only in cases where the collateral is deposited with a third-party custodian, not in cases where a clearing member banking organization offers ''self-custody'' arrangements with its clients. In addition, this revision makes the collateral requirement for a clearing member client banking organization consistent with the treatment of collateral posted by a clearing member banking organization, which does not require that the posted collateral be bankruptcy remote from the custodian, but requires in each case that the custodian be acting in its capacity as a custodian.

E. Adjusted Collateral Haircuts for Derivative Contracts

For a cleared transaction, the clearing member banking organization must determine the exposure amount for the client-facing derivative transaction of the derivative contract using the collateralized transactions framework under § __.37(c)(3) of the capital rule or the counterparty credit risk framework under § __.132(b)(2)(ii) of the capital rule. The clearing member banking organization may recognize the credit risk-mitigation benefits of the collateral posted by the client; however, under §§ __.37(c) and __.132(b) of the capital rule, the value of the collateral must be discounted by the application of a standard supervisory haircut to reflect any market price volatility in the value of the collateral over a ten-business-day holding period. For a repo-style transaction, the capital rule applies a scaling factor of the square root of ½ (which equals 0.707107) to the standard supervisory haircuts to reflect the limited risk to collateral in those transactions and effectively reduce the holding period to five business days. The proposal would have provided a similar reduction in the haircuts for client-facing derivative transactions, as they typically have a holding period of less than ten business days. Some commenters requested clarification whether a five-business-day holding period would apply for the purpose of calculating collateral haircuts for client-facing derivatives under § __.132(b)(2)(ii)(A)(*3*) of the proposal. The final rule revises §§ __.37(c)(3)(iii) and __.132(b)(2)(ii)(A)(*3*) of the capital rule to adjust the holding period for client-facing derivative transactions by applying a scaling factor of 0.71, which represents a five-business-day holding period. The final rule also requires a banking organization to use a larger scaling factor for collateral haircuts for client-facing derivatives when it determines a holding period longer than five days is appropriate.

F. OCC Revisions to Lending Limits

The OCC proposed to revise its lending limit rule at 12 CFR part 32. The current lending limits rule references sections of CEM in the OCC's advanced approaches capital rule as one available methodology for calculating exposures to derivatives transactions. However, these sections were proposed to be amended or replaced with SA–CCR in the advanced approaches. Therefore, the OCC proposed to replace the references to CEM in the advanced approaches with references to CEM in the standardized approach. The OCC also proposed to adopt SA–CCR as an option for calculation of exposures under lending limits.

The agencies received two comments supporting the OCC's proposal to use SA–CCR to measure counterparty credit risk under both the capital rules and other agency rules, including lending limits, as creating less burden on institutions. The OCC agrees that it would be less burdensome for institutions to use similar methodologies to measure counterparty credit risk across OCC regulations, and therefore are finalizing these revisions to the lending limits rule as proposed.

G. Other Clarifications and Technical Amendments From the Proposal to the Final Rule

Some commenters suggested that the agencies make a revision to the approaches for calculating capital requirements regarding CVAs under § __.132(e). Under the final rule, the agencies are clarifying that for purposes of calculating the CVA capital requirements under § __.132(e)(5)(i)(C), (e)(6)(i)(B) and (e)(6)(viii), an advanced approaches banking organization must use SA–CCR instead of CEM where CEM was provided as an option. In addition, the final rule revises the definition of CEM in § __.2 to refer to § __.34(b) instead of § __.34(a).

VII. Impact of the Final Rule

For the proposal, the agencies reviewed data provided by advanced approaches banking organizations that represent a significant majority of the derivatives market. In particular, the agencies analyzed the change in exposure amount between CEM and SA–CCR, as well as the change in risk-weighted assets as determined under the standardized approach.[143] The data cover diverse portfolios of derivative contracts, both in terms of asset type and counterparty. In addition, the data include firms that serve as clearing members, allowing the agencies to consider the effect of the proposal under the cleared transactions framework for both a direct exposure to a CCP and a clearing member's exposure to its client with respect to client-facing derivative transactions. As a result, the analysis provides a reasonable proxy for the potential changes for all advanced approaches banking organizations.

The agencies estimated that, under the proposal, the exposure amount for derivative contracts held by advanced approaches banking organizations would have decreased by approximately 7 percent. The agencies also estimated that the proposal would have resulted in an approximately 5 percent increase in advanced approaches banking organizations' standardized risk-weighted assets associated with derivative contract exposures.[144] In addition, the proposal would have resulted in an increase (approximately 30 basis points) in advanced approaches banking organizations' supplementary leverage ratios, on average.

The agencies made several changes to the SA–CCR methodology for the final rule that could have a material effect on the impact of the final rule. First, the final rule changes certain of the supervisory factors for commodity derivative contracts to coincide with the supervisory factors in the Basel Committee standard.[145] Second, the

[143] The agencies estimated that, on aggregate, exposure amounts under SA–CCR would equal approximately 170 percent of the exposure amounts for identical derivative contracts under IMM. Thus, firms that use IMM currently would likely continue to use IMM to determine the exposure amount of their derivative contracts to determine advanced approaches total risk-weighted assets. However, the standardized approach serves as a floor on advanced approaches banking organizations' total risk-weighted assets. Thus, a firm would only receive the benefit of IMM if the firm is not bound by standardized total risk-weighted assets.

[144] Total risk-weighted assets are a function of the exposure amount of the netting set and the applicable risk-weight of the counterparty. Total risk-weighted assets increase under the analysis while exposure amounts decrease because higher applicable risk weights amplify increases in the exposure amount of certain derivative contracts, which outweighs decreases in the exposure amount of other derivative contracts.

[145] The change in the supervisory factors for commodity derivative contracts will not result in a change in the agencies initial estimate of the impact of the final rule. This is because the data received from the advanced approach banking organizations already reflected the supervisory factors for commodity derivative contracts included in the Basel Standard, and the agencies did not adjust the data to account for the proposed 40 percent supervisory factor for all energy derivative contracts.

final rule removes the alpha factor for exposures to commercial end-users. Third, the final rule allows a banking organization to treat settled-to-market derivative contracts as subject to a variation margin agreement, allowing such contracts to net with collateralized-to-market derivative contracts of the same netting set. Lastly, the final rule allows clearing member banking organizations to recognize client collateral under the supplementary leverage ratio, to the same extent a banking organization may recognize collateral for risk-based capital purposes.

Using the same data set as used for the proposal, the agencies found that the exposure amount for derivative contracts held by advanced approaches banking organizations will decrease by approximately 9 percent under the final rule. Generally speaking, exposure amounts for interest rate, credit and foreign exchange derivatives would be expected to decrease, and exposure amounts for equities and commodities would be expected to increase. The agencies estimate that the final rule will result in an approximately 4 percent decrease in advanced approaches banking organizations' standardized risk-weighted assets associated with derivative contract exposures and that the final rule will result in an increase (approximately 37 basis points) in advanced approaches banking organizations' reported supplementary leverage ratios, on average. While too much precision should not be attached to estimates regarding individual banking organizations owing to variations in data quality, estimated changes in individual banking organizations' supplementary leverage ratios range from −5 basis points to 85 basis points.

In the proposal, the agencies found that the effects of the proposed rule likely would be limited for non-advanced approaches banking organizations. First, these banking organizations hold relatively small derivative portfolios. Non-advanced approaches banking organizations account for less than 9 percent of derivative contracts of all banking organizations, even though they account for roughly 36 percent of total assets of all banking organizations.[146] Second, nearly all non-advanced approaches banking organizations are not subject to supplementary leverage ratio requirements, and thus would not be affected by any changes to the calculation of total leverage exposure. These banking organizations retain the option of using CEM, including for the supplementary leverage ratio, if applicable, and the agencies anticipate that only those banking organizations that receive a material net benefit from using SA–CCR would elect to use it. Therefore, the agencies continue to find that the impact on non-advanced approaches banking organizations under the final rule would be limited.

VIII. Regulatory Analyses

A. Paperwork Reduction Act

The agencies' regulatory capital rule contains ''collections of information'' within the meaning of the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501–3521). In accordance with the requirements of the PRA, the agencies may not conduct or sponsor, and the respondent is not required to respond to, an information collection unless it displays a currently-valid Office of Management and Budget (OMB) control number. The OMB control number for the OCC is 1557–0318, Board is 7100–0313, and FDIC is 3064–0153. The information collections that are part of the agencies' regulatory capital rule will not be affected by this final rule and therefore no final submissions will be made by the FDIC or OCC to OMB under section 3507(d) of the PRA (44 U.S.C. 3507(d)) or section 1320.11 of the OMB's implementing regulations (5 CFR 1320) in connection with this rulemaking.[147]

As a result of this final rule, the agencies have proposed to clarify the reporting instructions for the Consolidated Reports of Condition and Income (Call Reports) (FFIEC 031, FFIEC 041, and FFIEC 051) and Regulatory Capital Reporting for Institutions Subject to the Advanced Capital Adequacy Framework (FFIEC 101).[148] The OCC and FDIC expect to clarify the reporting instructions for DFAST 14A, and the Board expects to clarify the reporting instructions for the Consolidated Financial Statements for Holding Companies (FR Y–9C), Capital Assessments and Stress Testing (FR Y–14A and FR Y–14Q), and Banking Organization Systemic Risk Report (FR Y–15) as appropriate to reflect the changes to the regulatory capital rule related to this final rule.

B. Regulatory Flexibility Act

OCC: The Regulatory Flexibility Act, 5 U.S.C. 601 *et seq.* (RFA), requires an agency, in connection with a final rule, to prepare a Final Regulatory Flexibility Analysis describing the impact of the rule on small entities (defined by the Small Business Administration (SBA) for purposes of the RFA to include commercial banks and savings institutions with total assets of $600 million or less and trust companies with total revenue of $41.5 million or less) or to certify that the final rule would not have a significant economic impact on a substantial number of small entities. As of December 31, 2018, the OCC supervised 782 small entities. The rule would impose requirements on all OCC supervised entities that are subject to the advanced approaches risk-based capital rules, which typically have assets in excess of $250 billion, and therefore would not be small entities. While small entities would have the option to adopt SA–CCR, the OCC does not expect any small entities to elect that option. Therefore, the OCC estimates the final rule would not generate any costs for small entities. Therefore, the OCC certifies that the final rule would not have a significant economic impact on a substantial number of OCC-supervised small entities.

FDIC: The RFA generally requires that, in connection with a final rulemaking, an agency prepare and make available for public comment a final regulatory flexibility analysis describing the impact of the rule on small entities.[149] However, a regulatory flexibility analysis is not required if the agency certifies that the final rule will not have a significant economic impact on a substantial number of small entities. The SBA has defined ''small entities'' to include banking

[146] According to data from the Consolidated Reports of Condition and Income for a Bank with Domestic and Foreign Offices (FFIEC report forms 031, 041, and 051), as of March 31, 2018.

[147] The OCC and FDIC submitted their information collections to OMB at the proposed rule stage. However, these submissions were done solely in an effort to apply a conforming methodology for calculating the burden estimates and not due to the proposed rule. OMB filed comments requesting that the agencies examine public comment in response to the proposed rule and describe in the supporting statement of its next collection any public comments received regarding the collection as well as why (or why it did not) incorporate the commenters' recommendation. In addition, OMB requested that the OCC and the FDIC note the convergence of the agencies on the single methodology. The agencies received no comments on the information collection requirements. Since the proposed rule stage, the agencies have conformed their respective methodologies in a separate final rulemaking titled, ''Regulatory Capital Rule: Implementation and Transition of the Current Expected Credit Losses Methodology for Allowances and Related Adjustments to the Regulatory Capital Rule and Conforming Amendments to Other Regulations,'' 84 FR 4222 (February 14, 2019), and have had their submissions approved through OMB. As a result, the agencies information collections related to the regulatory capital rules are currently aligned and therefore no submission will be made to OMB.

[148] *See* 84 FR 53227 (October 4, 2019).

[149] 5 U.S.C. 601 *et seq.*

organizations with total assets of less than or equal to $600 million that are independently owned and operated or owned by a holding company with less than or equal to $600 million in total assets.[150] 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 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, the FDIC believes that the final rule will not have a significant economic impact on a substantial number of small entities. Nevertheless, the FDIC has conducted and is providing a final regulatory flexibility analysis.

1. The Need for, and Objectives of, the Rule

The policy objective of the final rule is to provide a new and more risk-sensitive methodology for calculating the exposure amount for derivative contracts. SA–CCR will replace the existing CEM methodology for advanced approaches institutions. Non-advanced approaches banking organizations will have the option of using SA–CCR in place of CEM.

2. The Significant Issues Raised by the Public Comments in Response to the Initial Regulatory Flexibility Analysis

No significant issues were raised by the public comments in response to the initial regulatory flexibility analysis.

3. Response of the Agency to Any Comments Filed by the Chief Counsel for Advocacy of the Small Business Administration in Response to the Proposed Rule

No comments were filed by the Chief Counsel for Advocacy of the Small Business Administration in response to the proposed rule.

4. A Description of and an Estimate of the Number of Small Entities to Which the Rule Will Apply or an Explanation of Why no Such Estimate Is Available

As of June 30, 2019, the FDIC supervised 3,424 institutions, of which 2,665 are considered small entities for the purposes of RFA. These small IDIs hold $514 billion in assets, accounting for 16.6 percent of total assets held by FDIC-supervised institutions.[151]

The final rule will require advanced approaches institutions to use either SA–CCR or IMM to calculate the exposure amount of its noncleared and cleared derivative contracts under the advanced approaches. For purposes of determining the exposure amount of its noncleared and cleared derivative contracts under the standardized approach, an advanced approaches institution must use SA–CCR. An advanced approaches institution must use SA–CCR to determine the risk-weighted asset amount of its default fund contributions under both the approaches. There are no FDIC-supervised advanced approaches institutions that are considered small entities for the purposes of RFA.[152]

The final rule will allow, but not require, non-advanced approaches institutions to replace CEM with SA–CCR as the approach for calculating EAD. While this allowance applies to all 2,665 small entities, only 401 (15 percent) report holding any volume of derivatives and would therefore be affected by differences between CEM and SA–CCR. These 401 banks' holdings of derivatives account for only 7.6 percent of their assets, so the effects of calculating the exposure amount of derivatives using SA–CCR on their capital requirements would likely be insignificant.[153] Since adoption of SA–CCR is optional, these banks would weigh the benefits of SA–CCR adoption against its costs. Given that SA–CCR adoption necessitates internal systems enhancements and other operational modifications that could be particularly burdensome for smaller, less complex banking organizations, the FDIC expects that no small institutions will likely adopt SA–CCR.

5. A Description of the Projected Reporting, Recordkeeping and Other Compliance Requirements of the Rule

No small entity will be compelled to use SA–CCR, so the rule does not impose any reporting, recordkeeping and other compliance requirements onto small entities.

The FDIC does not expect any small entity to adopt SA–CCR, given the internal systems enhancements and operational modifications needed for SA–CCR adoption. A small institution will elect to use SA–CCR only if the net benefits of doing so are positive. Thus, the FDIC expects the proposed rule will not impose any net economic costs on these entities.

6. A Description of the Steps the Agency Has Taken To Minimize the Significant Economic Impact on Small Entities

As described above, the FDIC does not believe this rule will have a significant economic impact on a substantial number of small entities. Further, since adopting SA–CCR is voluntary, only entities that expect to benefit from SA–CCR will adopt it.

Board: An initial regulatory flexibility analysis (IRFA) was included in the proposal in accordance with section 603(a) of the Regulatory Flexibility Act (RFA), 5 U.S.C. 601 *et seq.* In the IRFA, the Board requested comment on the effect of the proposed rule on small entities and on any significant alternatives that would reduce the regulatory burden on small entities. The Board did not receive any comments on the IRFA. The RFA requires an agency to prepare a final regulatory flexibility analysis unless the agency certifies that the rule will not, if promulgated, have a significant economic impact on a substantial number of small entities. Based on its analysis, and for the reasons stated below, the Board certifies that the rule will not have a significant economic impact on a substantial number of small entities.[154]

Under regulations issued by the Small Business Administration, a small entity includes a bank, bank holding company, or savings and loan holding company with assets of $600 million or less and trust companies with total assets of $41.5 million or less (small banking organization).[155] As of June 30, 2019, there were approximately 2,976 small bank holding companies, 133 small savings and loan holding companies, and 537 small SMBs.

As discussed in the **SUPPLEMENTARY INFORMATION** section, the final rule revises the capital rule to provide a new and more risk-sensitive methodology for calculating the exposure amount for derivative contracts. For purposes of

[150] The SBA defines a small banking organization as having $600 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 by 84 FR 34261, effective August 19, 2019). 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.

[151] Consolidated Reports of Condition and Income for the quarter ending June 30, 2019.

[152] *Id.*

[153] *Id.*

[154] 5 U.S.C. 605(b).

[155] *See* 13 CFR 121.201. Effective August 19, 2019, the SBA revised the size standards for banking organizations to $600 million in assets from $550 million in assets. 84 FR 34261 (July 18, 2019).

calculating advanced approaches total risk-weighted assets, an advanced approaches Board-regulated institution may use either SA–CCR or the internal models methodology. For purposes of calculating standardized total risk-weighted assets, an advanced approaches Board-regulated institution must use SA–CCR and a non-advanced approaches Board-regulated institution may elect either SA–CCR or CEM.[156] In addition, for purposes of the denominator of the supplementary leverage ratio, the final rule integrates SA–CCR into the calculation of the denominator, replacing CEM.[157]

The Board does not expect that the final rule will result in a material change in the level of capital maintained by small banking organizations or in the compliance burden on small banking organizations because the framework is optional for non-advanced approaches banking organizations. To the extent that small banking organizations elect to adopt SA–CCR because it provides advantageous regulatory capital treatment of derivatives, any implementation costs or increased compliance costs associated with SA–CCR should be outweighed by the capital impact of SA–CCR. In any event, small banking organizations generally do not have substantial portfolios of derivative contracts and therefore any impact of SA–CCR on capital requirements is expected to be minimal. For these reasons, the Board does not expect the rule to have a significant economic impact on a substantial number of small entities.

[156] Advanced approaches banking organizations include depository institutions, bank holding companies, savings and loan holding companies, or intermediate holding companies subject to Category I or Category II standards. *See supra* note 23.

[157] In general, the Board's capital rule only applies to bank holding companies and savings and loan holding companies that are not subject to the Board's Small Bank Holding Company and Savings and Loan Holding Company Policy Statement, which applies to bank holding companies and savings and loan holding companies with less than $3 billion in total assets that also meet certain additional criteria. In addition, the agencies recently adopted a final rule to implement a community bank leverage ratio framework that is applicable, on an optional basis to depository institutions and depository institution holding companies with less than $10 billion in total consolidated assets and that meet certain other criteria. Such banking organizations that opt into the community bank leverage ratio framework will be deemed compliant with the capital rule's generally applicable requirements and are not required to calculate risk-based capital ratios. *See supra* note 3. Very few bank holding companies and savings and loan holding companies that are small entities would be impacted by the final rule because very few such entities are subject to the Board's capital rule.

C. Plain Language

Section 722 of the Gramm-Leach-Bliley Act[158] requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The agencies have sought to present the final rule in a simple and straightforward manner, and did not receive comment on the use of plain language.

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),[159] in determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on IDIs, 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 depository institutions, including small depository institutions, and customers of depository institutions, as well as the benefits of such regulations. In addition, section 302(b) of RCDRIA requires new regulations and amendments to regulations that impose additional reporting, disclosures, or other new requirements on IDIs 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.[160]

In accordance with these provisions of RCDRIA, the agencies considered any administrative burdens, as well as benefits, that the final rule would place on depository institutions and their customers in determining the effective date and administrative compliance requirements of the final rule. In conjunction with the requirements of RCDRIA, the final rule is effective on April 1, 2020.

E. OCC Unfunded Mandates Reform Act of 1995 Determination

The OCC analyzed the proposed rule under the factors set forth in the Unfunded Mandates Reform Act of 1995 (UMRA) (2 U.S.C. 1532). Under this analysis, the OCC considered whether the final rule includes a Federal mandate that may result in the expenditure by State, local, and Tribal governments, in the aggregate, or by the private sector, of $100 million or more in any one year (adjusted for inflation). The OCC has determined that this final rule would not result in expenditures by State, local, and Tribal governments, or the private sector, of $100 million or more in any one year. Accordingly, the OCC has not prepared a written statement to accompany this proposal.

[158] *See* Public Law 106–102, section 722, 113 Stat. 1338, 1471 (1999).

[159] 12 U.S.C. 4802(a).

[160] 12 U.S.C. 4802.

F. The Congressional Review Act

For purposes of Congressional Review Act, the OMB makes a determination as to whether a final rule constitutes a ''major'' rule.[161] If a rule is deemed a ''major rule'' by the OMB, the Congressional Review Act generally provides that the rule may not take effect until at least 60 days following its publication.[162]

The Congressional Review Act defines a ''major rule'' as any rule that the Administrator of the Office of Information and Regulatory Affairs of the OMB finds has resulted in or is likely to result in—(A) an annual effect on the economy of $100,000,000 or more; (B) a major increase in costs or prices for consumers, individual industries, Federal, State, or 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.[163] As required by the Congressional Review Act, the agencies will submit the final rule and other appropriate reports to Congress and the Government Accountability Office for review.

List of Subjects

12 CFR Part 3

Administrative practice and procedure, Capital, National banks, Risk.

12 CFR Part 32

National banks, Reporting and recordkeeping requirements.

12 CFR Part 217

Administrative practice and procedure, Banks, Banking, Capital, Federal Reserve System, Holding companies.

12 CFR Part 324

Administrative practice and procedure, Banks, Banking, Capital adequacy, Savings associations, State non-member banks.

[161] 5 U.S.C. 801 *et seq.*

[162] 5 U.S.C. 801(a)(3).

[163] 5 U.S.C. 804(2).

12 CFR Part 327

Bank deposit insurance, Banks, Banking, Savings associations.

Office of the Comptroller of the Currency

For the reasons set out in the joint preamble, the OCC amends 12 CFR parts 3 and 32 as follows:

PART 3—CAPITAL ADEQUACY STANDARDS

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

Authority: 12 U.S.C. 93a, 161, 1462, 1462a, 1463, 1464, 1818, 1828(n), 1828 note, 1831n note, 1835, 3907, 3909, and 5412(b)(2)(B).

■ 2. Section 3.2 is amended by:
■ a. Adding the definitions of ''Basis derivative contract,'' ''Client-facing derivative transaction,'' and ''Commercial end-user'' in alphabetical order;
■ b. Revising the definitions of ''Current exposure'' and ''Current exposure methodology;''
■ c. Revising paragraph (2) of the definition of ''Financial collateral;''
■ d. Adding the definitions of ''Independent collateral,'' ''Minimum transfer amount,'' and ''Net independent collateral amount'' in alphabetical order;
■ e. Revising the definition of ''Netting set;'' and
■ f. Adding the definitions of ''Speculative grade,'' ''Sub-speculative grade,'' ''Variation margin,'' ''Variation margin agreement,'' ''Variation margin amount,'' ''Variation margin threshold,'' and ''Volatility derivative contract'' in alphabetical order.

The additions and revisions read as follows:

§ 3.2 Definitions.

* * * * *

Basis derivative contract means a non-foreign-exchange derivative contract (*i.e.,* the contract is denominated in a single currency) in which the cash flows of the derivative contract depend on the difference between two risk factors that are attributable solely to one of the following derivative asset classes: Interest rate, credit, equity, or commodity.

* * * * *

Client-facing derivative transaction means a derivative contract that is not a cleared transaction where the national bank or Federal savings association is either acting as a financial intermediary and enters into an offsetting transaction with a qualifying central counterparty (QCCP) or where the national bank or Federal savings association provides a guarantee on the performance of a client on a transaction between the client and a QCCP.

* * * * *

Commercial end-user means an entity that:

(1)(i) Is using derivative contracts to hedge or mitigate commercial risk; and

(ii)(A) Is not an entity described in section 2(h)(7)(C)(i)(I) through (VIII) of the Commodity Exchange Act (7 U.S.C. 2(h)(7)(C)(i)(I) through (VIII)); or

(B) Is not a ''financial entity'' for purposes of section 2(h)(7) of the Commodity Exchange Act (7 U.S.C. 2(h)) by virtue of section 2(h)(7)(C)(iii) of the Act (7 U.S.C. 2(h)(7)(C)(iii)); or

(2)(i) Is using derivative contracts to hedge or mitigate commercial risk; and

(ii) Is not an entity described in section 3C(g)(3)(A)(i) through (viii) of the Securities Exchange Act of 1934 (15 U.S.C. 78c–3(g)(3)(A)(i) through (viii)); or

(3) Qualifies for the exemption in section 2(h)(7)(A) of the Commodity Exchange Act (7 U.S.C. 2(h)(7)(A)) by virtue of section 2(h)(7)(D) of the Act (7 U.S.C. 2(h)(7)(D)); or

(4) Qualifies for an exemption in section 3C(g)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78c–3(g)(1)) by virtue of section 3C(g)(4) of the Act (15 U.S.C. 78c–3(g)(4)).

* * * * *

Current exposure means, with respect to a netting set, the larger of zero or the fair value of a transaction or portfolio of transactions within the netting set that would be lost upon default of the counterparty, assuming no recovery on the value of the transactions.

Current exposure methodology means the method of calculating the exposure amount for over-the-counter derivative contracts in § 3.34(b).

* * * * *

Financial collateral * * *

(2) In which the national bank and Federal savings association has a perfected, first-priority security interest or, outside of the United States, the legal equivalent thereof (with the exception of cash on deposit; and notwithstanding the prior security interest of any custodial agent or any priority security interest granted to a CCP in connection with collateral posted to that CCP).

* * * * *

Independent collateral means financial collateral, other than variation margin, that is subject to a collateral agreement, or in which a national bank and Federal savings association has a perfected, first-priority security interest or, outside of the United States, the legal equivalent thereof (with the exception of cash on deposit; notwithstanding the prior security interest of any custodial agent or any prior security interest granted to a CCP in connection with collateral posted to that CCP), and the amount of which does not change directly in response to the value of the derivative contract or contracts that the financial collateral secures.

* * * * *

Minimum transfer amount means the smallest amount of variation margin that may be transferred between counterparties to a netting set pursuant to the variation margin agreement.

* * * * *

Net independent collateral amount means the fair value amount of the independent collateral, as adjusted by the standard supervisory haircuts under § 3.132(b)(2)(ii), as applicable, that a counterparty to a netting set has posted to a national bank or Federal savings association less the fair value amount of the independent collateral, as adjusted by the standard supervisory haircuts under § 3.132(b)(2)(ii), as applicable, posted by the national bank or Federal savings association to the counterparty, excluding such amounts held in a bankruptcy remote manner or posted to a QCCP and held in conformance with the operational requirements in § 3.3.

Netting set means a group of transactions with a single counterparty that are subject to a qualifying master netting agreement. For derivative contracts, netting set also includes a single derivative contract between a national bank or Federal savings association and a single counterparty. For purposes of the internal model methodology under § 3.132(d), netting set also includes a group of transactions with a single counterparty that are subject to a qualifying cross-product master netting agreement and does not include a transaction:

(1) That is not subject to such a master netting agreement; or

(2) Where the national bank or Federal savings association has identified specific wrong-way risk.

* * * * *

Speculative grade means the reference entity has adequate capacity to meet financial commitments in the near term, but is vulnerable to adverse economic conditions, such that should economic conditions deteriorate, the reference entity would present an elevated default risk.

* * * * *

Sub-speculative grade means the reference entity depends on favorable economic conditions to meet its financial commitments, such that should such economic conditions deteriorate the reference entity likely

would default on its financial commitments.

* * * * *

Variation margin means financial collateral that is subject to a collateral agreement provided by one party to its counterparty to meet the performance of the first party's obligations under one or more transactions between the parties as a result of a change in value of such obligations since the last time such financial collateral was provided.

Variation margin agreement means an agreement to collect or post variation margin.

Variation margin amount means the fair value amount of the variation margin, as adjusted by the standard supervisory haircuts under § 3.132(b)(2)(ii), as applicable, that a counterparty to a netting set has posted to a national bank or Federal savings association less the fair value amount of the variation margin, as adjusted by the standard supervisory haircuts under § 3.132(b)(2)(ii), as applicable, posted by the national bank or Federal savings association to the counterparty.

Variation margin threshold means the amount of credit exposure of a national bank or Federal savings association to its counterparty that, if exceeded, would require the counterparty to post variation margin to the national bank or Federal savings association pursuant to the variation margin agreement.

Volatility derivative contract means a derivative contract in which the payoff of the derivative contract explicitly depends on a measure of the volatility of an underlying risk factor to the derivative contract.

* * * * *

■ 3. Section 3.10 is amended by revising paragraphs (c)(4)(ii)(A) through (C) to read as follows:

§ 3.10 Minimum capital requirements.

* * * * *

(c) * * *

(4) * * *

(ii) * * *

(A) The balance sheet carrying value of all of the national bank or Federal savings association's on-balance sheet assets, *plus* the value of securities sold under a repurchase transaction or a securities lending transaction that qualifies for sales treatment under U.S. GAAP, *less* amounts deducted from tier 1 capital under § 3.22(a), (c), and (d), and *less* the value of securities received in security-for-security repo-style transactions, where the national bank or Federal savings association acts as a securities lender and includes the securities received in its on-balance sheet assets but has not sold or re-hypothecated the securities received, and, for a national bank or Federal savings association that uses the standardized approach for counterparty credit risk under § 3.132(c) for its standardized risk-weighted assets, *less* the fair value of any derivative contracts;

(B)(*1*) For a national bank or Federal savings association that uses the current exposure methodology under § 3.34(b) for its standardized risk-weighted assets, the potential future credit exposure (PFE) for each derivative contract or each single-product netting set of derivative contracts (including a cleared transaction except as provided in paragraph (c)(4)(ii)(I) of this section and, at the discretion of the national bank or Federal savings association, excluding a forward agreement treated as a derivative contract that is part of a repurchase or reverse repurchase or a securities borrowing or lending transaction that qualifies for sales treatment under U.S. GAAP), to which the national bank or Federal savings association is a counterparty as determined under § 3.34, but without regard to § 3.34(b), provided that:

(*i*) A national bank or Federal savings association may choose to exclude the PFE of all credit derivatives or other similar instruments through which it provides credit protection when calculating the PFE under § 3.34, but without regard to § 3.34(b), provided that it does not adjust the net-to-gross ratio (NGR); and

(*ii*) A national bank or Federal savings association that chooses to exclude the PFE of credit derivatives or other similar instruments through which it provides credit protection pursuant to paragraph (c)(4)(ii)(B)(*1*) of this section must do so consistently over time for the calculation of the PFE for all such instruments; or

(*2*)(*i*) For a national bank or Federal savings association that uses the standardized approach for counterparty credit risk under section § 3.132(c) for its standardized risk-weighted assets, the PFE for each netting set to which the national bank or Federal savings association is a counterparty (including cleared transactions except as provided in paragraph (c)(4)(ii)(I) of this section and, at the discretion of the national bank or Federal savings association, excluding a forward agreement treated as a derivative contract that is part of a repurchase or reverse repurchase or a securities borrowing or lending transaction that qualifies for sales treatment under U.S. GAAP), as determined under § 3.132(c)(7)(i), in which the term C in § 3.132(c)(7)(i) equals zero except as provided in paragraph (c)(4)(ii)(B)(*2*)(*ii*) of this section, and, for any counterparty that is not a commercial end-user, multiplied by 1.4; and

(*ii*) For purposes of paragraph (c)(4)(ii)(B)(*2*)(*i*) of this section, a national bank or Federal savings association may set the value of the term C in § 3.132(c)(7)(i) equal to the amount of collateral posted by a clearing member client of the national bank or Federal savings association, in connection with the client-facing derivative transactions within the netting set;

(C)(*1*)(*i*) For a national bank or Federal savings association that uses the current exposure methodology under § 3.34(b) for its standardized risk-weighted assets, the amount of cash collateral that is received from a counterparty to a derivative contract and that has offset the mark-to-fair value of the derivative asset, or cash collateral that is posted to a counterparty to a derivative contract and that has reduced the national bank or Federal savings association's on-balance sheet assets, unless such cash collateral is all or part of variation margin that satisfies the conditions in paragraphs (c)(4)(ii)(C)(*3*) through (*7*) of this section; and

(*ii*) The variation margin is used to reduce the current credit exposure of the derivative contract, calculated as described in § 3.34(b), and not the PFE; and

(*iii*) For the purpose of the calculation of the NGR described in § 3.34(b)(2)(ii)(B), variation margin described in paragraph (c)(4)(ii)(C)(*1*)(*ii*) of this section may not reduce the net current credit exposure or the gross current credit exposure; or

(*2*)(*i*) For a national bank or Federal savings association that uses the standardized approach for counterparty credit risk under § 3.132(c) for its standardized risk-weighted assets, the replacement cost of each derivative contract or single product netting set of derivative contracts to which the national bank or Federal savings association is a counterparty, calculated according to the following formula, and, for any counterparty that is not a commercial end-user, multiplied by 1.4:

$$\textit{Replacement Cost} = \max\{V - CVM_r + CVM_p; 0\}$$

Where:

V equals the fair value for each derivative contract or each single-product netting set of derivative contracts (including a cleared transaction except as provided in paragraph (c)(4)(ii)(I) of this section and, at the discretion of the national bank or Federal savings association, excluding a forward agreement treated as a derivative contract that is part of a repurchase or

reverse repurchase or a securities borrowing or lending transaction that qualifies for sales treatment under U.S. GAAP);

CVM_r equals the amount of cash collateral received from a counterparty to a derivative contract and that satisfies the conditions in paragraphs (c)(4)(ii)(C)(*3*) through (*7*) of this section, or, in the case of a client-facing derivative transaction, the amount of collateral received from the clearing member client; and

CVM_p equals the amount of cash collateral that is posted to a counterparty to a derivative contract and that has not offset the fair value of the derivative contract and that satisfies the conditions in paragraphs (c)(4)(ii)(C)(*3*) through (*7*) of this section, or, in the case of a client-facing derivative transaction, the amount of collateral posted to the clearing member client;

(*ii*) Notwithstanding paragraph (c)(4)(ii)(C)(*2*)(*i*) of this section, where multiple netting sets are subject to a single variation margin agreement, a national bank or Federal savings association must apply the formula for replacement cost provided in § 3.132(c)(10)(i), in which the term C_{MA} may only include cash collateral that satisfies the conditions in paragraphs (c)(4)(ii)(C)(*3*) through (*7*) of this section; and

(*iii*) For purposes of paragraph (c)(4)(ii)(C)(*2*)(*i*), a national bank or Federal savings association must treat a derivative contract that references an index as if it were multiple derivative contracts each referencing one component of the index if the national bank or Federal savings association elected to treat the derivative contract as multiple derivative contracts under § 3.132(c)(5)(vi);

(*3*) For derivative contracts that are not cleared through a QCCP, the cash collateral received by the recipient counterparty is not segregated (by law, regulation, or an agreement with the counterparty);

(*4*) Variation margin is calculated and transferred on a daily basis based on the mark-to-fair value of the derivative contract;

(*5*) The variation margin transferred under the derivative contract or the governing rules of the CCP or QCCP for a cleared transaction is the full amount that is necessary to fully extinguish the net current credit exposure to the counterparty of the derivative contracts, subject to the threshold and minimum transfer amounts applicable to the counterparty under the terms of the derivative contract or the governing rules for a cleared transaction;

(*6*) The variation margin is in the form of cash in the same currency as the currency of settlement set forth in the derivative contract, provided that for the purposes of this paragraph (c)(4)(ii)(C)(*6*), currency of settlement means any currency for settlement specified in the governing qualifying master netting agreement and the credit support annex to the qualifying master netting agreement, or in the governing rules for a cleared transaction; and

(*7*) The derivative contract and the variation margin are governed by a qualifying master netting agreement between the legal entities that are the counterparties to the derivative contract or by the governing rules for a cleared transaction, and the qualifying master netting agreement or the governing rules for a cleared transaction must explicitly stipulate that the counterparties agree to settle any payment obligations on a net basis, taking into account any variation margin received or provided under the contract if a credit event involving either counterparty occurs;

* * * * *

■ 4. Section 3.32 is amended by revising paragraph (f) to read as follows:

§ 3.32 General risk weights.

* * * * *

(f) *Corporate exposures.* (1) A national bank or Federal savings association must assign a 100 percent risk weight to all its corporate exposures, except as provided in paragraph (f)(2) of this section.

(2) A national bank or Federal savings association must assign a 2 percent risk weight to an exposure to a QCCP arising from the national bank or Federal savings association posting cash collateral to the QCCP in connection with a cleared transaction that meets the requirements of § 3.35(b)(3)(i)(A) and a 4 percent risk weight to an exposure to a QCCP arising from the national bank or Federal savings association posting cash collateral to the QCCP in connection with a cleared transaction that meets the requirements of § 3.35(b)(3)(i)(B).

(3) A national bank or Federal savings association must assign a 2 percent risk weight to an exposure to a QCCP arising from the national bank or Federal savings association posting cash collateral to the QCCP in connection with a cleared transaction that meets the requirements of § 3.35(c)(3)(i).

* * * * *

■ 5. Section 3.34 is revised to read as follows:

§ 3.34 Derivative contracts.

(a) *Exposure amount for derivative contracts*—(1) *National bank or Federal savings association that is not an advanced approaches national bank or Federal savings association.* (i) A national bank or Federal savings association that is not an advanced approaches national bank or Federal savings association must use the current exposure methodology (CEM) described in paragraph (b) of this section to calculate the exposure amount for all its OTC derivative contracts, unless the national bank or Federal savings association makes the election provided in paragraph (a)(1)(ii) of this section.

(ii) A national bank or Federal savings association that is not an advanced approaches national bank or Federal savings association may elect to calculate the exposure amount for all its OTC derivative contracts under the standardized approach for counterparty credit risk (SA–CCR) in § 3.132(c) by notifying the OCC, rather than calculating the exposure amount for all its derivative contracts using CEM. A national bank or Federal savings association that elects under this paragraph (a)(1)(ii) to calculate the exposure amount for its OTC derivative contracts under SA–CCR must apply the treatment of cleared transactions under § 3.133 to its derivative contracts that are cleared transactions and to all default fund contributions associated with such derivative contracts, rather than applying § 3.35. A national bank or Federal savings association that is not an advanced approaches national bank or Federal savings association must use the same methodology to calculate the exposure amount for all its derivative contracts and, if a national bank or Federal savings association has elected to use SA–CCR under this paragraph (a)(1)(ii), the national bank or Federal savings association may change its election only with prior approval of the OCC.

(2) *Advanced approaches national bank or Federal savings association.* An advanced approaches national bank or Federal savings association must calculate the exposure amount for all its derivative contracts using SA–CCR in § 3.132(c) for purposes of standardized total risk-weighted assets. An advanced approaches national bank or Federal savings association must apply the treatment of cleared transactions under § 3.133 to its derivative contracts that are cleared transactions and to all default fund contributions associated with such derivative contracts for purposes of standardized total risk-weighted assets.

(b) *Current exposure methodology exposure amount*—(1) *Single OTC derivative contract.* Except as modified by paragraph (c) of this section, the exposure amount for a single OTC derivative contract that is not subject to

a qualifying master netting agreement is equal to the sum of the national bank's or Federal savings association's current credit exposure and potential future credit exposure (PFE) on the OTC derivative contract.

(i) *Current credit exposure.* The current credit exposure for a single OTC derivative contract is the greater of the fair value of the OTC derivative contract or zero.

(ii) *PFE.* (A) The PFE for a single OTC derivative contract, including an OTC derivative contract with a negative fair value, is calculated by multiplying the notional principal amount of the OTC derivative contract by the appropriate conversion factor in Table 1 to this section.

(B) For purposes of calculating either the PFE under this paragraph (b)(1)(ii) or the gross PFE under paragraph (b)(2)(ii)(A) of this section for exchange rate contracts and other similar contracts in which the notional principal amount is equivalent to the cash flows, notional principal amount is the net receipts to each party falling due on each value date in each currency.

(C) For an OTC derivative contract that does not fall within one of the specified categories in Table 1 to this section, the PFE must be calculated using the appropriate ''other'' conversion factor.

(D) A national bank or Federal savings association must use an OTC derivative contract's effective notional principal amount (that is, the apparent or stated notional principal amount multiplied by any multiplier in the OTC derivative contract) rather than the apparent or stated notional principal amount in calculating PFE.

(E) The PFE of the protection provider of a credit derivative is capped at the net present value of the amount of unpaid premiums.

TABLE 1 TO § 3.34—CONVERSION FACTOR MATRIX FOR DERIVATIVE CONTRACTS [1]

Remaining maturity [2]	Interest rate	Foreign exchange rate and gold	Credit (investment grade reference asset) [3]	Credit (non-investment-grade reference asset)	Equity	Precious metals (except gold)	Other
One year or less	0.00	0.01	0.05	0.10	0.06	0.07	0.10
Greater than one year and less than or equal to five years	0.005	0.05	0.05	0.10	0.08	0.07	0.12
Greater than five years	0.015	0.075	0.05	0.10	0.10	0.08	0.15

[1] For a derivative contract with multiple exchanges of principal, the conversion factor is multiplied by the number of remaining payments in the derivative contract.

[2] For an OTC derivative contract that is structured such that on specified dates any outstanding exposure is settled and the terms are reset so that the fair value of the contract is zero, the remaining maturity equals the time until the next reset date. For an interest rate derivative contract with a remaining maturity of greater than one year that meets these criteria, the minimum conversion factor is 0.005.

[3] A national bank or Federal savings association must use the column labeled ''Credit (investment-grade reference asset)'' for a credit derivative whose reference asset is an outstanding unsecured long-term debt security without credit enhancement that is investment grade. A national bank or Federal savings association must use the column labeled ''Credit (non-investment-grade reference asset)'' for all other credit derivatives.

(2) *Multiple OTC derivative contracts subject to a qualifying master netting agreement.* Except as modified by paragraph (c) of this section, the exposure amount for multiple OTC derivative contracts subject to a qualifying master netting agreement is equal to the sum of the net current credit exposure and the adjusted sum of the PFE amounts for all OTC derivative contracts subject to the qualifying master netting agreement.

(i) *Net current credit exposure.* The net current credit exposure is the greater of the net sum of all positive and negative fair values of the individual OTC derivative contracts subject to the qualifying master netting agreement or zero.

(ii) *Adjusted sum of the PFE amounts.* The adjusted sum of the PFE amounts, Anet, is calculated as Anet = (0.4 × Agross) + (0.6 × NGR × Agross), where:

(A) Agross = the gross PFE (that is, the sum of the PFE amounts as determined under paragraph (b)(1)(ii) of this section for each individual derivative contract subject to the qualifying master netting agreement); and

(B) Net-to-gross Ratio (NGR) = the ratio of the net current credit exposure to the gross current credit exposure. In calculating the NGR, the gross current credit exposure equals the sum of the positive current credit exposures (as determined under paragraph (b)(1)(i) of this section) of all individual derivative contracts subject to the qualifying master netting agreement.

(c) *Recognition of credit risk mitigation of collateralized OTC derivative contracts.* (1) A national bank or Federal savings association using CEM under paragraph (b) of this section may recognize the credit risk mitigation benefits of financial collateral that secures an OTC derivative contract or multiple OTC derivative contracts subject to a qualifying master netting agreement (netting set) by using the simple approach in § 3.37(b).

(2) As an alternative to the simple approach, a national bank or Federal savings association using CEM under paragraph (b) of this section may recognize the credit risk mitigation benefits of financial collateral that secures such a contract or netting set if the financial collateral is marked-to-fair value on a daily basis and subject to a daily margin maintenance requirement by applying a risk weight to the uncollateralized portion of the exposure, after adjusting the exposure amount calculated under paragraph (b)(1) or (2) of this section using the collateral haircut approach in § 3.37(c). The national bank or Federal savings association must substitute the exposure amount calculated under paragraph (b)(1) or (2) of this section for ΣE in the equation in § 3.37(c)(2).

(d) *Counterparty credit risk for credit derivatives*—(1) *Protection purchasers.* A national bank or Federal savings association that purchases a credit derivative that is recognized under § 3.36 as a credit risk mitigant for an exposure that is not a covered position under subpart F of this part is not required to compute a separate counterparty credit risk capital requirement under this subpart provided that the national bank or Federal savings association does so consistently for all such credit derivatives. The national bank or Federal savings association must either include all or exclude all such credit derivatives that are subject to a qualifying master netting agreement from any measure used to determine counterparty credit risk exposure to all relevant counterparties for risk-based capital purposes.

(2) *Protection providers.* (i) A national bank or Federal savings association that is the protection provider under a credit derivative must treat the credit derivative as an exposure to the underlying reference asset. The national bank or Federal savings association is

not required to compute a counterparty credit risk capital requirement for the credit derivative under this subpart, provided that this treatment is applied consistently for all such credit derivatives. The national bank or Federal savings association must either include all or exclude all such credit derivatives that are subject to a qualifying master netting agreement from any measure used to determine counterparty credit risk exposure.

(ii) The provisions of this paragraph (d)(2) apply to all relevant counterparties for risk-based capital purposes unless the national bank or Federal savings association is treating the credit derivative as a covered position under subpart F of this part, in which case the national bank or Federal savings association must compute a supplemental counterparty credit risk capital requirement under this section.

(e) *Counterparty credit risk for equity derivatives.* (1) A national bank or Federal savings association must treat an equity derivative contract as an equity exposure and compute a risk-weighted asset amount for the equity derivative contract under §§ 3.51 through 3.53 (unless the national bank or Federal savings association is treating the contract as a covered position under subpart F of this part).

(2) In addition, the national bank or Federal savings association must also calculate a risk-based capital requirement for the counterparty credit risk of an equity derivative contract under this section if the national bank or Federal savings association is treating the contract as a covered position under subpart F of this part.

(3) If the national bank or Federal savings association risk weights the contract under the Simple Risk-Weight Approach (SRWA) in § 3.52, the national bank or Federal savings association may choose not to hold risk-based capital against the counterparty credit risk of the equity derivative contract, as long as it does so for all such contracts. Where the equity derivative contracts are subject to a qualified master netting agreement, a national bank or Federal savings association using the SRWA must either include all or exclude all of the contracts from any measure used to determine counterparty credit risk exposure.

(f) *Clearing member national bank's or Federal savings association's exposure amount.* The exposure amount of a clearing member national bank or Federal savings association using CEM under paragraph (b) of this section for a client-facing derivative transaction or netting set of client-facing derivative transactions equals the exposure amount calculated according to paragraph (b)(1) or (2) of this section multiplied by the scaling factor of the square root of ½ (which equals 0.707107). If the national bank or Federal savings association determines that a longer period is appropriate, the national bank or Federal savings association must use a larger scaling factor to adjust for a longer holding period as follows:

$$\text{Scaling factor} = \sqrt{\frac{H}{10}}$$

Where H = the holding period greater than or equal to five days.

Additionally, the OCC may require the national bank or Federal savings association to set a longer holding period if the OCC determines that a longer period is appropriate due to the nature, structure, or characteristics of the transaction or is commensurate with the risks associated with the transaction.

■ 6. Section 3.35 is amended by adding paragraph (a)(3), revising paragraph (b)(4)(i), and adding paragraph (c)(3)(iii) to read as follows:

§ 3.35 Cleared transactions.

(a) * * *

(3) *Alternate requirements.* Notwithstanding any other provision of this section, an advanced approaches national bank or Federal savings association or a national bank or Federal savings association that is not an advanced approaches national bank or Federal savings association and that has elected to use SA–CCR under § 3.34(a)(1) must apply § 3.133 to its derivative contracts that are cleared transactions rather than this section.

(b) * * *

(4) * * *

(i) Notwithstanding any other requirements in this section, collateral posted by a clearing member client national bank or Federal savings association that is held by a custodian (in its capacity as custodian) in a manner that is bankruptcy remote from the CCP, clearing member, and other clearing member clients of the clearing member, is not subject to a capital requirement under this section.

* * * * *

(c) * * *

(3) * * *

(iii) Notwithstanding paragraphs (c)(3)(i) and (ii) of this section, a clearing member national bank or Federal savings association may apply a risk weight of zero percent to the trade exposure amount for a cleared transaction with a CCP where the clearing member national bank or Federal savings association is acting as a financial intermediary on behalf of a clearing member client, the transaction offsets another transaction that satisfies the requirements set forth in § 3.3(a), and the clearing member national bank or Federal savings association is not obligated to reimburse the clearing member client in the event of the CCP default.

* * * * *

■ 7. Section 3.37 is amended by revising paragraphs (c)(3)(iii), (c)(3)(iv)(A) and (C), (c)(4)(i)(B) introductory text, and (c)(4)(i)(B)(*1*) to read as follows:

§ 3.37 Collateralized transactions.

* * * * *

(c) * * *

(3) * * *

(iii) For repo-style transactions and client-facing derivative transactions, a national bank or Federal savings association may multiply the standard supervisory haircuts provided in paragraphs (c)(3)(i) and (ii) of this section by the square root of ½ (which equals 0.707107). For client-facing derivative transactions, if a larger scaling factor is applied under § 3.34(f), the same factor must be used to adjust the supervisory haircuts.

(iv) * * *

(A) T_M equals a holding period of longer than 10 business days for eligible margin loans and derivative contracts other than client-facing derivative transactions or longer than 5 business days for repo-style transactions and client-facing derivative transactions;

* * * * *

(C) T_S equals 10 business days for eligible margin loans and derivative contracts other than client-facing derivative transactions or 5 business days for repo-style transactions and client-facing derivative transactions.

* * * * *

(4) * * *

(i) * * *

(B) The minimum holding period for a repo-style transaction and client-facing derivative transaction is five business days and for an eligible margin loan and a derivative contract other than a client-facing derivative transaction is ten business days except for transactions or netting sets for which paragraph (c)(4)(i)(C) of this section applies. When a national bank or Federal savings association calculates an own-estimates haircut on a T_N-day holding period, which is different from the minimum holding period for the transaction type, the applicable haircut

(H_M) is calculated using the following square root of time formula:

* * * * *

(*1*) T_M equals 5 for repo-style transactions and client-facing derivative transactions and 10 for eligible margin loans and derivative contracts other than client-facing derivative transactions;

* * * * *

§ § 3.134, 3.202, and 3.210 [Amended]

■ 8. For each section listed in the following table, the footnote number listed in the ''Old footnote number'' column is redesignated as the footnote number listed in the ''New footnote number'' column as follows:

Section	Old footnote number	New footnote number
3.134(d)(3)	30	31
3.202, paragraph (1) introductory text of the definition of ''Covered position''	31	32
3.202, paragraph (1)(i) of the definition of ''Covered position''	32	33
3.210(e)(1)	33	34

■ 9. Section 3.132 is amended by:

■ a. Revising paragraphs (b)(2)(ii)(A)(*3*) through (*5*);

■ b. Adding paragraphs (b)(2)(ii)(A)(*6*) and (*7*);

■ c. Revising paragraphs (c) heading and (c)(1) and (2) and (5) through (8);

■ d. Adding paragraphs (c)(9) through (11);

■ e. Revising paragraph (d)(10)(i);

■ f. In paragraphs (e)(5)(i)(A) and (H), removing ''Table 3 to § 3.132'' and adding in its place ''Table 4 to this section'';

■ g. In paragraphs (e)(5)(i)(C) and (e)(6)(i)(B), removing ''current exposure methodology'' and adding in its place ''standardized approach for counterparty credit risk methodology'' wherever it appears;

■ h. Redesignating Table 3 to § 3.132 following paragraph (e)(5)(ii) as Table 4 to § 3.132; and

■ i. Revising paragraph (e)(6)(viii).

The revisions and additions read as follows:

§ 3.132 Counterparty credit risk of repo-style transactions, eligible margin loans, and OTC derivative contracts.

* * * * *

(b) * * *

(2) * * *

(ii) * * *

(A) * * *

(*3*) For repo-style transactions and client-facing derivative transactions, a national bank or Federal savings association may multiply the supervisory haircuts provided in paragraphs (b)(2)(ii)(A)(*1*) and (*2*) of this section by the square root of ½ (which equals 0.707107). If the national bank or Federal savings association determines that a longer holding period is appropriate for client-facing derivative transactions, then it must use a larger scaling factor to adjust for the longer holding period pursuant to paragraph (b)(2)(ii)(A)(*6*) of this section.

(*4*) A national bank or Federal savings association must adjust the supervisory haircuts upward on the basis of a holding period longer than ten business days (for eligible margin loans) or five business days (for repo-style transactions), using the formula provided in paragraph (b)(2)(ii)(A)(*6*) of this section where the conditions in this paragraph (b)(2)(ii)(A)(*4*) apply. If the number of trades in a netting set exceeds 5,000 at any time during a quarter, a national bank or Federal savings association must adjust the supervisory haircuts upward on the basis of a minimum holding period of twenty business days for the following quarter (except when a national bank or Federal savings association is calculating EAD for a cleared transaction under § 3.133). If a netting set contains one or more trades involving illiquid collateral, a national bank or Federal savings association must adjust the supervisory haircuts upward on the basis of a minimum holding period of twenty business days. If over the two previous quarters more than two margin disputes on a netting set have occurred that lasted longer than the holding period, then the national bank or Federal savings association must adjust the supervisory haircuts upward for that netting set on the basis of a minimum holding period that is at least two times the minimum holding period for that netting set.

(*5*)(*i*) A national bank or Federal savings association must adjust the supervisory haircuts upward on the basis of a holding period longer than ten business days for collateral associated with derivative contracts (five business days for client-facing derivative contracts) using the formula provided in paragraph (b)(2)(ii)(A)(*6*) of this section where the conditions in this paragraph (b)(2)(ii)(A)(*5*)(*i*) apply. For collateral associated with a derivative contract that is within a netting set that is composed of more than 5,000 derivative contracts that are not cleared transactions, a national bank or Federal savings association must use a minimum holding period of twenty business days. If a netting set contains one or more trades involving illiquid collateral or a derivative contract that cannot be easily replaced, a national bank or Federal savings association must use a minimum holding period of twenty business days.

(*ii*) Notwithstanding paragraph (b)(2)(ii)(A)(*1*) or (*3*) or (b)(2)(ii)(A)(*5*)(*i*) of this section, for collateral associated with a derivative contract in a netting set under which more than two margin disputes that lasted longer than the holding period occurred during the previous two quarters, the minimum holding period is twice the amount provided under paragraph (b)(2)(ii)(A)(*1*) or (*3*) or (b)(2)(ii)(A)(*5*)(*i*) of this section.

(*6*) A national bank or Federal savings association must adjust the standard supervisory haircuts upward, pursuant to the adjustments provided in paragraphs (b)(2)(ii)(A)(*3*) through (*5*) of this section, using the following formula:

$$H_A = H_S \sqrt{\frac{T_M}{T_S}}$$

Where:

T_M equals a holding period of longer than 10 business days for eligible margin loans and derivative contracts other than client-facing derivative transactions or longer than 5 business days for repo-style transactions and client-facing derivative transactions;

H_S equals the standard supervisory haircut; and

T_S equals 10 business days for eligible margin loans and derivative contracts other than client-facing derivative transactions or 5 business days for repo-style transactions and client-facing derivative transactions.

(*7*) If the instrument a national bank or Federal savings association has lent, sold subject to repurchase, or posted as collateral does not meet the definition of

financial collateral, the national bank or Federal savings association must use a 25.0 percent haircut for market price volatility (H_S).

* * * * *

(c) *EAD for derivative contracts*—(1) *Options for determining EAD.* A national bank or Federal savings association must determine the EAD for a derivative contract using the standardized approach for counterparty credit risk (SA–CCR) under paragraph (c)(5) of this section or using the internal models methodology described in paragraph (d) of this section. If a national bank or Federal savings association elects to use SA–CCR for one or more derivative contracts, the exposure amount determined under SA–CCR is the EAD for the derivative contract or derivative contracts. A national bank or Federal savings association must use the same methodology to calculate the exposure amount for all its derivative contracts and may change its election only with prior approval of the OCC. A national bank or Federal savings association may reduce the EAD calculated according to paragraph (c)(5) of this section by the credit valuation adjustment that the national bank or Federal savings association has recognized in its balance sheet valuation of any derivative contracts in the netting set. For purposes of this paragraph (c)(1), the credit valuation adjustment does not include any adjustments to common equity tier 1 capital attributable to changes in the fair value of the national bank's or Federal savings association's liabilities that are due to changes in its own credit risk since the inception of the transaction with the counterparty.

(2) *Definitions.* For purposes of this paragraph (c) of this section, the following definitions apply:

(i) *End date* means the last date of the period referenced by an interest rate or credit derivative contract or, if the derivative contract references another instrument, by the underlying instrument, except as otherwise provided in paragraph (c) of this section.

(ii) *Start date* means the first date of the period referenced by an interest rate or credit derivative contract or, if the derivative contract references the value of another instrument, by underlying instrument, except as otherwise provided in paragraph (c) of this section.

(iii) *Hedging set* means:

(A) With respect to interest rate derivative contracts, all such contracts within a netting set that reference the same reference currency;

(B) With respect to exchange rate derivative contracts, all such contracts within a netting set that reference the same currency pair;

(C) With respect to credit derivative contract, all such contracts within a netting set;

(D) With respect to equity derivative contracts, all such contracts within a netting set;

(E) With respect to a commodity derivative contract, all such contracts within a netting set that reference one of the following commodity categories: Energy, metal, agricultural, or other commodities;

(F) With respect to basis derivative contracts, all such contracts within a netting set that reference the same pair of risk factors and are denominated in the same currency; or

(G) With respect to volatility derivative contracts, all such contracts within a netting set that reference one of interest rate, exchange rate, credit, equity, or commodity risk factors, separated according to the requirements under paragraphs (c)(2)(iii)(A) through (E) of this section.

(H) If the risk of a derivative contract materially depends on more than one of interest rate, exchange rate, credit, equity, or commodity risk factors, the OCC may require a national bank or Federal savings association to include the derivative contract in each appropriate hedging set under paragraphs (c)(2)(iii)(A) through (E) of this section.

* * * * *

(5) *Exposure amount.* (i) The exposure amount of a netting set, as calculated under paragraph (c) of this section, is equal to 1.4 multiplied by the sum of the replacement cost of the netting set, as calculated under paragraph (c)(6) of this section, and the potential future exposure of the netting set, as calculated under paragraph (c)(7) of this section.

(ii) Notwithstanding the requirements of paragraph (c)(5)(i) of this section, the exposure amount of a netting set subject to a variation margin agreement, excluding a netting set that is subject to a variation margin agreement under which the counterparty to the variation margin agreement is not required to post variation margin, is equal to the lesser of the exposure amount of the netting set calculated under paragraph (c)(5)(i) of this section and the exposure amount of the netting set calculated as if the netting set were not subject to a variation margin agreement.

(iii) Notwithstanding the requirements of paragraph (c)(5)(i) of this section, the exposure amount of a netting set that consists of only sold options in which the premiums have been fully paid by the counterparty to the options and where the options are not subject to a variation margin agreement is zero.

(iv) Notwithstanding the requirements of paragraph (c)(5)(i) of this section, the exposure amount of a netting set in which the counterparty is a commercial end-user is equal to the sum of replacement cost, as calculated under paragraph (c)(6) of this section, and the potential future exposure of the netting set, as calculated under paragraph (c)(7) of this section.

(v) For purposes of the exposure amount calculated under paragraph (c)(5)(i) of this section and all calculations that are part of that exposure amount, a national bank or Federal savings association may elect, at the netting set level, to treat a derivative contract that is a cleared transaction that is not subject to a variation margin agreement as one that is subject to a variation margin agreement, if the derivative contract is subject to a requirement that the counterparties make daily cash payments to each other to account for changes in the fair value of the derivative contract and to reduce the net position of the contract to zero. If a national bank or Federal savings association makes an election under this paragraph (c)(5)(v) for one derivative contract, it must treat all other derivative contracts within the same netting set that are eligible for an election under this paragraph (c)(5)(v) as derivative contracts that are subject to a variation margin agreement.

(vi) For purposes of the exposure amount calculated under paragraph (c)(5)(i) of this section and all calculations that are part of that exposure amount, a national bank or Federal savings association may elect to treat a credit derivative contract, equity derivative contract, or commodity derivative contract that references an index as if it were multiple derivative contracts each referencing one component of the index.

(6) *Replacement cost of a netting set*—(i) *Netting set subject to a variation margin agreement under which the counterparty must post variation margin.* The replacement cost of a netting set subject to a variation margin agreement, excluding a netting set that is subject to a variation margin agreement under which the counterparty is not required to post variation margin, is the greater of:

(A) The sum of the fair values (after excluding any valuation adjustments) of the derivative contracts within the netting set less the sum of the net independent collateral amount and the

variation margin amount applicable to such derivative contracts;

(B) The sum of the variation margin threshold and the minimum transfer amount applicable to the derivative contracts within the netting set less the net independent collateral amount applicable to such derivative contracts; or

(C) Zero.

(ii) *Netting sets not subject to a variation margin agreement under which the counterparty must post variation margin.* The replacement cost of a netting set that is not subject to a variation margin agreement under which the counterparty must post variation margin to the national bank or Federal savings association is the greater of:

(A) The sum of the fair values (after excluding any valuation adjustments) of the derivative contracts within the netting set less the sum of the net independent collateral amount and variation margin amount applicable to such derivative contracts; or

(B) Zero.

(iii) *Multiple netting sets subject to a single variation margin agreement.* Notwithstanding paragraphs (c)(6)(i) and (ii) of this section, the replacement cost for multiple netting sets subject to a single variation margin agreement must be calculated according to paragraph (c)(10)(i) of this section.

(iv) *Netting set subject to multiple variation margin agreements or a hybrid netting set.* Notwithstanding paragraphs (c)(6)(i) and (ii) of this section, the replacement cost for a netting set subject to multiple variation margin agreements or a hybrid netting set must be calculated according to paragraph (c)(11)(i) of this section.

(7) *Potential future exposure of a netting set.* The potential future exposure of a netting set is the product of the PFE multiplier and the aggregated amount.

(i) *PFE multiplier.* The PFE multiplier is calculated according to the following formula:

$$PFE\ multiplier = min\left\{1; 0.05 + 0.95 * e^{\left(\frac{V-C}{1.9*A}\right)}\right\}$$

Where:

V is the sum of the fair values (after excluding any valuation adjustments) of the derivative contracts within the netting set;

C is the sum of the net independent collateral amount and the variation margin amount applicable to the derivative contracts within the netting set; and

A is the aggregated amount of the netting set.

(ii) *Aggregated amount.* The aggregated amount is the sum of all hedging set amounts, as calculated under paragraph (c)(8) of this section, within a netting set.

(iii) *Multiple netting sets subject to a single variation margin agreement.* Notwithstanding paragraphs (c)(7)(i) and (ii) of this section and when calculating the potential future exposure for purposes of total leverage exposure under § 3.10(c)(4)(ii)(B), the potential future exposure for multiple netting sets subject to a single variation margin agreement must be calculated according to paragraph (c)(10)(ii) of this section.

(iv) *Netting set subject to multiple variation margin agreements or a hybrid netting set.* Notwithstanding paragraphs (c)(7)(i) and (ii) of this section and when calculating the potential future exposure for purposes of total leverage exposure under § 3.10(c)(4)(ii)(B), the potential future exposure for a netting set subject to multiple variation margin agreements or a hybrid netting set must be calculated according to paragraph (c)(11)(ii) of this section.

(8) *Hedging set amount*—(i) *Interest rate derivative contracts.* To calculate the hedging set amount of an interest rate derivative contract hedging set, a national bank or Federal savings association may use either of the formulas provided in paragraphs (c)(8)(i)(A) and (B) of this section:

(A) Formula 1 is as follows:

$$Hedging\ set\ amount = [(AddOn_{TB1}^{IR})^2 + (AddOn_{TB2}^{IR})^2 + (AddOn_{TB3}^{IR})^2 + 1.4 * AddOn_{TB1}^{IR} * AddOn_{TB2}^{IR} + 1.4 * AddOn_{TB2}^{IR} * AddOn_{TB3}^{IR} + 0.6 * AddOn_{TB1}^{IR} * AddOn_{TB3}^{IR})]^{\frac{1}{2}};\ \text{or}$$

(B) Formula 2 is as follows:

$$Hedging\ set\ amount = |AddOn_{TB1}{}^{IR}| + |AddOn_{TB2}{}^{IR}| + |AddOn_{TB3}{}^{IR}|.$$

Where in paragraphs (c)(8)(i)(A) and (B) of this section:

$AddOn_{TB1}{}^{IR}$ is the sum of the adjusted derivative contract amounts, as calculated under paragraph (c)(9) of this section, within the hedging set with an end date of less than one year from the present date;

$AddOn_{TB2}{}^{IR}$ is the sum of the adjusted derivative contract amounts, as calculated under paragraph (c)(9) of this section, within the hedging set with an end date of one to five years from the present date; and

$AddOn_{TB3}{}^{IR}$ is the sum of the adjusted derivative contract amounts, as calculated under paragraph (c)(9) of this section, within the hedging set with an end date of more than five years from the present date.

(ii) *Exchange rate derivative contracts.* For an exchange rate derivative contract hedging set, the hedging set amount equals the absolute value of the sum of the adjusted derivative contract amounts, as calculated under paragraph (c)(9) of this section, within the hedging set.

(iii) *Credit derivative contracts and equity derivative contracts.* The hedging set amount of a credit derivative contract hedging set or equity derivative contract hedging set within a netting set is calculated according to the following formula:

$$Hedging\ set\ amount = \left[\left(\sum_{k=1}^{K} \rho_k * AddOn(Ref_k)\right)^2 + \sum_{k=1}^{K}(1-(\rho_k)^2) * (AddOn(Ref_k))^2\right]^{\frac{1}{2}}$$

Where:

k is each reference entity within the hedging set.

K is the number of reference entities within the hedging set.

AddOn(*Ref*$_k$) equals the sum of the adjusted derivative contract amounts, as determined under paragraph (c)(9) of this section, for all derivative contracts within the hedging set that reference reference entity *k*.

ρ_k equals the applicable supervisory correlation factor, as provided in Table 2 to this section.

(iv) *Commodity derivative contracts.* The hedging set amount of a commodity derivative contract hedging set within a netting set is calculated according to the following formula:

$$Hedging\ set\ amount = \left[\left(\rho * \sum_{k=1}^{K} AddOn(Type_k)\right)^2 + (1-(\rho)^2) * \sum_{k=1}^{K}(AddOn(Type_k))^2\right]^{\frac{1}{2}}$$

Where:

k is each commodity type within the hedging set.

K is the number of commodity types within the hedging set.

AddOn(*Type*$_k$) equals the sum of the adjusted derivative contract amounts, as determined under paragraph (c)(9) of this section, for all derivative contracts within the hedging set that reference reference commodity type *k*.

ρ equals the applicable supervisory correlation factor, as provided in Table 2 to this section.

(v) *Basis derivative contracts and volatility derivative contracts.* Notwithstanding paragraphs (c)(8)(i) through (iv) of this section, a national bank or Federal savings association must calculate a separate hedging set amount for each basis derivative contract hedging set and each volatility derivative contract hedging set. A national bank or Federal savings association must calculate such hedging set amounts using one of the formulas under paragraphs (c)(8)(i) through (iv) of this section that corresponds to the primary risk factor of the hedging set being calculated.

(9) *Adjusted derivative contract amount*—(i) *Summary.* To calculate the adjusted derivative contract amount of a derivative contract, a national bank or Federal savings association must determine the adjusted notional amount of derivative contract, pursuant to paragraph (c)(9)(ii) of this section, and multiply the adjusted notional amount by each of the supervisory delta adjustment, pursuant to paragraph (c)(9)(iii) of this section, the maturity factor, pursuant to paragraph (c)(9)(iv) of this section, and the applicable supervisory factor, as provided in Table 2 to this section.

(ii) *Adjusted notional amount.* (A)(*1*) For an interest rate derivative contract or a credit derivative contract, the adjusted notional amount equals the product of the notional amount of the derivative contract, as measured in U.S. dollars using the exchange rate on the date of the calculation, and the supervisory duration, as calculated by the following formula:

$$\text{Supervisory duration} = max\left\{\frac{e^{-0.05*\left(\frac{S}{250}\right)} - e^{-0.05*\left(\frac{E}{250}\right)}}{0.05}, 0.04\right\}$$

Where:

S is the number of business days from the present day until the start date of the derivative contract, or zero if the start date has already passed; and

E is the number of business days from the present day until the end date of the derivative contract.

(*2*) For purposes of paragraph (c)(9)(ii)(A)(*1*) of this section:

(*i*) For an interest rate derivative contract or credit derivative contract that is a variable notional swap, the notional amount is equal to the time-weighted average of the contractual notional amounts of such a swap over the remaining life of the swap; and

(*ii*) For an interest rate derivative contract or a credit derivative contract that is a leveraged swap, in which the notional amount of all legs of the derivative contract are divided by a factor and all rates of the derivative contract are multiplied by the same factor, the notional amount is equal to the notional amount of an equivalent unleveraged swap.

(B)(*1*) For an exchange rate derivative contract, the adjusted notional amount is the notional amount of the non-U.S. denominated currency leg of the derivative contract, as measured in U.S. dollars using the exchange rate on the date of the calculation. If both legs of the exchange rate derivative contract are denominated in currencies other than U.S. dollars, the adjusted notional amount of the derivative contract is the largest leg of the derivative contract, as measured in U.S. dollars using the exchange rate on the date of the calculation.

(*2*) Notwithstanding paragraph (c)(9)(ii)(B)(*1*) of this section, for an exchange rate derivative contract with multiple exchanges of principal, the national bank or Federal savings

association must set the adjusted notional amount of the derivative contract equal to the notional amount of the derivative contract multiplied by the number of exchanges of principal under the derivative contract.

(C)(*1*) For an equity derivative contract or a commodity derivative contract, the adjusted notional amount is the product of the fair value of one unit of the reference instrument underlying the derivative contract and the number of such units referenced by the derivative contract.

(*2*) Notwithstanding paragraph (c)(9)(ii)(C)(*1*) of this section, when calculating the adjusted notional amount for an equity derivative contract or a commodity derivative contract that is a volatility derivative contract, the national bank or Federal savings association must replace the unit price with the underlying volatility referenced by the volatility derivative contract and replace the number of units with the notional amount of the volatility derivative contract.

(iii) *Supervisory delta adjustments.* (A) For a derivative contract that is not an option contract or collateralized debt obligation tranche, the supervisory delta adjustment is 1 if the fair value of the derivative contract increases when the value of the primary risk factor increases and −1 if the fair value of the derivative contract decreases when the value of the primary risk factor increases.

(B)(*1*) For a derivative contract that is an option contract, the supervisory delta adjustment is determined by the following formulas, as applicable:

Table 2 to §3.132--Supervisory Delta Adjustment for Options Contracts

	Bought	Sold
Call Options	$\Phi\left(\frac{\ln\left(\frac{P+\lambda}{K+\lambda}\right)+0.5*\sigma^2*T/250}{\sigma*\sqrt{T/250}}\right)$	$-\Phi\left(\frac{\ln\left(\frac{P+\lambda}{K+\lambda}\right)+0.5*\sigma^2*T/250}{\sigma*\sqrt{T/250}}\right)$
Put Options	$-\Phi\left(-\frac{\ln\left(\frac{P+\lambda}{K+\lambda}\right)+0.5*\sigma^2*T/250}{\sigma*\sqrt{T/250}}\right)$	$\Phi\left(-\frac{\ln\left(\frac{P+\lambda}{K+\lambda}\right)+0.5*\sigma^2*T/250}{\sigma*\sqrt{T/250}}\right)$

(*2*) As used in the formulas in Table 2 to this section:

(*i*) Φ is the standard normal cumulative distribution function;

(*ii*) P equals the current fair value of the instrument or risk factor, as applicable, underlying the option;

(*iii*) K equals the strike price of the option;

(*iv*) T equals the number of business days until the latest contractual exercise date of the option;

(*v*) λ equals zero for all derivative contracts except interest rate options for the currencies where interest rates have negative values. The same value of λ must be used for all interest rate options that are denominated in the same currency. To determine the value of λ for a given currency, a national bank or Federal savings association must find the lowest value L of P and K of all interest rate options in a given currency that the national bank or Federal savings association has with all counterparties. Then, λ is set according to this formula: $\lambda = max\{-L + 0.1\%, 0\}$; and

(*vi*) σ equals the supervisory option volatility, as provided in Table 3 to of this section.

(C)(*1*) For a derivative contract that is a collateralized debt obligation tranche, the supervisory delta adjustment is determined by the following formula:

$$\text{Supervisory delta adjustment} = \frac{15}{(1+14*A)*(1+14*D)}$$

(*2*) As used in the formula in paragraph (c)(9)(iii)(C)(*1*) of this section:

(*i*) A is the attachment point, which equals the ratio of the notional amounts of all underlying exposures that are subordinated to the national bank's or Federal savings association's exposure to the total notional amount of all underlying exposures, expressed as a decimal value between zero and one;[30]

(*ii*) D is the detachment point, which equals one minus the ratio of the notional amounts of all underlying exposures that are senior to the national bank's or Federal savings association's exposure to the total notional amount of all underlying exposures, expressed as a decimal value between zero and one; and

(*iii*) The resulting amount is designated with a positive sign if the collateralized debt obligation tranche was purchased by the national bank or Federal savings association and is designated with a negative sign if the collateralized debt obligation tranche was sold by the national bank or Federal savings association.

(iv) *Maturity factor.* (A)(*1*) The maturity factor of a derivative contract

[30] In the case of a first-to-default credit derivative, there are no underlying exposures that are subordinated to the national bank's or Federal savings association's exposure. In the case of a second-or-subsequent-to-default credit derivative, the smallest (n − 1) notional amounts of the underlying exposures are subordinated to the national bank's or Federal savings association's exposure.

that is subject to a variation margin agreement, excluding derivative contracts that are subject to a variation margin agreement under which the counterparty is not required to post variation margin, is determined by the following formula:

$$\text{Maturity factor} = \frac{3}{2}\sqrt{\frac{MPOR}{250}}$$

Where MPOR refers to the period from the most recent exchange of collateral covering a netting set of derivative contracts with a defaulting counterparty until the derivative contracts are closed out and the resulting market risk is re-hedged.

(*2*) Notwithstanding paragraph (c)(9)(iv)(A)(*1*) of this section:

(*i*) For a derivative contract that is not a client-facing derivative transaction, MPOR cannot be less than ten business days plus the periodicity of re-margining expressed in business days minus one business day;

(*ii*) For a derivative contract that is a client-facing derivative transaction, MPOR cannot be less than five business days plus the periodicity of re-margining expressed in business days minus one business day; and

(*iii*) For a derivative contract that is within a netting set that is composed of more than 5,000 derivative contracts that are not cleared transactions, or a netting set that contains one or more trades involving illiquid collateral or a derivative contract that cannot be easily replaced, MPOR cannot be less than twenty business days.

(*3*) Notwithstanding paragraphs (c)(9)(iv)(A)(*1*) and (*2*) of this section, for a netting set subject to two or more outstanding disputes over margin that lasted longer than the MPOR over the previous two quarters, the applicable floor is twice the amount provided in (c)(9)(iv)(A)(*1*) and (*2*) of this section.

(B) The maturity factor of a derivative contract that is not subject to a variation margin agreement, or derivative contracts under which the counterparty is not required to post variation margin, is determined by the following formula:

$$\text{Maturity factor} = \sqrt{\frac{\min\{M;250\}}{250}}$$

Where M equals the greater of 10 business days and the remaining maturity of the contract, as measured in business days.

(C) For purposes of paragraph (c)(9)(iv) of this section, if a national bank or Federal savings association has elected pursuant to paragraph (c)(5)(v) of this section to treat a derivative contract that is a cleared transaction that is not subject to a variation margin agreement as one that is subject to a variation margin agreement, the national bank or Federal savings association must treat the derivative contract as subject to a variation margin agreement with maturity factor as determined according to (c)(9)(iv)(A) of this section, and daily settlement does not change the end date of the period referenced by the derivative contract.

(v) *Derivative contract as multiple effective derivative contracts.* A national bank or Federal savings association must separate a derivative contract into separate derivative contracts, according to the following rules:

(A) For an option where the counterparty pays a predetermined amount if the value of the underlying asset is above or below the strike price and nothing otherwise (binary option), the option must be treated as two separate options. For purposes of paragraph (c)(9)(iii)(B) of this section, a binary option with strike K must be represented as the combination of one bought European option and one sold European option of the same type as the original option (put or call) with the strikes set equal to 0.95 * K and 1.05 * K so that the payoff of the binary option is reproduced exactly outside the region between the two strikes. The absolute value of the sum of the adjusted derivative contract amounts of the bought and sold options is capped at the payoff amount of the binary option.

(B) For a derivative contract that can be represented as a combination of standard option payoffs (such as collar, butterfly spread, calendar spread, straddle, and strangle), a national bank or Federal savings association must treat each standard option component as a separate derivative contract.

(C) For a derivative contract that includes multiple-payment options, (such as interest rate caps and floors), a national bank or Federal savings association may represent each payment option as a combination of effective single-payment options (such as interest rate caplets and floorlets).

(D) A national bank or Federal savings association may not decompose linear derivative contracts (such as swaps) into components.

(10) *Multiple netting sets subject to a single variation margin agreement*—(i) *Calculating replacement cost.* Notwithstanding paragraph (c)(6) of this section, a national bank or Federal savings association shall assign a single replacement cost to multiple netting sets that are subject to a single variation margin agreement under which the counterparty must post variation margin, calculated according to the following formula:

$$\textit{Replacement Cost} = max\{\Sigma_{NS}\, max\{V_{NS}; 0\} - max\{C_{MA}; 0\}; 0\} + max\{\Sigma_{NS}\, min\{V_{NS}; 0\} - min\{C_{MA}; 0\}; 0\}$$

Where:

NS is each netting set subject to the variation margin agreement MA.

V_{NS} is the sum of the fair values (after excluding any valuation adjustments) of the derivative contracts within the netting set NS.

C_{MA} is the sum of the net independent collateral amount and the variation margin amount applicable to the derivative contracts within the netting sets subject to the single variation margin agreement.

(ii) *Calculating potential future exposure.* Notwithstanding paragraph (c)(5) of this section, a national bank or Federal savings association shall assign a single potential future exposure to multiple netting sets that are subject to a single variation margin agreement under which the counterparty must post variation margin equal to the sum of the potential future exposure of each such netting set, each calculated according to paragraph (c)(7) of this section as if such nettings sets were not subject to a variation margin agreement.

(11) *Netting set subject to multiple variation margin agreements or a hybrid netting set*—(i) *Calculating replacement cost.* To calculate replacement cost for either a netting set subject to multiple variation margin agreements under which the counterparty to each variation margin agreement must post variation margin, or a netting set composed of at least one derivative contract subject to variation margin agreement under which the counterparty must post variation margin and at least one derivative contract that is not subject to such a variation margin agreement, the calculation for replacement cost is provided under paragraph (c)(6)(i) of this section, except that the variation margin threshold equals the sum of the variation margin thresholds of all variation margin agreements within the netting set and the minimum transfer amount equals the sum of the minimum transfer amounts of all the variation margin agreements within the netting set.

(ii) *Calculating potential future exposure.* (A) To calculate potential future exposure for a netting set subject to multiple variation margin agreements under which the counterparty to each variation margin agreement must post variation margin, or a netting set composed of at least one derivative contract subject to variation margin agreement under which the counterparty to the derivative contract

must post variation margin and at least one derivative contract that is not subject to such a variation margin agreement, a national bank or Federal savings association must divide the netting set into sub-netting sets (as described in paragraph (c)(11)(ii)(B) of this section) and calculate the aggregated amount for each sub-netting set. The aggregated amount for the netting set is calculated as the sum of the aggregated amounts for the sub-netting sets. The multiplier is calculated for the entire netting set.

(B) For purposes of paragraph (c)(11)(ii)(A) of this section, the netting set must be divided into sub-netting sets as follows:

(*1*) All derivative contracts within the netting set that are not subject to a variation margin agreement or that are subject to a variation margin agreement under which the counterparty is not required to post variation margin form a single sub-netting set. The aggregated amount for this sub-netting set is calculated as if the netting set is not subject to a variation margin agreement.

(*2*) All derivative contracts within the netting set that are subject to variation margin agreements in which the counterparty must post variation margin and that share the same value of the MPOR form a single sub-netting set. The aggregated amount for this sub-netting set is calculated as if the netting set is subject to a variation margin agreement, using the MPOR value shared by the derivative contracts within the netting set.

TABLE 3 TO § 3.132—SUPERVISORY OPTION VOLATILITY, SUPERVISORY CORRELATION PARAMETERS, AND SUPERVISORY FACTORS FOR DERIVATIVE CONTRACTS

Asset class	Category	Type	Supervisory option volatility (percent)	Supervisory correlation factor (percent)	Supervisory factor [1] (percent)
Interest rate	N/A	N/A	50	N/A	0.50
Exchange rate	N/A	N/A	15	N/A	4.0
Credit, single name	Investment grade	N/A	100	50	0.46
	Speculative grade	N/A	100	50	1.3
	Sub-speculative grade	N/A	100	50	6.0
Credit, index	Investment Grade	N/A	80	80	0.38
	Speculative Grade	N/A	80	80	1.06
Equity, single name	N/A	N/A	120	50	32
Equity, index	N/A	N/A	75	80	20
Commodity	Energy	Electricity	150	40	40
		Other	70	40	18
	Metals	N/A	70	40	18
	Agricultural	N/A	70	40	18
	Other	N/A	70	40	18

[1] The applicable supervisory factor for basis derivative contract hedging sets is equal to one-half of the supervisory factor provided in this Table 3, and the applicable supervisory factor for volatility derivative contract hedging sets is equal to 5 times the supervisory factor provided in this Table 3.

(d) * * *

(10) * * *

(i) With prior written approval of the OCC, a national bank or Federal savings association may set EAD equal to a measure of counterparty credit risk exposure, such as peak EAD, that is more conservative than an alpha of 1.4 times the larger of $EPE_{unstressed}$ and $EPE_{stressed}$ for every counterparty whose EAD will be measured under the alternative measure of counterparty exposure. The national bank or Federal savings association must demonstrate the conservatism of the measure of counterparty credit risk exposure used for EAD. With respect to paragraph (d)(10)(i) of this section:

(A) For material portfolios of new OTC derivative products, the national bank or Federal savings association may assume that the standardized approach for counterparty credit risk pursuant to paragraph (c) of this section meets the conservatism requirement of this section for a period not to exceed 180 days.

(B) For immaterial portfolios of OTC derivative contracts, the national bank or Federal savings association generally may assume that the standardized approach for counterparty credit risk pursuant to paragraph (c) of this section meets the conservatism requirement of this section.

* * * * *

(e) * * *

(6) * * *

(viii) If a national bank or Federal savings association uses the standardized approach for counterparty credit risk pursuant to paragraph (c) of this section to calculate the EAD for any immaterial portfolios of OTC derivative contracts, the national bank or Federal savings association must use that EAD as a constant EE in the formula for the calculation of CVA with the maturity equal to the maximum of:

(A) Half of the longest maturity of a transaction in the netting set; and

(B) The notional weighted average maturity of all transactions in the netting set.

10. Section 3.133 is amended by revising paragraphs (a), (b)(1) through (3), (b)(4)(i), (c)(1) thorough (3), (c)(4)(i), and (d) to read as follows:

§ 3.133 Cleared transactions.

(a) *General requirements*—(1) *Clearing member clients.* A national bank or Federal savings association that is a clearing member client must use the methodologies described in paragraph (b) of this section to calculate risk-weighted assets for a cleared transaction.

(2) *Clearing members.* A national bank or Federal savings association that is a clearing member must use the methodologies described in paragraph (c) of this section to calculate its risk-weighted assets for a cleared transaction and paragraph (d) of this section to calculate its risk-weighted assets for its default fund contribution to a CCP.

(b) * * *

(1) *Risk-weighted assets for cleared transactions.* (i) To determine the risk-weighted asset amount for a cleared transaction, a national bank or Federal savings association that is a clearing member client must multiply the trade exposure amount for the cleared transaction, calculated in accordance with paragraph (b)(2) of this section, by the risk weight appropriate for the

cleared transaction, determined in accordance with paragraph (b)(3) of this section.

(ii) A clearing member client national bank's or Federal savings association's total risk-weighted assets for cleared transactions is the sum of the risk-weighted asset amounts for all of its cleared transactions.

(2) *Trade exposure amount.* (i) For a cleared transaction that is a derivative contract or a netting set of derivative contracts, trade exposure amount equals the EAD for the derivative contract or netting set of derivative contracts calculated using the methodology used to calculate EAD for derivative contracts set forth in § 3.132(c) or (d), plus the fair value of the collateral posted by the clearing member client national bank or Federal savings association and held by the CCP or a clearing member in a manner that is not bankruptcy remote. When the national bank or Federal savings association calculates EAD for the cleared transaction using the methodology in § 3.132(d), EAD equals $EAD_{unstressed}$.

(ii) For a cleared transaction that is a repo-style transaction or netting set of repo-style transactions, trade exposure amount equals the EAD for the repo-style transaction calculated using the methodology set forth in § 3.132(b)(2) or (3) or (d), plus the fair value of the collateral posted by the clearing member client national bank or Federal savings association and held by the CCP or a clearing member in a manner that is not bankruptcy remote. When the national bank or Federal savings association calculates EAD for the cleared transaction under § 3.132(d), EAD equals $EAD_{unstressed}$.

(3) *Cleared transaction risk weights.* (i) For a cleared transaction with a QCCP, a clearing member client national bank or Federal savings association must apply a risk weight of:

(A) 2 percent if the collateral posted by the national bank or Federal savings association to the QCCP or clearing member is subject to an arrangement that prevents any loss to the clearing member client national bank or Federal savings association due to the joint default or a concurrent insolvency, liquidation, or receivership proceeding of the clearing member and any other clearing member clients of the clearing member; and the clearing member client national bank or Federal savings association has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that in the event of a legal challenge (including one resulting from an event of default or from liquidation, insolvency, or receivership proceedings) the relevant court and administrative authorities would find the arrangements to be legal, valid, binding, and enforceable under the law of the relevant jurisdictions.

(B) 4 percent, if the requirements of paragraph (b)(3)(i)(A) of this section are not met.

(ii) For a cleared transaction with a CCP that is not a QCCP, a clearing member client national bank or Federal savings association must apply the risk weight applicable to the CCP under subpart D of this part.

(4) * * *

(i) Notwithstanding any other requirement of this section, collateral posted by a clearing member client national bank or Federal savings association that is held by a custodian (in its capacity as a custodian) in a manner that is bankruptcy remote from the CCP, clearing member, and other clearing member clients of the clearing member, is not subject to a capital requirement under this section.

* * * * *

(c) * * *

(1) *Risk-weighted assets for cleared transactions.* (i) To determine the risk-weighted asset amount for a cleared transaction, a clearing member national bank or Federal savings association must multiply the trade exposure amount for the cleared transaction, calculated in accordance with paragraph (c)(2) of this section by the risk weight appropriate for the cleared transaction, determined in accordance with paragraph (c)(3) of this section.

(ii) A clearing member national bank's or Federal savings association's total risk-weighted assets for cleared transactions is the sum of the risk-weighted asset amounts for all of its cleared transactions.

(2) *Trade exposure amount.* A clearing member national bank or Federal savings association must calculate its trade exposure amount for a cleared transaction as follows:

(i) For a cleared transaction that is a derivative contract or a netting set of derivative contracts, trade exposure amount equals the EAD calculated using the methodology used to calculate EAD for derivative contracts set forth in § 3.132(c) or (d), plus the fair value of the collateral posted by the clearing member national bank or Federal savings association and held by the CCP in a manner that is not bankruptcy remote. When the clearing member national bank or Federal savings association calculates EAD for the cleared transaction using the methodology in § 3.132(d), EAD equals $EAD_{unstressed}$.

(ii) For a cleared transaction that is a repo-style transaction or netting set of repo-style transactions, trade exposure amount equals the EAD calculated under § 3.132(b)(2) or (3) or (d), plus the fair value of the collateral posted by the clearing member national bank or Federal savings association and held by the CCP in a manner that is not bankruptcy remote. When the clearing member national bank or Federal savings association calculates EAD for the cleared transaction under § 3.132(d), EAD equals $EAD_{unstressed}$.

(3) *Cleared transaction risk weights.* (i) A clearing member national bank or Federal savings association must apply a risk weight of 2 percent to the trade exposure amount for a cleared transaction with a QCCP.

(ii) For a cleared transaction with a CCP that is not a QCCP, a clearing member national bank or Federal savings association must apply the risk weight applicable to the CCP according to subpart D of this part.

(iii) Notwithstanding paragraphs (c)(3)(i) and (ii) of this section, a clearing member national bank or Federal savings association may apply a risk weight of zero percent to the trade exposure amount for a cleared transaction with a QCCP where the clearing member national bank or Federal savings association is acting as a financial intermediary on behalf of a clearing member client, the transaction offsets another transaction that satisfies the requirements set forth in § 3.3(a), and the clearing member national bank or Federal savings association is not obligated to reimburse the clearing member client in the event of the QCCP default.

(4) * * *

(i) Notwithstanding any other requirement of this section, collateral posted by a clearing member national bank or Federal savings association that is held by a custodian (in its capacity as a custodian) in a manner that is bankruptcy remote from the CCP, clearing member, and other clearing member clients of the clearing member, is not subject to a capital requirement under this section.

* * * * *

(d) *Default fund contributions*—(1) *General requirement.* A clearing member national bank or Federal savings association must determine the risk-weighted asset amount for a default fund contribution to a CCP at least quarterly, or more frequently if, in the opinion of the national bank or Federal savings association or the OCC, there is a material change in the financial condition of the CCP.

(2) *Risk-weighted asset amount for default fund contributions to nonqualifying CCPs.* A clearing member national bank's or Federal savings association's risk-weighted asset amount for default fund contributions to CCPs that are not QCCPs equals the sum of such default fund contributions multiplied by 1,250 percent, or an amount determined by the OCC, based on factors such as size, structure, and membership characteristics of the CCP and riskiness of its transactions, in cases where such default fund contributions may be unlimited.

(3) *Risk-weighted asset amount for default fund contributions to QCCPs.* A clearing member national bank's or Federal savings association's risk-weighted asset amount for default fund contributions to QCCPs equals the sum of its capital requirement, K_{CM} for each QCCP, as calculated under the methodology set forth in paragraph (d)(4) of this section, multiplied by 12.5.

(4) *Capital requirement for default fund contributions to a QCCP.* A clearing member national bank's or Federal savings association's capital requirement for its default fund contribution to a QCCP (K_{CM}) is equal to:

$$K_{CM} = \max\{K_{CCP} * \left(\frac{DF^{pref}}{DF_{CCP}+DF^{pref}_{CCPCM}}\right); 0.16\, percent * DF^{pref}\}$$

Where:

K_{CCP} is the hypothetical capital requirement of the QCCP, as determined under paragraph (d)(5) of this section;

DF^{pref} is the prefunded default fund contribution of the clearing member national bank or Federal savings association to the QCCP;

DF_{CCP} is the QCCP's own prefunded amounts that are contributed to the default waterfall and are junior or pari passu with prefunded default fund contributions of clearing members of the CCP; and

$DF_{CM}{}^{pref}$ is the total prefunded default fund contributions from clearing members of the QCCP to the QCCP.

(5) *Hypothetical capital requirement of a QCCP.* Where a QCCP has provided its K_{CCP}, a national bank or Federal savings association must rely on such disclosed figure instead of calculating K_{CCP} under this paragraph (d)(5), unless the national bank or Federal savings association determines that a more conservative figure is appropriate based on the nature, structure, or characteristics of the QCCP. The hypothetical capital requirement of a QCCP (K_{CCP}), as determined by the national bank or Federal savings association, is equal to:

$K_{CCP} = \Sigma_{CM_i} EAD_i * 1.6\ percent$

Where:

CM_i is each clearing member of the QCCP; and

EAD_i is the exposure amount of each clearing member of the QCCP to the QCCP, as determined under paragraph (d)(6) of this section.

(6) *EAD of a clearing member national bank or Federal savings association to a QCCP.* (i) The EAD of a clearing member national bank or Federal savings association to a QCCP is equal to the sum of the EAD for derivative contracts determined under paragraph (d)(6)(ii) of this section and the EAD for repo-style transactions determined under paragraph (d)(6)(iii) of this section.

(ii) With respect to any derivative contracts between the national bank or Federal savings association and the CCP that are cleared transactions and any guarantees that the national bank or Federal savings association has provided to the CCP with respect to performance of a clearing member client on a derivative contract, the EAD is equal to the exposure amount for all such derivative contracts and guarantees of derivative contracts calculated under SA–CCR in § 3.132(c) (or, with respect to a CCP located outside the United States, under a substantially identical methodology in effect in the jurisdiction) using a value of 10 business days for purposes of § 3.132(c)(9)(iv); less the value of all collateral held by the CCP posted by the clearing member national bank or Federal savings association or a clearing member client of the national bank or Federal savings association in connection with a derivative contract for which the national bank or Federal savings association has provided a guarantee to the CCP and the amount of the prefunded default fund contribution of the national bank or Federal savings association to the CCP.

(iii) With respect to any repo-style transactions between the national bank or Federal savings association and the CCP that are cleared transactions, EAD is equal to:

$EAD = \max\{EBRM - IM - DF; 0\}$

Where:

EBRM is the sum of the exposure amounts of each repo-style transaction between the national bank or Federal savings association and the CCP as determined under § 3.132(b)(2) and without recognition of any collateral securing the repo-style transactions;

IM is the initial margin collateral posted by the national bank or Federal savings association to the CCP with respect to the repo-style transactions; and

DF is the prefunded default fund contribution of the national bank or Federal savings association to the CCP that is not already deducted in paragraph (d)(6)(ii) of this section.

(iv) EAD must be calculated separately for each clearing member's sub-client accounts and sub-house account (*i.e.,* for the clearing member's proprietary activities). If the clearing member's collateral and its client's collateral are held in the same default fund contribution account, then the EAD of that account is the sum of the EAD for the client-related transactions within the account and the EAD of the house-related transactions within the account. For purposes of determining such EADs, the independent collateral of the clearing member and its client must be allocated in proportion to the respective total amount of independent collateral posted by the clearing member to the QCCP.

(v) If any account or sub-account contains both derivative contracts and repo-style transactions, the EAD of that account is the sum of the EAD for the derivative contracts within the account and the EAD of the repo-style transactions within the account. If independent collateral is held for an account containing both derivative contracts and repo-style transactions, then such collateral must be allocated to the derivative contracts and repo-style transactions in proportion to the respective product specific exposure amounts, calculated, excluding the effects of collateral, according to § 3.132(b) for repo-style transactions and to § 3.132(c)(5) for derivative contracts.

(vi) Notwithstanding any other provision of paragraph (d) of this section, with the prior approval of the OCC, a national bank or Federal savings association may determine the risk-weighted asset amount for a default fund contribution to a QCCP according to § 3.35(d)(3)(ii).

■ 10. Section 3.173 is amended in Table 13 to § 3.173 by revising line 4 under Part 2, Derivative exposures, to read as follows:

§ 3.173 Disclosures by certain advanced approaches national banks or Federal savings associations and Category III national banks or Federal savings associations.

* * * * *

TABLE 13 TO § 3.173—SUPPLEMENTARY LEVERAGE RATIO

				Dollar amounts in thousands			
				Tril	Bil	Mil	Thou
*	*	*	*	*	*	*	
Part 2: Supplementary leverage ratio							
*	*	*	*	*	*	*	
Derivative exposures							
*	*	*	*	*	*	*	
4 Current exposure for derivative exposures (that is, net of cash variation margin).							
*	*	*	*	*	*	*	

■ 11. Section 3.300 is amended by adding paragraphs (g) and (h) to read as follows:

§ 3.300 Transitions.

* * * * *

(g) *SA–CCR.* An advanced approaches national bank or Federal savings association may use CEM rather than SA–CCR for purposes of §§ 3.34(a) and 3.132(c) until January 1, 2022. An advanced approaches national bank or Federal savings association must provide prior notice to the OCC if it decides to begin using SA–CCR before January 1, 2022. On January 1, 2022, and thereafter, an advanced approaches national bank or Federal savings association must use SA–CCR for purposes of §§ 3.34(a), 3.132(c), and 3.133(d). Once an advanced approaches national bank or Federal savings association has begun to use SA–CCR, the advanced approaches national bank or Federal savings association may not change to use CEM.

(h) *Default fund contributions.* Prior to January 1, 2022, a national bank or Federal savings association that calculates the exposure amounts of its derivative contracts under the standardized approach for counterparty credit risk in § 3.132(c) may calculate the risk-weighted asset amount for a default fund contribution to a QCCP under either method 1 under § 3.35(d)(3)(i) or method 2 under § 3.35(d)(3)(ii), rather than under § 3.133(d).

PART 32—LENDING LIMITS

■ 12. The authority citation for part 32 continues to read as follows:

Authority: 12 U.S.C. 1 *et seq.,* 12 U.S.C. 84, 93a, 1462a, 1463, 1464(u), 5412(b)(2)(B), and 15 U.S.C. 1639h.

■ 13. Section 32.9 is amended by revising paragraph (b)(1)(iii) and adding paragraph (b)(1)(iv) to read as follows:

§ 32.9 Credit exposure arising from derivative and securities financing transactions.

* * * * *

(b) * * *

(1) * * *

(iii) *Current Exposure Method.* The credit exposure arising from a derivative transaction (other than a credit derivative transaction) under the Current Exposure Method shall be calculated pursuant to 12 CFR 3.34(b)(1) and (2) and (c) or 324.34(b)(1) and (2) and (c), as appropriate.

(iv) *Standardized Approach for Counterparty Credit Risk Method.* The credit exposure arising from a derivative transaction (other than a credit derivative transaction) under the Standardized Approach for Counterparty Credit Risk Method shall be calculated pursuant to 12 CFR 3.132(c)(5) or 324.132(c)(5), as appropriate.

* * * * *

FEDERAL RESERVE SYSTEM

12 CFR Chapter II

Authority and Issuance

For the reasons set forth in the preamble, chapter II of title 12 of the Code of Federal Regulations is amended as set forth below:

PART 217—CAPITAL ADEQUACY OF BANK HOLDING COMPANIES, SAVINGS AND LOAN HOLDING COMPANIES, AND STATE MEMBER BANKS (REGULATION Q)

■ 14. The authority citation for part 217 continues to read as follows:

Authority: 12 U.S.C. 248(a), 321–338a, 481–486, 1462a, 1467a, 1818, 1828, 1831n, 1831o, 1831p–l, 1831w, 1835, 1844(b), 1851, 3904, 3906–3909, 4808, 5365, 5368, 5371, and 5371 note.

■ 15. Section 217.2 is amended by:

■ a. Adding the definitions of ''Basis derivative contract,'' ''Client-facing derivative transaction,'' and ''Commercial end-user'' in alphabetical order;

■ b. Revising the definitions of ''Current exposure'' and ''Current exposure methodology;''

■ c. Revising paragraph (2) of the definition of ''Financial collateral;''

■ d. Adding the definitions of ''Independent collateral,'' ''Minimum transfer amount,'' and ''Net independent collateral amount'' in alphabetical order;

■ e. Revising the definition of ''Netting set;'' and

■ f. Adding the definitions of ''Speculative grade,'' ''Sub-speculative grade,'' ''Variation margin,'' ''Variation margin agreement,'' ''Variation margin amount,'' ''Variation margin threshold,'' and ''Volatility derivative contract'' in alphabetical order.

The additions and revisions read as follows:

§ 217.2 Definitions.

* * * * *

Basis derivative contract means a non-foreign-exchange derivative contract (*i.e.,* the contract is denominated in a single currency) in which the cash flows of the derivative contract depend on the difference between two risk factors that are attributable solely to one of the following derivative asset classes: Interest rate, credit, equity, or commodity.

* * * * *

Client-facing derivative transaction means a derivative contract that is not a cleared transaction where the Board-regulated institution is either acting as a financial intermediary and enters into an offsetting transaction with a qualifying central counterparty (QCCP) or where the Board-regulated institution provides a guarantee on the performance of a client on a transaction between the client and a QCCP.

* * * * *

Commercial end-user means an entity that:

(1)(i) Is using derivative contracts to hedge or mitigate commercial risk; and

(ii)(A) Is not an entity described in section 2(h)(7)(C)(i)(I) through (VIII) of the Commodity Exchange Act (7 U.S.C. 2(h)(7)(C)(i)(I) through (VIII)); or

(B) Is not a ''financial entity'' for purposes of section 2(h)(7) of the Commodity Exchange Act (7 U.S.C. 2(h)) by virtue of section 2(h)(7)(C)(iii) of the Act (7 U.S.C. 2(h)(7)(C)(iii)); or

(2)(i) Is using derivative contracts to hedge or mitigate commercial risk; and

(ii) Is not an entity described in section 3C(g)(3)(A)(i) through (viii) of the Securities Exchange Act of 1934 (15 U.S.C. 78c–3(g)(3)(A)(i) through (viii)); or

(3) Qualifies for the exemption in section 2(h)(7)(A) of the Commodity Exchange Act (7 U.S.C. 2(h)(7)(A)) by virtue of section 2(h)(7)(D) of the Act (7 U.S.C. 2(h)(7)(D)); or

(4) Qualifies for an exemption in section 3C(g)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78c–3(g)(1)) by virtue of section 3C(g)(4) of the Act (15 U.S.C. 78c–3(g)(4)).

* * * * *

Current exposure means, with respect to a netting set, the larger of zero or the fair value of a transaction or portfolio of transactions within the netting set that would be lost upon default of the counterparty, assuming no recovery on the value of the transactions.

Current exposure methodology means the method of calculating the exposure amount for over-the-counter derivative contracts in § 217.34(b).

* * * * *

Financial collateral * * *

(2) In which the Board-regulated institution has a perfected, first-priority security interest or, outside of the United States, the legal equivalent thereof, (with the exception of cash on deposit; and notwithstanding the prior security interest of any custodial agent or any priority security interest granted to a CCP in connection with collateral posted to that CCP).

* * * * *

Independent collateral means financial collateral, other than variation margin, that is subject to a collateral agreement, or in which a Board-regulated institution has a perfected, first-priority security interest or, outside of the United States, the legal equivalent thereof (with the exception of cash on deposit; notwithstanding the prior security interest of any custodial agent or any prior security interest granted to a CCP in connection with collateral posted to that CCP), and the amount of which does not change directly in response to the value of the derivative contract or contracts that the financial collateral secures.

* * * * *

Minimum transfer amount means the smallest amount of variation margin that may be transferred between counterparties to a netting set pursuant to the variation margin agreement.

* * * * *

Net independent collateral amount means the fair value amount of the independent collateral, as adjusted by the standard supervisory haircuts under § 217.132(b)(2)(ii), as applicable, that a counterparty to a netting set has posted to a Board-regulated institution less the fair value amount of the independent collateral, as adjusted by the standard supervisory haircuts under § 217.132(b)(2)(ii), as applicable, posted by the Board-regulated institution to the counterparty, excluding such amounts held in a bankruptcy remote manner or posted to a QCCP and held in conformance with the operational requirements in § 217.3.

Netting set means a group of transactions with a single counterparty that are subject to a qualifying master netting agreement. For derivative contracts, netting set also includes a single derivative contract between a Board-regulated institution and a single counterparty. For purposes of the internal model methodology under § 217.132(d), netting set also includes a group of transactions with a single counterparty that are subject to a qualifying cross-product master netting agreement and does not include a transaction:

(1) That is not subject to such a master netting agreement; or

(2) Where the Board-regulated institution has identified specific wrong-way risk.

* * * * *

Speculative grade means the reference entity has adequate capacity to meet financial commitments in the near term, but is vulnerable to adverse economic conditions, such that should economic conditions deteriorate, the reference entity would present an elevated default risk.

* * * * *

Sub-speculative grade means the reference entity depends on favorable economic conditions to meet its financial commitments, such that should such economic conditions deteriorate the reference entity likely would default on its financial commitments.

* * * * *

Variation margin means financial collateral that is subject to a collateral agreement provided by one party to its counterparty to meet the performance of the first party's obligations under one or more transactions between the parties as a result of a change in value of such obligations since the last time such financial collateral was provided.

Variation margin agreement means an agreement to collect or post variation margin.

Variation margin amount means the fair value amount of the variation margin, as adjusted by the standard supervisory haircuts under § 217.132(b)(2)(ii), as applicable, that a counterparty to a netting set has posted to a Board-regulated institution less the fair value amount of the variation margin, as adjusted by the standard supervisory haircuts under § 217.132(b)(2)(ii), as applicable, posted by the Board-regulated institution to the counterparty.

Variation margin threshold means the amount of credit exposure of a Board-regulated institution to its counterparty that, if exceeded, would require the counterparty to post variation margin to the Board-regulated institution pursuant to the variation margin agreement.

Volatility derivative contract means a derivative contract in which the payoff

of the derivative contract explicitly depends on a measure of the volatility of an underlying risk factor to the derivative contract.

* * * * *

■ 16. Section 217.10 is amended by revising paragraphs (c)(4)(ii)(A) through (C) to read as follows:

§ 217.10 Minimum capital requirements.

* * * * *

(c) * * *

(4) * * *

(ii) * * *

(A) The balance sheet carrying value of all of the Board-regulated institution's on-balance sheet assets, *plus* the value of securities sold under a repurchase transaction or a securities lending transaction that qualifies for sales treatment under U.S. GAAP, *less* amounts deducted from tier 1 capital under § 217.22(a), (c), and (d), and *less* the value of securities received in security-for-security repo-style transactions, where the Board-regulated institution acts as a securities lender and includes the securities received in its on-balance sheet assets but has not sold or re-hypothecated the securities received, and, for a Board-regulated institution that uses the standardized approach for counterparty credit risk under § 217.132(c) for its standardized risk-weighted assets, *less* the fair value of any derivative contracts;

(B)(*1*) For a Board-regulated institution that uses the current exposure methodology under § 217.34(b) for its standardized risk-weighted assets, the potential future credit exposure (PFE) for each derivative contract or each single-product netting set of derivative contracts (including a cleared transaction except as provided in paragraph (c)(4)(ii)(I) of this section and, at the discretion of the Board-regulated institution, excluding a forward agreement treated as a derivative contract that is part of a repurchase or reverse repurchase or a securities borrowing or lending transaction that qualifies for sales treatment under U.S. GAAP), to which the Board-regulated institution is a counterparty as determined under § 217.34, but without regard to § 217.34(b), provided that:

(*i*) A Board-regulated institution may choose to exclude the PFE of all credit derivatives or other similar instruments through which it provides credit protection when calculating the PFE under § 217.34, but without regard to § 217.34(b), provided that it does not adjust the net-to-gross ratio (NGR); and

(*ii*) A Board-regulated institution that chooses to exclude the PFE of credit derivatives or other similar instruments through which it provides credit protection pursuant to paragraph (c)(4)(ii)(B)(*1*) of this section must do so consistently over time for the calculation of the PFE for all such instruments; or

(*2*)(*i*) For a Board-regulated institution that uses the standardized approach for counterparty credit risk under section § 217.132(c) for its standardized risk-weighted assets, the PFE for each netting set to which the Board-regulated institution is a counterparty (including cleared transactions except as provided in paragraph (c)(4)(ii)(I) of this section and, at the discretion of the Board-regulated institution, excluding a forward agreement treated as a derivative contract that is part of a repurchase or reverse repurchase or a securities borrowing or lending transaction that qualifies for sales treatment under U.S. GAAP), as determined under § 217.132(c)(7), in which the term C in § 217.132(c)(7)(i) equals zero except as provided in paragraph (c)(4)(ii)(B)(*2*)(*ii*) of this section, and, for any counterparty that is not a commercial end-user, multiplied by 1.4; and

(*ii*) For purposes of paragraph (c)(4)(ii)(B)(*2*)(*i*) of this section, a Board-regulated institution may set the value of the term C in § 217.132(c)(7)(i) equal to the amount of collateral posted by a clearing member client of the Board-regulated institution in connection with the client-facing derivative transactions within the netting set;

(C)(*1*)(*i*) For a Board-regulated institution that uses the current exposure methodology under § 217.34(b) for its standardized risk-weighted assets, the amount of cash collateral that is received from a counterparty to a derivative contract and that has offset the mark-to-fair value of the derivative asset, or cash collateral that is posted to a counterparty to a derivative contract and that has reduced the Board-regulated institution's on-balance sheet assets, unless such cash collateral is all or part of variation margin that satisfies the conditions in paragraphs (c)(4)(ii)(C)(*3*) through (*7*) of this section; and

(*ii*) The variation margin is used to reduce the current credit exposure of the derivative contract, calculated as described in § 217.34(b), and not the PFE; and

(*iii*) For the purpose of the calculation of the NGR described in § 217.34(b)(2)(ii)(B), variation margin described in paragraph (c)(4)(ii)(C)(*1*)(*ii*) of this section may not reduce the net current credit exposure or the gross current credit exposure; or

(*2*)(*i*) For a Board-regulated institution that uses the standardized approach for counterparty credit risk under § 217.132(c) for its standardized risk-weighted assets, the replacement cost of each derivative contract or single product netting set of derivative contracts to which the Board-regulated institution is a counterparty, calculated according to the following formula, and, for any counterparty that is not a commercial end-user, multiplied by 1.4:

$$\textit{Replacement Cost} = \max\{V - CVM_r + CVM_p; 0\}$$

Where:

V equals the fair value for each derivative contract or each single-product netting set of derivative contracts (including a cleared transaction except as provided in paragraph (c)(4)(ii)(I) of this section and, at the discretion of the Board-regulated institution, excluding a forward agreement treated as a derivative contract that is part of a repurchase or reverse repurchase or a securities borrowing or lending transaction that qualifies for sales treatment under U.S. GAAP);

CVM_r equals the amount of cash collateral received from a counterparty to a derivative contract and that satisfies the conditions in paragraphs (c)(4)(ii)(C)(*3*) through (*7*) of this section, or, in the case of a client-facing derivative transaction, the amount of collateral received from the clearing member client; and

CVM_p equals the amount of cash collateral that is posted to a counterparty to a derivative contract and that has not offset the fair value of the derivative contract and that satisfies the conditions in paragraphs (c)(4)(ii)(C)(*3*) through (*7*) of this section, or, in the case of a client-facing derivative transaction, the amount of collateral posted to the clearing member client;

(*ii*) Notwithstanding paragraph (c)(4)(ii)(C)(*2*)(*i*) of this section, where multiple netting sets are subject to a single variation margin agreement, a Board-regulated institution must apply the formula for replacement cost provided in § 217.132(c)(10)(i), in which the term C_{MA} may only include cash collateral that satisfies the conditions in paragraphs (c)(4)(ii)(C)(*3*) through (*7*) of this section; and

(*iii*) For purposes of paragraph (c)(4)(ii)(C)(*2*)(*i*), a Board-regulated institution must treat a derivative contract that references an index as if it were multiple derivative contracts each referencing one component of the index if the Board-regulated institution elected to treat the derivative contract as multiple derivative contracts under § 217.132(c)(5)(vi);

(*3*) For derivative contracts that are not cleared through a QCCP, the cash collateral received by the recipient counterparty is not segregated (by law,

regulation, or an agreement with the counterparty);

(*4*) Variation margin is calculated and transferred on a daily basis based on the mark-to-fair value of the derivative contract;

(*5*) The variation margin transferred under the derivative contract or the governing rules of the CCP or QCCP for a cleared transaction is the full amount that is necessary to fully extinguish the net current credit exposure to the counterparty of the derivative contracts, subject to the threshold and minimum transfer amounts applicable to the counterparty under the terms of the derivative contract or the governing rules for a cleared transaction;

(*6*) The variation margin is in the form of cash in the same currency as the currency of settlement set forth in the derivative contract, provided that for the purposes of this paragraph (c)(4)(ii)(C)(*6*), currency of settlement means any currency for settlement specified in the governing qualifying master netting agreement and the credit support annex to the qualifying master netting agreement, or in the governing rules for a cleared transaction; and

(*7*) The derivative contract and the variation margin are governed by a qualifying master netting agreement between the legal entities that are the counterparties to the derivative contract or by the governing rules for a cleared transaction, and the qualifying master netting agreement or the governing rules for a cleared transaction must explicitly stipulate that the counterparties agree to settle any payment obligations on a net basis, taking into account any variation margin received or provided under the contract if a credit event involving either counterparty occurs;

* * * * *

■ 17. Section 217.32 is amended by revising paragraph (f) to read as follows:

§ 217.32 General risk weights.

* * * * *

(f) *Corporate exposures.* (1) A Board-regulated institution must assign a 100 percent risk weight to all its corporate exposures, except as provided in paragraph (f)(2) of this section.

(2) A Board-regulated institution must assign a 2 percent risk weight to an exposure to a QCCP arising from the Board-regulated institution posting cash collateral to the QCCP in connection with a cleared transaction that meets the requirements of § 217.35(b)(3)(i)(A) and a 4 percent risk weight to an exposure to a QCCP arising from the Board-regulated institution posting cash collateral to the QCCP in connection with a cleared transaction that meets the requirements of § 217.35(b)(3)(i)(B).

(3) A Board-regulated institution must assign a 2 percent risk weight to an exposure to a QCCP arising from the Board-regulated institution posting cash collateral to the QCCP in connection with a cleared transaction that meets the requirements of § 217.35(c)(3)(i).

* * * * *

■ 18. Section 217.34 is revised to read as follows:

§ 217.34 Derivative contracts.

(a) *Exposure amount for derivative contracts*—(1) *Board-regulated institution that is not an advanced approaches Board-regulated institution.* (i) A Board-regulated institution that is not an advanced approaches Board-regulated institution must use the current exposure methodology (CEM) described in paragraph (b) of this section to calculate the exposure amount for all its OTC derivative contracts, unless the Board-regulated institution makes the election provided in paragraph (a)(1)(ii) of this section.

(ii) A Board-regulated institution that is not an advanced approaches Board-regulated institution may elect to calculate the exposure amount for all its OTC derivative contracts under the standardized approach for counterparty credit risk (SA–CCR) in § 217.132(c) by notifying the Board, rather than calculating the exposure amount for all its derivative contracts using CEM. A Board-regulated institution that elects under this paragraph (a)(1)(ii) to calculate the exposure amount for its OTC derivative contracts under SA–CCR must apply the treatment of cleared transactions under § 217.133 to its derivative contracts that are cleared transactions and to all default fund contributions associated with such derivative contracts, rather than applying § 217.35. A Board-regulated institution that is not an advanced approaches Board-regulated institution must use the same methodology to calculate the exposure amount for all its derivative contracts and, if a Board-regulated institution has elected to use SA–CCR under this paragraph (a)(1)(ii), the Board-regulated institution may change its election only with prior approval of the Board.

(2) *Advanced approaches Board-regulated institution.* An advanced approaches Board-regulated institution must calculate the exposure amount for all its derivative contracts using SA–CCR in § 217.132(c) for purposes of standardized total risk-weighted assets. An advanced approaches Board-regulated institution must apply the treatment of cleared transactions under § 217.133 to its derivative contracts that are cleared transactions and to all default fund contributions associated with such derivative contracts for purposes of standardized total risk-weighted assets.

(b) *Current exposure methodology exposure amount*—(1) *Single OTC derivative contract.* Except as modified by paragraph (c) of this section, the exposure amount for a single OTC derivative contract that is not subject to a qualifying master netting agreement is equal to the sum of the Board-regulated institution's current credit exposure and potential future credit exposure (PFE) on the OTC derivative contract.

(i) *Current credit exposure.* The current credit exposure for a single OTC derivative contract is the greater of the fair value of the OTC derivative contract or zero.

(ii) *PFE.* (A) The PFE for a single OTC derivative contract, including an OTC derivative contract with a negative fair value, is calculated by multiplying the notional principal amount of the OTC derivative contract by the appropriate conversion factor in Table 1 to this section.

(B) For purposes of calculating either the PFE under this paragraph (b)(1)(ii) or the gross PFE under paragraph (b)(2)(ii)(A) of this section for exchange rate contracts and other similar contracts in which the notional principal amount is equivalent to the cash flows, notional principal amount is the net receipts to each party falling due on each value date in each currency.

(C) For an OTC derivative contract that does not fall within one of the specified categories in Table 1 to this section, the PFE must be calculated using the appropriate ''other'' conversion factor.

(D) A Board-regulated institution must use an OTC derivative contract's effective notional principal amount (that is, the apparent or stated notional principal amount multiplied by any multiplier in the OTC derivative contract) rather than the apparent or stated notional principal amount in calculating PFE.

(E) The PFE of the protection provider of a credit derivative is capped at the net present value of the amount of unpaid premiums.

TABLE 1 TO § 217.34—CONVERSION FACTOR MATRIX FOR DERIVATIVE CONTRACTS [1]

Remaining maturity [2]	Interest rate	Foreign exchange rate and gold	Credit (investment grade reference asset) [3]	Credit (non-investment-grade reference asset)	Equity	Precious metals (except gold)	Other
One year or less	0.00	0.01	0.05	0.10	0.06	0.07	0.10
Greater than one year and less than or equal to five years	0.005	0.05	0.05	0.10	0.08	0.07	0.12
Greater than five years	0.015	0.075	0.05	0.10	0.10	0.08	0.15

[1] For a derivative contract with multiple exchanges of principal, the conversion factor is multiplied by the number of remaining payments in the derivative contract.

[2] For an OTC derivative contract that is structured such that on specified dates any outstanding exposure is settled and the terms are reset so that the fair value of the contract is zero, the remaining maturity equals the time until the next reset date. For an interest rate derivative contract with a remaining maturity of greater than one year that meets these criteria, the minimum conversion factor is 0.005.

[3] A Board-regulated institution must use the column labeled "Credit (investment-grade reference asset)" for a credit derivative whose reference asset is an outstanding unsecured long-term debt security without credit enhancement that is investment grade. A Board-regulated institution must use the column labeled "Credit (non-investment-grade reference asset)" for all other credit derivatives.

(2) *Multiple OTC derivative contracts subject to a qualifying master netting agreement.* Except as modified by paragraph (c) of this section, the exposure amount for multiple OTC derivative contracts subject to a qualifying master netting agreement is equal to the sum of the net current credit exposure and the adjusted sum of the PFE amounts for all OTC derivative contracts subject to the qualifying master netting agreement.

(i) *Net current credit exposure.* The net current credit exposure is the greater of the net sum of all positive and negative fair values of the individual OTC derivative contracts subject to the qualifying master netting agreement or zero.

(ii) *Adjusted sum of the PFE amounts.* The adjusted sum of the PFE amounts, Anet, is calculated as Anet = $(0.4 \times \text{Agross}) + (0.6 \times \text{NGR} \times \text{Agross})$, where:

(A) Agross = the gross PFE (that is, the sum of the PFE amounts as determined under paragraph (b)(1)(ii) of this section for each individual derivative contract subject to the qualifying master netting agreement); and

(B) Net-to-gross Ratio (NGR) = the ratio of the net current credit exposure to the gross current credit exposure. In calculating the NGR, the gross current credit exposure equals the sum of the positive current credit exposures (as determined under paragraph (b)(1)(i) of this section) of all individual derivative contracts subject to the qualifying master netting agreement.

(c) *Recognition of credit risk mitigation of collateralized OTC derivative contracts.* (1) A Board-regulated institution using CEM under paragraph (b) of this section may recognize the credit risk mitigation benefits of financial collateral that secures an OTC derivative contract or multiple OTC derivative contracts subject to a qualifying master netting agreement (netting set) by using the simple approach in § 217.37(b).

(2) As an alternative to the simple approach, a Board-regulated institution using CEM under paragraph (b) of this section may recognize the credit risk mitigation benefits of financial collateral that secures such a contract or netting set if the financial collateral is marked-to-fair value on a daily basis and subject to a daily margin maintenance requirement by applying a risk weight to the uncollateralized portion of the exposure, after adjusting the exposure amount calculated under paragraph (b)(1) or (2) of this section using the collateral haircut approach in § 217.37(c). The Board-regulated institution must substitute the exposure amount calculated under paragraph (b)(1) or (2) of this section for ΣE in the equation in § 217.37(c)(2).

(d) *Counterparty credit risk for credit derivatives*—(1) *Protection purchasers.* A Board-regulated institution that purchases a credit derivative that is recognized under § 217.36 as a credit risk mitigant for an exposure that is not a covered position under subpart F of this part is not required to compute a separate counterparty credit risk capital requirement under this subpart provided that the Board-regulated institution does so consistently for all such credit derivatives. The Board-regulated institution must either include all or exclude all such credit derivatives that are subject to a qualifying master netting agreement from any measure used to determine counterparty credit risk exposure to all relevant counterparties for risk-based capital purposes.

(2) *Protection providers.* (i) A Board-regulated institution that is the protection provider under a credit derivative must treat the credit derivative as an exposure to the underlying reference asset. The Board-regulated institution is not required to compute a counterparty credit risk capital requirement for the credit derivative under this subpart, provided that this treatment is applied consistently for all such credit derivatives. The Board-regulated institution must either include all or exclude all such credit derivatives that are subject to a qualifying master netting agreement from any measure used to determine counterparty credit risk exposure.

(ii) The provisions of this paragraph (d)(2) apply to all relevant counterparties for risk-based capital purposes unless the Board-regulated institution is treating the credit derivative as a covered position under subpart F of this part, in which case the Board-regulated institution must compute a supplemental counterparty credit risk capital requirement under this section.

(e) *Counterparty credit risk for equity derivatives.* (1) A Board-regulated institution must treat an equity derivative contract as an equity exposure and compute a risk-weighted asset amount for the equity derivative contract under §§ 217.51 through 217.53 (unless the Board-regulated institution is treating the contract as a covered position under subpart F of this part).

(2) In addition, the Board-regulated institution must also calculate a risk-based capital requirement for the counterparty credit risk of an equity derivative contract under this section if the Board-regulated institution is treating the contract as a covered position under subpart F of this part.

(3) If the Board-regulated institution risk weights the contract under the Simple Risk-Weight Approach (SRWA) in § 217.52, the Board-regulated institution may choose not to hold risk-based capital against the counterparty credit risk of the equity derivative contract, as long as it does so for all such contracts. Where the equity derivative contracts are subject to a qualified master netting agreement, a Board-regulated institution using the SRWA must either include all or

exclude all of the contracts from any measure used to determine counterparty credit risk exposure.

(f) *Clearing member Board-regulated institution's exposure amount.* The exposure amount of a clearing member Board-regulated institution using CEM under paragraph (b) of this section for a client-facing derivative transaction or netting set of client-facing derivative transactions equals the exposure amount calculated according to paragraph (b)(1) or (2) of this section multiplied by the scaling factor the square root of ½ (which equals 0.707107). If the Board-regulated institution determines that a longer period is appropriate, the Board-regulated institution must use a larger scaling factor to adjust for a longer holding period as follows:

$$\text{Scaling factor} = \sqrt{\frac{H}{10}}$$

Where H = the holding period greater than or equal to five days.

Additionally, the Board may require the Board-regulated institution to set a longer holding period if the Board determines that a longer period is appropriate due to the nature, structure, or characteristics of the transaction or is commensurate with the risks associated with the transaction.

■ 19. Section 217.35 is amended by adding paragraph (a)(3), revising paragraph (b)(4)(i), and adding paragraph (c)(3)(iii) to read as follows:

§ 217.35 Cleared transactions.

(a) * * *

(3) *Alternate requirements.* Notwithstanding any other provision of this section, an advanced approaches Board-regulated institution or a Board-regulated institution that is not an advanced approaches Board-regulated institution and that has elected to use SA–CCR under § 217.34(a)(1) must apply § 217.133 to its derivative contracts that are cleared transactions rather than this section.

(b) * * *

(4) * * *

(i) Notwithstanding any other requirements in this section, collateral posted by a clearing member client Board-regulated institution that is held by a custodian (in its capacity as custodian) in a manner that is bankruptcy remote from the CCP, clearing member, and other clearing member clients of the clearing member, is not subject to a capital requirement under this section.

* * * * *

(c) * * *

(3) * * *

(iii) Notwithstanding paragraphs (c)(3)(i) and (ii) of this section, a clearing member Board-regulated institution may apply a risk weight of zero percent to the trade exposure amount for a cleared transaction with a CCP where the clearing member Board-regulated institution is acting as a financial intermediary on behalf of a clearing member client, the transaction offsets another transaction that satisfies the requirements set forth in § 217.3(a), and the clearing member Board-regulated institution is not obligated to reimburse the clearing member client in the event of the CCP default.

* * * * *

■ 20. Section 217.37 is amended by revising paragraphs (c)(3)(iii), (c)(3)(iv)(A) and (C), (c)(4)(i)(B) introductory text, and (c)(4)(i)(B)(*1*) to read as follows:

§ 217.37 Collateralized transactions.

* * * * *

(c) * * *

(3) * * *

(iii) For repo-style transactions and client-facing derivative transactions, a Board-regulated institution may multiply the standard supervisory haircuts provided in paragraphs (c)(3)(i) and (ii) of this section by the square root of ½ (which equals 0.707107). For client-facing derivative transactions, if a larger scaling factor is applied under § 217.34(f), the same factor must be used to adjust the supervisory haircuts.

(iv) * * *

(A) T_M equals a holding period of longer than 10 business days for eligible margin loans and derivative contracts other than client-facing derivative transactions or longer than 5 business days for repo-style transactions and client-facing derivative transactions;

* * * * *

(C) T_S equals 10 business days for eligible margin loans and derivative contracts other than client-facing derivative transactions or 5 business days for repo-style transactions and client-facing derivative transactions.

* * * * *

(4) * * *

(i) * * *

(B) The minimum holding period for a repo-style transaction and client-facing derivative transaction is five business days and for an eligible margin loan and a derivative contract other than a client-facing derivative transaction is ten business days except for transactions or netting sets for which paragraph (c)(4)(i)(C) of this section applies. When a Board-regulated institution calculates an own-estimates haircut on a T_N-day holding period, which is different from the minimum holding period for the transaction type, the applicable haircut (H_M) is calculated using the following square root of time formula:

* * * * *

(*1*) T_M equals 5 for repo-style transactions and client-facing derivative transactions and 10 for eligible margin loans and derivative contracts other than client-facing derivative transactions;

* * * * *

§ § 217.134, 217.202, and 217.210 [Amended]

■ 21. For each section listed in the following table, the footnote number listed in the ''Old footnote number'' column is redesignated as the footnote number listed in the ''New footnote number'' column as follows:

Section	Old footnote number	New footnote number
217.134(d)(3)	30	31
217.202, paragraph (1) introductory text of the definition of ''Covered position''	31	32
217.202, paragraph (1)(i) of the definition of ''Covered position''	32	33
217.210(e)(1)	33	34

■ 22. Section 217.132 is amended by:

■ a. Revising paragraphs (b)(2)(ii)(A)(*3*) through (*5*);

■ b. Adding paragraphs (b)(2)(ii)(A)(*6*) and (*7*);

■ c. Revising paragraphs (c) heading and (c)(1) and (2) and (5) through (8);

■ d. Adding paragraphs (c)(9) through (11);

■ e. Revising paragraph (d)(10)(i);

■ f. In paragraphs (e)(5)(i)(A) and (H), removing ''Table 3 to § 217.132'' and adding in its place ''Table 4 to this section'';

■ g. In paragraphs (e)(5)(i)(C) and (e)(6)(i)(B), removing ''current exposure methodology'' and adding in its place ''standardized approach to counterparty credit risk'' wherever it appears;
■ h. Redesignating Table 3 to § 217.132 following paragraph (e)(5)(ii) as Table 4 to § 217.132; and
■ i. Revising paragraph (e)(6)(viii).

The revisions and additions read as follows:

§ 217.132 Counterparty credit risk of repo-style transactions, eligible margin loans, and OTC derivative contracts.

* * * * *

(b) * * *
(2) * * *
(ii) * * *
(A) * * *

(*3*) For repo-style transactions and client-facing derivative transactions, a Board-regulated institution may multiply the supervisory haircuts provided in paragraphs (b)(2)(ii)(A)(*1*) and (*2*) of this section by the square root of ½ (which equals 0.707107). If the Board-regulated institution determines that a longer holding period is appropriate for client-facing derivative transactions, then it must use a larger scaling factor to adjust for the longer holding period pursuant to paragraph (b)(2)(ii)(A)(*6*) of this section.

(*4*) A Board-regulated institution must adjust the supervisory haircuts upward on the basis of a holding period longer than ten business days (for eligible margin loans) or five business days (for repo-style transactions), using the formula provided in paragraph (b)(2)(ii)(A)(*6*) of this section where the conditions in this paragraph (b)(2)(ii)(A)(*4*) apply. If the number of trades in a netting set exceeds 5,000 at any time during a quarter, a Board-regulated institution must adjust the supervisory haircuts upward on the basis of a minimum holding period of twenty business days for the following quarter (except when a Board-regulated institution is calculating EAD for a cleared transaction under § 217.133). If a netting set contains one or more trades involving illiquid collateral, a Board-regulated institution must adjust the supervisory haircuts upward on the basis of a minimum holding period of twenty business days. If over the two previous quarters more than two margin disputes on a netting set have occurred that lasted longer than the holding period, then the Board-regulated institution must adjust the supervisory haircuts upward for that netting set on the basis of a minimum holding period that is at least two times the minimum holding period for that netting set.

(*5*)(*i*) A Board-regulated institution must adjust the supervisory haircuts upward on the basis of a holding period longer than ten business days for collateral associated with derivative contracts (five business days for client-facing derivative contracts) using the formula provided in paragraph (b)(2)(ii)(A)(*6*) of this section where the conditions in this paragraph (b)(2)(ii)(A)(*5*)(*i*) apply. For collateral associated with a derivative contract that is within a netting set that is composed of more than 5,000 derivative contracts that are not cleared transactions, a Board-regulated institution must use a minimum holding period of twenty business days. If a netting set contains one or more trades involving illiquid collateral or a derivative contract that cannot be easily replaced, a Board-regulated institution must use a minimum holding period of twenty business days.

(*ii*) Notwithstanding paragraph (b)(2)(ii)(A)(*1*) or (*3*) or (b)(2)(ii)(A)(*5*)(*i*) of this section, for collateral associated with a derivative contract in a netting set under which more than two margin disputes that lasted longer than the holding period occurred during the two previous quarters, the minimum holding period is twice the amount provided under paragraph (b)(2)(ii)(A)(*1*) or (*3*) or (b)(2)(ii)(A)(*5*)(*i*) of this section.

(*6*) A Board-regulated institution must adjust the standard supervisory haircuts upward, pursuant to the adjustments provided in paragraphs (b)(2)(ii)(A)(*3*) through (*5*) of this section, using the following formula:

$$H_A = H_S \sqrt{\frac{T_M}{T_S}}$$

Where:

T_M equals a holding period of longer than 10 business days for eligible margin loans and derivative contracts other than client-facing derivative transactions or longer than 5 business days for repo-style transactions and client-facing derivative transactions;

Hs equals the standard supervisory haircut; and

Ts equals 10 business days for eligible margin loans and derivative contracts other than client-facing derivative transactions or 5 business days for repo-style transactions and client-facing derivative transactions.

(*7*) If the instrument a Board-regulated institution has lent, sold subject to repurchase, or posted as collateral does not meet the definition of financial collateral, the Board-regulated institution must use a 25.0 percent haircut for market price volatility (Hs).

* * * * *

(c) *EAD for derivative contracts*—(1) *Options for determining EAD.* A Board-regulated institution must determine the EAD for a derivative contract using the standardized approach for counterparty credit risk (SA–CCR) under paragraph (c)(5) of this section or using the internal models methodology described in paragraph (d) of this section. If a Board-regulated institution elects to use SA–CCR for one or more derivative contracts, the exposure amount determined under SA–CCR is the EAD for the derivative contract or derivatives contracts. A Board-regulation institution must use the same methodology to calculate the exposure amount for all its derivative contracts and may change its election only with prior approval of the Board. A Board-regulated institution may reduce the EAD calculated according to paragraph (c)(5) of this section by the credit valuation adjustment that the Board-regulated institution has recognized in its balance sheet valuation of any derivative contracts in the netting set. For purposes of this paragraph (c)(1), the credit valuation adjustment does not include any adjustments to common equity tier 1 capital attributable to changes in the fair value of the Board-regulated institution's liabilities that are due to changes in its own credit risk since the inception of the transaction with the counterparty.

(2) *Definitions.* For purposes of this paragraph (c) of this section, the following definitions apply:

(i) *End date* means the last date of the period referenced by an interest rate or credit derivative contract or, if the derivative contract references another instrument, by the underlying instrument, except as otherwise provided in paragraph (c) of this section.

(ii) *Start date* means the first date of the period referenced by an interest rate or credit derivative contract or, if the derivative contract references the value of another instrument, by underlying instrument, except as otherwise provided in paragraph (c) of this section.

(iii) *Hedging set* means:

(A) With respect to interest rate derivative contracts, all such contracts within a netting set that reference the same reference currency;

(B) With respect to exchange rate derivative contracts, all such contracts within a netting set that reference the same currency pair;

(C) With respect to credit derivative contract, all such contracts within a netting set;

(D) With respect to equity derivative contracts, all such contracts within a netting set;

(E) With respect to a commodity derivative contract, all such contracts within a netting set that reference one of the following commodity categories: Energy, metal, agricultural, or other commodities;

(F) With respect to basis derivative contracts, all such contracts within a netting set that reference the same pair of risk factors and are denominated in the same currency; or

(G) With respect to volatility derivative contracts, all such contracts within a netting set that reference one of interest rate, exchange rate, credit, equity, or commodity risk factors, separated according to the requirements under paragraphs (c)(2)(iii)(A) through (E) of this section.

(H) If the risk of a derivative contract materially depends on more than one of interest rate, exchange rate, credit, equity, or commodity risk factors, the Board may require a Board-regulated institution to include the derivative contract in each appropriate hedging set under paragraphs (c)(1)(iii)(A) through (E) of this section.

* * * * *

(5) *Exposure amount.* (i) The exposure amount of a netting set, as calculated under paragraph (c) of this section, is equal to 1.4 multiplied by the sum of the replacement cost of the netting set, as calculated under paragraph (c)(6) of this section, and the potential future exposure of the netting set, as calculated under paragraph (c)(7) of this section.

(ii) Notwithstanding the requirements of paragraph (c)(5)(i) of this section, the exposure amount of a netting set subject to a variation margin agreement, excluding a netting set that is subject to a variation margin agreement under which the counterparty to the variation margin agreement is not required to post variation margin, is equal to the lesser of the exposure amount of the netting set calculated under paragraph (c)(5)(i) of this section and the exposure amount of the netting set calculated under paragraph (c)(5)(i) of this section as if the netting set were not subject to a variation margin agreement.

(iii) Notwithstanding the requirements of paragraph (c)(5)(i) of this section, the exposure amount of a netting set that consists of only sold options in which the premiums have been fully paid by the counterparty to the options and where the options are not subject to a variation margin agreement is zero.

(iv) Notwithstanding the requirements of paragraph (c)(5)(i) of this section, the exposure amount of a netting set in which the counterparty is a commercial end-user is equal to the sum of replacement cost, as calculated under paragraph (c)(6) of this section, and the potential future exposure of the netting set, as calculated under paragraph (c)(7) of this section.

(v) For purposes of the exposure amount calculated under paragraph (c)(5)(i) of this section and all calculations that are part of that exposure amount, a Board-regulated institution may elect to treat a derivative contract that is a cleared transaction that is not subject to a variation margin agreement as one that is subject to a variation margin agreement, if the derivative contract is subject to a requirement that the counterparties make daily cash payments to each other to account for changes in the fair value of the derivative contract and to reduce the net position of the contract to zero. If a Board-regulated institution makes an election under this paragraph (c)(5)(v) for one derivative contract, it must treat all other derivative contracts within the same netting set that are eligible for an election under this paragraph (c)(5)(v) as derivative contracts that are subject to a variation margin agreement.

(vi) For purposes of the exposure amount calculated under paragraph (c)(5)(i) of this section and all calculations that are part of that exposure amount, a Board-regulated institution may elect to treat a credit derivative contract, equity derivative contract, or commodity derivative contract that references an index as if it were multiple derivative contracts each referencing one component of the index.

(6) *Replacement cost of a netting set*—(i) *Netting set subject to a variation margin agreement under which the counterparty must post variation margin.* The replacement cost of a netting set subject to a variation margin agreement, excluding a netting set that is subject to a variation margin agreement under which the counterparty is not required to post variation margin, is the greater of:

(A) The sum of the fair values (after excluding any valuation adjustments) of the derivative contracts within the netting set less the sum of the net independent collateral amount and the variation margin amount applicable to such derivative contracts;

(B) The sum of the variation margin threshold and the minimum transfer amount applicable to the derivative contracts within the netting set less the net independent collateral amount applicable to such derivative contracts; or

(C) Zero.

(ii) *Netting sets not subject to a variation margin agreement under which the counterparty must post variation margin.* The replacement cost of a netting set that is not subject to a variation margin agreement under which the counterparty must post variation margin to the Board-regulated institution is the greater of:

(A) The sum of the fair values (after excluding any valuation adjustments) of the derivative contracts within the netting set less the sum of the net independent collateral amount and variation margin amount applicable to such derivative contracts; or

(B) Zero.

(iii) *Multiple netting sets subject to a single variation margin agreement.* Notwithstanding paragraphs (c)(6)(i) and (ii) of this section, the replacement cost for multiple netting sets subject to a single variation margin agreement must be calculated according to paragraph (c)(10)(i) of this section.

(iv) *Netting set subject to multiple variation margin agreements or a hybrid netting set.* Notwithstanding paragraphs (c)(6)(i) and (ii) of this section, the replacement cost for a netting set subject to multiple variation margin agreements or a hybrid netting set must be calculated according to paragraph (c)(11)(i) of this section.

(7) *Potential future exposure of a netting set.* The potential future exposure of a netting set is the product of the PFE multiplier and the aggregated amount.

(i) *PFE multiplier.* The PFE multiplier is calculated according to the following formula:

$$PFE\ multiplier = min\left\{1; 0.05 + 0.95 * e^{\left(\frac{V-C}{1.9*A}\right)}\right\}$$

Where:

V is the sum of the fair values (after excluding any valuation adjustments) of the derivative contracts within the netting set;

C is the sum of the net independent collateral amount and the variation margin amount applicable to the derivative contracts within the netting set; and

A is the aggregated amount of the netting set.

(ii) *Aggregated amount.* The aggregated amount is the sum of all hedging set amounts, as calculated under paragraph (c)(8) of this section, within a netting set.

(iii) *Multiple netting sets subject to a single variation margin agreement.* Notwithstanding paragraphs (c)(7)(i) and (ii) of this section and when calculating the potential future exposure for purposes of total leverage exposure under § 217.10(c)(4)(ii)(B)(*2*), the potential future exposure for multiple netting sets subject to a single variation margin agreement must be calculated according to paragraph (c)(10)(ii) of this section.

(iv) *Netting set subject to multiple variation margin agreements or a hybrid netting set.* Notwithstanding paragraphs (c)(7)(i) and (ii) of this section and when calculating the potential future exposure for purposes of total leverage exposure under § 217.10(c)(4)(ii)(B)(*2*), the potential future exposure for a netting set subject to multiple variation margin agreements or a hybrid netting set must be calculated according to paragraph (c)(11)(ii) of this section.

(8) *Hedging set amount*—(i) *Interest rate derivative contracts.* To calculate the hedging set amount of an interest rate derivative contract hedging set, a Board-regulated institution may use either of the formulas provided in paragraphs (c)(8)(i)(A) and (B) of this section:

(A) Formula 1 is as follows:

$$Hedging\ set\ amount = [(AddOn_{TB1}^{IR})^2 + (AddOn_{TB2}^{IR})^2 + (AddOn_{TB3}^{IR})^2 + 1.4 * AddOn_{TB1}^{IR} * AddOn_{TB2}^{IR} + 1.4 * AddOn_{TB2}^{IR} * AddOn_{TB3}^{IR} + 0.6 * AddOn_{TB1}^{IR} * AddOn_{TB3}^{IR})]^{\frac{1}{2}}; \text{ or}$$

(B) Formula 2 is as follows:

$$Hedging\ set\ amount = |AddOn^{IR}{}_{TB1}| + |AddOn^{IR}{}_{TB2}| + |AddOn^{IR}{}_{TB3}|.$$

Where in paragraphs (c)(8)(i)(A) and (B) of this section:

$AddOn^{IR}{}_{TB1}$ is the sum of the adjusted derivative contract amounts, as calculated under paragraph (c)(9) of this section, within the hedging set with an end date of less than one year from the present date;

$AddOn^{IR}{}_{TB2}$ is the sum of the adjusted derivative contract amounts, as calculated under paragraph (c)(9) of this section, within the hedging set with an end date of one to five years from the present date; and

$AddOn^{IR}{}_{TB3}$ is the sum of the adjusted derivative contract amounts, as calculated under paragraph (c)(9) of this section, within the hedging set with an end date of more than five years from the present date.

(ii) *Exchange rate derivative contracts.* For an exchange rate derivative contract hedging set, the hedging set amount equals the absolute value of the sum of the adjusted derivative contract amounts, as calculated under paragraph (c)(9) of this section, within the hedging set.

(iii) *Credit derivative contracts and equity derivative contracts.* The hedging set amount of a credit derivative contract hedging set or equity derivative contract hedging set within a netting set is calculated according to the following formula:

$$Hedging\ set\ amount = [(\sum_{k=1}^{K} \rho_k * AddOn(Ref_k))^2 + \sum_{k=1}^{K}(1 - (\rho_k)^2) * (AddOn(Ref_k))^2]^{\frac{1}{2}}$$

Where:

k is each reference entity within the hedging set.

K is the number of reference entities within the hedging set.

$AddOn(Ref_k)$ equals the sum of the adjusted derivative contract amounts, as determined under paragraph (c)(9) of this section, for all derivative contracts within the hedging set that reference reference entity k.

ρ_k equals the applicable supervisory correlation factor, as provided in Table 2 to this section.

(iv) *Commodity derivative contracts.* The hedging set amount of a commodity derivative contract hedging set within a netting set is calculated according to the following formula:

$$\textit{Hedging set amount} = \left[\left(\rho * \sum_{k=1}^{K} AddOn\left(Type_k\right)\right)^2 + \left(1 - (\rho)^2\right) * \sum_{k=1}^{K} \left(AddOn\left(Type_k\right)\right)^2\right]^{\frac{1}{2}}$$

Where:

k is each commodity type within the hedging set.

K is the number of commodity types within the hedging set.

$AddOn(Type_k)$ equals the sum of the adjusted derivative contract amounts, as determined under paragraph (c)(9) of this section, for all derivative contracts within the hedging set that reference reference commodity type.

ρ equals the applicable supervisory correlation factor, as provided in Table 2 to this section.

(v) *Basis derivative contracts and volatility derivative contracts.* Notwithstanding paragraphs (c)(8)(i) through (iv) of this section, a Board-regulated institution must calculate a separate hedging set amount for each basis derivative contract hedging set and each volatility derivative contract hedging set. A Board-regulated institution must calculate such hedging set amounts using one of the formulas under paragraphs (c)(8)(i) through (iv) that corresponds to the primary risk factor of the hedging set being calculated.

(9) *Adjusted derivative contract amount*—(i) *Summary.* To calculate the adjusted derivative contract amount of a derivative contract, a Board-regulated institution must determine the adjusted notional amount of derivative contract, pursuant to paragraph (c)(9)(ii) of this section, and multiply the adjusted notional amount by each of the supervisory delta adjustment, pursuant to paragraph (c)(9)(iii) of this section, the maturity factor, pursuant to paragraph (c)(9)(iv) of this section, and the applicable supervisory factor, as provided in Table 2 to this section.

(ii) *Adjusted notional amount.* (A)(*1*) For an interest rate derivative contract or a credit derivative contract, the adjusted notional amount equals the product of the notional amount of the derivative contract, as measured in U.S. dollars using the exchange rate on the date of the calculation, and the supervisory duration, as calculated by the following formula:

$$\text{Supervisory duration} = max\left\{\frac{e^{-0.05*\left(\frac{S}{250}\right)} - e^{-0.05*\left(\frac{E}{250}\right)}}{0.05}, 0.04\right\}$$

Where:

S is the number of business days from the present day until the start date of the derivative contract, or zero if the start date has already passed; and

E is the number of business days from the present day until the end date of the derivative contract.

(*2*) For purposes of paragraph (c)(9)(ii)(A)(*1*) of this section:

(*i*) For an interest rate derivative contract or credit derivative contract that is a variable notional swap, the notional amount is equal to the time-weighted average of the contractual notional amounts of such a swap over the remaining life of the swap; and

(*ii*) For an interest rate derivative contract or a credit derivative contract that is a leveraged swap, in which the notional amount of all legs of the derivative contract are divided by a factor and all rates of the derivative contract are multiplied by the same factor, the notional amount is equal to the notional amount of an equivalent unleveraged swap.

(B)(*1*) For an exchange rate derivative contract, the adjusted notional amount is the notional amount of the non-U.S. denominated currency leg of the derivative contract, as measured in U.S. dollars using the exchange rate on the date of the calculation. If both legs of the exchange rate derivative contract are denominated in currencies other than U.S. dollars, the adjusted notional amount of the derivative contract is the largest leg of the derivative contract, as measured in U.S. dollars using the exchange rate on the date of the calculation.

(*2*) Notwithstanding paragraph (c)(9)(ii)(B)(*1*) of this section, for an exchange rate derivative contract with multiple exchanges of principal, the Board-regulated institution must set the adjusted notional amount of the derivative contract equal to the notional amount of the derivative contract multiplied by the number of exchanges of principal under the derivative contract.

(C)(*1*) For an equity derivative contract or a commodity derivative contract, the adjusted notional amount is the product of the fair value of one unit of the reference instrument underlying the derivative contract and the number of such units referenced by the derivative contract.

(*2*) Notwithstanding paragraph (c)(9)(ii)(C)(*1*) of this section, when calculating the adjusted notional amount for an equity derivative contract or a commodity derivative contract that is a volatility derivative contract, the Board-regulated institution must replace the unit price with the underlying volatility referenced by the volatility derivative contract and replace the number of units with the notional amount of the volatility derivative contract.

(iii) *Supervisory delta adjustments.* (A) For a derivative contract that is not an option contract or collateralized debt obligation tranche, the supervisory delta adjustment is 1 if the fair value of the derivative contract increases when the value of the primary risk factor increases and −1 if the fair value of the derivative contract decreases when the value of the primary risk factor increases.

(B)(*1*) For a derivative contract that is an option contract, the supervisory delta adjustment is determined by the following formulas, as applicable:

Table 2 to §217.132--Supervisory Delta Adjustment for Options Contracts

	Bought	Sold
Call Options	$\Phi\left(\frac{\ln\left(\frac{P+\lambda}{K+\lambda}\right)+0.5*\sigma^2*T/250}{\sigma*\sqrt{T/250}}\right)$	$-\Phi\left(\frac{\ln\left(\frac{P+\lambda}{K+\lambda}\right)+0.5*\sigma^2*T/250}{\sigma*\sqrt{T/250}}\right)$
Put Options	$-\Phi\left(-\frac{\ln\left(\frac{P+\lambda}{K+\lambda}\right)+0.5*\sigma^2*T/250}{\sigma*\sqrt{T/250}}\right)$	$\Phi\left(-\frac{\ln\left(\frac{P+\lambda}{K+\lambda}\right)+0.5*\sigma^2*T/250}{\sigma*\sqrt{T/250}}\right)$

(*2*) As used in the formulas in Table 2 to this section:

(*i*) Φ is the standard normal cumulative distribution function;

(*ii*) P equals the current fair value of the instrument or risk factor, as applicable, underlying the option;

(*iii*) K equals the strike price of the option;

(*iv*) T equals the number of business days until the latest contractual exercise date of the option;

(*v*) λ equals zero for all derivative contracts except interest rate options for the currencies where interest rates have negative values. The same value of λ must be used for all interest rate options that are denominated in the same currency. To determine the value of λ for a given currency, a Board-regulated institution must find the lowest value L of P and K of all interest rate options in a given currency that the Board-regulated institution has with all counterparties. Then, λ is set according to this formula: $\lambda = max\{-L + 0.1\%, 0\}$; and

(*vi*) σ equals the supervisory option volatility, as provided in Table 3 to this section.

(C)(*1*) For a derivative contract that is a collateralized debt obligation tranche, the supervisory delta adjustment is determined by the following formula:

$$\text{Supervisory delta adjustment} = \frac{15}{(1+14*A)*(1+14*D)}$$

(*2*) As used in the formula in paragraph (c)(9)(iii)(C)(*1*) of this section:

(*i*) A is the attachment point, which equals the ratio of the notional amounts of all underlying exposures that are subordinated to the Board-regulated institution's exposure to the total notional amount of all underlying exposures, expressed as a decimal value between zero and one;[30]

(*ii*) D is the detachment point, which equals one minus the ratio of the notional amounts of all underlying exposures that are senior to the Board-regulated institution's exposure to the total notional amount of all underlying exposures, expressed as a decimal value between zero and one; and

(*iii*) The resulting amount is designated with a positive sign if the collateralized debt obligation tranche was purchased by the Board-regulated institution and is designated with a negative sign if the collateralized debt obligation tranche was sold by the Board-regulated institution.

(iv) *Maturity factor.* (A)(*1*) The maturity factor of a derivative contract that is subject to a variation margin agreement, excluding derivative contracts that are subject to a variation margin agreement under which the counterparty is not required to post variation margin, is determined by the following formula:

$$\text{Maturity factor} = \frac{3}{2}\sqrt{\frac{MPOR}{250}}$$

Where MPOR refers to the period from the most recent exchange of collateral covering a netting set of derivative contracts with a defaulting counterparty until the derivative contracts are closed out and the resulting market risk is re-hedged.

(*2*) Notwithstanding paragraph (c)(9)(iv)(A)(*1*) of this section:

(*i*) For a derivative contract that is not a client-facing derivative transaction, MPOR cannot be less than ten business days plus the periodicity of re-margining expressed in business days minus one business day;

(*ii*) For a derivative contract that is a client-facing derivative transaction, cannot be less than five business days plus the periodicity of re-margining expressed in business days minus one business day; and

(*iii*) For a derivative contract that is within a netting set that is composed of more than 5,000 derivative contracts that are not cleared transactions, or a netting set that contains one or more trades involving illiquid collateral or a derivative contract that cannot be easily replaced, MPOR cannot be less than twenty business days.

(*3*) Notwithstanding paragraphs (c)(9)(iv)(A)(*1*) and (*2*) of this section, for a netting set subject to two or more outstanding disputes over margin that lasted longer than the MPOR over the previous two quarters, the applicable floor is twice the amount provided in (c)(9)(iv)(A)(*1*) and (*2*) of this section.

(B) The maturity factor of a derivative contract that is not subject to a variation margin agreement, or derivative contracts under which the counterparty

[30] In the case of a first-to-default credit derivative, there are no underlying exposures that are subordinated to the Board-regulated institution's exposure. In the case of a second-or-subsequent-to-default credit derivative, the smallest (n − 1) notional amounts of the underlying exposures are subordinated to the Board-regulated institution's exposure.

is not required to post variation margin, is determined by the following formula:

$$\text{Maturity factor} = \sqrt{\frac{\min\{M;250\}}{250}}$$

Where M equals the greater of 10 business days and the remaining maturity of the contract, as measured in business days.

(C) For purposes of paragraph (c)(9)(iv) of this section, if a Board-regulated institution has elected pursuant to paragraph (c)(5)(v) of this section to treat a derivative contract that is a cleared transaction that is not subject to a variation margin agreement as one that is subject to a variation margin agreement, the Board-regulated institution must treat the derivative contract as subject to a variation margin agreement with maturity factor as determined according to (c)(9)(iv)(A) of this section, and daily settlement does not change the end date of the period referenced by the derivative contract.

(v) *Derivative contract as multiple effective derivative contracts.* A Board-regulated institution must separate a derivative contract into separate derivative contracts, according to the following rules:

(A) For an option where the counterparty pays a predetermined amount if the value of the underlying asset is above or below the strike price and nothing otherwise (binary option), the option must be treated as two separate options. For purposes of paragraph (c)(9)(iii)(B) of this section, a binary option with strike K must be represented as the combination of one bought European option and one sold European option of the same type as the original option (put or call) with the strikes set equal to 0.95 * K and 1.05 * K so that the payoff of the binary option is reproduced exactly outside the region between the two strikes. The absolute value of the sum of the adjusted derivative contract amounts of the bought and sold options is capped at the payoff amount of the binary option.

(B) For a derivative contract that can be represented as a combination of standard option payoffs (such as collar, butterfly spread, calendar spread, straddle, and strangle), a Board-regulated institution must treat each standard option component as a separate derivative contract.

(C) For a derivative contract that includes multiple-payment options, (such as interest rate caps and floors), a Board-regulated institution may represent each payment option as a combination of effective single-payment options (such as interest rate caplets and floorlets).

(D) A Board-regulated institution may not decompose linear derivative contracts (such as swaps) into components.

(10) *Multiple netting sets subject to a single variation margin agreement*—(i) *Calculating replacement cost.* Notwithstanding paragraph (c)(6) of this section, a Board-regulated institution shall assign a single replacement cost to multiple netting sets that are subject to a single variation margin agreement under which the counterparty must post variation margin, calculated according to the following formula:

$$\textit{Replacement Cost} = max\{\Sigma_{NS} max\{V_{NS}; 0\} - max\{C_{MA}; 0\}; 0\} + max\{\Sigma_{NS} min\{V_{NS}; 0\} - min\{C_{MA}; 0\}; 0\}$$

Where:

NS is each netting set subject to the variation margin agreement MA;

V_{NS} is the sum of the fair values (after excluding any valuation adjustments) of the derivative contracts within the netting set NS; and

C_{MA} is the sum of the net independent collateral amount and the variation margin amount applicable to the derivative contracts within the netting sets subject to the single variation margin agreement.

(ii) *Calculating potential future exposure.* Notwithstanding paragraph (c)(5) of this section, a Board-regulated institution shall assign a single potential future exposure to multiple netting sets that are subject to a single variation margin agreement under which the counterparty must post variation margin equal to the sum of the potential future exposure of each such netting set, each calculated according to paragraph (c)(7) of this section as if such nettings sets were not subject to a variation margin agreement.

(11) *Netting set subject to multiple variation margin agreements or a hybrid netting set*—(i) *Calculating replacement cost.* To calculate replacement cost for either a netting set subject to multiple variation margin agreements under which the counterparty to each variation margin agreement must post variation margin, or a netting set composed of at least one derivative contract subject to variation margin agreement under which the counterparty must post variation margin and at least one derivative contract that is not subject to such a variation margin agreement, the calculation for replacement cost is provided under paragraph (c)(6)(i) of this section, except that the variation margin threshold equals the sum of the variation margin thresholds of all variation margin agreements within the netting set and the minimum transfer amount equals the sum of the minimum transfer amounts of all the variation margin agreements within the netting set.

(ii) *Calculating potential future exposure.* (A) To calculate potential future exposure for a netting set subject to multiple variation margin agreements under which the counterparty to each variation margin agreement must post variation margin, or a netting set composed of at least one derivative contract subject to variation margin agreement under which the counterparty to the derivative contract must post variation margin and at least one derivative contract that is not subject to such a variation margin agreement, a Board-regulated institution must divide the netting set into sub-netting sets (as described in paragraph (c)(11)(ii)(B) of this section) and calculate the aggregated amount for each sub-netting set. The aggregated amount for the netting set is calculated as the sum of the aggregated amounts for the sub-netting sets. The multiplier is calculated for the entire netting set.

(B) For purposes of paragraph (c)(11)(ii)(A) of this section, the netting set must be divided into sub-netting sets as follows:

(*1*) All derivative contracts within the netting set that are not subject to a variation margin agreement or that are subject to a variation margin agreement under which the counterparty is not required to post variation margin form a single sub-netting set. The aggregated amount for this sub-netting set is calculated as if the netting set is not subject to a variation margin agreement.

(*2*) All derivative contracts within the netting set that are subject to variation margin agreements in which the counterparty must post variation margin and that share the same value of the MPOR form a single sub-netting set. The aggregated amount for this sub-netting set is calculated as if the netting set is subject to a variation margin agreement, using the MPOR value shared by the derivative contracts within the netting set.

TABLE 3 TO § 217.132—SUPERVISORY OPTION VOLATILITY, SUPERVISORY CORRELATION PARAMETERS, AND SUPERVISORY FACTORS FOR DERIVATIVE CONTRACTS

Asset class	Category	Type	Supervisory option volatility (percent)	Supervisory correlation factor (percent)	Supervisory factor [1] (percent)
Interest rate	N/A	N/A	50	N/A	0.50
Exchange rate	N/A	N/A	15	N/A	4.0
Credit, single name	Investment grade	N/A	100	50	0.46
	Speculative grade	N/A	100	50	1.3
	Sub-speculative grade	N/A	100	50	6.0
Credit, index	Investment Grade	N/A	80	80	0.38
	Speculative Grade	N/A	80	80	1.06
Equity, single name	N/A	N/A	120	50	32
Equity, index	N/A	N/A	75	80	20
Commodity	Energy	Electricity	150	40	40
		Other	70	40	18
	Metals	N/A	70	40	18
	Agricultural	N/A	70	40	18
	Other	N/A	70	40	18

[1] The applicable supervisory factor for basis derivative contract hedging sets is equal to one-half of the supervisory factor provided in this Table 3, and the applicable supervisory factor for volatility derivative contract hedging sets is equal to 5 times the supervisory factor provided in this Table 3.

(d) * * *

(10) * * *

(i) With prior written approval of the Board, a Board-regulated institution may set EAD equal to a measure of counterparty credit risk exposure, such as peak EAD, that is more conservative than an alpha of 1.4 times the larger of $EPE_{unstressed}$ and $EPE_{stressed}$ for every counterparty whose EAD will be measured under the alternative measure of counterparty exposure. The Board-regulated institution must demonstrate the conservatism of the measure of counterparty credit risk exposure used for EAD. With respect to paragraph (d)(10)(i) of this section:

(A) For material portfolios of new OTC derivative products, the Board-regulated institution may assume that the standardized approach for counterparty credit risk pursuant to paragraph (c) of this section meets the conservatism requirement of this section for a period not to exceed 180 days.

(B) For immaterial portfolios of OTC derivative contracts, the Board-regulated institution generally may assume that the standardized approach for counterparty credit risk pursuant to paragraph (c) of this section meets the conservatism requirement of this section.

* * * * *

(e) * * *

(6) * * *

(viii) If a Board-regulated institution uses the standardized approach for counterparty credit risk pursuant to paragraph (c) of this section to calculate the EAD for any immaterial portfolios of OTC derivative contracts, the Board-regulated institution must use that EAD as a constant EE in the formula for the calculation of CVA with the maturity equal to the maximum of:

(A) Half of the longest maturity of a transaction in the netting set; and

(B) The notional weighted average maturity of all transactions in the netting set.

■ 23. Section 217.133 is amended by revising paragraphs (a), (b)(1) through (3), (b)(4)(i), (c)(1) through (3), (c)(4)(i), and (d) to read as follows:

§ 217.133 Cleared transactions.

(a) *General requirements*—(1) *Clearing member clients.* A Board-regulated institution that is a clearing member client must use the methodologies described in paragraph (b) of this section to calculate risk-weighted assets for a cleared transaction.

(2) *Clearing members.* A Board-regulated institution that is a clearing member must use the methodologies described in paragraph (c) of this section to calculate its risk-weighted assets for a cleared transaction and paragraph (d) of this section to calculate its risk-weighted assets for its default fund contribution to a CCP.

(b) * * *

(1) *Risk-weighted assets for cleared transactions.* (i) To determine the risk-weighted asset amount for a cleared transaction, a Board-regulated institution that is a clearing member client must multiply the trade exposure amount for the cleared transaction, calculated in accordance with paragraph (b)(2) of this section, by the risk weight appropriate for the cleared transaction, determined in accordance with paragraph (b)(3) of this section.

(ii) A clearing member client Board-regulated institution's total risk-weighted assets for cleared transactions is the sum of the risk-weighted asset amounts for all of its cleared transactions.

(2) *Trade exposure amount.* (i) For a cleared transaction that is a derivative contract or a netting set of derivative contracts, trade exposure amount equals the EAD for the derivative contract or netting set of derivative contracts calculated using the methodology used to calculate EAD for derivative contracts set forth in § 217.132(c) or (d), plus the fair value of the collateral posted by the clearing member client Board-regulated institution and held by the CCP or a clearing member in a manner that is not bankruptcy remote. When the Board-regulated institution calculates EAD for the cleared transaction using the methodology in § 217.132(d), EAD equals $EAD_{unstressed}$.

(ii) For a cleared transaction that is a repo-style transaction or netting set of repo-style transactions, trade exposure amount equals the EAD for the repo-style transaction calculated using the methodology set forth in § 217.132(b)(2) or (3) or (d), plus the fair value of the collateral posted by the clearing member client Board-regulated institution and held by the CCP or a clearing member in a manner that is not bankruptcy remote. When the Board-regulated institution calculates EAD for the cleared transaction under § 217.132(d), EAD equals $EAD_{unstressed}$.

(3) *Cleared transaction risk weights.* (i) For a cleared transaction with a QCCP, a clearing member client Board-regulated institution must apply a risk weight of:

(A) 2 percent if the collateral posted by the Board-regulated institution to the QCCP or clearing member is subject to an arrangement that prevents any loss to the clearing member client Board-regulated institution due to the joint default or a concurrent insolvency, liquidation, or receivership proceeding of the clearing member and any other clearing member clients of the clearing member; and the clearing member client Board-regulated institution has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that in the event of a legal challenge (including one resulting from an event of default or from liquidation, insolvency, or receivership proceedings) the relevant court and administrative authorities would find the arrangements to be legal, valid, binding, and enforceable under the law of the relevant jurisdictions.

(B) 4 percent, if the requirements of paragraph (b)(3)(i)(A) of this section are not met.

(ii) For a cleared transaction with a CCP that is not a QCCP, a clearing member client Board-regulated institution must apply the risk weight applicable to the CCP under subpart D of this part.

(4) * * *

(i) Notwithstanding any other requirement of this section, collateral posted by a clearing member client Board-regulated institution that is held by a custodian (in its capacity as a custodian) in a manner that is bankruptcy remote from the CCP, clearing member, and other clearing member clients of the clearing member, is not subject to a capital requirement under this section.

* * * * *

(c) * * *

(1) *Risk-weighted assets for cleared transactions.* (i) To determine the risk-weighted asset amount for a cleared transaction, a clearing member Board-regulated institution must multiply the trade exposure amount for the cleared transaction, calculated in accordance with paragraph (c)(2) of this section by the risk weight appropriate for the cleared transaction, determined in accordance with paragraph (c)(3) of this section.

(ii) A clearing member Board-regulated institution's total risk-weighted assets for cleared transactions is the sum of the risk-weighted asset amounts for all of its cleared transactions.

(2) *Trade exposure amount.* A clearing member Board-regulated institution must calculate its trade exposure amount for a cleared transaction as follows:

(i) For a cleared transaction that is a derivative contract or a netting set of derivative contracts, trade exposure amount equals the EAD calculated using the methodology used to calculate EAD for derivative contracts set forth in § 217.132(c) or (d), plus the fair value of the collateral posted by the clearing member Board-regulated institution and held by the CCP in a manner that is not bankruptcy remote. When the clearing member Board-regulated institution calculates EAD for the cleared transaction using the methodology in § 217.132(d), EAD equals $EAD_{unstressed}$.

(ii) For a cleared transaction that is a repo-style transaction or netting set of repo-style transactions, trade exposure amount equals the EAD calculated under § 217.132(b)(2) or (3) or (d), plus the fair value of the collateral posted by the clearing member Board-regulated institution and held by the CCP in a manner that is not bankruptcy remote. When the clearing member Board-regulated institution calculates EAD for the cleared transaction under § 217.132(d), EAD equals $EAD_{unstressed}$.

(3) *Cleared transaction risk weights.* (i) A clearing member Board-regulated institution must apply a risk weight of 2 percent to the trade exposure amount for a cleared transaction with a QCCP.

(ii) For a cleared transaction with a CCP that is not a QCCP, a clearing member Board-regulated institution must apply the risk weight applicable to the CCP according to subpart D of this part.

(iii) Notwithstanding paragraphs (c)(3)(i) and (ii) of this section, a clearing member Board-regulated institution may apply a risk weight of zero percent to the trade exposure amount for a cleared transaction with a QCCP where the clearing member Board-regulated institution is acting as a financial intermediary on behalf of a clearing member client, the transaction offsets another transaction that satisfies the requirements set forth in § 217.3(a), and the clearing member Board-regulated institution is not obligated to reimburse the clearing member client in the event of the QCCP default.

(4) * * *

(i) Notwithstanding any other requirement of this section, collateral posted by a clearing member Board-regulated institution that is held by a custodian (in its capacity as a custodian) in a manner that is bankruptcy remote from the CCP, clearing member, and other clearing member clients of the clearing member, is not subject to a capital requirement under this section.

* * * * *

(d) *Default fund contributions*—(1) *General requirement.* A clearing member Board-regulated institution must determine the risk-weighted asset amount for a default fund contribution to a CCP at least quarterly, or more frequently if, in the opinion of the Board-regulated institution or the Board, there is a material change in the financial condition of the CCP.

(2) *Risk-weighted asset amount for default fund contributions to nonqualifying CCPs.* A clearing member Board-regulated institution's risk-weighted asset amount for default fund contributions to CCPs that are not QCCPs equals the sum of such default fund contributions multiplied by 1,250 percent, or an amount determined by the Board, based on factors such as size, structure, and membership characteristics of the CCP and riskiness of its transactions, in cases where such default fund contributions may be unlimited.

(3) *Risk-weighted asset amount for default fund contributions to QCCPs.* A clearing member Board-regulated institution's risk-weighted asset amount for default fund contributions to QCCPs equals the sum of its capital requirement, K_{CM} for each QCCP, as calculated under the methodology set forth in paragraph (d)(4) of this section, multiplied by 12.5.

(4) *Capital requirement for default fund contributions to a QCCP.* A clearing member Board-regulated institution's capital requirement for its default fund contribution to a QCCP (K_{CM}) is equal to:

$$K_{CM} = \max\{K_{CCP} * \left(\frac{DF^{pref}}{DF_{CCP} + DF^{pref}_{CCPCM}}\right); 0.16\, percent * DF^{pref}\}$$

Where:

K_{CCP} is the hypothetical capital requirement of the QCCP, as determined under paragraph (d)(5) of this section;

DF^{pref} is the prefunded default fund contribution of the clearing member Board-regulated institution to the QCCP;

DF_{CCP} is the QCCP's own prefunded amounts that are contributed to the default waterfall and are junior or pari passu with prefunded default fund contributions of clearing members of the CCP; and

DF_{CM}^{pref} is the total prefunded default fund contributions from clearing members of the QCCP to the QCCP.

(5) *Hypothetical capital requirement of a QCCP.* Where a QCCP has provided its K_{CCP}, a Board-regulated institution must rely on such disclosed figure instead of calculating K_{CCP} under this paragraph (d)(5), unless the Board-regulated institution determines that a more conservative figure is appropriate based on the nature, structure, or characteristics of the QCCP. The hypothetical capital requirement of a QCCP (K_{CCP}), as determined by the Board-regulated institution, is equal to:

$$K_{CCP} = \Sigma_{CM_i} EAD_i * 1.6 \text{ percent}$$

Where:

CM_i is each clearing member of the QCCP; and

EAD_i is the exposure amount of each clearing member of the QCCP to the QCCP, as determined under paragraph (d)(6) of this section.

(6) *EAD of a clearing member Board-regulated institution to a QCCP.* (i) The EAD of a clearing member Board-regulated institution to a QCCP is equal to the sum of the EAD for derivative contracts determined under paragraph (d)(6)(ii) of this section and the EAD for repo-style transactions determined under paragraph (d)(6)(iii) of this section.

(ii) With respect to any derivative contracts between the Board-regulated institution and the CCP that are cleared transactions and any guarantees that the Board-regulated institution has provided to the CCP with respect to performance of a clearing member client on a derivative contract, the EAD is equal to the exposure amount for all such derivative contracts and guarantees of derivative contracts calculated under SA–CCR in § 217.132(c) (or, with respect to a CCP located outside the United States, under a substantially identical methodology in effect in the jurisdiction) using a value of 10 business days for purposes of § 217.132(c)(9)(iv); less the value of all collateral held by the CCP posted by the clearing member Board-regulated institution or a clearing member client of the Board-regulated institution in connection with a derivative contract for which the Board-regulated institution has provided a guarantee to the CCP and the amount of the prefunded default fund contribution of the Board-regulated institution to the CCP.

(iii) With respect to any repo-style transactions between the Board-regulated institution and the CCP that are cleared transactions, EAD is equal to:

$$EAD = \max\{EBRM - IM - DF; 0\}$$

Where:

EBRM is the sum of the exposure amounts of each repo-style transaction between the Board-regulated institution and the CCP as determined under § 217.132(b)(2) and without recognition of any collateral securing the repo-style transactions;

IM is the initial margin collateral posted by the Board-regulated institution to the CCP with respect to the repo-style transactions; and

DF is the prefunded default fund contribution of the Board-regulated institution to the CCP that is not already deducted in § 217.133(d)(6)(ii).

(iv) EAD must be calculated separately for each clearing member's sub-client accounts and sub-house account (*i.e.,* for the clearing member's proprietary activities). If the clearing member's collateral and its client's collateral are held in the same default fund contribution account, then the EAD of that account is the sum of the EAD for the client-related transactions within the account and the EAD of the house-related transactions within the account. For purposes of determining such EADs, the independent collateral of the clearing member and its client must be allocated in proportion to the respective total amount of independent collateral posted by the clearing member to the QCCP.

(v) If any account or sub-account contains both derivative contracts and repo-style transactions, the EAD of that account is the sum of the EAD for the derivative contracts within the account and the EAD of the repo-style transactions within the account. If independent collateral is held for an account containing both derivative contracts and repo-style transactions, then such collateral must be allocated to the derivative contracts and repo-style transactions in proportion to the respective product specific exposure amounts, calculated, excluding the effects of collateral, according to § 217.132(b) for repo-style transactions and to § 217.132(c)(5) for derivative contracts.

(vi) Notwithstanding any other provision of paragraph (d) of this section, with the prior approval of the Board, a Board-regulated institution may determine the risk-weighted asset amount for a default fund contribution to a QCCP according to § 217.35(d)(3)(ii).

■ 24. Section 217.173 is amended in Table 13 to § 217.173 by revising line 4 under Part 2, Derivative exposures, to read as follows:

§ 217.173 Disclosures by certain advanced approaches Board-regulated institutions and Category III Board-regulated institutions.

* * * * *

TABLE 13 TO § 217.173—SUPPLEMENTARY LEVERAGE RATIO

				Dollar amounts in thousands			
				Tril	Bil	Mil	Thou
*	*	*	*	*	*	*	
Part 2: Supplementary leverage ratio							
*	*	*	*	*	*	*	
Derivative exposures							
*	*	*	*	*	*	*	

4 Current exposure for derivative exposures (that is, net of cash variation margin).

TABLE 13 TO § 217.173—SUPPLEMENTARY LEVERAGE RATIO—Continued

				Dollar amounts in thousands			
				Tril	Bil	Mil	Thou
*	*	*	*	*	*	*	

■ 25. Section 217.300 is amended by adding paragraph (h) and (i) to read as follows:

§ 217.300 Transitions.

* * * * *

(h) *SA–CCR.* An advanced approaches Board-regulated institution may use CEM rather than SA–CCR for purposes of §§ 217.34(a) and 217.132(c) until January 1, 2022. A Board-regulated institution must provide prior notice to the Board if it decides to begin using SA–CCR before January 1, 2022. On January 1, 2022, and thereafter, an advanced approaches Board-regulated institution must use SA–CCR for purposes of §§ 217.34(a), 217.132(c), and 217.135(d). Once an advanced approaches Board-regulated institution has begun to use SA–CCR, the advanced approaches Board-regulated institution may not change to use CEM.

(i) *Default fund contributions.* Prior to January 1, 2022, a Board-regulated institution that calculates the exposure amounts of its derivative contracts under the standardized approach for counterparty credit risk in § 217.132(c) may calculate the risk-weighted asset amount for a default fund contribution to a QCCP under either method 1 under § 217.35(d)(3)(i) or method 2 under § 217.35(d)(3)(ii), rather than under § 217.133(d).

FEDERAL DEPOSIT INSURANCE CORPORATION

For the reasons forth out in the preamble, 12 CFR parts 324 and 327 are amended as set forth below.

PART 324—CAPITAL ADEQUACY OF FDIC-SUPERVISED INSTITUTIONS

■ 26. The authority citation for part 324 continues to read as follows:

Authority: 12 U.S.C. 1815(a), 1815(b), 1816, 1818(a), 1818(b), 1818(c), 1818(t), 1819(Tenth), 1828(c), 1828(d), 1828(i), 1828(n), 1828(o), 1831o, 1835, 3907, 3909, 4808; 5371; 5412; Pub. L. 102–233, 105 Stat. 1761, 1789, 1790 (12 U.S.C. 1831n note); Pub. L. 102–242, 105 Stat. 2236, 2355, as amended by Pub. L. 103–325, 108 Stat. 2160, 2233 (12 U.S.C. 1828 note); Pub. L. 102–242, 105 Stat. 2236, 2386, as amended by Pub. L. 102–550, 106 Stat. 3672, 4089 (12 U.S.C. 1828 note); Pub. L. 111–203, 124 Stat. 1376, 1887 (15 U.S.C. 78o–7 note).

■ 27. Section 324.2 is amended by:

■ a. Adding the definitions of ''Basis derivative contract,'' ''Client-facing derivative transaction,'' and ''Commercial end-user'' in alphabetical order;

■ b. Revising the definition of ''Current exposure'' and ''Current exposure methodology;''

■ c. Revising paragraph (2) of the definition of ''Financial collateral;''

■ d. Adding the definitions of ''Independent collateral,'' ''Minimum transfer amount,'' and ''Net independent collateral amount'' in alphabetical order;

■ e. Revising the definition of ''Netting set;'' and

■ f. Adding the definitions of ''Speculative grade,'' ''Sub-speculative grade,'' ''Variation margin,'' ''Variation margin agreement,'' ''Variation margin amount,'' ''Variation margin threshold,'' and ''Volatility derivative contract'' in alphabetical order.

The additions and revisions read as follows:

§ 324.2 Definitions.

* * * * *

Basis derivative contract means a non-foreign-exchange derivative contract (*i.e.,* the contract is denominated in a single currency) in which the cash flows of the derivative contract depend on the difference between two risk factors that are attributable solely to one of the following derivative asset classes: Interest rate, credit, equity, or commodity.

* * * * *

Client-facing derivative transaction means a derivative contract that is not a cleared transaction where the FDIC-supervised institution is either acting as a financial intermediary and enters into an offsetting transaction with a qualifying central counterparty (QCCP) or where the FDIC-supervised institution provides a guarantee to the QCCP on the performance of a client on a transaction between the client and a QCCP.

* * * * *

Commercial end-user means an entity that:

(1)(i) Is using derivative contracts to hedge or mitigate commercial risk; and

(ii)(A) Is not an entity described in section 2(h)(7)(C)(i)(I) through (VIII) of the Commodity Exchange Act (7 U.S.C. 2(h)(7)(C)(i)(I) through (VIII)); or

(B) Is not a ''financial entity'' for purposes of section 2(h)(7) of the Commodity Exchange Act (7 U.S.C. 2(h)) by virtue of section 2(h)(7)(C)(iii) of the Act (7 U.S.C. 2(h)(7)(C)(iii)); or

(2)(i) Is using derivative contracts to hedge or mitigate commercial risk; and

(ii) Is not an entity described in section 3C(g)(3)(A)(i) through (viii) of the Securities Exchange Act of 1934 (15 U.S.C. 78c–3(g)(3)(A)(i) through (viii)); or

(3) Qualifies for the exemption in section 2(h)(7)(A) of the Commodity Exchange Act (7 U.S.C. 2(h)(7)(A)) by virtue of section 2(h)(7)(D) of the Act (7 U.S.C. 2(h)(7)(D)); or

(4) Qualifies for an exemption in section 3C(g)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78c–3(g)(1)) by virtue of section 3C(g)(4) of the Act (15 U.S.C. 78c–3(g)(4)).

* * * * *

Current exposure means, with respect to a netting set, the larger of zero or the fair value of a transaction or portfolio of transactions within the netting set that would be lost upon default of the counterparty, assuming no recovery on the value of the transactions.

Current exposure methodology means the method of calculating the exposure amount for over-the-counter derivative contracts in § 324.34(b).

* * * * *

Financial collateral * * *

(2) In which the FDIC-supervised institution has a perfected, first-priority security interest or, outside of the United States, the legal equivalent thereof (with the exception of cash on deposit; and notwithstanding the prior security interest of any custodial agent or any priority security interest granted to a CCP in connection with collateral posted to that CCP).

* * * * *

Independent collateral means financial collateral, other than variation margin, that is subject to a collateral agreement, or in which a FDIC-supervised institution has a perfected, first-priority security interest or, outside of the United States, the legal equivalent thereof (with the exception of cash on

deposit; notwithstanding the prior security interest of any custodial agent or any prior security interest granted to a CCP in connection with collateral posted to that CCP), and the amount of which does not change directly in response to the value of the derivative contract or contracts that the financial collateral secures.

* * * * *

Minimum transfer amount means the smallest amount of variation margin that may be transferred between counterparties to a netting set pursuant to the variation margin agreement.

* * * * *

Net independent collateral amount means the fair value amount of the independent collateral, as adjusted by the standard supervisory haircuts under § 324.132(b)(2)(ii), as applicable, that a counterparty to a netting set has posted to a FDIC-supervised institution less the fair value amount of the independent collateral, as adjusted by the standard supervisory haircuts under § 324.132(b)(2)(ii), as applicable, posted by the FDIC-supervised institution to the counterparty, excluding such amounts held in a bankruptcy remote manner or posted to a QCCP and held in conformance with the operational requirements in § 324.3.

Netting set means a group of transactions with a single counterparty that are subject to a qualifying master netting agreement. For derivative contracts, netting set also includes a single derivative contract between a FDIC-supervised institution and a single counterparty. For purposes of the internal model methodology under § 324.132(d), netting set also includes a group of transactions with a single counterparty that are subject to a qualifying cross-product master netting agreement and does not include a transaction:

(1) That is not subject to such a master netting agreement; or

(2) Where the FDIC-supervised institution has identified specific wrong-way risk.

* * * * *

Speculative grade means the reference entity has adequate capacity to meet financial commitments in the near term, but is vulnerable to adverse economic conditions, such that should economic conditions deteriorate, the reference entity would present an elevated default risk.

* * * * *

Sub-speculative grade means the reference entity depends on favorable economic conditions to meet its financial commitments, such that should such economic conditions deteriorate the reference entity likely would default on its financial commitments.

* * * * *

Variation margin means financial collateral that is subject to a collateral agreement provided by one party to its counterparty to meet the performance of the first party's obligations under one or more transactions between the parties as a result of a change in value of such obligations since the last time such financial collateral was provided.

Variation margin agreement means an agreement to collect or post variation margin.

Variation margin amount means the fair value amount of the variation margin, as adjusted by the standard supervisory haircuts under § 324.132(b)(2)(ii), as applicable, that a counterparty to a netting set has posted to a FDIC-supervised institution less the fair value amount of the variation margin, as adjusted by the standard supervisory haircuts under § 324.132(b)(2)(ii), as applicable, posted by the FDIC-supervised institution to the counterparty.

Variation margin threshold means the amount of credit exposure of a FDIC-supervised institution to its counterparty that, if exceeded, would require the counterparty to post variation margin to the FDIC-supervised institution pursuant to the variation margin agreement.

Volatility derivative contract means a derivative contract in which the payoff of the derivative contract explicitly depends on a measure of the volatility of an underlying risk factor to the derivative contract.

* * * * *

■ 28. Section 324.10 is amended by revising paragraphs (c)(4)(ii)(A) through (C) to read as follows:

§ 324.10 Minimum capital requirements.

* * * * *

(c) * * *

(4) * * *

(ii) * * *

(A) The balance sheet carrying value of all of the FDIC-supervised institution's on-balance sheet assets, *plus* the value of securities sold under a repurchase transaction or a securities lending transaction that qualifies for sales treatment under U.S. GAAP, *less* amounts deducted from tier 1 capital under § 324.22(a), (c), and (d), and *less* the value of securities received in security-for-security repo-style transactions, where the FDIC-supervised institution acts as a securities lender and includes the securities received in its on-balance sheet assets but has not sold or re-hypothecated the securities received, and, for a FDIC-supervised institution that uses the standardized approach for counterparty credit risk under § 324.132(c) for its standardized risk-weighted assets, *less* the fair value of any derivative contracts;

(B)(*1*) For a FDIC-supervised institution that uses the current exposure methodology under § 324.34(b) for its standardized risk-weighted assets, the potential future credit exposure (PFE) for each derivative contract or each single-product netting set of derivative contracts (including a cleared transaction except as provided in paragraph (c)(4)(ii)(I) of this section and, at the discretion of the FDIC-supervised institution, excluding a forward agreement treated as a derivative contract that is part of a repurchase or reverse repurchase or a securities borrowing or lending transaction that qualifies for sales treatment under U.S. GAAP), to which the FDIC-supervised institution is a counterparty as determined under § 324.34, but without regard to § 324.34(b), provided that:

(*i*) A FDIC-supervised institution may choose to exclude the PFE of all credit derivatives or other similar instruments through which it provides credit protection when calculating the PFE under § 324.34, but without regard to § 324.34(b), provided that it does not adjust the net-to-gross ratio (NGR); and

(*ii*) A FDIC-supervised institution that chooses to exclude the PFE of credit derivatives or other similar instruments through which it provides credit protection pursuant to paragraph (c)(4)(ii)(B)(*1*) of this section must do so consistently over time for the calculation of the PFE for all such instruments; or

(*2*)(*i*) For a FDIC-supervised institution that uses the standardized approach for counterparty credit risk under section § 324.132(c) for its standardized risk-weighted assets, the PFE for each netting set to which the FDIC-supervised institution is a counterparty (including cleared transactions except as provided in paragraph (c)(4)(ii)(I) of this section and, at the discretion of the FDIC-supervised institution, excluding a forward agreement treated as a derivative contract that is part of a repurchase or reverse repurchase or a securities borrowing or lending transaction that qualifies for sales treatment under U.S. GAAP), as determined under § 324.132(c)(7), in which the term C in § 324.132(c)(7)(i) equals zero except as provided in paragraph (c)(4)(ii)(B)(*2*)(*ii*) of this section, and, for any counterparty

that is not a commercial end-user, multiplied by 1.4; and

(*ii*) For purposes of paragraph (c)(4)(ii)(B)(*2*)(*i*) of this section, a FDIC-supervised institution may set the value of the term C in § 324.132(c)(7)(i) equal to the amount of collateral posted by a clearing member client of the FDIC-supervised institution in connection with the client-facing derivative transactions within the netting set;

(C)(*1*)(*i*) For a FDIC-supervised institution that uses the current exposure methodology under § 324.34(b) for its standardized risk-weighted assets, the amount of cash collateral that is received from a counterparty to a derivative contract and that has offset the mark-to-fair value of the derivative asset, or cash collateral that is posted to a counterparty to a derivative contract and that has reduced the FDIC-supervised institution's on-balance sheet assets, unless such cash collateral is all or part of variation margin that satisfies the conditions in paragraphs (c)(4)(ii)(C)(*3*) through (*7*) of this section; and

(*ii*) The variation margin is used to reduce the current credit exposure of the derivative contract, calculated as described in § 324.34(b), and not the PFE; and

(*iii*) For the purpose of the calculation of the NGR described in § 324.34(b)(2)(ii)(B), variation margin described in paragraph (c)(4)(ii)(C)(*1*)(*ii*) of this section may not reduce the net current credit exposure or the gross current credit exposure; or

(*2*)(*i*) For a FDIC-supervised institution that uses the standardized approach for counterparty credit risk under § 324.132(c) for its standardized risk-weighted assets, the replacement cost of each derivative contract or single product netting set of derivative contracts to which the FDIC-supervised institution is a counterparty, calculated according to the following formula, and, for any counterparty that is not a commercial end-user, multiplied by 1.4:

$$\textit{Replacement Cost} = \max\{V - CVM_r + CVM_p; 0\}$$

Where:

V equals the fair value for each derivative contract or each single-product netting set of derivative contracts (including a cleared transaction except as provided in paragraph (c)(4)(ii)(I) of this section and, at the discretion of the FDIC-supervised institution, excluding a forward agreement treated as a derivative contract that is part of a repurchase or reverse repurchase or a securities borrowing or lending transaction that qualifies for sales treatment under U.S. GAAP);

CVM_r equals the amount of cash collateral received from a counterparty to a derivative contract and that satisfies the conditions in paragraphs (c)(4)(ii)(C)(*3*) through (*7*) of this section, or, in the case of a client-facing derivative transaction on behalf of a clearing member client, the amount of collateral received from the clearing member client; and

CVM_p equals the amount of cash collateral that is posted to a counterparty to a derivative contract and that has not offset the fair value of the derivative contract and that satisfies the conditions in paragraphs (c)(4)(ii)(C)(*3*) through (*7*) of this section, or, in the case of a client-facing derivative transaction on behalf of a clearing member client, the amount of collateral posted to the clearing member client;

(*ii*) Notwithstanding paragraph (c)(4)(ii)(C)(*2*)(*i*) of this section, where multiple netting sets are subject to a single variation margin agreement, a FDIC-supervised institution must apply the formula for replacement cost provided in § 324.132(c)(10)(i), in which the term C_{MA} may only include cash collateral that satisfies the conditions in paragraphs (c)(4)(ii)(C)(*3*) through (*7*) of this section; and

(*iii*) For purposes of paragraph (c)(4)(ii)(C)(*2*)(*i*), a FDIC-supervised institution must treat a derivative contract that references an index as if it were multiple derivative contracts each referencing one component of the index if the FDIC-supervised institution elected to treat the derivative contract as multiple derivative contracts under § 324.132(c)(5)(vi);

(*3*) For derivative contracts that are not cleared through a QCCP, the cash collateral received by the recipient counterparty is not segregated (by law, regulation, or an agreement with the counterparty);

(*4*) Variation margin is calculated and transferred on a daily basis based on the mark-to-fair value of the derivative contract;

(*5*) The variation margin transferred under the derivative contract or the governing rules of the CCP or QCCP for a cleared transaction is the full amount that is necessary to fully extinguish the net current credit exposure to the counterparty of the derivative contracts, subject to the threshold and minimum transfer amounts applicable to the counterparty under the terms of the derivative contract or the governing rules for a cleared transaction;

(*6*) The variation margin is in the form of cash in the same currency as the currency of settlement set forth in the derivative contract, provided that for the purposes of this paragraph (c)(4)(ii)(C)(*6*), currency of settlement means any currency for settlement specified in the governing qualifying master netting agreement and the credit support annex to the qualifying master netting agreement, or in the governing rules for a cleared transaction; and

(*7*) The derivative contract and the variation margin are governed by a qualifying master netting agreement between the legal entities that are the counterparties to the derivative contract or by the governing rules for a cleared transaction, and the qualifying master netting agreement or the governing rules for a cleared transaction must explicitly stipulate that the counterparties agree to settle any payment obligations on a net basis, taking into account any variation margin received or provided under the contract if a credit event involving either counterparty occurs;

* * * * *

■ 29. Section 324.32 is amended by revising paragraph (f) to read as follows:

§ 324.32 General risk weights.

* * * * *

(f) *Corporate exposures.* (1) A FDIC-supervised institution must assign a 100 percent risk weight to all its corporate exposures, except as provided in paragraph (f)(2) of this section.

(2) A FDIC-supervised institution must assign a 2 percent risk weight to an exposure to a QCCP arising from the FDIC-supervised institution posting cash collateral to the QCCP in connection with a cleared transaction that meets the requirements of § 324.35(b)(3)(i)(A) and a 4 percent risk weight to an exposure to a QCCP arising from the FDIC-supervised institution posting cash collateral to the QCCP in connection with a cleared transaction that meets the requirements of § 324.35(b)(3)(i)(B).

(3) A FDIC-supervised institution must assign a 2 percent risk weight to an exposure to a QCCP arising from the FDIC-supervised institution posting cash collateral to the QCCP in connection with a cleared transaction that meets the requirements of § 324.35(c)(3)(i).

* * * * *

■ 30. Section 324.34 is revised to read as follows:

§ 324.34 Derivative contracts.

(a) *Exposure amount for derivative contracts*—(1) *FDIC-supervised institution that is not an advanced approaches FDIC-supervised institution.* (i) A FDIC-supervised institution that is not an advanced approaches FDIC-supervised institution must use the current exposure methodology (CEM) described in paragraph (b) of this section to calculate the exposure amount for all its OTC derivative contracts, unless the FDIC-supervised

institution makes the election provided in paragraph (a)(1)(ii) of this section.

(ii) A FDIC-supervised institution that is not an advanced approaches FDIC-supervised institution may elect to calculate the exposure amount for all its OTC derivative contracts under the standardized approach for counterparty credit risk (SA–CCR) in § 324.132(c) by notifying the FDIC, rather than calculating the exposure amount for all its derivative contracts using CEM. A FDIC-supervised institution that elects under this paragraph (a)(1)(ii) to calculate the exposure amount for its OTC derivative contracts under SA–CCR must apply the treatment of cleared transactions under § 324.133 to its derivative contracts that are cleared transactions and to all default fund contributions associated with such derivative contracts, rather than applying § 324.35. A FDIC-supervised institution that is not an advanced approaches FDIC-supervised institution must use the same methodology to calculate the exposure amount for all its derivative contracts and, if a FDIC-supervised institution has elected to use SA–CCR under this paragraph (a)(1)(ii), the FDIC-supervised institution may change its election only with prior approval of the FDIC.

(2) *Advanced approaches FDIC-supervised institution.* An advanced approaches FDIC-supervised institution must calculate the exposure amount for all its derivative contracts using SA–CCR in § 324.132(c) for purposes of standardized total risk-weighted assets. An advanced approaches FDIC-supervised institution must apply the treatment of cleared transactions under § 324.133 to its derivative contracts that are cleared transactions and to all default fund contributions associated with such derivative contracts for purposes of standardized total risk-weighted assets.

(b) *Current exposure methodology exposure amount*—(1) *Single OTC derivative contract.* Except as modified by paragraph (c) of this section, the exposure amount for a single OTC derivative contract that is not subject to a qualifying master netting agreement is equal to the sum of the FDIC-supervised institution's current credit exposure and potential future credit exposure (PFE) on the OTC derivative contract.

(i) *Current credit exposure.* The current credit exposure for a single OTC derivative contract is the greater of the fair value of the OTC derivative contract or zero.

(ii) *PFE.* (A) The PFE for a single OTC derivative contract, including an OTC derivative contract with a negative fair value, is calculated by multiplying the notional principal amount of the OTC derivative contract by the appropriate conversion factor in Table 1 to this section.

(B) For purposes of calculating either the PFE under this paragraph (b)(1)(ii) or the gross PFE under paragraph (b)(2)(ii)(A) of this section for exchange rate contracts and other similar contracts in which the notional principal amount is equivalent to the cash flows, notional principal amount is the net receipts to each party falling due on each value date in each currency.

(C) For an OTC derivative contract that does not fall within one of the specified categories in Table 1 to this section, the PFE must be calculated using the appropriate ''other'' conversion factor.

(D) A FDIC-supervised institution must use an OTC derivative contract's effective notional principal amount (that is, the apparent or stated notional principal amount multiplied by any multiplier in the OTC derivative contract) rather than the apparent or stated notional principal amount in calculating PFE.

(E) The PFE of the protection provider of a credit derivative is capped at the net present value of the amount of unpaid premiums.

TABLE 1 TO § 324.34—CONVERSION FACTOR MATRIX FOR DERIVATIVE CONTRACTS [1]

Remaining maturity [2]	Interest rate	Foreign exchange rate and gold	Credit (investment grade reference asset) [3]	Credit (non-investment-grade reference asset)	Equity	Precious metals (except gold)	Other
One year or less	0.00	0.01	0.05	0.10	0.06	0.07	0.10
Greater than one year and less than or equal to five years	0.005	0.05	0.05	0.10	0.08	0.07	0.12
Greater than five years	0.015	0.075	0.05	0.10	0.10	0.08	0.15

[1] For a derivative contract with multiple exchanges of principal, the conversion factor is multiplied by the number of remaining payments in the derivative contract.

[2] For an OTC derivative contract that is structured such that on specified dates any outstanding exposure is settled and the terms are reset so that the fair value of the contract is zero, the remaining maturity equals the time until the next reset date. For an interest rate derivative contract with a remaining maturity of greater than one year that meets these criteria, the minimum conversion factor is 0.005.

[3] A FDIC-supervised institution must use the column labeled ''Credit (investment-grade reference asset)'' for a credit derivative whose reference asset is an outstanding unsecured long-term debt security without credit enhancement that is investment grade. A FDIC-supervised institution must use the column labeled ''Credit (non-investment-grade reference asset)'' for all other credit derivatives.

(2) *Multiple OTC derivative contracts subject to a qualifying master netting agreement.* Except as modified by paragraph (c) of this section, the exposure amount for multiple OTC derivative contracts subject to a qualifying master netting agreement is equal to the sum of the net current credit exposure and the adjusted sum of the PFE amounts for all OTC derivative contracts subject to the qualifying master netting agreement.

(i) *Net current credit exposure.* The net current credit exposure is the greater of the net sum of all positive and negative fair values of the individual OTC derivative contracts subject to the qualifying master netting agreement or zero.

(ii) *Adjusted sum of the PFE amounts.* The adjusted sum of the PFE amounts, Anet, is calculated as Anet = $(0.4 \times \text{Agross}) + (0.6 \times \text{NGR} \times \text{Agross})$, where:

(A) Agross = the gross PFE (that is, the sum of the PFE amounts as determined under paragraph (b)(1)(ii) of this section for each individual derivative contract subject to the qualifying master netting agreement); and

(B) Net-to-gross Ratio (NGR) = the ratio of the net current credit exposure to the gross current credit exposure. In calculating the NGR, the gross current credit exposure equals the sum of the positive current credit exposures (as determined under paragraph (b)(1)(i) of this section) of all individual derivative contracts subject to the qualifying master netting agreement.

(c) *Recognition of credit risk mitigation of collateralized OTC derivative contracts.* (1) A FDIC-supervised institution using CEM under paragraph (b) of this section may recognize the credit risk mitigation benefits of financial collateral that

secures an OTC derivative contract or multiple OTC derivative contracts subject to a qualifying master netting agreement (netting set) by using the simple approach in § 324.37(b).

(2) As an alternative to the simple approach, a FDIC-supervised institution using CEM under paragraph (b) of this section may recognize the credit risk mitigation benefits of financial collateral that secures such a contract or netting set if the financial collateral is marked-to-fair value on a daily basis and subject to a daily margin maintenance requirement by applying a risk weight to the uncollateralized portion of the exposure, after adjusting the exposure amount calculated under paragraph (b)(1) or (2) of this section using the collateral haircut approach in § 324.37(c). The FDIC-supervised institution must substitute the exposure amount calculated under paragraph (b)(1) or (2) of this section for ΣE in the equation in § 324.37(c)(2).

(d) *Counterparty credit risk for credit derivatives*—(1) *Protection purchasers.* A FDIC-supervised institution that purchases a credit derivative that is recognized under § 324.36 as a credit risk mitigant for an exposure that is not a covered position under subpart F of this part is not required to compute a separate counterparty credit risk capital requirement under this subpart provided that the FDIC-supervised institution does so consistently for all such credit derivatives. The FDIC-supervised institution must either include all or exclude all such credit derivatives that are subject to a qualifying master netting agreement from any measure used to determine counterparty credit risk exposure to all relevant counterparties for risk-based capital purposes.

(2) *Protection providers.* (i) A FDIC-supervised institution that is the protection provider under a credit derivative must treat the credit derivative as an exposure to the underlying reference asset. The FDIC-supervised institution is not required to compute a counterparty credit risk capital requirement for the credit derivative under this subpart, provided that this treatment is applied consistently for all such credit derivatives. The FDIC-supervised institution must either include all or exclude all such credit derivatives that are subject to a qualifying master netting agreement from any measure used to determine counterparty credit risk exposure.

(ii) The provisions of this paragraph (d)(2) apply to all relevant counterparties for risk-based capital purposes unless the FDIC-supervised institution is treating the credit derivative as a covered position under subpart F of this part, in which case the FDIC-supervised institution must compute a supplemental counterparty credit risk capital requirement under this section.

(e) *Counterparty credit risk for equity derivatives.* (1) A FDIC-supervised institution must treat an equity derivative contract as an equity exposure and compute a risk-weighted asset amount for the equity derivative contract under §§ 324.51 through 324.53 (unless the FDIC-supervised institution is treating the contract as a covered position under subpart F of this part).

(2) In addition, the FDIC-supervised institution must also calculate a risk-based capital requirement for the counterparty credit risk of an equity derivative contract under this section if the FDIC-supervised institution is treating the contract as a covered position under subpart F of this part.

(3) If the FDIC-supervised institution risk weights the contract under the Simple Risk-Weight Approach (SRWA) in § 324.52, the FDIC-supervised institution may choose not to hold risk-based capital against the counterparty credit risk of the equity derivative contract, as long as it does so for all such contracts. Where the equity derivative contracts are subject to a qualified master netting agreement, a FDIC-supervised institution using the SRWA must either include all or exclude all of the contracts from any measure used to determine counterparty credit risk exposure.

(f) *Clearing member FDIC-supervised institution's exposure amount.* The exposure amount of a clearing member FDIC-supervised institution using CEM under paragraph (b) of this section for a client-facing derivative transaction or netting set of client-facing derivative transactions equals the exposure amount calculated according to paragraph (b)(1) or (2) of this section multiplied by the scaling factor the square root of ½ (which equals 0.707107). If the FDIC-supervised institution determines that a longer period is appropriate, the FDIC-supervised institution must use a larger scaling factor to adjust for a longer holding period as follows:

$$\text{Scaling factor} = \sqrt{\frac{H}{10}}$$

Where H = the holding period greater than or equal to five days. Additionally, the FDIC may require the FDIC-supervised institution to set a longer holding period if the FDIC determines that a longer period is appropriate due to the nature, structure, or characteristics of the transaction or is commensurate with the risks associated with the transaction.

■ 31. Section 324.35 is amended by adding paragraph (a)(3), revising paragraph (b)(4)(i), and adding paragraph (c)(3)(iii) to read as follows:

§ 324.35 Cleared transactions.

(a) * * *

(3) *Alternate requirements.* Notwithstanding any other provision of this section, an advanced approaches FDIC-supervised institution or a FDIC-supervised institution that is not an advanced approaches FDIC-supervised institution and that has elected to use SA–CCR under § 324.34(a)(1) must apply § 324.133 to its derivative contracts that are cleared transactions rather than this section.

(b) * * *

(4) * * *

(i) Notwithstanding any other requirements in this section, collateral posted by a clearing member client FDIC-supervised institution that is held by a custodian (in its capacity as custodian) in a manner that is bankruptcy remote from the CCP, clearing member, and other clearing member clients of the clearing member, is not subject to a capital requirement under this section.

* * * * *

(c) * * *

(3) * * *

(iii) Notwithstanding paragraphs (c)(3)(i) and (ii) of this section, a clearing member FDIC-supervised institution may apply a risk weight of zero percent to the trade exposure amount for a cleared transaction with a CCP where the clearing member FDIC-supervised institution is acting as a financial intermediary on behalf of a clearing member client, the transaction offsets another transaction that satisfies the requirements set forth in § 324.3(a), and the clearing member FDIC-supervised institution is not obligated to reimburse the clearing member client in the event of the CCP default.

* * * * *

■ 32. Section 324.37 is amended by revising paragraphs (c)(3)(iii), (c)(3)(iv)(A) and (C), (c)(4)(i)(B) introductory text, and (c)(4)(i)(B)(*1*) to read as follows:

§ 324.37 Collateralized transactions.

* * * * *

(c) * * *

(3) * * *

(iii) For repo-style transactions and client-facing derivative transactions, a

FDIC-supervised institution may multiply the standard supervisory haircuts provided in paragraphs (c)(3)(i) and (ii) of this section by the square root of ½ (which equals 0.707107). For client-facing derivative transactions, if a larger scaling factor is applied under § 324.34(f), the same factor must be used to adjust the supervisory haircuts.

(iv) * * *

(A) T_M equals a holding period of longer than 10 business days for eligible margin loans and derivative contracts other than client-facing derivative transactions or longer than 5 business days for repo-style transactions and client-facing derivative transactions;

* * * * *

(C) T_S equals 10 business days for eligible margin loans and derivative contracts other than client-facing derivative transactions or 5 business days for repo-style transactions and client-facing derivative transactions.

* * * * *

(4) * * *

(i) * * *

(B) The minimum holding period for a repo-style transaction and client-facing derivative transaction is five business days and for an eligible margin loan and a derivative contract other than a client-facing derivative transaction is ten business days except for transactions or netting sets for which paragraph (c)(4)(i)(C) of this section applies. When a FDIC-supervised institution calculates an own-estimates haircut on a T_N-day holding period, which is different from the minimum holding period for the transaction type, the applicable haircut (H_M) is calculated using the following square root of time formula:

* * * * *

(*1*) T_M equals 5 for repo-style transactions and client-facing derivative transactions and 10 for eligible margin loans and derivative contracts other than client-facing derivative transactions;

* * * * *

§§ 324.134, 324.202, and 324.210 [Amended]

■ 33. For each section listed in the following table, the footnote number listed in the ''Old footnote number'' column is redesignated as the footnote number listed in the ''New footnote number'' column as follows:

Section	Old footnote number	New footnote number
324.134(d)(3)	30	31
324.202, paragraph (1) introductory text of the definition of ''Covered position''	31	32
324.202, paragraph (1)(i) of the definition of ''Covered position''	32	33
324.210(e)(1)	33	34

■ 34. Section 324.132 is amended by:

■ a. Revising paragraphs (b)(2)(ii)(A)(*3*) through (*5*);

■ b. Adding paragraphs (b)(2)(ii)(A)(*6*) and (*7*);

■ c. Revising paragraphs (c) heading and (c)(1) and (2) and (5) through (8);

■ d. Adding paragraphs (c)(9) through (11);

■ e. Revising paragraph (d)(10)(i);

■ f. In paragraphs (e)(5)(i)(A) and (H), removing ''Table 3 to § 324.132'' and adding in its pace ''Table 4 to this section'';

■ g. In paragraphs (e)(5)(i)(C) and (e)(6)(i)(B), removing ''current exposure methodology'' and adding in its place ''standardized approach for counterparty credit risk'' wherever it appears;

■ h. Redesignating Table 3 to § 324.132 following paragraph (e)(5)(ii) as Table 4 to § 324.132; and

■ i. Revising paragraph (e)(6)(viii).

The revisions and additions read as follows:

§ 324.132 Counterparty credit risk of repo-style transactions, eligible margin loans, and OTC derivative contracts.

* * * * *

(b) * * *

(2) * * *

(ii) * * *

(A) * * *

(*3*) For repo-style transactions and client-facing derivative transactions, a FDIC-supervised institution may multiply the supervisory haircuts provided in paragraphs (b)(2)(ii)(A)(*1*) and (*2*) of this section by the square root of ½ (which equals 0.707107). If the FDIC-supervised institution determines that a longer holding period is appropriate for client-facing derivative transactions, then it must use a larger scaling factor to adjust for the longer holding period pursuant to paragraph (b)(2)(ii)(A)(*6*) of this section.

(*4*) A FDIC-supervised institution must adjust the supervisory haircuts upward on the basis of a holding period longer than ten business days (for eligible margin loans) or five business days (for repo-style transactions), using the formula provided in paragraph (b)(2)(ii)(A)(*6*) of this section where the conditions in this paragraph (b)(2)(ii)(A)(*4*) apply. If the number of trades in a netting set exceeds 5,000 at any time during a quarter, a FDIC-supervised institution must adjust the supervisory haircuts upward on the basis of a minimum holding period of twenty business days for the following quarter (except when a FDIC-supervised institution is calculating EAD for a cleared transaction under § 324.133). If a netting set contains one or more trades involving illiquid collateral, a FDIC-supervised institution must adjust the supervisory haircuts upward on the basis of a minimum holding period of twenty business days. If over the two previous quarters more than two margin disputes on a netting set have occurred that lasted longer than the holding period, then the FDIC-supervised institution must adjust the supervisory haircuts upward for that netting set on the basis of a minimum holding period that is at least two times the minimum holding period for that netting set.

(*5*)(*i*) A FDIC-supervised institution must adjust the supervisory haircuts upward on the basis of a holding period longer than ten business days for collateral associated with derivative contracts (five business days for client-facing derivative contracts) using the formula provided in paragraph (b)(2)(ii)(A)(*6*) of this section where the conditions in this paragraph (b)(2)(ii)(A)(*5*)(*i*) apply. For collateral associated with a derivative contract that is within a netting set that is composed of more than 5,000 derivative contracts that are not cleared transactions, a FDIC-supervised institution must use a minimum holding period of twenty business days. If a netting set contains one or more trades involving illiquid collateral or a derivative contract that cannot be easily replaced, a FDIC-supervised institution must use a minimum holding period of twenty business days.

(*ii*) Notwithstanding paragraph (b)(2)(ii)(A)(*1*) or (*3*) or (b)(2)(ii)(A)(*5*)(*i*) of this section, for collateral associated with a derivative contract in a netting set under which more than two margin disputes that lasted longer than the holding period occurred during the two previous quarters, the minimum holding

period is twice the amount provided under paragraph (b)(2)(ii)(A)(*1*) or (*3*) or (b)(2)(ii)(A)(*5*)(*i*) of this section.

(*6*) A FDIC-supervised institution must adjust the standard supervisory haircuts upward, pursuant to the adjustments provided in paragraphs (b)(2)(ii)(A)(*3*) through (*5*) of this section, using the following formula:

$$H_A = H_S \sqrt{\frac{T_M}{T_S}}$$

Where:

T_M equals a holding period of longer than 10 business days for eligible margin loans and derivative contracts other than client-facing derivative transactions or longer than 5 business days for repo-style transactions and client-facing derivative transactions;

Hs equals the standard supervisory haircut; and

Ts equals 10 business days for eligible margin loans and derivative contracts other than client-facing derivative transactions or 5 business days for repo-style transactions and client-facing derivative transactions.

(*7*) If the instrument a FDIC-supervised institution has lent, sold subject to repurchase, or posted as collateral does not meet the definition of financial collateral, the FDIC-supervised institution must use a 25.0 percent haircut for market price volatility (Hs).

* * * * *

(c) *EAD for derivative contracts*—(1) *Options for determining EAD.* A FDIC-supervised institution must determine the EAD for a derivative contract using the standardized approach for counterparty credit risk (SA–CCR) under paragraph (c)(5) of this section or using the internal models methodology described in paragraph (d) of this section. If a FDIC-supervised institution elects to use SA–CCR for one or more derivative contracts, the exposure amount determined under SA–CCR is the EAD for the derivative contract or derivatives contracts. A FDIC-supervised institution must use the same methodology to calculate the exposure amount for all its derivative contracts and may change its election only with prior approval of the FDIC. A FDIC-supervised institution may reduce the EAD calculated according to paragraph (c)(5) of this section by the credit valuation adjustment that the FDIC-supervised institution has recognized in its balance sheet valuation of any derivative contracts in the netting set. For purposes of this paragraph (c)(1), the credit valuation adjustment does not include any adjustments to common equity tier 1 capital attributable to changes in the fair value of the FDIC-supervised institution's liabilities that are due to changes in its own credit risk since the inception of the transaction with the counterparty.

(2) *Definitions.* For purposes of this paragraph (c) of this section, the following definitions apply:

(i) *End date* means the last date of the period referenced by an interest rate or credit derivative contract or, if the derivative contract references another instrument, by the underlying instrument, except as otherwise provided in paragraph (c) of this section.

(ii) S*tart date* means the first date of the period referenced by an interest rate or credit derivative contract or, if the derivative contract references the value of another instrument, by underlying instrument, except as otherwise provided in paragraph (c) of this section.

(iii) *Hedging set* means:

(A) With respect to interest rate derivative contracts, all such contracts within a netting set that reference the same reference currency;

(B) With respect to exchange rate derivative contracts, all such contracts within a netting set that reference the same currency pair;

(C) With respect to credit derivative contract, all such contracts within a netting set;

(D) With respect to equity derivative contracts, all such contracts within a netting set;

(E) With respect to a commodity derivative contract, all such contracts within a netting set that reference one of the following commodity categories: Energy, metal, agricultural, or other commodities;

(F) With respect to basis derivative contracts, all such contracts within a netting set that reference the same pair of risk factors and are denominated in the same currency; or

(G) With respect to volatility derivative contracts, all such contracts within a netting set that reference one of interest rate, exchange rate, credit, equity, or commodity risk factors, separated according to the requirements under paragraphs (c)(2)(iii)(A) through (E) of this section.

(H) If the risk of a derivative contract materially depends on more than one of interest rate, exchange rate, credit, equity, or commodity risk factors, the FDIC may require a FDIC-supervised institution to include the derivative contract in each appropriate hedging set under paragraphs (c)(2)(iii)(A) through (E) of this section.

* * * * *

(5) *Exposure amount.* (i) The exposure amount of a netting set, as calculated under paragraph (c) of this section, is equal to 1.4 multiplied by the sum of the replacement cost of the netting set, as calculated under paragraph (c)(6) of this section, and the potential future exposure of the netting set, as calculated under paragraph (c)(7) of this section.

(ii) Notwithstanding the requirements of paragraph (c)(5)(i) of this section, the exposure amount of a netting set subject to a variation margin agreement, excluding a netting set that is subject to a variation margin agreement under which the counterparty to the variation margin agreement is not required to post variation margin, is equal to the lesser of the exposure amount of the netting set calculated under paragraph (c)(5)(i) of this section and the exposure amount of the netting set calculated as if the netting set were not subject to a variation margin agreement.

(iii) Notwithstanding the requirements of paragraph (c)(5)(i) of this section, the exposure amount of a netting set that consists of only sold options in which the premiums have been fully paid by the counterparty to the options and where the options are not subject to a variation margin agreement is zero.

(iv) Notwithstanding the requirements of paragraph (c)(5)(i) of this section, the exposure amount of a netting set in which the counterparty is a commercial end-user is equal to the sum of replacement cost, as calculated under paragraph (c)(6) of this section, and the potential future exposure of the netting set, as calculated under paragraph (c)(7) of this section.

(v) For purposes of the exposure amount calculated under paragraph (c)(5)(i) of this section and all calculations that are part of that exposure amount, a FDIC-supervised institution may elect, at the netting set level, to treat a derivative contract that is a cleared transaction that is not subject to a variation margin agreement as one that is subject to a variation margin agreement, if the derivative contract is subject to a requirement that the counterparties make daily cash payments to each other to account for changes in the fair value of the derivative contract and to reduce the net position of the contract to zero. If a FDIC-supervised institution makes an election under this paragraph (c)(5)(v) for one derivative contract, it must treat all other derivative contracts within the same netting set that are eligible for an

election under this paragraph (c)(5)(v) as derivative contracts that are subject to a variation margin agreement.

(vi) For purposes of the exposure amount calculated under paragraph (c)(5)(i) of this section and all calculations that are part of that exposure amount, a FDIC-supervised institution may elect to treat a credit derivative contract, equity derivative contract, or commodity derivative contract that references an index as if it were multiple derivative contracts each referencing one component of the index.

(6) *Replacement cost of a netting set*—(i) *Netting set subject to a variation margin agreement under which the counterparty must post variation margin.* The replacement cost of a netting set subject to a variation margin agreement, excluding a netting set that is subject to a variation margin agreement under which the counterparty is not required to post variation margin, is the greater of:

(A) The sum of the fair values (after excluding any valuation adjustments) of the derivative contracts within the netting set less the sum of the net independent collateral amount and the variation margin amount applicable to such derivative contracts;

(B) The sum of the variation margin threshold and the minimum transfer amount applicable to the derivative contracts within the netting set less the net independent collateral amount applicable to such derivative contracts; or

(C) Zero.

(ii) *Netting sets not subject to a variation margin agreement under which the counterparty must post variation margin.* The replacement cost of a netting set that is not subject to a variation margin agreement under which the counterparty must post variation margin to the FDIC-supervised institution is the greater of:

(A) The sum of the fair values (after excluding any valuation adjustments) of the derivative contracts within the netting set less the sum of the net independent collateral amount and variation margin amount applicable to such derivative contracts; or

(B) Zero.

(iii) *Multiple netting sets subject to a single variation margin agreement.* Notwithstanding paragraphs (c)(6)(i) and (ii) of this section, the replacement cost for multiple netting sets subject to a single variation margin agreement must be calculated according to paragraph (c)(10)(i) of this section.

(iv) *Netting set subject to multiple variation margin agreements or a hybrid netting set.* Notwithstanding paragraphs (c)(6)(i) and (ii) of this section, the replacement cost for a netting set subject to multiple variation margin agreements or a hybrid netting set must be calculated according to paragraph (c)(11)(i) of this section.

(7) *Potential future exposure of a netting set.* The potential future exposure of a netting set is the product of the PFE multiplier and the aggregated amount.

(i) *PFE multiplier.* The PFE multiplier is calculated according to the following formula:

$$PFE\ multiplier = min\left\{1; 0.05 + 0.95 * e^{\left(\frac{V-C}{1.9*A}\right)}\right\}$$

Where:

V is the sum of the fair values (after excluding any valuation adjustments) of the derivative contracts within the netting set;

C is the sum of the net independent collateral amount and the variation margin amount applicable to the derivative contracts within the netting set; and

A is the aggregated amount of the netting set.

(ii) *Aggregated amount.* The aggregated amount is the sum of all hedging set amounts, as calculated under paragraph (c)(8) of this section, within a netting set.

(iii) *Multiple netting sets subject to a single variation margin agreement.* Notwithstanding paragraphs (c)(7)(i) and (ii) of this section and when calculating the potential future exposure for purposes of total leverage exposure under § 324.10(c)(4)(ii)(B), the potential future exposure for multiple netting sets subject to a single variation margin agreement must be calculated according to paragraph (c)(10)(ii) of this section.

(iv) *Netting set subject to multiple variation margin agreements or a hybrid netting set.* Notwithstanding paragraphs (c)(7)(i) and (ii) of this section and when calculating the potential future exposure for purposes of total leverage exposure under § 324.10(c)(4)(ii)(B), the potential future exposure for a netting set subject to multiple variation margin agreements or a hybrid netting set must be calculated according to paragraph (c)(11)(ii) of this section.

(8) *Hedging set amount*—(i) *Interest rate derivative contracts.* To calculate the hedging set amount of an interest rate derivative contract hedging set, a FDIC-supervised institution may use either of the formulas provided in paragraphs (c)(8)(i)(A) and (B) of this section:

(A) Formula 1 is as follows:

$$Hedging\ set\ amount = [(AddOn_{TB1}^{IR})^2 + (AddOn_{TB2}^{IR})^2 + (AddOn_{TB3}^{IR})^2 + 1.4 * AddOn_{TB1}^{IR} * AddOn_{TB2}^{IR} + 1.4 * AddOn_{TB2}^{IR} * AddOn_{TB3}^{IR} + 0.6 * AddOn_{TB1}^{IR} * AddOn_{TB3}^{IR})]^{\frac{1}{2}};\ \text{or}$$

(B) Formula 2 is as follows:

$$Hedging\ set\ amount = |AddOn_{TB1}{}^{IR}| + |AddOn_{TB2}{}^{IR} + |AddOn_{TB3}{}^{IR}|.$$

Where in paragraphs (c)(8)(i)(A) and (B) of this section:

$AddOn_{TB1}{}^{IR}$ is the sum of the adjusted derivative contract amounts, as calculated under paragraph (c)(9) of this section, within the hedging set with an end date of less than one year from the present date;

$AddOn_{TB2}{}^{IR}$ is the sum of the adjusted derivative contract amounts, as calculated under paragraph (c)(9) of this section, within the hedging set with an end date of one to five years from the present date; and

$AddOn_{TB3}{}^{IR}$ is the sum of the adjusted derivative contract amounts, as calculated under paragraph (c)(9) of this section, within the hedging set with an end date of more than five years from the present date.

(ii) *Exchange rate derivative contracts.* For an exchange rate derivative contract hedging set, the hedging set amount equals the absolute value of the sum of the adjusted derivative contract amounts, as calculated under paragraph (c)(9) of this section, within the hedging set.

(iii) *Credit derivative contracts and equity derivative contracts.* The hedging set amount of a credit derivative contract hedging set or equity derivative contract hedging set within a netting set is calculated according to the following formula:

$$Hedging\ set\ amount = \left[\left(\sum_{k=1}^{K} \rho_k * AddOn(Ref_k)\right)^2 + \sum_{k=1}^{K}\left(1 - (\rho_k)^2\right) * \left(AddOn(Ref_k)\right)^2\right]^{\frac{1}{2}}$$

Where:

k is each reference entity within the hedging set.

K is the number of reference entities within the hedging set.

$AddOn(Ref_k)$ equals the sum of the adjusted derivative contract amounts, as determined under paragraph (c)(9) of this section, for all derivative contracts within the hedging set that reference reference entity k.

ρ_k equals the applicable supervisory correlation factor, as provided in Table 2 to this section.

(iv) *Commodity derivative contracts.* The hedging set amount of a commodity derivative contract hedging set within a netting set is calculated according to the following formula:

$$Hedging\ set\ amount = \left[\left(\rho * \sum_{k=1}^{K} AddOn(Type_k)\right)^2 + (1 - (\rho)^2) * \sum_{k=1}^{K}\left(AddOn(Type_k)\right)^2\right]^{\frac{1}{2}}$$

Where:

k is each commodity type within the hedging set.

K is the number of commodity types within the hedging set.

$AddOn(Type_k)$ equals the sum of the adjusted derivative contract amounts, as determined under paragraph (c)(9) of this section, for all derivative contracts within the hedging set that reference commodity type k.

ρ equals the applicable supervisory correlation factor, as provided in Table 2 to this section.

(v) *Basis derivative contracts and volatility derivative contracts.* Notwithstanding paragraphs (c)(8)(i) through (iv) of this section, a FDIC-supervised institution must calculate a separate hedging set amount for each basis derivative contract hedging set and each volatility derivative contract hedging set. A FDIC-supervised institution must calculate such hedging set amounts using one of the formulas under paragraphs (c)(8)(i) through (iv) that corresponds to the primary risk factor of the hedging set being calculated.

(9) *Adjusted derivative contract amount*—(i) *Summary.* To calculate the adjusted derivative contract amount of a derivative contract, a FDIC-supervised institution must determine the adjusted notional amount of derivative contract, pursuant to paragraph (c)(9)(ii) of this section, and multiply the adjusted notional amount by each of the supervisory delta adjustment, pursuant to paragraph (c)(9)(iii) of this section, the maturity factor, pursuant to paragraph (c)(9)(iv) of this section, and the applicable supervisory factor, as provided in Table 2 to this section.

(ii) *Adjusted notional amount.* (A)(*1*) For an interest rate derivative contract or a credit derivative contract, the adjusted notional amount equals the product of the notional amount of the derivative contract, as measured in U.S. dollars using the exchange rate on the date of the calculation, and the supervisory duration, as calculated by the following formula:

$$\text{Supervisory duration} = max\left\{\frac{e^{-0.05*\left(\frac{S}{250}\right)} - e^{-0.05*\left(\frac{E}{250}\right)}}{0.05}, 0.04\right\}$$

Where:

S is the number of business days from the present day until the start date of the derivative contract, or zero if the start date has already passed; and

E is the number of business days from the present day until the end date of the derivative contract.

(*2*) For purposes of paragraph (c)(9)(ii)(A)(*1*) of this section:

(*i*) For an interest rate derivative contract or credit derivative contract that is a variable notional swap, the notional amount is equal to the time-weighted average of the contractual notional amounts of such a swap over the remaining life of the swap; and

(*ii*) For an interest rate derivative contract or a credit derivative contract that is a leveraged swap, in which the notional amount of all legs of the derivative contract are divided by a factor and all rates of the derivative contract are multiplied by the same factor, the notional amount is equal to the notional amount of an equivalent unleveraged swap.

(B)(*1*) For an exchange rate derivative contract, the adjusted notional amount is the notional amount of the non-U.S. denominated currency leg of the derivative contract, as measured in U.S. dollars using the exchange rate on the date of the calculation. If both legs of the exchange rate derivative contract are denominated in currencies other than

U.S. dollars, the adjusted notional amount of the derivative contract is the largest leg of the derivative contract, as measured in U.S. dollars using the exchange rate on the date of the calculation.

(*2*) Notwithstanding paragraph (c)(9)(ii)(B)(*1*) of this section, for an exchange rate derivative contract with multiple exchanges of principal, the FDIC-supervised institution must set the adjusted notional amount of the derivative contract equal to the notional amount of the derivative contract multiplied by the number of exchanges of principal under the derivative contract.

(C)(*1*) For an equity derivative contract or a commodity derivative contract, the adjusted notional amount is the product of the fair value of one unit of the reference instrument underlying the derivative contract and the number of such units referenced by the derivative contract.

(*2*) Notwithstanding paragraph (c)(9)(ii)(C)(*1*) of this section, when calculating the adjusted notional amount for an equity derivative contract or a commodity derivative contract that is a volatility derivative contract, the FDIC-supervised institution must replace the unit price with the underlying volatility referenced by the volatility derivative contract and replace the number of units with the notional amount of the volatility derivative contract.

(iii) *Supervisory delta adjustments.* (A) For a derivative contract that is not an option contract or collateralized debt obligation tranche, the supervisory delta adjustment is 1 if the fair value of the derivative contract increases when the value of the primary risk factor increases and -1 if the fair value of the derivative contract decreases when the value of the primary risk factor increases.

(B)(*1*) For a derivative contract that is an option contract, the supervisory delta adjustment is determined by the following formulas, as applicable:

Table 2 to §324.132--Supervisory Delta Adjustment for Options Contracts

	Bought	Sold
Call Options	$\Phi\left(\frac{\ln\left(\frac{P+\lambda}{K+\lambda}\right)+0.5*\sigma^2*T/250}{\sigma*\sqrt{T/250}}\right)$	$-\Phi\left(\frac{\ln\left(\frac{P+\lambda}{K+\lambda}\right)+0.5*\sigma^2*T/250}{\sigma*\sqrt{T/250}}\right)$
Put Options	$-\Phi\left(-\frac{\ln\left(\frac{P+\lambda}{K+\lambda}\right)+0.5*\sigma^2*T/250}{\sigma*\sqrt{T/250}}\right)$	$\Phi\left(-\frac{\ln\left(\frac{P+\lambda}{K+\lambda}\right)+0.5*\sigma^2*T/250}{\sigma*\sqrt{T/250}}\right)$

(*2*) As used in the formulas in Table 2 to this section:

(*i*) Φ is the standard normal cumulative distribution function;

(*ii*) P equals the current fair value of the instrument or risk factor, as applicable, underlying the option;

(*iii*) K equals the strike price of the option;

(*iv*) T equals the number of business days until the latest contractual exercise date of the option;

(*v*) λ equals zero for all derivative contracts except interest rate options for the currencies where interest rates have negative values. The same value of λ must be used for all interest rate options that are denominated in the same currency. To determine the value of λ for a given currency, a FDIC-supervised institution must find the lowest value L of P and K of all interest rate options in a given currency that the FDIC-supervised institution has with all counterparties. Then, λ is set according to this formula: $\lambda = max\{-L + 0.1\%, 0\}$; and

(*vi*) σ equals the supervisory option volatility, as provided in Table 3 to this section.

(C)(*1*) For a derivative contract that is a collateralized debt obligation tranche, the supervisory delta adjustment is determined by the following formula:

$$\text{Supervisory delta adjustment} = \frac{15}{(1+14*A)*(1+14*D)}$$

(*2*) As used in the formula in paragraph (c)(9)(iii)(C)(*1*) of this section:

(*i*) A is the attachment point, which equals the ratio of the notional amounts of all underlying exposures that are subordinated to the FDIC-supervised institution's exposure to the total notional amount of all underlying exposures, expressed as a decimal value between zero and one; [30]

(*ii*) D is the detachment point, which equals one minus the ratio of the notional amounts of all underlying exposures that are senior to the FDIC-supervised institution's exposure to the total notional amount of all underlying exposures, expressed as a decimal value between zero and one; and

(*iii*) The resulting amount is designated with a positive sign if the collateralized debt obligation tranche was purchased by the FDIC-supervised institution and is designated with a negative sign if the collateralized debt obligation tranche was sold by the FDIC-supervised institution.

(iv) *Maturity factor.* (A)(*1*) The maturity factor of a derivative contract that is subject to a variation margin agreement, excluding derivative contracts that are subject to a variation

[30] In the case of a first-to-default credit derivative, there are no underlying exposures that are subordinated to the FDIC-supervised institution's exposure. In the case of a second-or-subsequent-to-default credit derivative, the smallest (n − 1) notional amounts of the underlying exposures are subordinated to the FDIC-supervised institution's exposure.

margin agreement under which the counterparty is not required to post variation margin, is determined by the following formula:

$$\text{Maturity factor} = \frac{3}{2}\sqrt{\frac{MPOR}{250}}$$

Where MPOR refers to the period from the most recent exchange of collateral covering a netting set of derivative contracts with a defaulting counterparty until the derivative contracts are closed out and the resulting market risk is re-hedged.

(*2*) Notwithstanding paragraph (c)(9)(iv)(A)(*1*) of this section:

(*i*) For a derivative contract that is not a client-facing derivative transaction, MPOR cannot be less than ten business days plus the periodicity of re-margining expressed in business days minus one business day;

(*ii*) For a derivative contract that is a client-facing derivative transaction, MPOR cannot be less than five business days plus the periodicity of re-margining expressed in business days minus one business day; and

(*iii*) For a derivative contract that is within a netting set that is composed of more than 5,000 derivative contracts that are not cleared transactions, or a netting set that contains one or more trades involving illiquid collateral or a derivative contract that cannot be easily replaced, MPOR cannot be less than twenty business days.

(*3*) Notwithstanding paragraphs (c)(9)(iv)(A)(*1*) and (*2*) of this section, for a netting set subject to two or more outstanding disputes over margin that lasted longer than the MPOR over the previous two quarters, the applicable floor is twice the amount provided in (c)(9)(iv)(A)(*1*) and (*2*) of this section.

(B) The maturity factor of a derivative contract that is not subject to a variation margin agreement, or derivative contracts under which the counterparty is not required to post variation margin, is determined by the following formula:

$$\text{Maturity factor} = \sqrt{\frac{\min\{M;250\}}{250}}$$

Where M equals the greater of 10 business days and the remaining maturity of the contract, as measured in business days.

(C) For purposes of paragraph (c)(9)(iv) of this section, if a FDIC-supervised institution has elected pursuant to paragraph (c)(5)(v) of this section to treat a derivative contract that is a cleared transaction that is not subject to a variation margin agreement as one that is subject to a variation margin agreement, the Board-regulated institution must treat the derivative contract as subject to a variation margin agreement with maturity factor as determined according to (c)(9)(iv)(A) of this section, and daily settlement does not change the end date of the period referenced by the derivative contract.

(v) *Derivative contract as multiple effective derivative contracts.* A FDIC-supervised institution must separate a derivative contract into separate derivative contracts, according to the following rules:

(A) For an option where the counterparty pays a predetermined amount if the value of the underlying asset is above or below the strike price and nothing otherwise (binary option), the option must be treated as two separate options. For purposes of paragraph (c)(9)(iii)(B) of this section, a binary option with strike K must be represented as the combination of one bought European option and one sold European option of the same type as the original option (put or call) with the strikes set equal to 0.95 * K and 1.05 * K so that the payoff of the binary option is reproduced exactly outside the region between the two strikes. The absolute value of the sum of the adjusted derivative contract amounts of the bought and sold options is capped at the payoff amount of the binary option.

(B) For a derivative contract that can be represented as a combination of standard option payoffs (such as collar, butterfly spread, calendar spread, straddle, and strangle), a FDIC-supervised institution must treat each standard option component must be treated as a separate derivative contract.

(C) For a derivative contract that includes multiple-payment options, (such as interest rate caps and floors), a FDIC-supervised institution may represent each payment option as a combination of effective single-payment options (such as interest rate caplets and floorlets).

(D) A FDIC-supervised institution may not decompose linear derivative contracts (such as swaps) into components.

(10) *Multiple netting sets subject to a single variation margin agreement*—(i) *Calculating replacement cost.* Notwithstanding paragraph (c)(6) of this section, a FDIC-supervised institution shall assign a single replacement cost to multiple netting sets that are subject to a single variation margin agreement under which the counterparty must post variation margin, calculated according to the following formula:

$$\textit{Replacement Cost} = max\{\Sigma_{NS}\ max\{V_{NS};0\} - max\{C_{MA};0\};0\} + max\{\Sigma_{NS}\ min\{V_{NS};0\} - min\{C_{MA};0\};0\}$$

Where:

NS is each netting set subject to the variation margin agreement MA;

V_{NS} is the sum of the fair values (after excluding any valuation adjustments) of the derivative contracts within the netting set NS; and

C_{MA} is the sum of the net independent collateral amount and the variation margin amount applicable to the derivative contracts within the netting sets subject to the single variation margin agreement.

(ii) *Calculating potential future exposure.* Notwithstanding paragraph (c)(5) of this section, a FDIC-supervised institution shall assign a single potential future exposure to multiple netting sets that are subject to a single variation margin agreement under which the counterparty must post variation margin equal to the sum of the potential future exposure of each such netting set, each calculated according to paragraph (c)(7) of this section as if such nettings sets were not subject to a variation margin agreement.

(11) *Netting set subject to multiple variation margin agreements or a hybrid netting set*—(i) *Calculating replacement cost.* To calculate replacement cost for either a netting set subject to multiple variation margin agreements under which the counterparty to each variation margin agreement must post variation margin, or a netting set composed of at least one derivative contract subject to variation margin agreement under which the counterparty must post variation margin and at least one derivative contract that is not subject to such a variation margin agreement, the calculation for replacement cost is provided under paragraph (c)(6)(i) of this section, except that the variation margin threshold equals the sum of the variation margin thresholds of all variation margin agreements within the netting set and the minimum transfer amount equals the sum of the minimum transfer amounts of all the variation margin agreements within the netting set.

(ii) *Calculating potential future exposure.* (A) To calculate potential future exposure for a netting set subject to multiple variation margin agreements under which the counterparty to each variation margin agreement must post variation margin, or a netting set composed of at least one derivative contract subject to variation margin agreement under which the counterparty to the derivative contract must post variation margin and at least one derivative contract that is not subject to such a variation margin agreement, a FDIC-supervised institution must divide the netting set

into sub-netting sets (as described in paragraph (c)(11)(ii)(B) of this section) and calculate the aggregated amount for each sub-netting set. The aggregated amount for the netting set is calculated as the sum of the aggregated amounts for the sub-netting sets. The multiplier is calculated for the entire netting set.

(B) For purposes of paragraph (c)(11)(ii)(A) of this section, the netting set must be divided into sub-netting sets as follows:

(*1*) All derivative contracts within the netting set that are not subject to a variation margin agreement or that are subject to a variation margin agreement under which the counterparty is not required to post variation margin form a single sub-netting set. The aggregated amount for this sub-netting set is calculated as if the netting set is not subject to a variation margin agreement.

(*2*) All derivative contracts within the netting set that are subject to variation margin agreements in which the counterparty must post variation margin and that share the same value of the MPOR form a single sub-netting set. The aggregated amount for this sub-netting set is calculated as if the netting set is subject to a variation margin agreement, using the MPOR value shared by the derivative contracts within the netting set.

TABLE 3 TO § 324.132—SUPERVISORY OPTION VOLATILITY, SUPERVISORY CORRELATION PARAMETERS, AND SUPERVISORY FACTORS FOR DERIVATIVE CONTRACTS

Asset class	Subclass	Type	Supervisory option volatility (percent)	Supervisory correlation factor (percent)	Supervisory factor [1] (percent)
Interest rate	N/A	N/A	50	N/A	0.50
Exchange rate	N/A	N/A	15	N/A	4.0
Credit, single name	Investment grade	N/A	100	50	0.46
	Speculative grade	N/A	100	50	1.3
	Sub-speculative grade	N/A	100	50	6.0
Credit, index	Investment Grade	N/A	80	80	0.38
	Speculative Grade	N/A	80	80	1.06
Equity, single name	N/A	N/A	120	50	32
Equity, index	N/A	N/A	75	80	20
Commodity	Energy	Electricity	150	40	40
		Other	70	40	18
	Metals	N/A	70	40	18
	Agricultural	N/A	70	40	18
	Other	N/A	70	40	18

[1] The applicable supervisory factor for basis derivative contract hedging sets is equal to one-half of the supervisory factor provided in this Table 3, and the applicable supervisory factor for volatility derivative contract hedging sets is equal to 5 times the supervisory factor provided in this Table 3.

(d) * * *

(10) * * *

(i) With prior written approval of the FDIC, a FDIC-supervised institution may set EAD equal to a measure of counterparty credit risk exposure, such as peak EAD, that is more conservative than an alpha of 1.4 times the larger of $EPE_{unstressed}$ and $EPE_{stressed}$ for every counterparty whose EAD will be measured under the alternative measure of counterparty exposure. The FDIC-supervised institution must demonstrate the conservatism of the measure of counterparty credit risk exposure used for EAD. With respect to paragraph (d)(10)(i) of this section:

(A) For material portfolios of new OTC derivative products, the FDIC-supervised institution may assume that the standardized approach for counterparty credit risk pursuant to paragraph (c) of this section meets the conservatism requirement of this section for a period not to exceed 180 days.

(B) For immaterial portfolios of OTC derivative contracts, the FDIC-supervised institution generally may assume that the standardized approach for counterparty credit risk pursuant to paragraph (c) of this section meets the conservatism requirement of this section.

* * * * *

(e) * * *

(6) * * *

(viii) If a FDIC-supervised institution uses the standardized approach for counterparty credit risk pursuant to paragraph (c) of this section to calculate the EAD for any immaterial portfolios of OTC derivative contracts, the FDIC-supervised institution must use that EAD as a constant EE in the formula for the calculation of CVA with the maturity equal to the maximum of:

(A) Half of the longest maturity of a transaction in the netting set; and

(B) The notional weighted average maturity of all transactions in the netting set.

■ 35. Section 324.133 is amended by revising paragraphs (a), (b)(1) through (3), (b)(4)(i), (c)(1) through (3), (c)(4)(i), and (d) to read as follows:

§ 324.133 Cleared transactions.

(a) *General requirements*—(1) *Clearing member clients.* A FDIC-supervised institution that is a clearing member client must use the methodologies described in paragraph (b) of this section to calculate risk-weighted assets for a cleared transaction.

(2) *Clearing members.* A FDIC-supervised institution that is a clearing member must use the methodologies described in paragraph (c) of this section to calculate its risk-weighted assets for a cleared transaction and paragraph (d) of this section to calculate its risk-weighted assets for its default fund contribution to a CCP.

(b) * * *

(1) *Risk-weighted assets for cleared transactions.* (i) To determine the risk-weighted asset amount for a cleared transaction, a FDIC-supervised institution that is a clearing member client must multiply the trade exposure amount for the cleared transaction, calculated in accordance with paragraph (b)(2) of this section, by the risk weight appropriate for the cleared transaction, determined in accordance with paragraph (b)(3) of this section.

(ii) A clearing member client FDIC-supervised institution's total risk-weighted assets for cleared transactions is the sum of the risk-weighted asset amounts for all of its cleared transactions.

(2) *Trade exposure amount.* (i) For a cleared transaction that is a derivative contract or a netting set of derivative contracts, trade exposure amount equals the EAD for the derivative contract or netting set of derivative contracts calculated using the methodology used to calculate EAD for derivative contracts set forth in § 324.132(c) or (d), plus the fair value of the collateral posted by the clearing member client FDIC-supervised institution and held by the CCP or a clearing member in a manner that is not bankruptcy remote. When the FDIC-supervised institution calculates EAD for the cleared transaction using the methodology in § 324.132(d), EAD equals $EAD_{unstressed}$.

(ii) For a cleared transaction that is a repo-style transaction or netting set of repo-style transactions, trade exposure amount equals the EAD for the repo-style transaction calculated using the methodology set forth in § 324.132(b)(2) or (3) or (d), plus the fair value of the collateral posted by the clearing member client FDIC-supervised institution and held by the CCP or a clearing member in a manner that is not bankruptcy remote. When the FDIC-supervised institution calculates EAD for the cleared transaction under § 324.132(d), EAD equals $EAD_{unstressed}$.

(3) *Cleared transaction risk weights.* (i) For a cleared transaction with a QCCP, a clearing member client FDIC-supervised institution must apply a risk weight of:

(A) 2 percent if the collateral posted by the FDIC-supervised institution to the QCCP or clearing member is subject to an arrangement that prevents any loss to the clearing member client FDIC-supervised institution due to the joint default or a concurrent insolvency, liquidation, or receivership proceeding of the clearing member and any other clearing member clients of the clearing member; and the clearing member client FDIC-supervised institution has conducted sufficient legal review to conclude with a well-founded basis (and maintains sufficient written documentation of that legal review) that in the event of a legal challenge (including one resulting from an event of default or from liquidation, insolvency, or receivership proceedings) the relevant court and administrative authorities would find the arrangements to be legal, valid, binding, and enforceable under the law of the relevant jurisdictions.

(B) 4 percent, if the requirements of paragraph (b)(3)(i)(A) of this section are not met.

(ii) For a cleared transaction with a CCP that is not a QCCP, a clearing member client FDIC-supervised institution must apply the risk weight applicable to the CCP under subpart D of this part.

(4) * * *

(i) Notwithstanding any other requirement of this section, collateral posted by a clearing member client FDIC-supervised institution that is held by a custodian (in its capacity as a custodian) in a manner that is bankruptcy remote from the CCP, clearing member, and other clearing member clients of the clearing member, is not subject to a capital requirement under this section.

* * * * *

(c) * * *

(1) *Risk-weighted assets for cleared transactions.* (i) To determine the risk-weighted asset amount for a cleared transaction, a clearing member FDIC-supervised institution must multiply the trade exposure amount for the cleared transaction, calculated in accordance with paragraph (c)(2) of this section by the risk weight appropriate for the cleared transaction, determined in accordance with paragraph (c)(3) of this section.

(ii) A clearing member FDIC-supervised institution's total risk-weighted assets for cleared transactions is the sum of the risk-weighted asset amounts for all of its cleared transactions.

(2) *Trade exposure amount.* A clearing member FDIC-supervised institution must calculate its trade exposure amount for a cleared transaction as follows:

(i) For a cleared transaction that is a derivative contract or a netting set of derivative contracts, trade exposure amount equals the EAD calculated using the methodology used to calculate EAD for derivative contracts set forth in § 324.132(c) or (d), plus the fair value of the collateral posted by the clearing member FDIC-supervised institution and held by the CCP in a manner that is not bankruptcy remote. When the clearing member FDIC-supervised institution calculates EAD for the cleared transaction using the methodology in § 324.132(d), EAD equals $EAD_{unstressed}$.

(ii) For a cleared transaction that is a repo-style transaction or netting set of repo-style transactions, trade exposure amount equals the EAD calculated under § 324.132(b)(2) or (3) or (d), plus the fair value of the collateral posted by the clearing member FDIC-supervised institution and held by the CCP in a manner that is not bankruptcy remote. When the clearing member FDIC-supervised institution calculates EAD for the cleared transaction under § 324.132(d), EAD equals $EAD_{unstressed}$.

(3) *Cleared transaction risk weights.* (i) A clearing member FDIC-supervised institution must apply a risk weight of 2 percent to the trade exposure amount for a cleared transaction with a QCCP.

(ii) For a cleared transaction with a CCP that is not a QCCP, a clearing member FDIC-supervised institution must apply the risk weight applicable to the CCP according to subpart D of this part.

(iii) Notwithstanding paragraphs (c)(3)(i) and (ii) of this section, a clearing member FDIC-supervised institution may apply a risk weight of zero percent to the trade exposure amount for a cleared transaction with a QCCP where the clearing member FDIC-supervised institution is acting as a financial intermediary on behalf of a clearing member client, the transaction offsets another transaction that satisfies the requirements set forth in § 324.3(a), and the clearing member FDIC-supervised institution is not obligated to reimburse the clearing member client in the event of the QCCP default.

(4) * * *

(i) Notwithstanding any other requirement of this section, collateral posted by a clearing member FDIC-supervised institution that is held by a custodian (in its capacity as a custodian) in a manner that is bankruptcy remote from the CCP, clearing member, and other clearing member clients of the clearing member, is not subject to a capital requirement under this section.

* * * * *

(d) *Default fund contributions*—(1) *General requirement.* A clearing member FDIC-supervised institution must determine the risk-weighted asset amount for a default fund contribution to a CCP at least quarterly, or more frequently if, in the opinion of the FDIC-supervised institution or the FDIC, there is a material change in the financial condition of the CCP.

(2) *Risk-weighted asset amount for default fund contributions to nonqualifying CCPs.* A clearing member FDIC-supervised institution's risk-weighted asset amount for default fund contributions to CCPs that are not QCCPs equals the sum of such default fund contributions multiplied by 1,250 percent, or an amount determined by the FDIC, based on factors such as size, structure, and membership characteristics of the CCP and riskiness of its transactions, in cases where such default fund contributions may be unlimited.

(3) *Risk-weighted asset amount for default fund contributions to QCCPs.* A clearing member FDIC-supervised institution's risk-weighted asset amount

for default fund contributions to QCCPs equals the sum of its capital requirement, K_{CM} for each QCCP, as calculated under the methodology set forth in paragraph (d)(4) of this section, multiplied by 12.5.

(4) *Capital requirement for default fund contributions to a QCCP.* A clearing member FDIC-supervised institution's capital requirement for its default fund contribution to a QCCP (K_{CM}) is equal to:

$$K_{CM} = \max\{K_{CCP} * \left(\frac{DF^{pref}}{DF_{CCP}+DF^{pref}_{CCPCM}}\right); 0.16\, percent * DF^{pref}\}$$

Where:

K_{CCP} is the hypothetical capital requirement of the QCCP, as determined under paragraph (d)(5) of this section;

DF^{pref} is the prefunded default fund contribution of the clearing member FDIC-supervised institution to the QCCP;

DF_{CCP} is the QCCP's own prefunded amounts that are contributed to the default waterfall and are junior or pari passu with prefunded default fund contributions of clearing members of the CCP; and

$DF_{CM}{}^{pref}$ is the total prefunded default fund contributions from clearing members of the QCCP to the QCCP.

(5) *Hypothetical capital requirement of a QCCP.* Where a QCCP has provided its K_{CCP}, a FDIC-supervised institution must rely on such disclosed figure instead of calculating K_{CCP} under this paragraph (d)(5), unless the FDIC-supervised institution determines that a more conservative figure is appropriate based on the nature, structure, or characteristics of the QCCP. The hypothetical capital requirement of a QCCP (K_{CCP}), as determined by the FDIC-supervised institution, is equal to:

$$K_{CCP} = \Sigma_{CM_i} EAD_i * 1.6\ percent$$

Where:

CM_i is each clearing member of the QCCP; and

EAD_i is the exposure amount of each clearing member of the QCCP to the QCCP, as determined under paragraph (d)(6) of this section.

(6) *EAD of a clearing member FDIC-supervised institution to a QCCP.* (i) The EAD of a clearing member FDIC-supervised institution to a QCCP is equal to the sum of the EAD for derivative contracts determined under paragraph (d)(6)(ii) of this section and the EAD for repo-style transactions determined under paragraph (d)(6)(iii) of this section.

(ii) With respect to any derivative contracts between the FDIC-supervised institution and the CCP that are cleared transactions and any guarantees that the FDIC-supervised institution has provided to the CCP with respect to performance of a clearing member client on a derivative contract, the EAD is equal to the exposure amount for all such derivative contracts and guarantees of derivative contracts calculated under SA–CCR in § 324.132(c) (or, with respect to a CCP located outside the United States, under a substantially identical methodology in effect in the jurisdiction) using a value of 10 business days for purposes of § 324.132(c)(9)(iv); less the value of all collateral held by the CCP posted by the clearing member FDIC-supervised institution or a clearing member client of the FDIC-supervised institution in connection with a derivative contract for which the FDIC-supervised institution has provided a guarantee to the CCP and the amount of the prefunded default fund contribution of the FDIC-supervised institution to the CCP.

(iii) With respect to any repo-style transactions between the FDIC-supervised institution and the CCP that are cleared transactions, EAD is equal to:

$$EAD = \max\{EBRM - IM - DF; 0\}$$

Where:

EBRM is the sum of the exposure amounts of each repo-style transaction between the FDIC-supervised institution and the CCP as determined under § 324.132(b)(2) and without recognition of any collateral securing the repo-style transactions;

IM is the initial margin collateral posted by the FDIC-supervised institution to the CCP with respect to the repo-style transactions; and

DF is the prefunded default fund contribution of the FDIC-supervised institution to the CCP that is not already deducted in paragraph (d)(6)(ii) of this section.

(iv) EAD must be calculated separately for each clearing member's sub-client accounts and sub-house account (*i.e.,* for the clearing member's proprietary activities). If the clearing member's collateral and its client's collateral are held in the same default fund contribution account, then the EAD of that account is the sum of the EAD for the client-related transactions within the account and the EAD of the house-related transactions within the account. For purposes of determining such EADs, the independent collateral of the clearing member and its client must be allocated in proportion to the respective total amount of independent collateral posted by the clearing member to the QCCP.

(v) If any account or sub-account contains both derivative contracts and repo-style transactions, the EAD of that account is the sum of the EAD for the derivative contracts within the account and the EAD of the repo-style transactions within the account. If independent collateral is held for an account containing both derivative contracts and repo-style transactions, then such collateral must be allocated to the derivative contracts and repo-style transactions in proportion to the respective product specific exposure amounts, calculated, excluding the effects of collateral, according to § 324.132(b) for repo-style transactions and to § 324.132(c)(5) for derivative contracts.

(vi) Notwithstanding any other provision of paragraph (d) of this section, with the prior approval of the FDIC, a FDIC-supervised institution may determine the risk-weighted asset amount for a default fund contribution to a QCCP according to § 324.35(d)(3)(ii).

■ 36. Section 324.173 is amended in Table 13 to § 324.173 by revising line 4 under Part 2, Derivative exposures, to read as follows:

§ 324.173 Disclosures by certain advanced approaches FDIC-supervised institutions and Category III FDIC-supervised institutions.

* * * * *

TABLE 13 TO § 324.173—SUPPLEMENTARY LEVERAGE RATIO

	Dollar amounts in thousands			
	Tril	Bil	Mil	Thou
* * * *	*	*	*	
Part 2: Supplementary leverage ratio				
* * * *	*	*	*	
Derivative exposures				
* * * *	*	*		
4 Current exposure for derivative exposures (that is, net of cash variation margin).				
* * * *	*	*	*	

■ 37. Section 324.300 is amended by adding paragraphs (g) and (h) to read as follows:

§ 324.300 Transitions.

* * * * *

(g) *SA–CCR.* An advanced approaches FDIC-supervised institution may use CEM rather than SA–CCR for purposes of §§ 324.34(a) and 324.132(c) until January 1, 2022. A FDIC-supervised institution must provide prior notice to the FDIC if it decides to begin using SA–CCR before January 1, 2022. On January 1, 2022, and thereafter, an advanced approaches FDIC-supervised institution must use SA–CCR for purposes of §§ 324.34(a), 324.132(c), and 324.133(d). Once an advanced approaches FDIC-supervised institution has begun to use SA–CCR, the advanced approaches FDIC-supervised institution may not change to use CEM.

(h) *Default fund contributions.* Prior to January 1, 2022, a FDIC-supervised institution that calculates the exposure amounts of its derivative contracts under the standardized approach for counterparty credit risk in § 324.132(c) may calculate the risk-weighted asset amount for a default fund contribution to a QCCP under either method 1 under § 324.35(d)(3)(i) or method 2 under § 324.35(d)(3)(ii), rather than under § 324.133(d).

PART 327—ASSESSMENTS

■ 38. The authority citation for part 327 continues to read as follows:

Authority: 12 U.S.C. 1441, 1813, 1815, 1817–19, 1821.

■ 39. Appendix A to subpart A of part 327 is amended in section VI by revising the entries ''(2) Top 20 Counterparty Exposure/Tier 1 Capital and Reserves'' and ''(3) Largest Counterparty Exposure/Tier 1 Capital and Reserves'' to read as follows:

Appendix A to Subpart A of Part 327—Method To Derive Pricing Multipliers and Uniform Amount

* * * * *

VI. Description of Scorecard Measures

Scorecard measures [1]	Description
* * * * * * *	
(2) Top 20 Counterparty Exposure/Tier 1 Capital and Reserves.	Sum of the 20 largest total exposure amounts to counterparties divided by Tier 1 capital and reserves. The total exposure amount is equal to the sum of the institution's exposure amounts to one counterparty (or borrower) for derivatives, securities financing transactions (SFTs), and cleared transactions, and its gross lending exposure (including all unfunded commitments) to that counterparty (or borrower). A counterparty includes an entity's own affiliates. Exposures to entities that are affiliates of each other are treated as exposures to one counterparty (or borrower). Counterparty exposure excludes all counterparty exposure to the U.S. Government and departments or agencies of the U.S. Government that is unconditionally guaranteed by the full faith and credit of the United States. The exposure amount for derivatives, including OTC derivatives, cleared transactions that are derivative contracts, and netting sets of derivative contracts, must be calculated using the methodology set forth in 12 CFR 324.34(b), but without any reduction for collateral other than cash collateral that is all or part of variation margin and that satisfies the requirements of 12 CFR 324.10(c)(4)(ii)(C)(*1*)(*ii*) and (*iii*) and 324.10(c)(4)(ii)(C)(*3*) through (*7*). The exposure amount associated with SFTs, including cleared transactions that are SFTs, must be calculated using the standardized approach set forth in 12 CFR 324.37(b) or (c). For both derivatives and SFT exposures, the exposure amount to central counterparties must also include the default fund contribution.[2]

Scorecard measures [1]	Description
(3) Largest Counterparty Exposure/Tier 1 Capital and Reserves.	The largest total exposure amount to one counterparty divided by Tier 1 capital and reserves. The total exposure amount is equal to the sum of the institution's exposure amounts to one counterparty (or borrower) for derivatives, SFTs, and cleared transactions, and its gross lending exposure (including all unfunded commitments) to that counterparty (or borrower). A counterparty includes an entity's own affiliates. Exposures to entities that are affiliates of each other are treated as exposures to one counterparty (or borrower). Counterparty exposure excludes all counterparty exposure to the U.S. Government and departments or agencies of the U.S. Government that is unconditionally guaranteed by the full faith and credit of the United States. The exposure amount for derivatives, including OTC derivatives, cleared transactions that are derivative contracts, and netting sets of derivative contracts, must be calculated using the methodology set forth in 12 CFR 324.34(b), but without any reduction for collateral other than cash collateral that is all or part of variation margin and that satisfies the requirements of 12 CFR 324.10(c)(4)(ii)(C)(*1*)(*ii*) and (*iii*) and 324.10(c)(4)(ii)(C)(*3*) through (*7*). The exposure amount associated with SFTs, including cleared transactions that are SFTs, must be calculated using the standardized approach set forth in 12 CFR 324.37(b) or (c). For both derivatives and SFT exposures, the exposure amount to central counterparties must also include the default fund contribution.[2]

* * * * * * *

[1] The FDIC retains the flexibility, as part of the risk-based assessment system, without the necessity of additional notice-and-comment rulemaking, to update the minimum and maximum cutoff values for all measures used in the scorecard. The FDIC may update the minimum and maximum cutoff values for the higher-risk assets to Tier 1 capital and reserves ratio in order to maintain an approximately similar distribution of higher-risk assets to Tier 1 capital and reserves ratio scores as reported prior to April 1, 2013, or to avoid changing the overall amount of assessment revenue collected. 76 FR 10672, 10700 (February 25, 2011). The FDIC will review changes in the distribution of the higher-risk assets to Tier 1 capital and reserves ratio scores and the resulting effect on total assessments and risk differentiation between banks when determining changes to the cutoffs. The FDIC may update the cutoff values for the higher-risk assets to Tier 1 capital and reserves ratio more frequently than annually. The FDIC will provide banks with a minimum one quarter advance notice of changes in the cutoff values for the higher-risk assets to Tier 1 capital and reserves ratio with their quarterly deposit insurance invoice.

[2] EAD and SFTs are defined and described in the compilation issued by the Basel Committee on Banking Supervision in its June 2006 document, ''International Convergence of Capital Measurement and Capital Standards.'' The definitions are described in detail in Annex 4 of the document. Any updates to the Basel II capital treatment of counterparty credit risk would be implemented as they are adopted. *http://www.bis.org/publ/bcbs128.pdf.*

* * * * *

Dated: November 18, 2019.

Morris R. Morgan,

First Deputy Comptroller, Comptroller of the Currency.

By order of the Board of Governors of the Federal Reserve System, November 19, 2019.

Ann E. Misback,

Secretary of the Board.

Federal Deposit Insurance Corporation.

By order of the Board of Directors.

Dated at Washington, DC, on November 19, 2019.

Annmarie H. Boyd,

Assistant Executive Secretary.

[FR Doc. 2019–27249 Filed 1–23–20; 8:45 am]

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Part III

Securities and Exchange Commission

17 CFR Parts 239, 240, 249, et al.

Use of Derivatives by Registered Investment Companies and Business Development Companies; Required Due Diligence by Broker-Dealers and Registered Investment Advisers Regarding Retail Customers' Transactions in Certain Leveraged/Inverse Investment Vehicles; Proposed Rule

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 239, 240, 249, 270, 274 and 275

[Release No. 34–87607; IA–5413; IC–33704; File No. S7–24–15]

RIN 3235–AL60

Use of Derivatives by Registered Investment Companies and Business Development Companies; Required Due Diligence by Broker-Dealers and Registered Investment Advisers Regarding Retail Customers' Transactions in Certain Leveraged/Inverse Investment Vehicles

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission (the ''Commission'') is re-proposing rule 18f–4, a new exemptive rule under the Investment Company Act of 1940 (the ''Investment Company Act'') designed to address the investor protection purposes and concerns underlying section 18 of the Act and to provide an updated and more comprehensive approach to the regulation of funds' use of derivatives and the other transactions addressed in the proposed rule. The Commission is also proposing new rule 15*l*–2 under the Securities Exchange Act of 1934 (the ''Exchange Act'') and new rule 211(h)–1 under the Investment Advisers Act of 1940 (''Advisers Act'') (collectively, the ''sales practices rules''). In addition, the Commission is proposing new reporting requirements and amendments to Form N–PORT, Form N–LIQUID (which we propose to be re-titled as ''Form N–RN''), and Form N–CEN, which are designed to enhance the Commission's ability to effectively oversee funds' use of and compliance with the proposed rules, and for the Commission and the public to have greater insight into the impact that funds' use of derivatives would have on their portfolios. Finally, the Commission is proposing to amend rule 6c–11 under the Investment Company Act to allow certain leveraged/inverse ETFs that satisfy the rule's conditions to operate without the expense and delay of obtaining an exemptive order.

DATES: Comments should be submitted on or before March 24, 2020.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's internet comment form (*http://www.sec.gov/rules/proposed.shtml*); or
- Send an email to *rule-comments@sec.gov*. Please include File No. S7–24–15 on the subject line.

Paper Comments

- Send paper comments to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090.

All submissions should refer to File Number S7–24–15. 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 of submission. The Commission will post all comments on the Commission's website (*http://www.sec.gov/rules/proposed.shtml*). Comments are also 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. 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 publicly available.

Studies, memoranda, or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the Commission's website. To ensure direct electronic receipt of such notifications, sign up through the ''Stay Connected'' option at *www.sec.gov* to receive notifications by email.

FOR FURTHER INFORMATION CONTACT: Asaf Barouk, Attorney-Adviser; Joel Cavanaugh, Senior Counsel; John Lee, Senior Counsel; Sirimal Mukerjee, Senior Counsel; Amanda Hollander Wagner, Branch Chief; Thoreau Bartmann, Senior Special Counsel; or Brian McLaughlin Johnson, Assistant Director, at (202) 551–6792, Investment Company Regulation Office, Division of Investment Management; and with respect to proposed rule 15*l*–2, Kelly Shoop, Senior Counsel; or Lourdes Gonzalez, Assistant Chief Counsel; Office of Chief Counsel, Division of Trading and Markets; Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090.

SUPPLEMENTARY INFORMATION: Proposed rule 18f–4 would apply to mutual funds (other than money market funds), exchange-traded funds (''ETFs''), registered closed-end funds, and companies that have elected to be treated as business development companies (''BDCs'') under the Investment Company Act (collectively, ''funds''). It would permit these funds to enter into derivatives transactions and certain other transactions, notwithstanding the restrictions under sections 18 and 61 of the Investment Company Act, provided that the funds comply with the conditions of the rule. The proposed sales practices rules would require a broker, dealer, or investment adviser that is registered with (or required to be registered with) the Commission to exercise due diligence in approving a retail customer's or client's account to buy or sell shares of certain ''leveraged/inverse investment vehicles'' before accepting an order from, or placing an order for, the customer or client to engage in these transactions.

The Commission is proposing for public comment 17 CFR 270.18f–4 (new rule 18f–4) under the Investment Company Act, 17 CFR 240.15*l*–2 (new rule 15*l*–2) under the Exchange Act, 17 CFR 275.211(h)–1 (new rule 211(h)–1) under the Advisers Act; amendments to 17 CFR 270.6c–11 (rule 6c–11) under the Investment Company Act; amendments to Form N–PORT [referenced in 17 CFR 274.150], Form N–LIQUID (which we propose to re-title as ''Form N–RN'') [referenced in 17 CFR 274.223], Form N–CEN [referenced in 17 CFR 274.101], and Form N–2 [referenced in 17 CFR 274.11a–1] under the Investment Company Act.

Table of Contents

I. Introduction

The fund industry has grown and evolved substantially in past decades in response to various factors, including investor demand, technological developments, and an increase in domestic and international investment opportunities, both retail and institutional.[1] Funds today follow a broad variety of investment strategies and provide diverse investment opportunities for fund investors, including retail investors. As funds' strategies have become increasingly diverse, funds' use of derivatives has grown in both volume and complexity over the past several decades.[2] Derivatives may be broadly described as instruments or contracts whose value is based upon, or derived from, some other asset or metric.[3] Funds use derivatives for a variety of purposes. For example, funds use derivatives to seek higher returns through increased investment exposure, to hedge risks in their investment portfolios, or to obtain exposure to particular investments or markets more efficiently than may be

[1] For example, the investment company industry consisted of more than 3,500 investment companies, and held over $1.3 trillion in assets, as of the end of 1991. *See* SEC Division of Investment Management, Protecting Investors: A Half Century of Investment Company Regulation (1992), *available at https://www.sec.gov/divisions/investment/guidance/icreg50-92.pdf*. The assets held by U.S.-registered investment companies grew to approximately $7.1 trillion as of the end of 1999, and from then until the end of 2018 grew over 200%, to approximately $21.4 trillion. *See* Investment Company Institute, 2018 Investment Company Fact Book at 32, *available at https://www.icifactbook.org/deployedfiles/FactBook/Site%20Properties/pdf/2019/2019_factbook.pdf* . Similarly, the number of mutual funds, registered closed-end funds, and ETFs grew from 7,970, 512, and 30 (respectively) as of the end of 1999, to 9,599, 506, and 2,057 (respectively) as of the end of 2018. *See id.* at 50.

The diversity of fund strategies has also increased over time, including, more recently, the introduction of funds pursuing so-called ''alternative strategies'' (which tend to use derivatives more than other fund types). *See* Daniel Deli, Paul Hanouna, Christof Stahel, Yue Tang & William Yost, *Use of Derivatives by Registered Investment Companies, Division of Economic and Risk Analysis* (2015), *available at http://www.sec.gov/dera/staffpapers/white-papers/derivatives12-2015.pdf* (''DERA White Paper'').

[2] *See* Use of Derivatives by Registered Investment Companies and Business Development Companies, Investment Company Act Release No. 31933 (Dec. 11, 2015) [80 FR 80883 (Dec. 28, 2015)], at n.6 and accompanying text (''2015 Proposing Release'').

[3] The asset or metric on which the derivative's value is based, or from which its value is derived, is commonly referred to as the ''reference asset,'' ''underlying asset,'' or ''underlier.'' *See id.* at n.3 and accompanying text (citing Use of Derivatives by Investment Companies under the Investment Company Act of 1940, Investment Company Act Release No. 29776 (Aug. 31, 2011) [76 FR 55237 (Sept. 7, 2011)], at n.3 (''2011 Concept Release'')). The comment letters on the 2011 Concept Release (File No. S7–33–11) are *available at https://www.sec.gov/comments/s7-33-11/s73311.shtml*.

possible through direct investments.[4] At the same time, derivatives can introduce certain new risks and heighten certain risks to a fund and its investors. These risks can arise from, for example, leverage, liquidity, markets, operations, legal matters (*e.g.,* contract enforceability), and counterparties.

Funds using derivatives must consider requirements under the Investment Company Act of 1940.[5] These include sections 18 and 61 of the Investment Company Act, which limit a fund's ability to obtain leverage or incur obligations to persons other than the fund's common shareholders through the issuance of ''senior securities.'' [6] As we discuss more fully in this release, as derivatives markets have expanded and funds have increased their use of derivatives, the Commission and its staff have issued guidance addressing the use of specific derivatives instruments and practices, and other financial instruments, under section 18. In determining how they will comply with section 18, we understand that funds consider this Commission and staff guidance, as well as staff no-action letters and the practices that other funds disclose in their registration statements.[7]

In the absence of Commission rules and guidance that address the current broad range of funds' derivatives use, inconsistent industry practices have developed.[8] We are concerned that certain of these practices may not address investor protection concerns that underlie section 18's limitations on funds' issuance of senior securities. Specifically, certain fund practices can heighten leverage-related risks, such as the risk of potentially significant losses and increased fund volatility, that section 18 is designed to address. We are also concerned that funds' disparate practices could create an un-level competitive landscape and make it difficult for funds and our staff to evaluate funds' compliance with section 18.[9]

To address these concerns, in 2015 the Commission proposed new rule 18f–4 under the Investment Company Act, which would have permitted a fund to enter into derivatives transactions and ''financial commitment transactions,'' subject to certain conditions.[10] We received approximately 200 comment letters in response to the 2015 proposal.[11] In developing this re-proposal we considered those comment letters, as well as subsequent staff engagement with large and small fund complexes and investor groups.[12]

We are re-proposing rule 18f–4, which is designed to address the investor protection purposes and concerns underlying section 18 and to provide an updated and more comprehensive approach to the regulation of funds' use of derivatives transactions and certain other transactions. The proposed rule would permit funds to enter into these transactions, notwithstanding the restrictions under section 18 of the Investment Company Act, provided that they comply with the conditions of the rule. The proposed rule's conditions are designed to require funds to manage the risks associated with their use of derivatives and to limit fund leverage risk consistent with the investor protection purposes underlying section 18. Our proposal also includes requirements designed to address specific risks posed by certain registered investment companies and exchange-listed commodity- or currency-based trusts or funds that obtain leveraged or inverse exposure to an underlying index, generally on a daily basis.[13] The proposal also addresses funds' use of reverse repurchase agreements and similar transactions and certain so-called ''unfunded commitments.'' Finally, we propose to amend rule 6c–11 under the Investment Company Act to allow certain leveraged/inverse ETFs that satisfy that rule's conditions to operate without the expense and delay of obtaining an exemptive order. Together, the rules we are proposing are designed to promote funds' ability to continue to use derivatives in a broad variety of ways that serve investors, while responding to the concerns underlying section 18 of the Investment Company Act and promoting a more

[4] *See, e.g.,* My Nguyen, *Using Financial Derivatives to Hedge Against Currency Risk,* Arcada University of Applied Sciences (2012).

[5] 15 U.S.C. 80a (the ''Investment Company Act,'' or the ''Act''). Except in connection with our discussion of proposed rule 15*l*–2 under the Securities Exchange Act of 1934 and proposed rule 211(h)–1 under the Advisers Act or as otherwise noted, all references to statutory sections are to the Investment Company Act, and all references to rules under the Investment Company Act, including proposed rule 18f–4, will be to title 17, part 270 of the Code of Federal Regulations, 17 CFR part 270.

[6] *See infra* section I.B.1. Funds using derivatives must also comply with all other applicable statutory and regulatory requirements, such as other federal securities law provisions, the Internal Revenue Code, Regulation T of the Federal Reserve Board, and the rules and regulations of the Commodity Futures Trading Commission (the ''CFTC''). *See also* Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010) (the ''Dodd-Frank Act''), *available at http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf.*

Section 61 of the Investment Company Act makes section 18 of the Act applicable to BDCs, with certain modifications. *See infra* note 32 and accompanying text. Except as otherwise noted, or unless the context dictates otherwise, references in this release to section 18 of the Act should be read to refer also to section 61 with respect to BDCs.

[7] Any staff guidance or no-action letters discussed in this release represent the views of the staff of the Division of Investment Management. They are not a rule, regulation, or statement of the Commission. Furthermore, the Commission has neither approved nor disapproved their content. Staff guidance has no legal force or effect; it does not alter or amend applicable law; and it creates no new or additional obligations for any person.

[8] *See infra* section I.B.2.b (discussing the asset segregation practices funds have developed to ''cover'' their derivatives positions, which vary based on the type of derivatives transaction and with respect to the types of assets that funds segregate to cover their derivatives positions).

[9] *See, e.g.,* Comment Letter of the Investment Company Institute on the 2011 Concept Release (Nov. 7, 2011) (File No. S7–33–11) at n.19 (''ICI Concept Release Comment Letter'') (noting that funds segregate the notional amount of physically-settled futures contracts, while some funds disclose that they segregate only the marked-to-marked obligation in respect of cash-settled futures and agreeing with the concern reflected in the 2011 Concept Release that this ''results in differing treatment of arguably equivalent products'').

[10] For purposes of this release, we will refer to the version of rule 18f–4 that the Commission proposed in the 2015 Proposing Release as the ''2015 proposed rule.'' We will generally refer to rule 18f–4 as we propose it here as the ''proposed rule.''

The 2015 proposed rule included four principal elements for funds entering into derivatives transactions: (1) A requirement to comply with one of two alternative portfolio limitations designed to limit the amount of leverage a fund may obtain through derivatives and other senior securities transactions; (2) asset segregation for derivatives transactions, designed to enable a fund to meet its derivatives-related obligations; (3) a derivatives risk management program requirement for funds that engage in more than limited derivatives transactions or that use complex derivatives; and (4) reporting requirements regarding a fund's derivatives usage.

The 2015 proposed rule included different requirements for derivatives transactions and ''financial commitment transactions'' (collectively, reverse repurchase agreements, short sale borrowings, or any firm or standby commitment agreement or similar agreement). Rule 18f–4 as we propose it here does not separately define ''financial commitment transactions,'' although the proposed rule does address—either directly or indirectly—all of the types of transactions that composed that defined term in the 2015 proposed rule. *See infra* section II.

[11] The comment letters on the 2015 proposed rule (File No. S7–24–15) are *available at https://www.sec.gov/comments/s7-24-15/s72415.shtml.*

[12] *See also* Division of Economic and Risk Analysis, Memorandum re: Risk Adjustment and Haircut Schedules (Nov. 1, 2016), *available at https://www.sec.gov/comments/s7-24-15/s72415-260.pdf* (''2016 DERA Memo'').

[13] As discussed in more detail in section II.G, the proposed sales practices rules would cover transactions in ''leveraged/inverse investment vehicles,'' which include registered investment companies and certain exchange-listed commodity- or currency-based trusts or funds that seek, directly or indirectly, to provide investment returns that correspond to the performance of a market index by a specified multiple, or to provide investment returns that have an inverse relationship to the performance of a market index, over a predetermined period of time. For purposes of this release, we refer to leveraged, inverse, and leveraged inverse investment vehicles collectively as ''leveraged/inverse.''

modern and comprehensive framework for regulating funds' use of derivatives and the other transactions addressed in the proposed rule.

A. Overview of Funds' Use of Derivatives

Funds today use a variety of derivatives. These derivatives can reference a range of assets or metrics, such as: Stocks, bonds, currencies, interest rates, market indexes, currency exchange rates, or other assets or interests. Examples of derivatives that funds commonly use include forwards, futures, swaps, and options. Derivatives are often characterized as either exchange-traded or over-the-counter (''OTC'').[14]

A common characteristic of most derivatives is that they involve leverage or the potential for leverage. The Commission has stated that ''[l]everage exists when an investor achieves the right to a return on a capital base that exceeds the investment which he has personally contributed to the entity or instrument achieving a return.'' [15] Many fund derivatives transactions, such as futures, swaps, and written options, involve leverage or the potential for leverage because they enable the fund to magnify its gains and losses compared to the fund's investment, while also obligating the fund to make a payment or deliver assets to a counterparty under specified conditions.[16] Other derivatives transactions, such as purchased call options, provide the economic equivalent of leverage because they can magnify the fund's exposure beyond its investment but do not impose a payment obligation on the fund beyond its investment.[17]

Funds use derivatives both to obtain investment exposures as part of their investment strategies and to manage risk. A fund may use derivatives to gain, maintain, or reduce exposure to a market, sector, or security more quickly, and with lower transaction costs and portfolio disruption, than investing directly in the underlying securities.[18] A fund also may use derivatives to obtain exposure to reference assets for which it may be difficult or impractical for the fund to make a direct investment, such as commodities.[19] With respect to risk management, funds may employ derivatives to hedge interest rate, currency, credit, and other risks, as well as to hedge portfolio exposures.[20]

At the same time, a fund's derivatives use may entail risks relating to, for example, leverage, markets, operations, liquidity (particularly with respect to complex OTC derivatives), and counterparties, as well as legal risks.[21] A fund's investment adviser, therefore, must manage (and the board of directors oversee) the fund's derivatives use, consistent with the fund's investment objectives, policies, restrictions, and risk profile. Furthermore, a fund's investment adviser and board of directors must bear in mind the requirements of section 18 of the Investment Company Act, as well as the Act's other requirements, when considering the use of derivatives.

Section 18 is designed to limit the leverage a fund can obtain or incur through the issuance of senior securities. Although the leverage limitations in section 18 apply regardless of whether the relevant fund actually experiences significant losses, several recent examples involving significant losses illustrate how a fund's use of derivatives may raise the investor protection concerns underlying section 18. The 2015 proposal discussed several circumstances in which substantial and rapid losses resulted from a fund's investment in derivatives.[22] For example, one of these cases shows that further losses can result when a fund's portfolio securities decline in value at the same time that the fund is required to make additional payments under its derivatives contracts.[23]

Similarly, last year the LJM Preservation and Growth Fund liquidated after sustaining considerable losses (with its net asset value declining approximately 80% in two days) when market volatility spiked. The fund's principal investment strategy involved purchasing and selling call and put options on the Standard & Poor's (''S&P'') 500 Futures Index.[24] S&P 500 options prices are determined in part by market volatility, and a volatility spike in early February 2018 caused the fund to incur significant losses. The fund closed to new investments on February 7, 2018 and announced on February 27,

[14] Exchange-traded derivatives—such as futures, certain options, and options on futures—are standardized contracts traded on regulated exchanges. *See* 2015 Proposing Release, *supra* note 2, at nn.10–13 and accompanying text. OTC derivatives—such as certain swaps, non-exchange-traded options, and combination products such as swaptions and forward swaps—are contracts that parties negotiate and enter into outside of an organized exchange. *See id.* at nn.14–16 and accompanying text. Unlike exchange-traded derivatives, OTC derivatives may be significantly customized and may not be cleared by a central clearing organization. Title VII of the Dodd-Frank Act provides a comprehensive framework for the regulation of the OTC swaps market. *See supra* note 6.

[15] *See* Securities Trading Practices of Registered Investment Companies, Investment Company Act Release No. 10666 (Apr. 18, 1979) [44 FR 25128 (Apr. 27, 1979)], at n.5 (''Release 10666'').

[16] The leverage created by such an arrangement is sometimes referred to as ''indebtedness leverage.'' *See* 2015 Proposing Release, *supra* note 2, at n.21 (citing 2011 Concept Release, *supra* note 3, at n.31).

[17] This type of leverage is sometimes referred to as ''economic leverage.'' *See id.* at n.22 (citing 2011 Concept Release, *supra* note 3, at n.32).

[18] *See, e.g., id.* at n.24 and accompanying text (citing 2011 Concept Release, *supra* note 3, at section I).

[19] *See, e.g.,* Comment Letter of Stone Ridge Asset Management LLC (Mar. 28, 2016) (''[I]t is not possible for AVRPX [a Stone Ridge fund] to trade many of the physical assets underlying the derivatives included in our portfolio—Stone Ridge does not maintain facilities to store oil or live hogs, for example.''); Comment Letter of Vanguard (Mar. 28, 2016) (''Vanguard Comment Letter'') (stating that a fund may use a derivative, such as commodity futures, when it is impractical to take delivery of physical commodities).

[20] *See* 2015 Proposing Release, *supra* note 2, at n.25 and accompanying text; *see also* 2011 Concept Release, *supra* note 3, at section I.B.

[21] *See* 2015 Proposing Release, *supra* note 2, at n.26 and accompanying text (citing 2011 Concept Release, *supra* note 3, at n.34).

[22] *See* 2015 Proposing Release, *supra* note 2, at section II.D.1.d. (discussing, among other things, the following settled actions: In the Matter of OppenheimerFunds, Inc. and OppenheimerFunds Distributor, Inc., Investment Company Act Release No. 30099 (June 6, 2012) (settled action) (''OppenheimerFunds Settled Action'') (involving two mutual funds that suffered losses driven primarily by their exposure to certain commercial mortgage-backed securities, obtained mainly through total return swaps); In the Matter of Claymore Advisors, LLC, Investment Company Act Release No. 30308 (Dec. 19, 2012) and In the Matter of Fiduciary Asset Management, LLC, Investment Company Act Release No. 30309 (Dec. 19, 2012) (settled actions) (involving a registered closed-end fund that pursued an investment strategy involving written out-of-the-money put options and short variance swaps, which led to substantial losses for the fund); In the Matter of UBS Willow Management L.L.C. and UBS Fund Advisor L.L.C., Investment Company Act Release No. 31869 (Oct. 16, 2015) (settled action) (involving a registered closed-end fund that incurred significant losses due in part to large losses on the fund's credit default swap portfolio)).

See also In the Matter of Team Financial Asset Management, LLC, Team Financial Managers, Inc., and James L. Dailey, Investment Company Act Release No. 32951 (Dec. 22, 2017) (settled action) (involving a mutual fund incurring substantial losses arising out of speculative derivatives instruments, including losing $34.67 million in 2013 from trading in derivatives such as futures, options, and currency contracts); In the Matter of Mohammed Riad and Kevin Timothy Swanson, Investment Company Act Release No. 33338 (Dec. 21, 2018) (settled action) (involving a registered closed-end fund incurring substantial losses resulting from the implementation of a new derivatives trading strategy); In the Matter of Top Fund Management, Inc. and Barry C. Ziskin, Investment Company Act Release No. 30315 (Dec. 21, 2012) (settled action) (involving a mutual fund engaged in a strategy of buying options for speculative purposes contrary to its stated investment policy, which permitted options trading for hedging purposes, losing about 69% of its assets as a result of this activity before liquidating).

[23] *See* OppenheimerFunds Settled Action, *supra* note 22.

[24] *See* Prospectus, LJM Preservation and Growth Fund (Feb. 28, 2017), *available at https://www.sec.gov/Archives/edgar/data/1552947/000158064217001225/ljm485b.htm.*

2018 that it would liquidate its assets and dissolve on March 29, 2018.[25]

The losses suffered by this fund and in the other examples we discuss above are extreme. Funds rarely suffer such large and rapid losses. We note these examples to illustrate the rapid and extensive losses that can result from a fund's investments in derivatives absent effective derivatives risk management. In contrast, there are many other instances in which funds, by employing derivatives, have avoided losses, increased returns, and lowered risk.

B. Derivatives and the Senior Securities Restrictions of the Investment Company Act

1. Requirements of Section 18

Section 18 of the Investment Company Act imposes various limits on the capital structure of funds, including, in part, by restricting the ability of funds to issue ''senior securities.'' Protecting investors against the potentially adverse effects of a fund's issuance of senior securities, and in particular the risks associated with excessive leverage of investment companies, is a core purpose of the Investment Company Act.[26] ''Senior security'' is defined, in part, as ''any bond, debenture, note, or similar obligation or instrument constituting a security and evidencing indebtedness.'' [27]

Congress' concerns underlying the limits in section 18 focused on: (1) Excessive borrowing and the issuance of excessive amounts of senior securities by funds when these activities increase unduly the speculative character of funds' junior securities; (2) funds operating without adequate assets and reserves; and (3) potential abuse of the purchasers of senior securities.[28] To address these concerns, section 18 prohibits an open-end fund from issuing or selling any ''senior security,'' other than borrowing from a bank (subject to a requirement to maintain 300% ''asset coverage'').[29] Section 18 similarly prohibits a closed-end fund from issuing or selling any ''senior security [that] represents an indebtedness'' unless it has at least 300% ''asset coverage,'' although closed-end funds' ability to issue senior securities representing indebtedness is not limited to bank borrowings.[30] Closed-end funds also may issue senior securities that are a stock, subject to the limitations of section 18.[31] The Investment Company Act also subjects BDCs to the limitations of section 18 to the same extent as registered closed-end funds, except the applicable asset coverage amount for any senior security representing indebtedness is 200% (and can be decreased to 150% under certain circumstances).[32]

2. Evolution of Commission and Staff Consideration of Section 18 Restrictions as Applied to Funds' Use of Derivatives

a. Investment Company Act Release 10666

In a 1979 General Statement of Policy (Release 10666), the Commission considered the application of section 18's restrictions on the issuance of senior securities to reverse repurchase agreements, firm commitment agreements, and standby commitment agreements.[33] The Commission concluded that these agreements fall within the ''functional meaning of the term 'evidence of indebtedness' for purposes of Section 18 of the Investment Company Act,'' noting ''the unique legislative purposes and policies underlying Section 18 of the Act.'' [34] The Commission stated in Release 10666 that, for purposes of section 18, ''evidence of indebtedness'' would include ''all contractual obligations to pay in the future for consideration presently received.'' The Commission recognized that, while section 18 would generally prohibit open-end funds' use of reverse repurchase agreements, firm commitment agreements, and standby commitment agreements, the Commission nonetheless permitted funds to use these and similar arrangements subject to the constraints that Release 10666 describes.

These constraints relied on funds' use of ''segregated accounts'' to ''cover'' senior securities, which ''if properly created and maintained, would limit the investment company's risk of loss.'' [35] The Commission also stated that the segregated account functions as ''a practical limit on the amount of leverage which the investment company may undertake and on the potential increase in the speculative character of its outstanding common stock'' and that it ''[would] assure the availability of adequate funds to meet the obligations arising from such activities.'' [36] The

[25] *See* Supplement to the Prospectus dated Feb. 28, 2017, LJM Preservation and Growth Fund (Feb. 27, 2018), *available at https://www.sec.gov/Archives/edgar/data/1552947/000158064218001068/ljm497.htm.*

[26] *See, e.g.,* sections 1(b)(7), 1(b)(8), 18(a), and 18(f) of the Investment Company Act; *see also Provisions Of The Proposed Bill Related To Capital Structure (Sections 18, 19(B), And 21(C)),* Introduced by L.M.C Smith, Associate Counsel, Investment Trust Study, Securities and Exchange Commission, *Hearings on S.3580 Before a Subcommittee of the Senate Committee on Banking and Currency,* 76th Congress, 3rd session (1940), at 1028 (''Senate Hearings'') (''Because of the leverage influence, a substantial swing of the securities market is likely to deprive the common stock of a leverage investment company of both its asset and market value. . . . [H]ad investment companies been simple structure companies exclusively, a very substantial part of the losses sustained by investors in the common stock would have been avoided.'').

[27] *See* section 18(g) of the Investment Company Act. The definition of ''senior security'' in section 18(g) also includes ''any stock of a class having priority over any other class as to the distribution of assets or payment of dividends'' and excludes certain limited temporary borrowings.

[28] For discussion of the excessive borrowing concern, *see* section 1(b)(7) of the Investment Company Act; Release 10666, *supra* note 15, at n.8; *see also* Senate Hearings, *supra* note 26, at 1028 (''The Commission believes that it has been clearly shown that it is the leverage aspect of the senior-junior capital structure in investment companies . . . which may be held accountable for a large part of the losses which have been suffered by the investor who purchases the common stock of a leverage company.'').

For discussion of concerns regarding funds operating without adequate assets and reserves, *see* section 1(b)(8) of the Investment Company Act; Release 10666, *supra* note 15, at n.8.

For discussion of, among other things, potential abuse of the purchasers of senior securities, *see* Senate Hearings, *supra* note 26, at 265–78; *see also Mutual Funds and Derivative Instruments,* Division of Investment Management Memorandum transmitted by Chairman Levitt to Representatives Markey and Fields (Sept. 26, 1994), at 23, *available at http://www.sec.gov/news/studies/deriv.txt* (''1994 Letter to Congress'') (describing practices in the 1920s and 1930s that gave rise to section 18's limits on leverage).

[29] *See* section 18(f)(1) of the Investment Company Act. ''Asset coverage'' of a class of senior securities representing indebtedness of an issuer generally is defined in section 18(h) of the Investment Company Act as ''the ratio which the value of the total assets of such issuer, less all liabilities and indebtedness not represented by senior securities, bears to the aggregate amount of senior securities representing indebtedness of such issuer.'' Take, for example, an open-end fund with $100 in assets and with no liabilities or senior securities outstanding. The fund could, while maintaining the required coverage of 300% of the value of its assets, borrow an additional $50 from a bank. The $50 in borrowings would represent one-third of the fund's $150 in total assets, measured after the borrowing (or 50% of the fund's $100 net assets).

[30] *See* section 18(a)(1) of the Investment Company Act.

[31] *See* section 18(a)(2) of the Investment Company Act. If a closed-end fund issues or sells a class of senior securities that is a stock, it must have an asset coverage of at least 200% immediately after such issuance or sale. *Id.*

[32] *See* section 61(a)(1) of the Investment Company Act. BDCs, like registered closed-end funds, also may issue a senior security that is a stock (*e.g.,* preferred stock), subject to limitations in section 18. *See* sections 18(a)(2) and 61(a)(1) of the Investment Company Act. In 2018, Congress passed the Small Business Credit Availability Act, which, among other things, modified the statutory asset coverage requirements applicable to BDCs (permitting BDCs that meet certain specified conditions to elect to decrease their effective asset coverage requirement from 200% to 150%). *See* section 802 of the Small Business Credit Availability Act, Public Law 115–141, 132 Stat. 348 (2018).

[33] *See* Release 10666, *supra* note 15.

[34] *See id.*

[35] *See* 2015 Proposing Release, *supra* note 2, at nn.45–47 and accompanying text (discussing Release 10666's discussion of segregated accounts).

[36] *See* Release 10666, *supra* note 15, at 25132; *see also* 2015 Proposing Release, *supra* note 2, at n.48 and accompanying text.

Commission stated that its expressed views were not limited to the particular trading practices discussed, but that the Commission sought to address the implications of comparable trading practices that could similarly affect funds' capital structures.[37]

We continue to view the transactions described in Release 10666 as falling within the functional meaning of the term ''evidence of indebtedness,'' for purposes of section 18.[38] The trading practices that Release 10666 describes, as well as short sales of securities for which the staff initially developed the segregated account approach that the Commission applied in Release 10666, all impose on a fund a contractual obligation under which the fund is or may be required to pay or deliver assets in the future to a counterparty. These transactions therefore involve the issuance of a senior security for purposes of section 18.[39]

We apply the same analysis to all derivatives transactions that create future payment obligations. This is the case where the fund has a contractual obligation to pay or deliver cash or other assets to a counterparty in the future, either during the life of the instrument or at maturity or early termination.[40] As was the case for trading practices that Release 10666 describes, where the fund has entered into a derivatives transaction and has such a future payment obligation, we believe that such a transaction involves an evidence of indebtedness that is a senior security for purposes of section 18.[41]

The express scope of section 18 supports this interpretation. Section 18 defines the term ''senior security'' broadly to include instruments and transactions that other provisions of the federal securities laws might not otherwise consider to be securities.[42] For example, section 18(f)(1) generally prohibits an open-end fund from issuing or selling any senior security ''except [that the fund] shall be permitted to borrow from any bank.''[43] This statutory permission to engage in a specific borrowing makes clear that such borrowings are senior securities, which otherwise section 18 would prohibit absent this specific permission.[44]

This interpretation also is consistent with the fundamental policy and purposes underlying the Investment Company Act expressed in sections 1(b)(7) and 1(b)(8) of the Act.[45] These respectively declare that ''the national public interest and the interest of investors are adversely affected'' when funds ''by excessive borrowing and the issuance of excessive amounts of senior securities increase unduly the speculative character'' of securities issued to common shareholders and when funds ''operate without adequate assets or reserves.'' The Commission emphasized these concerns in Release 10666, and we continue to believe that the prohibitions and restrictions under the senior security provisions of section 18 should ''function as a practical limit on the amount of leverage which the investment company may undertake and on the potential increase in the speculative character of its outstanding common stock'' and that funds should not ''operate without adequate assets or reserves.''[46] Funds' use of derivatives, like the trading practices the Commission addressed in Release 10666, may raise the undue speculation and asset sufficiency concerns in section 1(b).[47] First, funds' obtaining

[37] *See* 2015 Proposing Release, *supra* note 2, at nn.49–50 and accompanying text.

[38] *See* Release 10666, *supra* note 15, at ''The Agreements as Securities'' discussion. The Investment Company Act's definition of the term ''security'' is broader than the term's definition in other federal securities laws. *See* 2015 Proposing Release, *supra* note 2, at n.61. *Compare* section 2(a)(36) of the Investment Company Act with sections 2(a)(1) and 2A of the Securities Act of 1933 (15 U.S.C. 77a *et seq.*) (''Securities Act'') and sections 3(a)(10) and 3A of the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*) (''Exchange Act''). *See also* 2011 Concept Release, *supra* note 3, at n.57 and accompanying text (explaining that the Commission has interpreted the term ''security'' in light of the policies and purposes underlying the Investment Company Act).

[39] *See* Release 10666, *supra* note 15, at ''The Agreements as Securities'' discussion; *see also* section 18(g) (defining the term ''senior security,'' in part, as ''any bond, debenture, note, or similar obligation or instrument constituting a security and evidencing indebtedness'').

The Commission received several comments on the 2015 proposal that objected to the Commission treating derivatives and financial commitment transactions as involving senior securities where a fund has ''appropriately'' covered its obligations under those transactions. These comments generally argued that this approach is not consistent with the Commission's views in Release 10666 and that funds have for many years addressed senior security concerns raised by these transactions by segregating assets or engaging in offsetting, or ''cover,'' transactions that take into account Release 10666 and staff guidance. *See, e.g.,* Comment Letter of the American Action Forum (Mar. 25, 2016) (''AAF Comment Letter''); Comment Letter of Financial Services Roundtable (Mar. 28, 2016) (''FSR Comment Letter''); Comment Letter of Franklin Resources, Inc. (Mar. 28, 2016) (''Franklin Resources Comment Letter''); Comment Letter of Dechert LLP (Mar. 28, 2016) (''Dechert Comment Letter''). Whether a transaction involves the issuance of a senior security will depend on whether that transaction involves a senior security within the meaning of section 18(g). A fund's segregation of assets, although one way to address policy concerns underlying section 18 as the Commission described in Release 10666, does not, itself, affect the legal question of whether a fund has issued a senior security.

[40] These payments—which may include payments of cash, or delivery of other assets—may occur as margin, as settlement payments, or otherwise.

[41] As the Commission explained in Release 10666, we believe that an evidence of indebtedness, for purposes of section 18, includes not only a firm and un-contingent obligation, but also a contingent obligation, such as a standby commitment or a ''put'' (or call) option sold by a fund. *See* Release 10666, *supra* note 15, at ''Standby Commitment Agreements'' discussion. We understand it has been asserted that a contingent obligation that a standby commitment or similar agreement creates does not involve a senior security under section 18, unless and until generally accepted accounting principles (''GAAP'') would require the fund to recognize the contingent obligation as a liability on the fund's financial statements. The treatment of derivatives transactions under GAAP, including whether the derivatives transaction constitutes a liability for financial statement purposes at any given time or the extent of the liability for that purpose, is not determinative with respect to whether the derivatives transaction involves the issuance of a senior security under section 18. This is consistent with the Commission's analysis of a fund's obligation, and the corresponding segregated asset amounts, under the trading practices that Release 10666 describes. *See id.*

[42] Consistent with Release 10666, and as the Commission stated in the 2015 Proposing Release, we are only expressing our views in this release concerning the scope of the term ''senior security'' in section 18 of the Investment Company Act. *See also* section 12(a) of the Investment Company Act (prohibiting funds from engaging in short sales in contravention of Commission rules or orders).

[43] Section 18(c)(2) similarly treats all promissory notes or evidences of indebtedness issued in consideration of any loan as senior securities except as section 18 otherwise specifically provides.

[44] The Commission similarly observed in Release 10666 that section 18(f)(1), ''by implication, treats all borrowings as senior securities,'' and that ''[s]ection 18(f)(1) of the Act prohibits such borrowings unless entered into with banks and only if there is 300% asset coverage on all borrowings of the investment company.'' *See* Release 10666, *supra* note 15, at ''Reverse Repurchase Agreements'' discussion.

[45] The Commission received several comments on the 2015 proposal asserting that the provisions in section 1(b) of the Investment Company Act do not, themselves, provide us authority to regulate senior securities transactions. *See, e.g.,* AAF Comment Letter; Franklin Resources Comment Letter; Comment Letter of the Securities Industry and Financial Markets Association (Mar. 28, 2016) (''SIFMA Comment Letter'').

The fundamental statutory policy and purposes underlying the Investment Company Act, as expressed in section 1(b) of the Act, inform our interpretation of the scope of the term ''senior security'' in section 18, as we discuss in the paragraph accompanying this note (and separately inform our consideration of appropriate conditions for the exemption that proposed rule 18f–4 provides, as we discuss in sections II.B–II.G *infra*). The authority under which we are proposing rules today is set forth in section VII of this release and includes, among other provisions, section 6(c) of the Act.

[46] *See* Release 10666, *supra* note 15, at ''Segregated Account'' discussion.

[47] As the Commission stated in Release 10666, leveraging an investment company's portfolio through the issuance of senior securities ''magnifies the potential for gain or loss on monies invested and therefore results in an increase in the speculative character of the investment company's outstanding securities'' and ''leveraging without

Continued

leverage (or potential for leverage) through derivatives may raise the Investment Company Act's undue speculation concern because a fund may experience gains and losses that substantially exceed the fund's investment, and also may incur a conditional or unconditional obligation to make a payment or deliver assets to a counterparty.[48] Not viewing derivatives that impose a future payment obligation on the fund as involving senior securities, subject to appropriate limits under section 18, would frustrate the concerns underlying section 18.[49]

Second, with respect to the Investment Company Act's asset sufficiency concern, a fund's use of derivatives with future payment obligations also may raise concerns regarding the fund's ability to meet those obligations. Many fund derivatives investments, such as futures contracts, swaps, and written options, pose a risk of loss that can result in payment obligations owed to the fund's counterparties.[50] Losses on derivatives therefore can result in counterparty payment obligations that directly affect the capital structure of a fund and the relative rights of the fund's counterparties and shareholders. These losses and payment obligations also can force a fund's adviser to sell the fund's investments to meet its obligations. When a fund uses derivatives to leverage its portfolio, this can amplify the risk of a fund having to sell its investments, potentially generating additional losses for the fund.[51] In an extreme situation, a fund could default on its payment obligations.[52]

b. Market and Industry Developments Following Release 10666

Following the issuance of Release 10666, Commission staff issued more than thirty no-action letters to funds concerning the maintenance of segregated accounts or otherwise ''covering'' their obligations in connection with various transactions otherwise restricted by section 18.[53] In these letters (issued primarily in the 1970s through 1990s) and through other staff guidance, Commission staff has addressed questions—generally on an instrument-by-instrument basis—regarding the application of the Commission's statements in Release 10666 to various types of derivatives and other transactions.

Funds have developed certain general asset segregation practices to cover their derivatives positions, based at least in part on the staff's no-action letters and guidance. Practices vary based on the type of derivatives transaction. For certain derivatives, funds generally segregate an amount equal to the full amount of the fund's potential obligation under the contract, or the full market value of the underlying reference asset for the derivative (''notional amount segregation'').[54] For certain cash-settled derivatives, funds often segregate an amount equal to the fund's daily mark-to-market liability, if any (''mark-to-market segregation'').[55]

Similarly, funds use different practices regarding the types of assets that they segregate to cover their derivatives positions. Release 10666 states that the assets eligible to be included in segregated accounts should be ''liquid assets'' such as cash, U.S. government securities, or other appropriate high-grade debt obligations.[56] However, a subsequent staff no-action letter stated that the staff would not recommend enforcement action if a fund were to segregate any liquid asset, including equity securities and non-investment grade debt securities, to cover its senior securities-related obligations.[57]

As a result of these asset segregation practices, funds' derivatives use—and thus funds' potential leverage through derivatives transactions—does not appear to be subject to a practical limit as the Commission contemplated in Release 10666. Funds' mark-to-market liability often does not reflect the full investment exposure associated with their derivatives positions.[58] As a result, a fund that segregates only the mark-to-market liability could theoretically incur virtually unlimited investment leverage.[59]

These current asset segregation practices also may not assure the

any significant limitation'' was identified ''as one of the major abuses of investment companies prior to the passage of the Act by Congress.'' *Id.*

[48] *See, e.g., The Report of the Task Force on Investment Company Use of Derivatives and Leverage,* Committee on Federal Regulation of Securities, ABA Section of Business Law (July 6, 2010), at 8 (''2010 ABA Derivatives Report'') (stating that ''[f]utures contracts, forward contracts, written options and swaps can produce a leveraging effect on a fund's portfolio'' because ''for a relatively small up-front payment made by a fund (or no up-front payment, in the case with many swaps and written options), the fund contractually obligates itself to one or more potential future payments until the contract terminates or expires''; noting, for example, that an ''[interest rate] swap presents the possibility that the fund will be required to make payments out of its assets'' and that ''[t]he same possibility exists when a fund writes puts and calls, purchases short and long futures and forwards, and buys or sells credit protection through [credit default swaps]'').

[49] One commenter on the 2011 Concept Release made this point directly. *See* Comment Letter of Stephen A. Keen on the 2011 Concept Release (Nov. 8, 2011) (File No. S7–33–11), at 3 (''Keen Concept Release Comment Letter'') (''If permitted without limitation, derivative contracts can pose all of the concerns that section 18 was intended to address with respect to borrowings and the issuance of senior securities by investment companies.''); *see also, e.g.,* ICI Concept Release Comment Letter, at 8 (''The Act is thus designed to regulate the degree to which a fund issues any form of debt—including contractual obligations that could require a fund to make payments in the future.''). The Commission similarly noted in Release 10666 that, given the potential for reverse repurchase agreements to be used for leveraging and their ability to magnify the risk of investing in a fund, ''one of the important policies underlying section 18 would be rendered substantially nugatory'' if funds' use of reverse repurchase agreements were not subject to limitation. *See* 2015 Proposing Release, *supra* note 2, at text preceding n.76.

[50] Some derivatives transactions, like physically-settled futures and forwards, can require the fund to deliver the underlying reference assets regardless of whether the fund experiences losses on the transaction.

[51] *See, e.g.,* Markus K. Brunnermeier & Lasse Heje Pedersen, *Market Liquidity and Funding Liquidity,* 22 The Review of Financial Studies 6, 2201–2238 (June 2009), *available at https://www.princeton.edu/~markus/research/papers/liquidity.pdf* (providing both empirical support as well as a theoretical foundation for how short-term leverage obtained through borrowings or derivative positions can result in funds and other financial intermediaries becoming vulnerable to tighter funding conditions and increased margins, specifically during economic downturns (as in the recent financial crisis), thus potentially increasing the need for the fund or intermediary to de-lever and sell portfolio assets at a loss).

[52] *See* 2015 Proposing Release, *supra* note 2, at n.80.

[53] *See id.* at n.51 and accompanying text (citing 2011 Concept Release, *supra* note 3, at section I).

[54] *See id.* at nn.54–55 and accompanying text.

[55] *See id.* at nn.56–58, 96–98 and accompanying text (stating that funds initially applied the mark-to-market approach to segregation to specific types of transactions addressed through guidance by our staff (interest rate swaps, cash-settled futures, non-deliverable forwards), but that funds now apply mark-to-market segregation to a wider range of cash-settled instruments, with our staff observing that some funds appear to apply the mark-to-market approach to any derivative that is cash settled).

[56] *See id.* at n.47 and accompanying text.

[57] *See id.* at n.59 and accompanying text (citing Merrill Lynch Asset Management, L.P., SEC Staff No-Action Letter (July 2, 1996), *available at https://www.sec.gov/divisions/investment/imseniorsecurities/merrilllynch070196.pdf).*

[58] For example, for derivatives where there is no loss in a given day, a fund applying the mark-to-market approach might not segregate any assets. This may be the case, for example, because the derivative is currently in a gain position, or because the derivative has a market value of zero (as will generally be the case at the inception of a transaction). The fund may, however, still be required to post collateral to comply with other regulatory or contractual requirements.

[59] *See, e.g.,* Comment Letter of Ropes & Gray LLC on the Concept Release (Nov. 7, 2011) (File No. S7–33–11), at 4 (stating that ''[o]f course, in many cases [a fund's daily mark-to-market liability, if any] will not fully reflect the ultimate investment exposure associated with the swap position'' and that, ''[a]s a result, a fund that segregates only the market-to-market liability could theoretically incur virtually unlimited investment leverage using cash-settled swaps''); Keen Concept Release Comment Letter, at 20 (stating that the mark-to-market approach, as applied to cash settled swaps, ''imposes no effective control over the amount of investment leverage created by these swaps, and leaves it to the market to limit the amount of leverage a fund may use'').

availability of adequate assets to meet funds' derivatives obligations, as the Commission contemplated in Release 10666. A fund using the mark-to-market approach could segregate assets that only reflect the losses (and corresponding potential payment obligations) that the fund would then incur as a result of transaction termination. This practice provides no assurances that future losses will not exceed the value of the segregated assets or the value of all assets then available to meet the payment obligations resulting from such losses.[60] We also recognize that when a fund segregates any liquid asset, rather than the more narrow range of high-quality assets the Commission described in Release 10666, the segregated assets may be more likely to decline in value at the same time as the fund experiences losses on its derivatives.[61] In this case, or when a fund's derivatives payment obligations are substantial relative to the fund's liquid assets, the fund may be forced to sell portfolio securities to meet its derivatives payment obligations. These forced sales could occur during stressed market conditions, including at times when prudent management could advise against such liquidation.[62]

3. Need for Updated Regulatory Framework

As the Commission observed in the 2015 proposal and for the reasons discussed above, we continue to be concerned that funds' current practices regarding derivatives use may not address the undue speculation and asset sufficiency concerns underlying section 18.[63] Additionally, as recent events demonstrate, a fund's derivatives use may involve risks that can result in significant losses to a fund.[64] Accordingly, we continue to believe that it is appropriate for funds to address these risks and considerations relating to their derivatives use. Nevertheless, we also recognize the valuable role derivatives can play in helping funds to achieve their objectives efficiently or manage their investment risks.

We therefore believe funds that significantly use derivatives should adopt and implement formalized programs to manage the risks derivatives may pose. In addition, a more modern framework for regulating funds' derivatives use would respond to our concern that funds today are not subject to a practical limit on potential leverage that they may obtain through derivatives transactions. The risk management program requirement and limit on fund leverage risk we are proposing are designed to address these considerations, in turn.

A comprehensive approach to regulating funds' derivatives use also would help address potential adverse results from funds' current, disparate asset segregation practices. The development of staff guidance and industry practice on an instrument-by-instrument basis, together with growth in the volume and complexity of derivatives markets over past decades, has resulted in situations in which different funds may treat the same kind of derivative differently, based on their own view of our staff's guidance or observation of industry practice. This may unfairly disadvantage some funds.[65] The lack of comprehensive guidance also makes it difficult for funds and our staff to evaluate and inspect for funds' compliance with section 18 of the Investment Company Act. Moreover, where there is no specific guidance, or where the application of existing guidance is unclear or applied inconsistently, funds may take approaches that involve an extensive use of derivatives and may not address the purposes and concerns underlying section 18.

C. Overview of the Proposal

Our proposal consists of three parts. Proposed rule 18f–4 is designed to provide an updated, comprehensive approach to the regulation of funds' use of derivatives and the other transactions that the proposed rule addresses. The proposed sales practices rules are designed to address investor protection concerns with respect to leveraged/inverse funds by requiring broker-dealers and investment advisers to exercise due diligence on retail investors before approving retail investor accounts to invest in leveraged/inverse funds. The proposed amendments to Forms N–PORT, N–LIQUID (which we propose to re-title as ''Form N–RN''), and N–CEN are designed to enhance the Commission's ability to oversee funds' use of and compliance with the proposed rules, and for the Commission and the public to have greater insight into the impact that funds' use of derivatives would have on their portfolios.

Proposed rule 18f–4 would permit a fund to enter into derivatives transactions, notwithstanding the prohibitions and restrictions on the issuance of senior securities under section 18 of the Investment Company Act, subject to the following conditions:[66]

- *Derivatives risk management program.*[67] The proposed rule would generally require a fund to adopt a written derivatives risk management program with risk guidelines that must cover certain elements, but that otherwise would be tailored based on how the fund's use of derivatives may affect its investment portfolio and overall risk profile. The program also would have to include stress testing, backtesting, internal reporting and escalation, and program review elements. The program would institute a standardized risk management framework for funds that engage in more than a limited amount of derivatives transactions, while allowing principles-based tailoring to the fund's particular risks. We believe that a formalized derivatives risk management program is critical to appropriate derivatives risk management and is foundational to providing exemptive relief under section 18.
- *Limit on fund leverage risk.*[68] The proposed rule would generally require funds when engaging in derivatives

[60] A fund's mark-to-market liability on any particular day, if any, could be substantially smaller than the fund's ultimate obligations under a derivative. *See* 2015 Proposing Release, *supra* note 2, at n.113.

[61] *See id.* at n.115.

[62] The Commission noted in Release 10666 that ''in an extreme case an investment company which has segregated all its liquid assets might be forced to sell non-segregated portfolio securities to meet its obligations upon shareholder requests for redemption. Such forced sales could cause an investment company to sell securities which it wanted to retain or to realize gains or losses which it did not originally intend.'' *See* Release 10666, *supra* note 15, at ''Segregated Account'' discussion.

[63] *See* 2015 Proposing Release, *supra* note 2, at sections II.D.1.b and II.D.1.c; *see also supra* paragraphs accompanying notes 58–62.

[64] *See supra* paragraph accompanying notes 22–25.

[65] *See, e.g.,* Comment Letter of Davis Polk on the 2011 Concept Release (Nov. 11, 2011), at 1–2 (stating that ''funds and their sponsors may interpret the available guidance differently, even when applying it to the same instruments, which may unfairly disadvantage some funds''); *see also* Comment Letter of Federated Investors, Inc. (Mar. 23, 2016) (''Federated Comment Letter''); Comment Letter of Salient Partners, L.P. (Mar. 25, 2016) (''Salient Comment Letter).

[66] *See* proposed rule 18f–4(b) and (d). Proposed rule 18f–4(b) would provide an exemption for funds' derivatives transactions from sections 18(a)(1), 18(c), 18(f)(1), and 61 of the Investment Company Act. *See supra* section I.B.1 of this release (providing an overview of the requirements of section 18). Because the proposed conditions are designed to provide a tailored set of requirements for derivatives transactions, the proposed rule would also provide that a fund's derivatives transactions would not be considered for purposes of computing asset coverage under section 18(h). Applying section 18(h) asset coverage to a fund's derivatives transactions appears unnecessary in light of the tailored restrictions we are proposing. *See also infra* section II.M.

[67] *See* proposed rule 18f–4(c)(1); *infra* section II.A.2.

[68] *See* proposed rule 18f–4(c)(2); *infra* section II.D.

transactions to comply with an outer limit on fund leverage risk based on value at risk, or ''VaR.'' This outer limit would be based on a relative VaR test that compares the fund's VaR to the VaR of a ''designated reference index'' for that fund. If the fund's derivatives risk manager is unable to identify an appropriate designated reference index, the fund would be required to comply with an absolute VaR test. These proposed requirements are designed to limit fund leverage risk consistent with the investor protection purposes underlying section 18 and to complement the proposed risk management program. Because VaR is a commonly-known and broadly-used industry metric that enables risk to be measured in a reasonably comparable and consistent manner across the diverse instruments that may be included in a fund's portfolio, the proposed VaR-based limit is designed to address leverage risk for a variety of fund strategies.

• *Board oversight and reporting.*[69] The proposed rule would require a fund's board of directors to approve the fund's designation of a derivatives risk manager, who would be responsible for administering the fund's derivatives risk management program. The fund's derivatives risk manager would have to report to the fund's board on the derivatives risk management program's implementation and effectiveness and the results of the fund's stress testing. The derivatives risk manager would have a direct reporting line to the fund's board. We believe requiring a fund's derivatives risk manager to be responsible for the day-to-day administration of the fund's program, subject to board oversight, is consistent with the way we understand many funds currently manage derivatives risks and is key to appropriately managing these risks.

• *Exception for limited derivatives users.*[70] The proposed rule would except limited derivatives users from the derivatives risk management program requirement and the VaR-based limit on fund leverage risk. This proposed exception would be available to a fund that either limits its derivatives exposure to 10% of its net assets or uses derivatives transactions solely to hedge certain currency risks and, in either case, that also adopts and implements policies and procedures reasonably designed to manage the fund's derivatives risks. Requiring a derivatives risk management program that includes all of the program elements specified in the rule for funds that use derivatives only in a limited way could potentially require these funds to incur costs and bear compliance burdens that are disproportionate to the resulting benefits.

• *Alternative requirements for certain leveraged/inverse funds.*[71] The proposed rule would provide an exception from the limit on fund leverage risk for certain leveraged/inverse funds in light of the additional safeguards provided by the proposed requirements under the sales practices rules that broker-dealers and investment advisers exercise due diligence on retail investors before approving the investors' accounts to invest in these funds.[72] The conditions of this exception are designed to address the investor protection concerns that underlie section 18 of the Investment Company Act, while preserving choice for investors the investment adviser or broker-dealer reasonably believes have such financial knowledge and experience that they may reasonably be expected to be capable of evaluating the risk of these funds.

• *Recordkeeping.*[73] The proposed rule would require a fund to adhere to recordkeeping requirements that are designed to provide the Commission's staff, and the fund's board of directors and compliance personnel, the ability to evaluate the fund's compliance with the proposed rule's requirements.

Proposed rule 18f–4 would also permit funds to enter into reverse repurchase agreements and similar financing transactions, as well as ''unfunded commitments'' to make certain loans or investments, subject to conditions tailored to these transactions.[74] A fund would be permitted to engage in reverse repurchase agreements and similar financing transactions so long as they meet the asset coverage requirements under section 18. If the fund also borrows from a bank or issues bonds, for example, these senior securities as well as the reverse repurchase agreement would be required to comply with the asset coverage requirements under the Investment Company Act. This approach would provide the same asset coverage requirements under section 18 for reverse repurchase agreements and similar financing transactions, bank borrowings, and other borrowings permitted under the Investment Company Act. A fund would be permitted to enter into unfunded commitment agreements if the fund reasonably believes that its assets will allow the fund to meet its obligations under these agreements. This approach recognizes that, while unfunded commitment agreements do raise the risk that a fund may be unable to meet its obligations under these transactions, such unfunded commitments do not generally involve the leverage and other risks associated with derivatives transactions.

The proposed sales practices rules are designed to address certain specific considerations raised by certain leveraged/inverse funds and listed commodity pools that obtain leveraged or inverse exposure to an underlying index, on a periodic (generally, daily) basis.[75] These rules would require broker-dealers and investment advisers to exercise due diligence in determining whether to approve a retail customer or client's account to buy or sell these products. A broker-dealer or adviser could only approve the account if it had a reasonable basis to believe that the customer or client is capable of evaluating the risk associated with these products. In this regard, the proposed sales practices rules would complement the leveraged/inverse funds exception from proposed rule 18f–4's limit on leverage risk by subjecting broker-dealers or advisers to the proposed sales practices rules' due diligence and approval requirements.

In connection with proposed rules 15*l*–2, 211(h)–1, and 18f–4, we are proposing amendments to rule 6c–11 under the Investment Company Act. Rule 6c–11 generally permits ETFs to operate without obtaining a Commission exemptive order, subject to certain conditions.[76] The rule currently excludes leveraged/inverse ETFs from relying on the rule, however, to allow the Commission to consider the section 18 issues raised by these funds' investment strategies as part of a broader consideration of derivatives use by registered funds and BDCs.[77] As part of this further consideration, we are

[69] *See* proposed rule 18f–4(c)(5); *infra* section II.C.

[70] *See* proposed rule 18f–4(c)(3); *infra* section II.E.

[71] *See* proposed rule 18f–4(c)(4); *infra* section II.G.

[72] In our discussion in this release of the entities subject to the proposed sales practices rules, we use ''broker-dealer'' to refer to a broker-dealer that is registered with, or required to register with, the Commission. Similarly, we use ''investment adviser'' to refer to an investment adviser that is registered with, or required to register with, the Commission.

[73] *See* proposed rule 18f–4(c)(6); *infra* section II.K.

[74] *See* proposed rule 18f–4(d) and (e); *infra* sections II.I and II.J.

[75] *See infra* note 327 and accompanying text (defining ''listed commodity pools'').

[76] *See generally* Exchange-Traded Funds, Investment Company Act Release No. 33646 (Sept. 25, 2019) [84 FR 57162 (Oct. 24, 2019)] (''ETFs Adopting Release'').

[77] *See id.* at nn.72–74 and accompanying text.

proposing to remove this provision and permit leveraged/inverse ETFs to rely on rule 6c–11 because the proposed sales practices rules and rule 18f–4 are designed to address these issues. In this regard, we are also proposing to rescind the exemptive orders previously issued to the sponsors of leveraged/inverse ETFs. Amending rule 6c–11 and rescinding these exemptive orders would promote a level playing field by allowing any sponsor (in addition to the sponsors currently granted exemptive orders) to form and launch a leveraged/inverse ETF subject to the conditions in rule 6c–11 and proposed rule 18f–4, with transactions in the fund subject to the proposed sales practices rules.

The proposed amendments to Forms N–PORT, N–LIQUID, and N–CEN would require a fund to provide information regarding: (1) The fund's exposure to derivatives; (2) the fund's VaR (and, if applicable, the fund's designated reference index) and backtesting results; (3) VaR test breaches, to be reported to the Commission in a non-public current report; and (4) certain identifying information about the fund (*e.g.,* whether the fund is a limited derivatives user that is excepted from certain of the proposed requirements, or whether the fund is a ''leveraged/inverse fund'').

Finally, in view of our proposal for an updated, comprehensive approach to the regulation of funds' derivative use, we are proposing to rescind Release 10666. In addition, staff in the Division of Investment Management is reviewing certain of its no-action letters and other guidance addressing derivatives transactions and other transactions covered by proposed rule 18f–4 to determine which letters and other staff guidance, or portions thereof, should be withdrawn in connection with any adoption of this proposal. Upon the adoption of any final rule, some of these letters and other staff guidance, or portions thereof, would be moot, superseded, or otherwise inconsistent with the final rule and, therefore, would be withdrawn. We would expect to provide funds a one-year transition period while they prepare to come into compliance with rule 18f–4 before Release 10666 is withdrawn.

II. Discussion

A. Scope of Proposed Rule 18f–4

1. Funds Permitted To Rely on Proposed Rule 18f–4

The proposed rule would apply to a ''fund,'' defined as a registered open-end or closed-end company or a BDC, including any separate series thereof. The rule would therefore apply to mutual funds, ETFs, registered closed-end funds, and BDCs. The proposed rule's definition of a ''fund'' would, however, exclude money market funds regulated under rule 2a–7 under the Investment Company Act (''money market funds''). Under rule 2a–7, money market funds seek to maintain a stable share price or limit principal volatility by limiting their investments to short-term, high-quality debt securities that fluctuate very little in value under normal market conditions. As a result of these and other requirements in rule 2a–7, we believe that money market funds currently do not typically engage in derivatives transactions or the other transactions permitted by rule 18f–4.[78] We believe that these transactions would generally be inconsistent with a money market fund maintaining a stable share price or limiting principal volatility, and especially if used to leverage the fund's portfolio.[79] We therefore believe that excluding money market funds from the scope of the proposed rule is appropriate.

Section 18 applies only to open-end or closed-end companies, *i.e.,* to management investment companies. Proposed rule 18f–4 therefore also would not apply to unit investment trusts (''UITs'') because they are not management investment companies. In addition, as the Commission has noted, derivatives transactions generally require a significant degree of management, and a UIT engaging in derivatives transactions therefore may not meet the Investment Company Act requirements applicable to UITs.[80]

We request comment on all aspects of the proposed rule's definition of the term ''fund,'' including the following items.

1. The proposed definition excludes money market funds. Should we include money market funds in the definition? Why or why not?

2. Do money market funds currently engage in any transactions that might qualify as derivatives transactions under the rule or any of the other transactions permitted by the rule? For example, do money market funds engage in reverse repurchase agreements, ''to be announced'' dollar rolls, or ''when issued'' transactions? If so, which transactions, to what extent, and for what purpose? For example, do money market funds engage in reverse repurchase agreements for liquidity management purposes but not to leverage the fund's portfolio? If so, what effects would the proposed rule have on money market funds' liquidity management if they are excluded from the rule's scope as proposed? To the extent money market funds engage in any of the transactions that the proposed rule would permit, how do money market funds analyze them under rule 2a–7?

3. Should we permit money market funds to engage in some of the transactions that the rule would permit? If so, which transactions and why, and how would the transactions be consistent with rule 2a–7? If we were to include money market funds in the rule, or permit them to engage in specific types of transactions, should the rule provide specific conditions tailored to money market funds entering into those transactions? What kinds of conditions and why? Should they be permitted to engage in all (or certain types) of derivatives transactions, or reverse repurchase or similar financing transactions, for liquidity management or other purposes that do not leverage the fund's portfolio? If money market funds were permitted to rely on the rule for any transactions, should those transactions be limited in scale? For example, should that limit be the same as the proposed approach for limited derivatives users that limit the extent of their derivatives exposure, as discussed below in section II.E.1? Would even such limited use be consistent with funds that seek to maintain a stable share price or limit principal volatility?

4. If we were to include money market funds in the scope of rule 18f–4, should we revise Form N–MFP so that money market funds filing reports on the form could select among the list of investment categories set forth in Item C.6 of Form N–MFP derivatives and the other transactions addressed in the proposed rule 18f–4?[81] Why or why not?

2. Derivatives Transactions Permitted Under Proposed Rule 18f–4

The proposed rule would permit funds to enter into derivatives

[78] *See infra* note 583.

[79] *See* Money Market Fund Reform; Amendments to Form PF, Investment Company Act Release No. 31166 (July 23, 2014) [79 FR 47735 (Aug. 14, 2014)] (discussing (1) retail and government money market funds, which seek to maintain a stable net asset value per share and (2) institutional non-government money market funds whose net asset value fluctuates, but still must stress test their ability to minimize principal volatility given that ''commenters pointed out investors in floating NAV funds will continue to expect a relatively stable NAV'').

[80] *See* section 4(2) of the Investment Company Act; *see also* Custody Of Investment Company Assets with Futures Commission Merchants And Commodity Clearing Organizations, Investment Company Act Release No. 22389 (Dec. 11, 1996), at n.18 (explaining that UIT portfolios are generally unmanaged). *See also* ETFs Adopting Release, *supra* note 76, at n.42.

[81] *See infra* note 583.

transactions, subject to the rule's conditions. The proposed rule would define the term ''derivatives transaction'' to mean: (1) Any swap, security-based swap, futures contract, forward contract, option, any combination of the foregoing, or any similar instrument (''derivatives instrument''), under which a fund is or may be required to make any payment or delivery of cash or other assets during the life of the instrument or at maturity or early termination, whether as margin or settlement payment or otherwise; and (2) any short sale borrowing.[82]

The first prong of this proposed definition is designed to describe those derivatives transactions that involve the issuance of a senior security, because they involve a contractual future payment obligation.[83] When a fund engages in these transactions, the fund will have an obligation (or potential obligation) to make payments or deliver assets to the fund's counterparty. This prong of the definition incorporates a list of derivatives instruments that, together with the proposed inclusion in the definition of ''any similar instrument,'' covers the types of derivatives that funds currently use and that the requirements of section 18 would restrict. This list is designed to be sufficiently comprehensive to include derivatives that may be developed in the future. We believe that this approach is clearer than a more principles-based definition of the term ''derivatives transaction,'' such as defining this term as an instrument or contract whose value is based upon, or derived from, some other asset or metric.

This prong of the definition also provides that a derivatives instrument, for purposes of the proposed rule, must involve a future payment obligation.[84] This aspect of the definition recognizes that not every derivatives instrument imposes an obligation that may require the fund to make a future payment, and therefore not every derivatives instrument will involve the issuance of a senior security.[85] A derivative that does not impose any future payment obligation on a fund generally resembles a securities investment that is not a senior security, in that it may lose value but will not require the fund to make any payments in the future.[86] Whether a transaction involves the issuance of a senior security will depend on the nature of the transaction. The label that a fund or its counterparty assigns to the transaction is not determinative.[87]

Unlike the 2015 proposal, this proposal does not include references to, or a definition of, ''financial commitment transaction'' in addition to the proposed definition of ''derivatives transaction.'' The 2015 proposal defined a ''financial commitment transaction'' as any reverse repurchase agreement, short sale borrowing, or any firm or standby commitment agreement or similar agreement.[88] Because our proposal addresses funds' use of reverse repurchase agreements and unfunded commitment agreements separately from funds' use of derivatives, the proposed definition of ''derivatives transaction'' does not include reverse repurchase agreements and unfunded commitment agreements.[89]

Short sale borrowings, however, are included in the second prong of the proposed definition of ''derivatives transaction.'' We appreciate that short sales of securities do not involve derivatives instruments such as swaps, futures, and options. The value of a short position is, however, derived from the price of another asset, *i.e.,* the asset sold short. A short sale of a security provides the same economic exposure as a derivatives instrument, like a future or swap, that provides short exposure to the same security. The proposed rule therefore treats short sale borrowings and derivatives instruments identically for purposes of funds' reliance on the rule's exemption.[90]

While this proposal does not specifically list firm or standby commitment agreements in the definition of ''derivatives transaction,'' we interpret the definitional phrase ''or any similar instrument'' to include these agreements. A firm commitment agreement has the same economic characteristics as a forward contract.[91] Similarly, a standby commitment agreement has the same economic characteristics as an option contract, and the Commission has previously stated that such an agreement is economically equivalent to the issuance

[82] Proposed rule 18f–4(a). The 2015 proposal similarly defined a derivatives transaction as including enumerated derivatives instruments ''under which the fund is or may be required to make any payment or delivery of cash or other assets during the life of the instrument or at maturity or early termination, whether as a margin or settlement payment or otherwise.'' 2015 proposed rule 18f–4(c)(2). Most commenters did not address the proposed definition of the term ''derivatives transaction,'' although those commenters who did address the definition generally supported it. Some commenters more generally supported the view, or sought confirmation, that a derivative does not involve the issuance of a senior security if it does not impose an obligation under which the fund is or may be required to make a future payment (*e.g.,* a standard purchased option). *See, e.g.,* Comment Letter of The Options Clearing Corporation (Mar. 25, 2016); Comment Letter of Investment Adviser Association (Mar. 28, 2016) (''IAA Comment Letter''); FSR Comment Letter.

[83] *See supra* note 27 and accompanying text, and text following note 34 (together, noting that ''senior security'' is defined in part as ''any . . . similar obligation or instrument constituting a security and evidencing indebtedness,'' and that the Commission has previously stated that, for purposes of section 18, ''evidence of indebtedness'' would include ''all contractual obligations to pay in the future for consideration presently received''); *see also infra* notes 85–87 (recognizing that not every derivative instrument will involve the issuance of a senior security).

[84] Under the proposed rule, a derivatives instrument is one where the fund ''is or may be required to make any payment or delivery of cash or other assets during the life of the instrument or at maturity or early termination, whether as margin or settlement payment or otherwise.''

[85] *See* 2015 Proposing Release, *supra* note 2, at paragraph accompanying nn.82–83. A fund that purchases a standard option traded on an exchange, for example, generally will make a non-refundable premium payment to obtain the right to acquire (or sell) securities under the option. However, the option purchaser generally will not have any subsequent obligation to deliver cash or assets to the counterparty unless the fund chooses to exercise the option.

[86] *See id.* at n.82.

[87] For example, the Commission received a comment on the 2015 proposal addressing a type of total return swap, asserting that ''[t]he Swap operates in a manner similar to a purchased option or structure, in that the fund's losses under the Swap cannot exceed the amount posted to its tri-party custodian agreement for purposes of entering into the Swap,'' and that, in the commenter's view, the swap should be ''afforded the same treatment as a purchased option or structured note'' because ''[a]lthough the Swap involves interim payments through the potential posting of margin from the custodial account, the payment obligations cannot exceed the [amount posted for purposes of entering into the Swap].'' *See* Comment Letter of Dearborn Capital Management (Mar. 24, 2016) (''Dearborn Comment Letter''). Unlike a fund's payment of a one-time non-refundable premium in connection with a standard purchased option or a fund's purchase of a structured note, this transaction appears to involve a fund obligation to make interim payments of fund assets posted as margin or collateral to the fund's counterparty during the life of the transaction in response to market value changes of the underlying reference asset, as this commenter described. The fund also must deposit additional margin or collateral to maintain the position if the fund's losses deplete the assets that the fund posted to initiate the transaction; if a fund effectively pursues its strategy through such a swap, or a small number of these swaps, the fund may as a practical matter be required to continue reestablishing the trade or refunding the collateral account in order to continue to offer the fund's strategy. The transaction therefore appears to involve the issuance of a senior security as the fund may be required to make future payments.

See also infra section II.J (discussing the characterization of ''unfunded commitment'' agreements for purposes of the proposed rule, and as senior securities).

[88] *See* 2015 Proposing Release, *supra* note 2, at section III.A.2; 2015 proposed rule 18f–4(c)(4); *see also supra* note 10.

[89] *See infra* section II.I.

[90] *See* proposed rule 18f–4(b).

[91] Indeed, the Commission noted in Release 10666 that a firm commitment is known by other names such as a ''forward contract.'' *See* Release 10666, *supra* note 15, at nn.10–12 and accompanying text.

of a put option.[92] To the extent that a fund engages in transactions similar to firm or standby commitment agreements, they may fall within the ''any similar instrument'' definitional language, depending on the facts and circumstances.[93]

We request comment on all aspects of the proposed rule's definition of the term ''derivatives transaction,'' including the following items.

5. Is the definition of ''derivatives transaction'' sufficiently clear? Are there additional types of derivatives instruments, or other transactions, that we should include or exclude? Adding additional transactions to the definition would permit a fund to engage in those transactions by complying with the proposed rule, rather than section 18. Are there transactions that we should exclude from the definition so that funds must comply with the limits of section 18 (to the extent permitted under section 18) with respect to these transactions, rather than the proposed rule's conditions?

6. The proposed rule's definition of the term ''derivatives transaction'' is designed to describe those derivatives transactions that would involve the issuance of a senior security. Do commenters agree that derivatives transactions that involve obligations to make a payment or deliver assets involve the issuance of a senior security under section 18 of the Act? Does the rule effectively describe all of the types of derivatives transactions that would involve the issuance of a senior security? Conversely, are there any types of transactions that are included in the proposed definition of ''derivatives transaction'' that should not be considered to involve the issuance of a senior security? If so, which types of transactions and why?

7. Is it appropriate that the proposed rule's definition of ''derivatives transaction'' incorporates a list of derivatives instruments plus ''any similar instrument,'' rather than a principles-based definition, such as an instrument or contract whose value is based upon, or derived from, some other asset or metric? Why or why not? Is the reference to ''any similar instrument'' in the proposed definition sufficiently clear to address transactions that may be developed in the future? If not, how should we modify the rule to provide additional clarity?

8. Should the proposed definition of ''derivatives transaction'' include short sale borrowings? Would this approach cause any confusion because short sales are not typically understood as derivatives instruments? If the latter, what alternative approach would be preferable?

9. Should we specifically list firm or standby commitments in the proposed definition of ''derivatives transaction''? Would funds understand the phrase ''or any similar instrument'' in the proposed definition to include these agreements? Do funds currently use the terms ''firm commitment agreement'' or ''standby commitment agreement'' to describe any of their transactions?

10. Are there any transactions similar to firm or standby commitments that we should specifically address, either in the proposed definition of ''derivatives transaction'' or otherwise as guidance? Are there any other types of transactions that the Commission should address—either in the proposed definition or as guidance—as transactions that fall within the ''any similar instrument'' definitional language?

B. Derivatives Risk Management Program

1. Summary

Fund investments in derivatives transactions can pose a variety of risks, and poor risk management can cause significant harm to funds and their investors. Derivatives can raise potential risks such as market, counterparty, leverage, liquidity, and operational risk. Although many of these risks are not limited to derivatives, the complexity and character of certain derivatives—such as their multiple contingencies and optionality, path dependency, and non-linearity—may heighten these risks.[94] Even simple derivatives without multiple contingencies and optionality, for example, can present additional risks beyond a fund's investment in the underlying reference assets, such as the risk that a fund must have margin-eligible assets on hand to meet margin or collateral calls. We also recognize the valuable role derivatives can play in helping funds to achieve their objectives efficiently or manage their investment risks.

An investment adviser of a fund that uses derivatives therefore should manage this use to ensure alignment with the fund's investment objectives, policies, and restrictions, its risk profile, and relevant regulatory requirements. In addition, a fund's board of directors is responsible for overseeing the fund's activities and the adviser's management of risks, including any derivatives risks.[95] Given the dramatic growth in the volume and complexity of the derivatives markets over the past two decades, and the increased use of derivatives by certain funds and their related risks, we believe that requiring funds that are users of derivatives (other than limited derivatives users) to have a formalized risk management program with certain specified elements (a ''program'') supports exempting these transactions from section 18.

Under the proposed program requirement, a fund would have to adopt and implement a written derivatives risk management program, which would include policies and procedures reasonably designed to manage the fund's derivatives risks.[96] A fund's risk management program should take into the account the way the fund uses derivatives, whether to increase investment exposures in ways that increase portfolio risks or, conversely, to reduce portfolio risks or facilitate efficient portfolio management.[97]

The program requirement is designed to result in a program with elements that are tailored to the particular types of derivatives that the fund uses and their related risks, as well as how those derivatives impact the fund's investment portfolio and strategy. The proposal would require a fund's program to include the following elements:

• *Risk identification and assessment.*[98] The program would have to provide for the identification and assessment of a fund's derivatives risks,

[92] *See id.* at ''Standby Commitment Agreements'' (''The standby commitment agreement is a delayed delivery agreement in which the investment company contractually binds itself to accept delivery of a Ginnie Mae with a stated price and fixed yield upon the exercise of an option held by the other party to the agreement at a stated future date. . . . The Commission believes that the standby commitment agreement involves, in economic reality, the issuance and sale by the investment company of a 'put.' '').

[93] *See, e.g., infra* paragraph accompanying notes 419–420 (discussing agreements that would not qualify for the proposed rule's treatment of unfunded commitment agreements because they are functionally similar to derivatives transactions).

[94] *See* European Securities and Markets Authority (formerly Committee of European Securities Regulators), *Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS*, CESR/10–788 (July 28, 2010), at 12, *available at https://www.esma.europa.eu/sites/default/files/library/2015/11/10_788.pdf* (''CESR Global Guidelines'').

[95] *See, e.g.,* Interpretive Matters Concerning Independent Directors of Investment Companies, Investment Company Act Release No. 24083 (Oct. 14, 1999) [64 FR 59877 (Nov. 3, 1999)]; Role of Independent Directors of Investment Companies, Investment Company Act Release No. 24816 (Jan. 2, 2001) [66 FR 3733 (Jan. 16, 2001)]; Independent Directors Council, *Fund Board Oversight of Risk Management* (Sept. 2011), *available at http://www.ici.org/pdf/pub_11_oversight_risk.pdf* (''2011 IDC Report'').

[96] Proposed rule 18f–4(c)(1).

[97] *See supra* note 4 and accompanying text; *infra* section II.B.3.a.

[98] Proposed rule 18f–4(c)(1)(i); *see also infra* section II.B.3.a.

which would take into account the fund's derivatives transactions and other investments.

• *Risk guidelines.*[99] The program would have to provide for the establishment, maintenance, and enforcement of investment, risk management, or related guidelines that provide for quantitative or otherwise measurable criteria, metrics, or thresholds related to a fund's derivatives risks.

• *Stress testing.*[100] The program would have to provide for stress testing of derivatives risks to evaluate potential losses to a fund's portfolio under stressed conditions.

• *Backtesting.*[101] The program would have to provide for backtesting of the VaR calculation model that the fund uses under the proposed rule.

• *Internal reporting and escalation.*[102] The program would have to provide for the reporting of certain matters relating to a fund's derivatives use to the fund's portfolio management and board of directors.

• *Periodic review of the program.*[103] A fund's derivatives risk manager would be required to periodically review the program, at least annually, to evaluate the program's effectiveness and to reflect changes in risk over time.

The proposed program requirement is drawn from existing fund best practices. We believe it would enhance practices for funds that have not already implemented a derivatives risk management program, while building off practices of funds that already have one in place.[104]

Most commenters generally supported the 2015 proposal's derivatives risk management program requirement, which had many similar foundational elements to those of the program we are proposing here. These commenters stated that the use of derivatives transactions by a fund should be subject to a comprehensive and appropriate written risk management program, which would benefit investors.[105] Our proposal includes elements from the 2015 proposal's derivatives risk management program framework, and adds elements that take into account our analysis of the comments we received.

2. Program Administration

The proposed rule would require a fund adviser's officer or officers to serve as the fund's derivatives risk manager.[106] This requirement is designed to centralize derivatives risk management and to promote accountability. The designation of the derivatives risk manager must be approved by the fund's board of directors, and the derivatives risk manager must have direct communication with the fund's board of directors. Allowing multiple officers of the fund's adviser (including any sub-advisers) to serve as the fund's derivatives risk manager is designed to allow funds with differing sizes, organizational structures, or investment strategies to more effectively tailor the programs to their operations.[107] We understand that many advisers today involve committees or groups of officers in the vetting and analysis of portfolio risk and other types of risk.[108] Although the proposed rule would not permit a third party to serve as a fund's derivatives risk manager, the derivatives risk manager could obtain assistance from third parties in administering the program. For example, third parties could provide data relevant to the administration of a fund's program or other analysis that may inform the fund's derivatives risk management.

The proposed rule would also require that the fund's derivatives risk manager have relevant experience regarding derivatives risk management.[109] This requirement is designed to reflect the potential complex and unique risks that derivatives can pose to funds and promote the selection of a derivatives risk manager who is well-positioned to manage these risks. As discussed below, under the proposed rule, a fund's board must approve the designation of the fund's derivatives risk manager, taking into account the derivatives risk manager's relevant experience regarding derivatives risk management.[110]

The proposed rule would require a fund to reasonably segregate the functions of the program from its portfolio management.[111] Segregating derivatives risk management from portfolio management is designed to promote objective and independent identification, assessment, and management of the risks associated with derivatives use. Accordingly, this element is designed to enhance the accountability of the derivatives risk manager and other risk management personnel and, therefore, to enhance the program's effectiveness.[112] We understand that funds today often segregate risk management from portfolio management. Many have observed that independent oversight of derivatives activities by compliance and internal audit functions is valuable.[113] Because a fund may compensate its portfolio management personnel in part based on the returns of the fund, the incentives of portfolio managers may not always be consistent with the restrictions that a risk management program would impose. Keeping the functions separate in the context of derivatives risk management should help mitigate the possibility that these competing incentives diminish the program's effectiveness.

Separation of functions creates important checks and balances, and funds could institute this proposed requirement through a variety of methods, such as independent reporting chains, oversight arrangements, or separate monitoring systems and personnel. The proposed rule would require reasonable segregation of functions, rather than taking a more prescriptive approach, such as requiring funds to implement strict protocols regarding communications between specific fund personnel, to allow funds to structure their risk management and portfolio management functions in ways that are tailored to each fund's facts and circumstances, including the size and

[99] Proposed rule 18f–4(c)(1)(ii); *see also infra* section II.B.3.b.

[100] Proposed rule 18f–4(c)(1)(iii); *see also infra* section II.B.3.c.

[101] Proposed rule 18f–4(c)(1)(iv); *see also infra* section II.B.3.d.

[102] Proposed rule 18f–4(c)(1)(v); *see also infra* section II.B.3.e.

[103] Proposed rule 18f–4(c)(1)(vi); *see also infra* section II.B.3.f.

[104] *See, e.g.,* Aviva Comment Letter (discussing the implementation of formalized derivatives risk management programs); Vanguard Comment Letter.

[105] *See, e.g.,* Comment Letter of AFG-French Asset Management Association (Mar. 25, 2016) (''AFG Comment Letter''); Comment Letter of American Beacon Advisors (Mar. 28, 2016) (''American Beacon Comment Letter''); Comment Letter of AQR Capital Management (Mar. 28, 2016) (''AQR Comment Letter''); Federated Comment Letter; Comment Letter of Fidelity (Mar. 28, 2016) (''Fidelity Comment Letter''); Comment Letter of AFL–CIO (Mar. 28, 2016); Comment Letter of Alternative Investment Management Association (Mar. 28, 2016) (''AIMA Comment Letter''); Comment Letter of Aviva (Mar. 28, 2016) (''Aviva Comment Letter''); Comment Letter of BlackRock (Mar. 28, 2016) (''BlackRock Comment Letter''); Comment Letter of Capital Research and Management Company (Mar. 28, 2016) (''CRMC Comment Letter'').

[106] Proposed rule 18f–4(a).

[107] The term ''adviser'' as used in this release and rule 18f–4 generally refers to any person, including a sub-adviser, that is an ''investment adviser'' of an investment company as that term is defined in section 2(a)(20) of the Investment Company Act.

[108] *See, e.g.,* IAA Comment Letter.

[109] Proposed rule 18f–4(a).

[110] *See infra* section II.C.1.

[111] Proposed rule 18f–4(c)(1).

[112] *See, e.g.,* Comptroller of the Currency Administrator of National Banks, *Risk Management of Financial Derivatives: Comptroller's Handbook* (Jan. 1997), at 9 (discussing the importance of independent risk management functions in the banking context).

[113] *See, e.g.,* Kenneth K. Marshall, *Internal Control and Derivatives,* The CPA Journal (Oct. 1995), *available at http://archives.cpajournal.com/1995/OCT95/f461095.htm.*

resources of the fund's adviser. In this regard, the reasonable segregation requirement is not meant to indicate that the derivatives risk manager and portfolio management must be subject to a communications ''firewall.'' We recognize the important perspective and insight regarding the fund's use of derivatives that the portfolio manager can provide and generally understand that the fund's derivatives risk manager would work with the fund's portfolio management in implementing the program requirement.

For similar reasons, the proposed rule would also prohibit the derivatives risk manager position from being filled solely by the fund's portfolio manager, if a single fund officer serves in the position.[114] The proposed rule also would prohibit a majority of the officers who compose the derivatives risk manager position from being portfolio managers, if multiple fund officers serve in the position.

Commenters generally supported the 2015 proposal's requirement that a fund's derivatives risk management program be administered by a derivatives risk manager and that the fund's derivatives risk management be segregated from the fund's portfolio management.[115] Commenters did, however, express concern about the 2015 proposal's requirement that there be a single derivatives risk manager and urged that the Commission permit a fund's portfolio managers to provide some input into the fund's derivatives risk management function.[116] This re-proposal addresses these concerns by permitting a group or committee to serve as a fund's derivatives risk manager, a portion of whom could be portfolio managers.

We request comment on the proposed requirements that a fund's derivatives risk manager administer the fund's program, and that the derivatives risk management function be reasonably segregated from the fund's portfolio management.

11. Is the proposed definition of ''derivatives risk manager'' sufficiently clear? Why or why not? Should the rule, as proposed, require that a fund's derivatives risk manager be an officer or officers of the fund's adviser, and would this requirement further the goals of centralizing derivatives risk management and promoting accountability? Why or why not? Should the rule, as proposed, permit a fund's derivatives risk manager to be an officer or officers of the fund's sub-advisers? Why or why not? If so, should the rule require that at least one of the officers be an officer of the adviser or otherwise limit the number of sub-adviser officers? Why or why not? Would a fund's program be more effective if we required the derivatives risk manager to be a single individual? Why or why not? If so, should this individual be required to be an officer of a fund's adviser?

12. Should the rule, as proposed, require that a fund's derivatives risk manager have relevant experience regarding derivatives risk management? Why or why not? Is the proposed requirement that the derivatives risk manager have ''relevant experience regarding the management of derivatives risk'' sufficiently clear? Would this raise questions about whether portfolio management experience, or experience outside of formal derivatives risk management, would suffice for purposes of the rule? Should the rule, instead, require that a fund's derivatives risk manager simply have ''relevant experience''? Should the rule specify that the derivatives risk manager must have relevant experience as determined by the fund's board, to allow a board to determine the experience that would be appropriate? Or should the rule identify specific qualifications, training, or experience of a fund's derivatives risk manager? Why or why not? If so, what should they be and why?

13. Should the rule, as proposed, require a fund to segregate derivatives risk management functions from portfolio management? Why or why not? If we were not to require independence between a fund's derivatives risk manager and the fund's portfolio managers, how could we ensure that a fund's portfolio management personnel, who may have conflicting incentives, do not unduly influence the fund's program management?

14. Should we provide any additional clarification regarding the proposed reasonable segregation requirement? If so, what changes should we make? Should we add any specific requirements? For example, should we limit the extent to which fund risk management personnel can be compensated in part based on fund performance?

15. Is our understanding that many funds already segregate functions correct? If so, how and why do current approaches differ from the proposed rule's requirement to segregate functions?

16. Are there other ways to facilitate objective and independent risk assessment of portfolio strategies that we should consider? If so, what are they and how would these alternatives be more effective than the proposed rule's requirement to reasonably segregate functions?

17. Rule 22e–4 under the Investment Company Act, similar to the proposed rule, requires certain funds to implement a risk management program. In particular, rule 22e–4 requires person(s) designated to administer a fund's liquidity risk management program to be the fund's investment adviser, officer, or officers (which may not be solely portfolio managers of the fund) (the ''liquidity risk manager''). Should we amend rule 22e–4 to more closely align the definition of ''liquidity risk manager'' with the proposed definition of ''derivatives risk manager'' by prohibiting a fund's adviser from serving as a liquidity risk manager? Why or why not? Conversely, should we align the standard for derivatives risk manager with the liquidity risk manager standard under rule 22e–4?

18. Would the proposed derivatives risk manager requirement raise any particular challenges for funds with smaller advisers and, if so, what could we do to help mitigate these challenges? For example, should we modify the rule to permit funds to authorize the use of third parties not employed by the adviser to administer the program and, if so, under what conditions? Why or why not? Would allowing third parties to act as derivatives risk managers enhance the program by allowing specialized personnel to administer the program or detract from it by allowing for a derivatives risk manager who may not be as focused on the specific risks of the particular fund or as accountable to its board? Would the proposed requirement that a fund reasonably segregate derivatives risk management from portfolio management pose particular challenges for funds with smaller advisers? If so, how and why, and would additional guidance on this proposed requirement or changes to the proposed rule be useful? Conversely, would this proposed requirement (which does not prescribe how funds must segregate functions) provide appropriate flexibility for funds with smaller advisers?

19. Rule 38a–1(c) under the Investment Company Act prohibits officers, directors, and employees of the fund and its adviser from, among other things, coercing or unduly influencing a fund's chief compliance officer in the

[114] Proposed rule 18f–4(a).

[115] *See, e.g.,* BlackRock Comment Letter.

[116] *See, e.g.,* BlackRock Comment Letter; Comment Letter of Morningstar (Mar. 28, 2016) (''Morningstar Comment Letter''); Comment Letter of the Investment Company Institute (Mar. 28, 2016) (''ICI Comment Letter I''); Comment Letter of WisdomTree (Mar. 28, 2016).

performance of his or her duties. Should we include such a prohibition on unduly influencing a fund's derivatives risk manager in the proposed rule? Why or why not?

20. Should we include any other program administration requirements? If so, what? For example, should we include a requirement for training staff responsible for day-to-day management of the program, or for portfolio managers, senior management, and any personnel whose functions may include engaging in, or managing the risk of, derivatives transactions? If we require such training, should that involve setting minimum qualifications for staff responsible for carrying out the requirements of the program? Why or why not? Should we require training and education with respect to any new derivatives instruments that a fund may trade? Why or why not? Should we require a new instrument review committee?

3. Required Elements of the Program

a. Risk Identification and Assessment

The proposed program requirement would require a fund to identify and assess its derivatives risks in order to manage these risks.[117] It would require that the fund's identification and assessment take into account the fund's other investments as well as its derivatives transactions. An appropriate assessment of derivatives risks generally involves assessing how a fund's derivatives may interact with the fund's other investments or whether the fund's derivatives have the effect of helping the fund manage risks. For example, the risks associated with a currency forward would differ if a fund is using the forward to hedge the fund's exposure to currency risk associated with a fund investment denominated in a foreign currency or, conversely, to take a speculative position on the relative price movements of two currencies. We believe that by assessing its derivatives use holistically, a fund will be better positioned to implement a derivatives risk management program that does not over- or understate the risks its derivatives use may pose. Accordingly, we believe that this approach would result in a more-tailored derivatives risk management program.

The proposed rule would define the derivatives risks that must be identified and managed to include leverage, market, counterparty, liquidity, operational, and legal risks, as well as any other risks the derivatives risk manager deems material.[118] In the context of a fund's derivatives transactions:

- Leverage risk generally refers to the risk that derivatives transactions can magnify the fund's gains and losses;[119]
- Market risk generally refers to risk from potential adverse market movements in relation to the fund's derivatives positions, or the risk that markets could experience a change in volatility that adversely impacts fund returns and the fund's obligations and exposures;[120]
- Counterparty risk generally refers to the risk that a counterparty on a derivatives transaction may not be willing or able to perform its obligations under the derivatives contract, and the related risks of having concentrated exposure to such a counterparty;[121]
- Liquidity risk generally refers to risk involving the liquidity demands that derivatives can create to make payments of margin, collateral, or settlement payments to counterparties;
- Operational risk generally refers to risk related to potential operational issues, including documentation issues, settlement issues, systems failures, inadequate controls, and human error;[122] and
- Legal risk generally refers to insufficient documentation, insufficient capacity or authority of counterparty, or legality or enforceability of a contract.[123]

We believe these risks are common to most derivatives transactions.[124]

The proposed rule would not limit a fund's identification and assessment of derivatives risks to only those specified in the rule. The proposed definition of the term ''derivatives risks'' includes any other risks a fund's derivatives risk manager deems material.[125] Some derivatives transactions could pose certain idiosyncratic risks. For example,

[117] Proposed rule 18f–4(c)(1)(i).

[118] Proposed rule 18f–4(a). In the case of funds that are limited derivatives users under the proposed rule, the definition would include any other risks that the fund's investment adviser (as opposed to the fund's derivatives risk manager) deems material, because a fund that is a limited derivatives user would be exempt from the requirement to adopt a derivatives risk management program (and therefore also exempt from the requirement to have a derivatives risk manager). *See infra* section II.E.

[119] *See, e.g.,* Independent Directors Council, *Board Oversight of Derivatives Task Force Report* (July 2008), at 12 (''2008 IDC Report'').

[120] Funds should consider market risk together with leverage risk because leveraged exposures can magnify such impacts. *See, e.g.,* NAPF, *Derivatives and Risk Management Made Simple* (Dec. 2013), *available at https://www.jpmorgan.com/cm/BlobServer/is_napfms2013.pdf?blobkey=id&blobwhere=1320663533358&blobheader=application/pdf&blobheadername1=Cache-Control&blobheadervalue1=private&blobcol=urldata&blobtable=MungoBlobs.*

[121] *See, e.g.,* Nils Beier, *et al., Getting to Grips with Counterparty Risk,* McKinsey Working Papers on Risk, Number 20 (June 2010).

[122] *See, e.g.,* 2008 IDC Report, *supra* note 119; RMA, *Statement on best practices for managing risk in derivatives transactions* (2004) (''Statement on best practices for managing risk in derivatives transactions''), *available at http://www.rmahq.org/securities-lending/best-practices.*

[123] *See, e.g.,* Raimonda Martinkutė-Kaulienė, *Risk Factors in Derivatives Markets,* 2 Entrepreneurial Business and Economics Review 4 (2014); Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital and Segregation Requirements for Broker-Dealers, Exchange Act Release No. 86175 (June 21, 2019), 84 FR 43872 (Aug. 22, 2019), n.1055 (''Capital Margin Release'') (''Market participants face risks associated with the financial and legal ability of counterparties to perform under the terms of specific transactions''); *see also* Office of the Comptroller of the Currency, Risk Management of Financial Derivatives, Comptroller's Handbook (Jan. 1997) (narrative), (Feb. 1998) (procedures).

Because derivatives contracts that are traded over the counter are not standardized, they bear a certain amount of legal risk in that poor draftsmanship, changes in laws, or other reasons may cause the contract to not be legally enforceable against the counterparty. *See, e.g.,* Comprehensive Risk Management of OTC Derivatives, *supra* note 124. For example, some netting agreements or qualified financial contracts contain so-called ''walkaway'' clauses, such as provisions that, under certain circumstances, suspend, condition, or extinguish a party's payment obligation under the contract. These provisions would not be enforceable where the Federal Deposit Insurance Act is applicable. *See* 12 U.S.C 1821(e)(8)(G). As another example, many derivatives contracts and prime brokerage agreements that hedge funds and other counterparties had entered into with Lehman Brothers included cross-netting that allowed for payments owed to and from different Lehman affiliates to be offset against each other, and cross-liens that granted security interests to all Lehman affiliates (rather than only the specific Lehman entity entering into a particular transaction). In 2011, the U.S. Bankruptcy Court for the Southern District of New York held that cross-affiliate netting provisions in an ISDA swap agreement were unenforceable against a debtor in bankruptcy. In the Matter of Lehman Brothers Inc., Bankr. Case No. 08–01420 (JPM) (SIPA), 458 B.R. 134, 1135–137 (Bankr. S.D.N.Y. Oct. 4, 2011).

[124] *See* Numerix, *Comprehensive Risk Management of OTC Derivatives; A Tricky Endeavor* (July 16, 2013), *available at http://www.numerix.com/comprehensive-risk-management-otc-derivatives-tricky-endeavor* (''Comprehensive Risk Management of OTC Derivatives''); Statement on best practices for managing risk in derivatives transactions, *supra* note 122; 2008 IDC Report, *supra* note 119; Lawrence Metzger, *Derivatives Danger: internal auditors can play a role in reigning in the complex risks associated with financial instruments,* FSA Times (2011), *available at http://www.theiia.org/fsa/2011-features/derivatives-danger* (''FSA Times Derivatives Dangers''). *See also* 17 CFR 240.15c3–4(a) (''An OTC derivatives dealer shall establish, document, and maintain a system of internal risk management controls to assist it in managing the risks associated with its business activities, including market, credit, leverage, liquidity, legal, and operational risks.''). Nonbank security-based swap dealers and broker-dealers authorized to use internal models to compute net capital also are subject to rule 15c3–4. *See* Capital Margin Release, *supra* note 123.

[125] *See supra* note 118.

some derivatives transactions could pose a risk that a complex OTC derivative could fail to produce the expected result (*e.g.,* because historical correlations change or unexpected merger events occur) or pose a political risk (*e.g.,* events that affect currencies).

Commenters to the 2015 proposal generally supported its requirement that a fund engage in a process of identifying and evaluating the potential risks posed by its derivatives transactions.[126]

We request comment on all aspects of the proposed requirement to identify and assess a fund's derivatives risks, as well as the proposed definition of the term ''derivatives risks.''

21. Is the proposed definition of ''derivatives risks'' sufficiently clear? Why or why not?

22. Are the categories of risks that we have identified in the proposed rule appropriate? Why or why not? Should we remove any of the identified risk categories? If so, what categories should be removed, and why? Should we add any other specified categories of risks that should be addressed? If so, what additional categories and why? Should we provide further guidance regarding the assessment of any of these risks? If so, what should the guidance be, and why?

23. Do commenters believe the proposed approach with respect to risk identification and assessment is appropriate? Why or why not?

24. Do funds currently assess the risks associated with their derivatives transactions by taking into account both their derivatives transactions and other investments? If so, how do they perform this assessment? Are there certain derivatives transactions whose risks do not involve an assessment of other investments in a fund's portfolio? If so, which derivatives transactions, and why?

25. Should we require policies and procedures to include an assessment of particular risks based on an evaluation of certain identified risk categories as proposed? If not, why?

b. Risk Guidelines

The proposed rule would require a fund's program to provide for the establishment, maintenance, and enforcement of investment, risk management, or related guidelines that provide for quantitative or otherwise measurable criteria, metrics, or thresholds of the fund's derivatives risks (the ''guidelines'').[127] The guidelines would be required to specify levels of the given criterion, metric, or threshold that a fund does not normally expect to exceed and the measures to be taken if they are exceeded. The proposed guidelines requirement is designed to address the derivatives risks that a fund would be required to monitor routinely as part of its program, and to help the fund identify when it should respond to changes in those risks. We understand that many funds today have established risk management guidelines, with varying degrees of specificity.

The proposed rule would not impose specific risk limits for these guidelines. It would, however, require a fund to adopt guidelines that provide for quantitative thresholds that the fund determines to be appropriate and that are most pertinent to its investment portfolio, and that the fund reasonably determines are consistent with its risk disclosure.[128] Requiring a fund to establish discrete metrics to monitor its derivatives risks would require the fund and its derivatives risk manager to measure changes in its risks regularly, and this in turn is designed to lead to more timely steps to manage these risks. Moreover, requiring a fund to identify its response when these metrics have been exceeded would provide the fund's derivatives risk manager with a clear basis from which to determine whether to involve other persons, such as the fund's portfolio management or board of directors, in addressing derivatives risks appropriately.[129]

Funds may use a variety of approaches in developing guidelines that comply with the proposed rule.[130] This would draw on the risk identification element of the program and the scope and objectives of the fund's use of derivatives. A fund could use quantitative metrics that it determines would allow it to monitor and manage its particular derivatives risks most appropriately. We understand that today funds use a variety of quantitative models or methodologies to measure the risks associated with the derivatives transactions. With respect to market risk, we understand that funds commonly use VaR, stress testing, or horizon analysis. Concentration risk metrics are also being used in connection with monitoring counterparty risk (*e.g.,* requiring specific credit committee approval for transactions with a notional exposure in excess of a specified amount, aggregated with other outstanding positions with the same of affiliated counterparties). In addition, liquidity models have been designed to address liquidity risks over specified periods (*e.g.,* models identifying margin outlay requirements over a specified period under specified volatility scenarios).

In developing the guidelines, a fund generally should consider how to implement them in view of its investment portfolio and the fund's disclosure to investors. For example, a fund may wish to consider establishing corresponding investment size controls or lists of approved transactions across the fund.[131] A fund generally should consider whether to implement appropriate monitoring mechanisms designed to allow the fund to abide by the guidelines, including their quantitative metrics.

While the 2015 proposal did not require funds to adopt risk guidelines, commenters on the 2015 proposal generally supported the concept of a requirement that a fund adopt and implement policies and procedures reasonably designed to manage the risks of its derivatives transactions, including by monitoring whether those risks continue to be consistent with any investment guidelines established by the fund or the fund's investment adviser.[132]

We request comment on the proposed rule's guidelines requirement.

26. Should we require, as proposed, a fund's program to provide for the establishment, maintenance, and enforcement of investment, risk management, or related guidelines? Why or why not? Should we require, as proposed, that the guidelines provide for quantitative or otherwise measurable criteria, metrics, or thresholds of the fund's derivatives risks? Why or why not? If not, is there an alternative program element that would be more appropriate in promoting effective derivatives risk management? Should we prescribe particular tools or

[126] *See, e.g.,* ICI Comment Letter I; Comment Letter of the Consumer Federation of America (Mar. 28, 2016) (''CFA Comment Letter'').

[127] Proposed rule 18f–4(c)(1)(ii).

[128] *See, e.g.,* Mutual Fund Directors Forum, *Risk Principles for Fund Directors: Practical Guidance for Fund Directors on Effective Risk Management Oversight* (Apr. 2010), *available at http://www.mfdf.org/images/Newsroom/Risk_Principles_6.pdf* (''MFDF Guidance'').

[129] *See* proposed rule 18f–4(c)(1)(v); *see also infra* section II.B.3.e.

[130] *See, e.g.,* Comprehensive Risk Management of OTC Derivatives, *supra* note 124; Statement on best practices for managing risk in derivatives transactions, *supra* note 122; 2008 IDC Report, *supra* note 119.

[131] A fund could also consider establishing an ''approved list'' of specific derivatives instruments or strategies that may be used, as well as a list of persons authorized to engage in the transactions on behalf of the fund. A fund may wish to provide new instruments (or instruments newly used by the fund) additional scrutiny. *See, e.g.,* MFDF Guidance, *supra* note 128, at 8.

[132] *See, e.g.,* BlackRock Comment Letter; CRMC Comment Letter; ICI Comment Letter I.

approaches that funds must use to manage specific risks related to their use of derivatives? For example, should we require funds to manage derivatives' liquidity risks by maintaining highly liquid assets to cover potential future losses and other liquidity demands?

27. Should we require a specific number or range of numbers of guidelines that a fund should establish? For example, should we require a fund to establish a minimum of 2, 3, 4, or more different guidelines to cover a range of different risks? Why or why not?

28. Do funds currently adopt, and monitor compliance with, such guidelines? If so, do these guidelines provide for quantitative or otherwise measurable criteria, metrics, or thresholds of the funds' derivatives risks? If so, what criteria, metrics, or thresholds are provided for? Should we require that funds use specific risk management tools? If so, what tools should we require?

29. Should we specify a menu of guideline categories that all funds should use to promote consistency in risk management among funds? For example, should we identify certain commonly-used types of guidelines such as VaR, notional amounts, and duration, and require funds to choose among those commonly-used types? If we were to do so, which metrics should we allow funds to use? Would such a menu become stale as new risk measurement tools are developed?

30. Should we require, as proposed, that the guidelines specify set levels of a given criterion, metric, or threshold that the fund does not generally expect to exceed? Why or why not? If so, how would these levels be set or calculated? Should we instead set maximum levels for certain guidelines a fund would not exceed?

31. Should we require that a fund publicly disclose the guidelines it uses and the quantitative levels selected? If so, where (for example, in the fund's prospectus, website, or on Form N–PORT or N–CEN)? Should we instead require that funds confidentially report to us the guidelines they use and the quantitative levels selected? If so, on what form should they report this information?

32. Should we require, as proposed, that the guidelines identify measures to be taken when the fund exceeds a criterion, metric, or threshold in the fund's guidelines? Why or why not?

33. Should we require any form of public disclosure or confidential reporting to us if a fund were to exceed its risk guidelines? Would such reporting or disclosure result in funds setting guidelines that are so restrictive or lax that they would be unlikely to be useful as a monitoring and risk management tool?

34. Should the rule require the guidelines to provide for other elements? If so, what elements and why?

c. Stress Testing

The proposed rule would require a fund's program to provide for stress testing to evaluate potential losses to the fund's portfolio.[133] We understand that, as a derivatives risk management tool, stress testing is effective at measuring different drivers of derivatives risks, including non-linear derivatives risks that may be understated by metrics or analyses that do not focus on periods of stress. Stress testing is an important tool routinely used in other areas of the financial markets and in other regulatory regimes, and we understand that funds engaging in derivatives transactions have increasingly used stress testing as a risk management tool over the past decade.[134] The Commission has also required certain types of funds to conduct stress tests or otherwise consider the effect of stressed market conditions on their portfolios.[135] We believe that requiring a fund to stress test its portfolio would help the fund better manage its derivatives risks and facilitate board oversight.

We also believe that stress testing would serve as an important complement to the proposed VaR-based limit on fund leverage risk, as well as any VaR testing under the fund's risk guidelines.[136] During periods of stress, returns, correlations, and volatilities tend to change dramatically over a very short period of time. Losses under stressed conditions—or ''tail risks''—would not be reflected in VaR analyses that are not calibrated to a period of market stress and that do not estimate losses that occur on the trading days with the highest losses.[137] Requiring funds to stress test their portfolios would provide information regarding these ''tail risks'' that VaR and other analyses may miss.

Under the proposed rule, the fund's stress tests would be required to evaluate potential losses to the fund's portfolio in response to extreme but plausible market changes or changes in market risk factors that would have a significant adverse effect on the fund's portfolio.[138] The stress tests also would have to take into account correlations of market risk factors and resulting payments to derivatives counterparties.[139] We believe that these requirements would promote stress tests that produce results that are valuable in appropriately managing derivatives risks by focusing the testing on extreme events that may provide actionable information to inform a fund's derivatives risk management.[140] We understand that funds commonly consider the following market risk factors: liquidity, volatility, yield curve shifts, sector movements, or changes in the price of the underlying reference security or asset.[141] In addition, we believe it is important for a fund's stress testing to take into account payments to counterparties, as losses can result when the fund's portfolio securities decline in value at the same time that the fund is required to make additional payments under its derivatives contracts.[142]

To inform a fund's derivatives risk management effectively, a fund should stress test its portfolio with a frequency that would best position the derivative risk manager to appropriately administer, and the board to appropriately oversee, a fund's derivatives risk management, taking into account the frequency of change in the fund's investments and market conditions. The proposed rule, therefore, would permit a fund to determine the frequency of stress tests, provided that the fund must conduct stress testing at least weekly. In establishing such frequency, a fund

[133] Proposed rule 18f–4(c)(1)(iii); *see also infra* section II.D.6.a (discussing an alternative to the proposed limit on fund leverage risk that would rely on a stress testing framework). The proposed rule would require a fund that is required to establish a derivatives risk mangement program to stress test its portfolio, that is, all of the fund's investments, and not just the fund's derivatives transactions.

[134] *See, e.g.,* Comment Letter of Investment Company Institute (Oct. 8, 2019) (''ICI Comment Letter III'') (stating that, based on a survey of member firms, many funds perform ex ante stress testing).

[135] *See* rule 2a–7 under the Investment Company Act [17 CFR 270.2a–7]; *see also* rule 22e–4 under the Investment Company Act [17 CFR 270.22e–4] (requiring a fund subject to the rule to assess its liquidity risk by considering, for example, its investment strategy and portfolio investment liquidity under reasonably foreseeable stressed conditions).

[136] *See* proposed rule 18f–4(c)(2); *infra* section II.D.

[137] The proposed rule would not require a fund to implement a stressed VaR test. *See infra* section II.D.1.

[138] Proposed rule 18f–4(c)(1)(iii).

[139] *Id.*

[140] Krishan Mohan Nagpal, *Designing Stress Scenarios for Portfolios,* 19 Risk Management 323 (2017).

[141] *See, e.g.,* ICI Comment Letter I; Thomas Breuer, *et al., How to Find Plausible, Severe, and Useful Stress Scenarios,* International Journal of Central Banking 205 (Sept. 2009).

[142] *See* OppenheimerFunds Settled Action, *supra* note 22.

must take into account the fund's strategy and investments and current market conditions. For example, a fund whose strategy involves a high portfolio turnover might determine to conduct stress testing more frequently than a fund with a more static portfolio. A fund similarly might conduct more frequent stress tests in response to increases in market stress. The minimum weekly stress testing frequency is designed to balance the potential benefits of relatively frequent stress testing with the burdens of administering stress testing.[143] We also considered a less frequent requirement, such as monthly stress testing. A less frequent requirement, however, may fail to provide a fund's derivatives risk manager adequate and timely insight into the fund's derivatives risk, particularly where the fund has a high portfolio turnover. In determining this minimum frequency, we also took into account that this requirement would only apply to funds that do not qualify for the limited derivatives user exception because they use derivatives in more than a limited way. In addition, in view of the proposed rule's internal reporting and periodic review requirements, the weekly stress testing minimum would provide a fund's derivatives risk manager and board with multiple sets of stress testing results, which would allow them to observe trends and how the results may change over time.[144]

Although the 2015 proposal's risk management program did not include a stress testing requirement, some commenters stated that stress testing would serve as an important component of derivatives risk management and recommended that the Commission require a fund's designated risk manager to perform stress testing and report the results to the fund's board.[145]

We request comment on the proposed rule's stress testing requirement.

35. Should we require, as proposed, that funds conduct stress testing as part of the program requirement? Why or why not? How, if at all, would stress testing serve as a complement for other risk measurement tools, such as VaR? What does stress testing capture as part of derivatives risk management that other tools do not, and why?

36. Should the rule require funds to conduct a particular type of stress testing? If so, what type, and what should the required elements be? For example, should the rule require funds to conduct scenario analysis?

37. Should the rule identify specific stress events to be applied? Should any required stress events vary based on the primary risks of particular funds?

38. Do funds currently conduct stress testing? If so, what types of stress testing, for what purposes, and how does the stress testing that funds currently conduct differ from the proposed rule's requirement?

39. For funds that currently conduct stress testing, how frequently do they conduct it? Daily, weekly, or monthly? Why? Does it depend on the type of stress testing? On the investment objective or strategy of a fund? With what minimum frequency should the rule require stress testing be conducted? For example, instead of weekly tests should we require daily tests? Conversely should we allow longer periods of time between tests, such as monthly, or quarterly? Why? Should we require more frequent testing for funds with some investment objectives or strategies than other funds? If so, for which objectives or strategies should we require more frequent testing?

40. Is the proposed rule's reference to ''extreme but plausible market changes or changes in market risk factors'' sufficiently clear? Should we identify more quantitative changes, such as the worst change in a specific risk factor seen in the last 10, 20, or 50 years? Is the proposed rule's reference to ''significant adverse effect'' sufficiently clear? Should we instead identify quantitative levels of NAV change, such as a drop of 20, 30, or 50% of the fund's NAV?

41. Should we require stress tests to include certain identified market risk factors such as changes in interest rates or spreads, market volatility, market liquidity, or other market factors? If so, which market risk factors should we identify, and why? If we were to identify certain market risk factors to be tested, should we require a fund to take action (such as reporting to its board or to the Commission, or reducing its derivatives usage) if a stress test were to show that one of these factors would result in the fund losing a certain percentage of its NAV? If so, what level of NAV, what types of risk factors, and what types of action should we consider?

42. Should we require, as proposed, that funds take into account their strategy, investments, and current market conditions in considering the appropriate frequency for a fund's stress tests? Why or why not? Should we require, as proposed, that funds to take into account correlations of market risk factors and payments to derivatives counterparties as part of the fund's stress tests? Why or why not? Would any additional guidance help funds to better understand, and more consistently conduct, the stress tests that the proposed rule would require?

43. We discuss and request comment below on the proposed rule's requirements to provide information to a fund's board of directors, including the derivatives risk manager's analysis of a fund's stress testing. In addition to providing this information to the board, should we require funds to disclose stress test results to investors or report them confidentially to us? If so, what information should be disclosed or reported?

d. Backtesting

The proposed rule would require a fund to backtest the results of the VaR calculation model used by the fund in connection with the relative VaR or absolute VaR test, as applicable, as part of the program.[146] This proposed requirement is designed to require a fund to monitor the effectiveness of its VaR model. It would assist a fund in confirming the appropriateness of its model and related assumptions and help identify when funds should consider model adjustments.[147] We are proposing this requirement in light of the central role that VaR plays in the proposed VaR-based limit on leverage risk. This also is consistent with the comments we received on the 2015 proposal suggesting that we require backtesting, which we had not included in that proposal.[148]

Specifically, the proposed backtesting requirement provides that, each business day, the fund must compare its actual gain or loss for that business day with the VaR the fund had calculated for that day. For purposes of the backtesting requirement, the VaR would be estimated over a one-trading day time horizon. For example, on Monday at the

[143] We recognize that the costs associated with stress testing may increase with the frequency of conducting such tests. We understand, however, that once a fund initially implements a stress testing framework, subsequent stress tests could be automated and, as a result, be less costly.

[144] *See infra* sections II.B.3.e and II.C.

[145] *See, e.g.,* Comment Letter of Blackstone Alternative Investment Advisors LLC (Mar. 28, 2016) (''Blackstone Comment Letter''); Comment Letter of Invesco Management Group, Inc. (Mar. 28, 2016) (''Invesco Comment Letter''); *see also* ICI Comment Letter III.

[146] *See* proposed rule 18f–4(c)(1)(iv).

[147] Some commenters on the 2015 proposal suggested that the Commission require backtesting of a fund's VaR calculation models. *See, e.g.,* Blackstone Comment Letter; Comment Letter of Investment Company Institute (Sept. 27, 2016) (''ICI Comment Letter II''); Aviva Comment Letter; Comment Letter of the Global Association of Risk Professionals (Mar. 21, 2016) (''GARP Comment Letter'').

[148] *See, e.g.,* Blackstone Comment Letter; ICI Comment Letter II; Aviva Comment Letter; GARP Comment Letter.

end of the trading day, a fund would analyze whether the gain or loss it experienced that day exceeds the VaR calculated for that day. In this backtesting example, the fund could calculate the VaR for Monday on Friday evening (after Friday trading closes) or Monday morning (before Monday trading begins). The fund would have to identify as an exception any instance in which the fund experiences a loss exceeding the corresponding VaR calculation's estimated loss. This approach is generally consistent with the practice of firms that use internal models to compute regulatory capital and other regulatory approaches.[149] Because the proposed rule would require that the fund's backtest be conducted using a 99% confidence level and over a one-day time horizon, and assuming 250 trading days in a year, a fund would be expected to experience a backtesting exception approximately 2.5 times a year, or 1% of the 250 trading days.[150] If the fund were consistently to experience backtesting exceptions more (or less) frequently, this could suggest that the fund's VaR model may not be effectively taking into account and incorporating all significant, identifiable market risk factors associated with a fund's investments, as required by the proposed rule.[151]

The proposed rule would require funds to conduct a backtest each day so that a fund and its derivatives risk manager could more readily and efficiently adjust or calibrate its VaR calculation model and, therefore, could more effectively manage the risks associated with its derivatives use. We understand that some funds perform these calculations less frequently than daily.[152] We are proposing a daily backtesting requirement because market risk factors and fund investments are dynamic, which might result in frequent changes to the accuracy and effectiveness of a VaR model and calculations using the model. Some commenters on the 2015 proposal supported a backtesting requirement with a daily frequency.[153] We also believe that the additional costs associated with a daily backtesting requirement would be limited because a fund would be required to calculate its portfolio VaR each business day to satisfy the proposed limits on fund leverage discussed in section II.D of this release.

We request comment on the proposed backtesting requirement.

44. Is the proposed requirement that a fund backtest its VaR model each business day appropriate? Why or why not? Would less-frequent backtesting be sufficient? Is backtesting an effective tool to promote derivatives risk management and VaR model accuracy? Why or why not?

45. Should the rule specify the number of exceedances, or the number of consecutive days without an exceedance, that would require VaR model calibration? Why or why not?

46. How often do funds that currently use VaR backtest their VaR models and why? Should the backtesting requirement be less frequent? For example, should we require a fund to perform backtests weekly, monthly, or quarterly, in each case considering the one-day value change for each trading day in the period? Please explain.

47. For funds that currently backtest their VaR models, how often and for what reasons do funds recalibrate their VaR models? Are certain market risk factors or investment types particularly prone to requiring VaR model recalibrations (as well as backtesting)?

e. Internal Reporting and Escalation

The proposed rule would require communication between a fund's risk management and portfolio management regarding the operation of the program.[154] We believe these lines of communication are a key part of derivatives risk management.[155] Providing portfolio managers with the insight of a fund's derivatives risk manager is designed to inform portfolio managers' execution of the fund's strategy and recognize that portfolio managers will generally be responsible for transactions that could mitigate or address derivatives risks as they arise. The proposed rule also would require communication between a fund's derivatives risk manager and its board, as appropriate. We understand that funds today often have a dialogue between risk professionals and fund boards. Requiring a dialogue between a fund's derivatives risk manager and the fund's board would provide the fund's board with key information to facilitate its oversight function.

To provide flexibility for funds to communicate among these groups as they deem appropriate and taking into account funds' own facts and circumstances, the proposed rule would require a fund's program to identify the circumstances under which a fund must communicate with its portfolio management about the fund's derivatives risk management, including its program's operation.[156] A fund's program, in addition, could require that the fund's derivatives risk manager inform the fund's portfolio management, for example, by meeting with the fund's portfolio management on a regular and frequent basis, or require that the fund's portfolio management is notified of the fund's exceedances or stress tests through software designed to provide automated updates.

The proposed rule would also require a fund's derivatives risk manager to communicate material risks to the fund's portfolio management and, as appropriate, its board of directors.[157] Specifically, the rule would require the

[149] *See, e.g.,* rule 15c3–1e under the Exchange Act [17 CFR 240.15c3–1e] (Appendix E to 17 CFR 240.15c3–1) (''On the last business day of each quarter, the broker or 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.''); CESR Global Guidelines, *supra* note 94 (''The UCITS should carry out the back testing program at least on a monthly basis, subject to always performing retroactively the comparison for each business day,'' *i.e.,* ''provid[ing] for each business day a comparison of the one-day value-at-risk measure generated by the UCITS model for the UCITS' end-of-day positions to the one-day change of the UCITS' portfolio value by the end of the subsequent business day''); *see also infra* note 152 (discussing frequency variations for backtesting requirements).

[150] The proposed backtesting requirement would be based on a one-day time horizon. *See infra* section II.D.4 (discussing the proposed VaR model requirements that would be based on a twenty-day time horizon).

[151] If 10 or more exceptions are generated in a year from backtesting that is conducted using a 99% confidence level and over a one-day time horizon, and assuming 250 trading days in a year, it is statistically likely that such exceptions are a result of a VaR model that is not accurately estimating VaR. *See, e.g.,* Philippe Jorion, *Value at Risk: The New Benchmark for Managing Financial Risk* (3d ed. 2006), at 149–150 (''Jorion''). *See also* rule 15c3–1e under the Exchange Act (requiring backtesting of VaR models and the use of a multiplication factor based on the number of backtesting exceptions).

[152] *See, e.g.,* CESR Global Guidelines, *supra* note 94 (''The UCITS should carry out the back testing program at least on a monthly basis, subject to always performing retroactively the comparison for each business day,'' *i.e.,* ''provid[ing] for each business day a comparison of the one-day value-at-risk measure generated by the UCITS model for the UCITS' end-of-day positions to the one-day change of the UCITS' portfolio value by the end of the subsequent business day''); Blackstone Comment Letter (suggesting monthly backtests); Aviva Comment Letter (recommending reporting to the Commission on a semi-annual basis if a fund experienced a certain number of backtest exceptions). *Cf.* rule 15c3–1e under the Exchange Act [17 CFR 240.15c3–1e] (Appendix E to 17 CFR 240.15c3–1) (''On the last business day of each quarter, the broker or 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.'').

[153] *See, e.g.,* GARP Comment Letter; Aviva Comment Letter; ICI Comment Letter II.

[154] Proposed rule 18f–4(c)(1)(v).

[155] *See* 2011 IDC Report, *supra* note 95.

[156] Proposed rule 18f–4(c)(1)(v)(A).

[157] Proposed rule 18f–4(c)(1)(v)(B).

derivatives risk manager to inform, in a timely manner, persons responsible for the fund's portfolio management—and the fund's board of directors, as appropriate—of material risks arising from the fund's derivatives transactions.[158] The proposed rule would not require a fund's derivatives risk manager to escalate these risks to the fund's board automatically, but would require that the derivatives risk manager directly inform the fund's board of directors regarding these material risks if the manager determines board escalation to be appropriate. A fund's derivatives risk manager, for example, could determine to inform the fund's adviser's senior officers of material derivatives risks after informing the fund's portfolio management, and before informing the fund's board. As another example, a fund's derivatives risk manager could determine that it would be appropriate to communicate certain material derivatives risks (for example, those that put more than a certain percentage of the fund's assets at imminent risk) to the board at the same time it informs the fund's portfolio management. We believe that a fund's derivatives risk manager is best positioned to determine when to appropriately inform the fund's portfolio management and board of material risks.

The proposed rule would require that these material risks include any material risks identified by the fund's guideline exceedances or stress testing. For example, an unexpected risk may arise due to a sudden market event, such as a downgrade of a large investment bank that is a substantial derivatives counterparty to the fund. This requirement is designed to inform portfolio managers of material risks identified by a fund's derivatives risk management function so that portfolio managers can take them into account in managing the fund's portfolio and address or mitigate them as appropriate. It also would facilitate board oversight by empowering the derivatives risk manager to escalate a material risk directly to the fund's board where appropriate. Requiring that a fund's derivatives risk manager have this direct line of communication with the board regarding material risks arising from the fund's derivatives transactions is designed to foster an open and effective dialogue among the derivatives risk manager and the board.

We request comment on the internal reporting and escalation elements of the proposed program requirement.

48. Are the proposed internal reporting and escalation requirements appropriate? Why or why not? Should the rule describe the circumstances under which a fund must inform its portfolio management regarding the operation of the program, including any exceedances of its guidelines and the results of its stress tests? Why or why not? If so, what should the circumstances be and why? Should the rule require a fund to report to others at the fund or its adviser (*e.g.,* the fund's chief compliance officer)? If so, who should a fund report to and why?

49. Should we prescribe the types of internal reporting information that persons responsible for a fund's portfolio management or the fund's board should receive, and the means by which these persons receive such information? Why or why not? If so, what should we prescribe and why?

50. Are the proposed requirements to escalate material risks to the fund's portfolio management (and, as appropriate, the fund's board of directors) appropriate? Why or why not? Should these material risks include risks identified by the fund's guideline exceedances or stress testing? Why or why not? Should a fund's derivatives risk manager be required to report all material derivatives risks to the fund's board, as well as to its portfolio management? Why or why not?

51. Should the rule, as proposed, permit a fund to determine what risks arising from its derivatives transactions are material to the fund, for purposes of the proposed escalation requirement? Why or why not? If so, should the rule specifically require a fund's derivatives risk manager to make this determination?

52. Should the rule require the means by which internal reporting and/or material risk escalation occur? For example, should the rule specify that certain communications must be in writing? Why or why not?

53. Should the rule require a fund's derivatives risk manager to inform the fund's portfolio management regarding the operation of the program on a regular basis? Why or why not? If so, what should the frequency be and why?

54. Should the rule require a fund to report material risks to us? Why or why not? If so, what should a fund report and how should it be reported? For example, should a fund be required to report material exceedances to its guidelines? Why or why not? Should such a report be confidential?

55. Should the rule permit a fund to determine whether the material risk warrants informing the fund's board? Why or why not? If so, which person or persons at the fund or its adviser should be responsible for that determination? Should a fund's board always be informed of material risks regarding the fund's derivatives use? Why or why not? If so, under what circumstances and frequency should the board be informed, and why?

56. Should we require that a fund's derivatives risk manager be permitted to communicate directly with the fund's board of directors? If not, how should we otherwise address the concern that a board may not receive the derivatives risk manager's independent risk assessments if the derivatives risk manager is not empowered to communicate directly with the board?

f. Periodic Review of the Program

The proposed rule would require a fund's derivatives risk manager to review the program at least annually to evaluate the program's effectiveness and to reflect changes in the fund's derivatives risks over time.[159] The review would apply to the overall program, including each of the specific program elements discussed above.

The periodic review would also cover the VaR model a fund uses to comply with the proposed VaR-based limit on fund leverage risk and related matters. As discussed below, the proposed rule would require a fund to comply with a relative or absolute VaR test.[160] For the relative VaR test, the fund would compare its VaR to a ''designated reference index,'' as defined in the rule and selected by the fund's derivatives risk manager. The proposed periodic review would therefore include the VaR calculation model that the fund used in connection with either of the proposed VaR tests (including the fund's backtesting of the model) and any designated reference index that the derivatives risk manager selected, to evaluate whether the calculation model and designated reference index remain appropriate.

We believe that the periodic review of a fund's program and VaR calculation model is necessary to determine whether the fund is appropriately addressing its derivatives risks. A fund's derivatives risk manager, as a result of the review, could determine whether the fund should update its program, its VaR calculation model, or any designated reference index. Commenters on the 2015 proposal generally supported a similar proposed requirement that a fund review and

[158] *Id.*

[159] Proposed rule 18f–4(c)(1)(vi).

[160] *See* proposed rule 18f–4(c)(2); *infra* section II.D.

update its derivatives risk management program at least annually.[161]

The proposed rule would not prescribe review procedures or incorporate specific developments that a derivatives risk manager must consider as part of its review. We believe a derivatives risk manager generally should implement periodic review procedures for evaluating regulatory, market-wide, and fund-specific developments affecting the fund's program so that it is well positioned to evaluate the program's effectiveness.

We believe that a fund should review its program, VaR calculation model, and designated reference index on at least an annual basis, because derivatives and fund leverage risks, and the means by which funds evaluate such risks, can change. The proposed rule would require at least an annual review so that there would be a recurring dialogue between a fund's derivatives risk manager and its board regarding the implementation of the program and its effectiveness. This frequency also mirrors the minimum period in which the fund's derivatives risk manager would be required to provide a written report on the effectiveness of the program to the board.[162] A fund's derivatives risk manager could, however, determine that more frequent reviews are appropriate based on the fund's particular derivatives risks, the fund's policies and procedures implementing the program, market conditions, or other facts and circumstances.[163]

We request comment on the proposed rule's periodic review requirement.

57. Should the rule, as proposed, specifically require that a fund's derivatives risk manager periodically review the program's effectiveness, including the program's VaR calculation model and any designated reference index? Why or why not?

58. Should the rule, as proposed, require this review to take place at least annually, or should it require a more frequent review, such as quarterly? Should we, instead, not prescribe a minimum frequency for the periodic review? Why or why not?

59. Are there certain review procedures that the proposed rule should require and/or on which the Commission should provide guidance? If so, what are they? For example, should the periodic review involve board input? Should the Commission provide any additional guidance on regulatory, market-wide, and fund-specific developments that a fund's review procedures might cover? Why or why not? If so, how?

60. Should the rule, as proposed, specifically require that other program elements be periodically reviewed? Why or why not? If so, which elements and why, and should they be reviewed with the same frequency?

C. Board Oversight and Reporting

The proposed rule would require: (1) A fund's board of directors to approve the designation of the fund's derivatives risk manager and (2) the derivatives risk manager to provide regular written reports to the board regarding the program's implementation and effectiveness, and describing any exceedances of the fund's guidelines and the results of the fund's stress testing.[164] Requiring a fund's derivatives risk manager approved by the fund's board and with relevant experience as determined by the fund's board to be responsible for the day-to-day administration of the fund's program, subject to board oversight, is consistent with the way we believe many funds currently manage derivatives risks.[165] It is also consistent with a board's duty to oversee other aspects of the management and operations of a fund.

The proposed rule's requirements regarding board oversight and reporting are designed to further facilitate the board's oversight of the fund's derivatives risk management.[166] Board oversight should not be a passive activity. Consistent with that view, we believe that directors should understand the program and the derivatives risks it is designed to manage as well as participate in determining who should administer the program. They also should ask questions and seek relevant information regarding the adequacy of the program and the effectiveness of its implementation. The board should view oversight as an iterative process. Therefore, the board should inquire about material risks arising from the fund's derivatives transactions and follow up regarding the steps the fund has taken to address such risks, including as those risks may change over time. To facilitate the board's oversight, the proposed rule, as discussed below, would require the fund's derivatives risk manager to provide reports to the board.

A fund's board would also be responsible for overseeing a fund's compliance with proposed rule 18f–4. Rule 38a–1 under the Investment Company Act requires a fund's board, including a majority of its independent directors, to approve policies and procedures reasonably designed to prevent violation of the federal securities laws by the fund and its service providers.[167] Rule 38a–1 provides for oversight of compliance by the fund's adviser and other service providers through which the fund conducts its activities. Rule 38a–1 would encompass a fund's compliance obligations with respect to proposed rule 18f–4.

1. Board Approval of the Derivatives Risk Manager

The proposed rule would require a fund's board to approve the designation of the fund's derivatives risk manager, taking into account the derivatives risk manager's relevant experience regarding the management of derivatives risk.[168] This requirement is designed to establish the foundation for an effective relationship and line of communication between a fund's board and its derivatives risk manager, and to ensure that the board receives information it needs to approve the designation.[169] The requirement that the board consider the derivatives risk manager's relevant experience is designed to provide flexibility for a fund's board to take into account a derivatives risk manager's specific experience, rather than the rule taking a more prescriptive approach in identifying a specific amount or type of experience that a derivatives risk

[161] *See, e.g.,* Vanguard Comment Letter.

[162] *See infra* section II.C.2.

[163] *See also* proposed rule 18f–4(c)(2)(iii)(A) (requiring, for a fund that is not in compliance with the applicable VaR test within three business days, the derivatives risk manager to report to the fund's board of directors and explain how and by when (*i.e.,* number of business days) the derivatives risk manager reasonably expects that the fund will come back into compliance).

[164] Proposed rule 18f–4(c)(5). The board could designate a committee of directors to receive the report.

[165] *See, e.g.,* Comment Letter of the Independent Directors Council (June 22, 2016) (providing views regarding the appropriate oversight role of fund directors).

[166] Many commenters to the 2015 proposal expressed the view that the appropriate role of the board in the context of funds' derivatives risk management is one of oversight. *See, e.g.,* Comment Letter of Mutual Fund Directors Forum (Mar. 28, 2016) (stating it has long taken the position that boards and independent trustees have an important role to play in overseeing the risks associated with funds' use of derivatives, including the manner in which those risks are managed); *see also* Comment Letter of the Independent Directors Council (Mar. 28, 2016) (''IDC Comment Letter''); Morningstar Comment Letter.

[167] *See* rule 38a–1 under the Investment Company Act; Compliance Programs of Investment Companies and Investment Advisers, Investment Company Act Release No. 26299 (Dec. 17, 2003) [68 FR 74714 (Dec. 24, 2003)] (discussing the adoption and implementation of policies and procedures required under rule 38–1) (''Compliance Program Release'').

[168] Proposed rule 18f–4(c)(5)(i).

[169] *Cf.* rules 22e–4 and 38a–1 under the Investment Company Act.

manager must have. Detailing a derivatives risk manager's required experience in the rule would not be practical, given the numerous ways in which a person could obtain experience with derivatives or risk management. Any specification in the rule of the specific experience required to serve as a derivatives risk manager likely would be over- or under-inclusive and would not take into account the way that any particular fund uses derivatives. We believe that a fund's board, in its oversight role, is best-positioned to consider a prospective derivatives risk manager's experience based on all the facts and circumstances relevant to the fund in considering whether to approve the derivatives risk manager's designation.

Commenters on the 2015 proposal generally supported a requirement that the board approve a fund's derivatives risk manager, although some of these commenters objected to the proposed requirement that only a single individual could serve in that role. These commenters asserted that requiring the board to approve a single individual as the derivatives risk manager would have required the board to participate too closely in the management function of the fund.[170] This re-proposal, in contrast, would permit a fund's board to approve the designation of a single individual or group of individuals, subject to the other proposed requirements about who may serve as a derivatives risk manager.

We request comment on the proposed requirement that a fund's board approve the designation of the fund's derivatives risk manager.

61. Should we require, as proposed, that a fund's board approve the designation of the fund's derivatives risk manager? Why or why not? Are there any specific requirements we should include with respect to the derivatives risk manager's relationship with the board? For example, should we require the board to meet with the derivatives risk manager in executive session? Should we also require the derivatives risk manager to be removable only by the fund's board? Should we require the derivatives risk manager's compensation be approved by the board, like a fund's chief compliance officer? If so, why? Would such a requirement pose undue burdens on fund boards or place the board in an inappropriate role? If so, why?

62. Should the rule permit a board committee to approve the designation of the derivatives risk manager, rather than the full board (and a majority of directors who are not interested persons of the fund) as proposed? Why or why not? If so, should there be any requirements or guidance with respect to such a board committee (*e.g.,* composition or responsibilities)?

63. Should the rule, as proposed, require that a fund's board in approving the fund's derivatives risk manager, take into account the derivatives risk manager's relevant experience regarding the management of derivatives risk? Why or why not? Would a fund's board, in approving the designation of the fund's derivatives risk manager, only approve individuals with relevant experience even without this express requirement? Is the proposed requirement that a fund's board must take into account the derivatives risk manager's ''relevant experience regarding the management of derivatives risk'' sufficiently clear? Would this raise questions for a fund's board about whether portfolio management experience, or experience outside of formal derivatives risk management, would suffice for purposes of the rule? Should the rule, instead, require that a fund's board take into account the derivatives risk manager's ''relevant experience''? Or should the rule identify specific qualifications or experience of a fund's derivatives risk manager that the fund's board must consider? Why or why not? If so, what should they be and why?

64. Should we require a fund's board, or a committee thereof, to approve the derivatives risk management program or any material changes to the program? Why or why not? If so, should we require that the committee have a majority that are disinterested? Would such an approval requirement promote greater board engagement and oversight? Do a fund's derivatives use and related derivatives risks present matters for which it would be appropriate to require the fund's board, or committee thereof, to approve the program or any material changes to the program? Why or why not?

2. Board Reporting

The proposed rule would require the derivatives risk manager to provide a written report on the effectiveness of the program to the board at least annually and also to provide regular written reports at a frequency determined by the board. This requirement is designed to facilitate the board's oversight role, including its role under rule 38a–1.[171]

Many commenters to the 2015 proposal did not support the proposal's requirement that the board approve material changes to the program. Many commenters did state, however, that a fund's board of directors should be provided with notices of changes to the policies and procedures implementing the derivatives risk management program and that the fund's derivatives risk manager should provide the board with a written report describing the adequacy of the derivatives risk management program and the effectiveness of its implementation and the results of the fund's stress testing.[172]

Reporting on Program Implementation and Effectiveness

The proposed rule would require a fund's derivatives risk manager to provide to the fund's board, on or before the implementation of the program and at least annually thereafter, a written report providing a representation that the program is reasonably designed to manage the fund's derivatives risks and to incorporate the required elements of the program as well as the basis for the representation.[173] This requirement, as discussed below, is designed to provide a fund's board with information about the effectiveness and implementation of the program so that the board may appropriately exercise its oversight responsibilities, including its role under rule 38a–1.

To facilitate the board's oversight, the proposed rule would require the written report to include the basis for the derivatives risk manager's representation along with such information as may be reasonably necessary to evaluate the adequacy of the fund's program and the effectiveness of its implementation. In addition, the representation may be based on the derivatives risk manager's reasonable belief after due inquiry. A derivatives risk manager, for example, could form its reasonable belief based on an assessment of the program and taking into account input from fund personnel, including the fund's portfolio management, or from third parties. We propose to require that the derivatives risk manager include this representation and its basis, because we believe the derivatives risk manager—rather than the board—is best positioned to make this determination. Requiring the

[170] *See, e.g.,* Comment Letter of Guggenheim (Mar. 28, 2016) (''Guggenheim Comment Letter''); Dechert Comment Letter; IDC Comment Letter; American Beacon Comment Letter; Fidelity Comment Letter; IAA Comment Letter; ICI Comment Letter I; Invesco Comment Letter.

[171] *See* Compliance Program Release, *supra* note 166, at n.33 and accompanying text.

[172] *See, e.g.,* BlackRock Comment Letter; Vanguard Comment Letter.

[173] Proposed rule 18f–4(c)(5)(ii).

derivatives risk manager to include the information in a board report would also reinforce that the fund and its adviser are responsible for derivatives risk management while the board's responsibility is to oversee this activity. Reports following the initial implementation of the program must also address the effectiveness of the program. This requirement is designed to provide the board with appropriate and useful information so it can exercise its judgment in overseeing the program, and in light of its role under rule 38a–1.

The proposed rule would also require the written report to include a fund's derivatives risk manager's basis for the selection of the designated reference index used under the proposed relative VaR test or, if applicable, an explanation of why the derivatives risk manager was unable to identify a designated reference index appropriate for the fund such that the fund relied on the proposed absolute VaR test instead. The derivatives risk manager's selection of a particular designated reference index, or conclusion that one is not available, can affect the amount of leverage risk a fund may obtain under the proposed rule.[174] We therefore believe it is important that a fund's board have sufficient information to oversee this activity.

Regular Board Reporting

The proposed rule would require a fund's derivatives risk manager to provide to the fund's board, at a frequency determined by the board, a written report analyzing any exceedances of the fund's risk guidelines and the results of the fund's stress tests and backtesting.[175] Requiring the derivatives risk manager to provide information about how the fund performed relative to these measures and at a board-determined frequency is designed to provide the board with timely information to facilitate its oversight of the fund and the operation of the program. The program's guidelines and stress testing requirements are designed to address a fund's particular derivatives risks and are areas the fund should routinely monitor. The program's backtesting requirement is designed to require a fund to monitor the effectiveness of the fund's VaR model, which plays a central role in the proposed VaR-based limit on fund leverage risk. Therefore, we believe that a board overseeing a fund's derivatives risk management should receive regular reporting regarding the derivatives risk manager's analysis of guideline exceedances and the results of stress testing and backtesting. We also understand that many fund advisers today provide regular reports to fund boards, often in connection with quarterly board meetings, regarding a fund's use of derivatives and their effects on a fund's portfolio, among other information.

Accordingly, the proposed rule would require that the report include the derivatives risk manager's analysis of any exceedances and stress testing and backtesting results, and to include such information as may be reasonably necessary for the board to evaluate the fund's response to any exceedances and the stress testing and backtesting results. This requirement is designed to provide the board with information in a format, and with appropriate context, that would facilitate the board's understanding of the information. A simple listing of exceedances and stress testing and backtesting results without context, in contrast, would provide less useful information for a fund's board and would not satisfy this proposed requirement.

Under the proposed regular board reporting requirement, a fund's board would determine the frequency of this written report. Boards should be allowed flexibility in determining the frequency of reporting so that they can tailor their oversight to their funds' particular facts and circumstances.

We request comment on the proposed board reporting requirements.

65. Are the proposed requirements for the fund's derivatives risk manager to provide written reports to the fund's board on the program's implementation and effectiveness appropriate? Why or why not? Should the board receive a written report on or before the implementation of the program? Why or why not? Should we modify the proposed rule to require funds to provide boards reports with greater frequency than annually? Why or why not?

66. Is the proposed representation that the derivatives risk manager would have to make in the report appropriate? Why or why not? What should the representation entail, and why? Should we provide guidance as to what the representation should look like? Why or why not? Would the representation be helpful for a fund's board in exercising its oversight responsibilities? Why or why not? What effect, if any, would the representation have on a fund's derivatives risk management apart from the board's oversight of such risk management?

67. Would the responsibilities the proposed rule allocates to a fund's derivatives risk manager affect a fund's ability to hire or retain a derivatives risk manager? If so, how?

68. Is the proposed requirement for the written report to include the basis for the derivatives risk manager's representation along with information to evaluate the program's adequacy and effectiveness, appropriate? Why or why not? Should the rule require specific information in the written report? Why or why not? If so, what information and why? Should the rule, as proposed, permit the representation to be based on the derivatives risk manager's reasonable belief after due inquiry? Why or why not? Should we provide more guidance regarding the basis for the representation? If so, what should we provide? For example, should we provide guidance regarding the types of information on which a fund's derivatives risk manager may base this representation? Why or why not? Is the reference to due inquiry appropriate in this context? Is the reference sufficiently clear?

69. Should the rule require the written report to include a fund's derivatives risk manager's basis for the selection of the designated reference index or, if applicable, an explanation of why the derivatives risk manager was unable to identify a designated reference index appropriate for the fund? Why or why not? Should the rule require the written report to identify and explain any difference between the selected index and any indices that are used for performance comparisons in the fund's registration statement and shareholder reports? Why or why not?

70. Should the rule require a fund's derivatives risk manager to provide a written report regarding any exceedances to thresholds provided for in the fund's guidelines? Why or why not? Should the rule require a fund's derivatives risk manager to provide a written report regarding the results of the stress tests and backtests? Why or why not?

71. Should the rule require that a fund's derivatives risk manager report to the board? Why or why not? If not, should the fund determine who should report to the board, and why? Should the rule permit the derivatives risk manager to delegate its reporting obligations under the rule to other officers or employees of the adviser? Why or why not? If so, to whom should they be able to delegate these obligations?

[174] *See infra* section II.D.2.b. The proposed rule would not limit a derivatives risk manager from receiving input from the fund's portfolio managers or others regarding the fund's designated reference index.

[175] Proposed rule 18f–4(c)(5)(iii); *see also* proposed rule 18f–4(c)(1)(ii)–(iv); *see also supra* sections II.B.3.b, II.B.3.c, and II.B.3.d.

72. Should the rule permit a fund's board to determine the frequency with which it receives the written report? Why or why not? Or should the rule require that the derivatives risk manager provide the written report with a certain frequency? Why or why not? If so, what frequency should the rule require, and why? Should the rule permit a fund's derivatives risk manager to determine to report to the board sooner than the frequency determined by the board if appropriate? Why or why not?

73. Should the rule require that the written report include such information as may be reasonably necessary for the board to evaluate a fund's response to any exceedances and the results of the fund's stress testing? Why or why not? What information may be reasonably necessary for the board's evaluation? Should the rule require certain information to be provided in the written report? Why or why not? If so, what information should be required to be provided?

74. Should the rule require the report to be written? Why or why not? Should the rule require that the derivatives risk manager prepare the written report? Why or why not?

75. Would the approach provided by the proposed rule's board oversight provisions appropriately provide the board the ability to oversee a fund's derivatives risk management? Why or why not? Does the proposed rule provide an appropriate balance between the board's role of general oversight and the fund's roles of day-to-day risk management and portfolio management? Why or why not?

76. Should the board be required to approve the program, including initially, and any material changes to the program? Why or why not? What is current industry practice with respect to the board's oversight of a fund's derivatives risk management?

D. Proposed Limit on Fund Leverage Risk

The proposed rule would also generally require funds relying on the rule when engaging in derivatives transactions to comply with a VaR-based limit on fund leverage risk. This outer limit would be based on a relative VaR test that compares the fund's VaR to the VaR of a ''designated reference index.'' If the fund's derivatives risk manager is unable to identify an appropriate designated reference index, the fund would be required to comply with an absolute VaR test.[176]

1. Use of VaR

VaR is an estimate of an instrument or portfolio's potential losses over a given time horizon and at a specified confidence level. VaR will not provide, and is not intended to provide, an estimate of an instrument or portfolio's maximum loss amount. For example, if a fund's VaR calculated at a 99% confidence level was $100, this means the fund's VaR model estimates that, 99% of the time, the fund would not be expected to lose more than $100. However, 1% of the time, the fund would be expected to lose more than $100, and VaR does not estimate the extent of this loss.

We propose to use VaR tests to limit fund leverage risk associated with derivatives because VaR generally enables risk to be measured in a reasonably comparable and consistent manner across diverse types of instruments that may be included in a fund's portfolio. One benefit of the proposed VaR-based approach is that different funds could, and would be required to, tailor their VaR models to incorporate and reflect the risk characteristics of their fund's particular investments.[177] VaR is a commonly-known and broadly-used industry metric that integrates the market risk associated with different instruments into a single number that provides an overall indication of market risk, including the market risk associated with the fund's derivatives transactions.[178] We recognize that funds use many other risk analytic metrics suited to particular financial instrument categories.[179] Given the diverse portfolios of many funds, these more category-specific risk metrics may be less suitable for establishing a proposed limit on fund leverage risk that is applied more generally.

We recognize that VaR is not itself a leverage measure. But a VaR test, and especially one that compares a fund's VaR to an unleveraged index that reflects the markets or asset classes in which the fund invests, can be used to analyze whether a fund is using derivatives transactions to leverage the fund's portfolio, magnifying its potential for losses and significant payment obligations of fund assets to derivatives counterparties. At the same time, VaR tests can also be used to analyze whether a fund is using derivatives with effects other than leveraging the fund's portfolio that may be less likely to raise the concerns underlying section 18. For example, fixed-income funds use a range of derivatives instruments, including credit default swaps, interest rate swaps, swaptions, futures, and currency forwards. These funds often use these derivatives in part to seek to mitigate the risks associated with a fund's bond investments or to achieve particular risk targets, such as a specified duration. If a fund were using derivatives extensively, but had either a low VaR or a VaR that did not substantially exceed the VaR of an appropriate benchmark, this would indicate that the fund's derivatives were not substantially leveraging the fund's portfolio.

We also understand that VaR calculation tools are widely available, and many advisers that enter into derivatives transactions already use risk management or portfolio management platforms that include VaR capability.[180] Advisers to the funds that

[176] A fund that is a leveraged/inverse investment vehicle, as defined in the proposed sales practices rules, would not be required to comply with the proposed VaR-based limit on fund leverage risk. Broker-dealers and investment advisers would be required to approve retail investors' accounts to purchase or sell shares in these funds. *See infra* section II.G (discussing leveraged/inverse investment vehicles). The proposed rule also would provide an exception from the proposed VaR tests for funds that use derivatives to a limited extent or only to hedge currency risks. *See infra* sections II.E and II.G (discussing the proposed rule's provisions regarding limited derivatives users and leveraged/inverse funds covered by the sales practices rules).

[177] *See infra* section II.D.4 (discussing the choice of model and parameters for the VaR test).

[178] *See* Kevin Dowd, *An Introduction to Market Risk Measurement* (Oct. 2002), at 10 (''Dowd'') (VaR ''provides a common consistent measure of risk across different positions and risk factors. It enables us to measure the risk associated with a fixed-income position, say, in a way that is comparable to and consistent with a measure of the risk associated with equity positions''); *see also* Jorion, *supra* note 151, at 159 (stating that VaR ''explicitly accounts for leverage and portfolio diversification and provides a simple, single measure of risk based on current positions'').

[179] *See* Jorion, *supra* note 151. For example, risk measures for government bonds can include duration, convexity and term-structure models; for corporate bonds, ratings and default models; for stocks, volatility, correlations and beta; for options, delta, gamma and vega; and for foreign exchange, target zones and spreads. Certain funds are required to report on Form N–PORT some of these metrics, such as portfolio-level duration (DV01 and SDV01) and position-level delta. *See* Investment Company Reporting Modernization, Investment Company Act Release No. 32314 (Oct. 13, 2016) [81 FR 81870 (Nov. 18, 2016)] (''Investment Company Reporting Modernization Adopting Release'').

[180] *See, e.g.,* ICI Comment Letter III (''73 percent of respondents [to an Investment Company Institute survey of its member firms] use both some form of VaR and stress testing as derivatives risk management tools.)''; Comment Letter of OppenheimerFunds (Mar. 28, 2016) (''Oppenheimer Comment Letter''); Federated Comment Letter; Franklin Resources Comment Letter; *see also* Christopher L. Culp, Merton H. Miller & Andres M. P. Neves, *Value at Risk: Uses and Abuses,* 10 Journal of Applied Corporate Finance 26 (Jan. 1998) (VaR is ''used regularly by nonfinancial corporations, pension plans and mutual funds, clearing organizations, brokers and futures commission merchants, and insurers.''). Moreover, the proposed relative VaR test is similar to a relative VaR approach that applies to UCITS under

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use derivatives transactions more extensively may be particularly likely to already use risk management or portfolio management platforms that include VaR capability, as compared to advisers to the funds that are within the scope of the proposed provision for limited derivatives users and that would not be subject to the proposed VaR tests.[181]

While we believe there are significant benefits to using the proposed VaR-based limit on fund leverage risk, we recognize risk literature critiques of VaR (especially since the 2007–2009 financial crisis). One common critique of VaR is that it does not reflect the size of losses that may occur on the trading days during which the greatest losses occur—sometimes referred to as ''tail risks.'' [182] A related critique is that VaR calculations may underestimate the risk of loss under stressed market conditions.[183] These critiques often arise in the context of discussing risk managers' use of additional risk tools to address VaR's shortcomings. Our proposed VaR tests are designed to provide a metric that can help assess the extent to which a fund's derivatives transactions raise concerns underlying section 18, but we do not believe they should be the sole component of a derivatives risk management program.[184] We do not intend to encourage risk managers to over-rely on VaR as a stand-alone risk management tool.[185] Instead, as discussed above, the proposed rule would require a fund to establish risk guidelines and to stress test its portfolio as part of its risk management program in part because of concerns that VaR as a risk management tool may not adequately reflect tail risks.[186] We also recognize that a fund's use of derivatives transactions may pose other risks (such as counterparty risk and liquidity risk) that VaR does not capture. A fund that adopts a derivatives risk management program under the proposed rule would have to consider these risks as part of its derivatives risk management program.[187]

We also considered proposing tests based on stressed VaR, expected shortfall, or both. Stressed VaR refers to a VaR model that is calibrated to a period of market stress. A stressed VaR approach would address some of the VaR test critiques related to tail risk and underestimating expected losses during stressed conditions. Calibrating VaR to a period of market stress, however, can pose quantitative challenges by requiring funds to identify a stress period with a full set of risk factors for which historical data is available. Expected shortfall analysis is similar to VaR, but accounts for tail risk by taking the average of the potential losses beyond the specified confidence level. For example, if a fund's VaR at a 99% confidence level is $100, the fund's expected shortfall would be the average of the potential losses in the 1% ''tail.'' Because there are fewer observations in the tail, however, there is an inherent difficulty in estimating the expected value of larger losses. Expected shortfall analysis also could involve potentially greater sensitivity to extreme outlier losses because it is based on an average of a smaller number of observations that are in the tail. Taking these considerations into account, we are proposing tests based on VaR, which is commonly used and does not present all of the quantitative challenges associated with stressed VaR and expected shortfall, complemented by elements in the proposed risk management program designed to address VaR's limitations.

We request comment on the proposed definition of VaR, the proposed use of VaR as a means to limit funds' leverage risk, as well as alternative VaR-based methodologies (stressed VaR and expected shortfall). We also request comment and discuss alternatives to VaR and VaR-based methodologies in section II.D.6 below.

77. Is the proposed definition of the term ''VaR'' appropriate? Why or why not? If not, how should we define it?

78. Is a VaR-based test an appropriate way to limit funds' leverage risk? Why or why not? Do commenters agree with our observations regarding VaR's characteristics and its critiques? Do commenters believe that the proposed derivatives risk management program requirement would help to address VaR's limitations? Please explain.

79. Should we change the rule to require stressed VaR, either as part of the program's stress testing requirement or as part of the limit on fund leverage risk? If so, how should we implement a stressed VaR requirement? Should the rule provide, for example, that the historical data used to calculate VaR must include a period of market stress? What VaR model requirements should we include if the rule required stressed VaR? Please describe in detail. Are there any other corresponding changes we should make to the proposed VaR model requirements or proposed VaR tests if we used stressed VaR? Why or why not?

80. Should we change the rule to require expected shortfall or stressed expected shortfall, either as part of the program's stress testing requirement or as part of the limit on fund leverage risk? If so, how should we implement this element? What VaR model requirements should we include if the rule required expected shortfall or stressed expected shortfall? Please describe in detail. Are there any other corresponding changes we should make to the proposed VaR model requirements or proposed VaR tests if we were to require expected shortfall or stressed expected shortfall? Why or why not?

81. Are there risk metrics or measurements other than VaR that similarly can be applied to a wide breadth of fund strategy types and investments and used to limit fund leverage risk? Please explain.

82. Should we use VaR as the only methodology to establish an outside limit on funds' leverage risk in rule 18f–4? We discuss below additional alternatives to VaR for this purpose. Should we include in rule 18f–4 some combination of the proposed VaR tests and the alternatives discussed in that section, and provide flexibility to funds to comply with the approach that they believe is most appropriate based on their strategies and investments? If so,

European guidelines. *See infra* section II.D.6.c (discussing the UCITS approach).

[181] *See, e.g.,* ICI Comment Letter III.

[182] *See* Chris Downing, Ananth Madhavan, Alex Ulitsky & Ajit Singh, *Portfolio Construction and Tail Risk,* 42 The Journal of Portfolio Management 1, 85–102 (Fall 2015), *available at https://jpm.iijournals.com/content/42/1/85* (''for especially fat-tailed return distributions the VaR threshold value might appear to be low, but the actual amount of value at risk is high because VaR does not measure the mass of distribution beyond the threshold value'').

With respect to VaR, the ''tail'' refers to the observations in a probability distribution curve that are outside the specified confidence level. ''Tail risk'' describes the concern that losses outside the confidence level may be extreme.

[183] *See* Jorion, *supra* note 151, at 357 (VaR ''quantif[ies] potential losses under 'normal' market conditions, where *normal* is defined by the confidence level, typically 99 percent. . . . In practice, [VaR] measures based on recent historical data can fail to identify extreme unusual situations that could cause severe losses.'').

[184] *See supra* section II.B.3.

[185] *See, e.g.,* James O'Brien & Pawel J. Szerszen, *An Evaluation of Bank VaR Measures for Market Risk During and Before the Financial Crisis,* Federal Reserve Board Staff Working Paper 2014–21 (Mar. 7, 2014), *available at https://www.federalreserve.gov/pubs/feds/2014/201421/201421pap.pdf* (''Criticism of banks' VaR measures became vociferous during the financial crisis as the banks' risk measures appeared to give little forewarning of the loss potential and the high frequency and level of realized losses during the crisis period.''); *see also* Pablo Triana, *VaR: The Number That Killed Us,* Futures Magazine (Dec. 1, 2010), *available at http://www.futuresmag.com/2010/11/30/var-number-killed-us* (stating that ''in mid-2007, the VaR of the big Wall Street firms was relatively quite low, reflecting the fact that the immediate past had been dominated by uninterrupted good times and negligible volatility'').

[186] *See supra* section II.B.3.b.

[187] *See supra* section II.B.3.a.

which approaches should we include in the rule and why?

2. Relative VaR Test

The proposed relative VaR test would require a fund to calculate the VaR of the fund's portfolio and compare it to the VaR of a ''designated reference index.'' As discussed in more detail below, a fund's designated reference index must be unleveraged and reflect the markets or asset classes in which the fund invests, among other requirements. This index is designed to create a baseline VaR that approximates the VaR of a fund's unleveraged portfolio. To the extent a fund entered into derivatives to leverage its portfolio, the relative VaR test is designed to identify this leveraging effect. If a fund is using derivatives and its VaR exceeds that of the designated reference index, this difference may be attributable to leverage risk.

A fund would be required to comply with the relative VaR test unless a designated reference index is unavailable. We propose a relative VaR test as the default means of limiting fund leverage risk because it resembles the way that section 18 limits a fund's leverage risk. Section 18 limits the extent to which a fund can potentially increase its market exposure through leveraging by issuing senior securities, but it does not directly limit a fund's level of risk or volatility. For example, a fund that invests in less-volatile securities and leverages itself to the maximum extent may not be as volatile as a completely unleveraged fund that invests in more-volatile securities. The proposed relative VaR test likewise is designed to limit the extent to which a fund increases its market risk by leveraging its portfolio through derivatives, while not restricting a fund's ability to use derivatives for other purposes. For example, if a derivatives transaction reduces (or does not substantially increase) a fund's VaR relative to the VaR of the designated reference index, the transaction would not be restricted by the relative VaR test.

In addition, allowing funds to rely on the proposed absolute VaR test may be inconsistent with investors' expectations where a designated reference index is available. For example, a fund that invests in short-term fixed income securities would have a relatively low level of volatility. The fund's investors could reasonably expect that the fund might exhibit a degree of volatility that is broadly consistent with the volatility of the markets or asset classes in which the fund invests, as represented by the fund's designated reference index. This fund's designated reference index would be composed of short-term fixed income securities, and could, for example, have a VaR of 4%. If the fund were permitted to rely on the absolute VaR test, however, the fund could substantially leverage its portfolio almost four times its designated reference index's VaR to achieve a level of volatility that substantially exceeds the volatility associated with fixed-income securities.

a. Designated Reference Index

A fund would satisfy the proposed relative VaR test if the VaR of its entire portfolio does not exceed 150% of the VaR of its designated reference index.[188] The proposed rule would define a ''designated reference index'' as an unleveraged index that is selected by the derivatives risk manager, and that reflects the markets or asset classes in which the fund invests.[189] The proposed definition also would require that the designated reference index not be administered by an organization that is an affiliated person of the fund, its investment adviser, or principal underwriter, or created at the request of the fund or its investment adviser, unless the index is widely recognized and used.[190] Additionally, the designated reference index must either be an ''appropriate broad-based securities market index'' or an ''additional index'' as defined in Item 27 of Form N–1A.[191] A fund would have to disclose its designated reference index in the annual report, together with a presentation of the fund's performance relative to the designated reference index.[192]

The requirement that the designated reference index reflect the markets or asset classes in which the fund invests is designed to provide an appropriate baseline for the relative VaR test. Because of this requirement, differences between the fund's VaR and the VaR of the designated reference index are more likely to represent leverage than other factors, like differences between the securities in the fund's portfolio and those in the index, as compared to a relative VaR test that compares the fund's VaR to an index that does not reflect the markets or asset classes in which the fund invests.[193] Take, for example, a fund that invests primarily in S&P 500 index options and uses that index as its designated reference index. Differences between the fund's VaR and the VaR of the S&P 500 would be more likely attributable to the leverage risk associated with the options than, for example, if the fund were permitted to use an index that did not reflect the markets or assets classes in which the fund invests, such as an index of small capitalization stocks in this example. The derivatives risk manager could select a designated reference index that is a blended index under the proposed rule (assuming that the blended index meets the proposed requirements for a designated reference index), which would give some flexibility in identifying or constructing a designated reference index that provides an appropriate baseline for the relative VaR test.[194] For example, the derivatives risk manager of a balanced fund may determine that a blended index of an unleveraged equity index and an unleveraged fixed income index would be an appropriate designated reference index.

The requirement that the designated reference index be an unleveraged index also is designed to provide an appropriate baseline against which to measure a fund's portfolio VaR for

[188] *See* proposed rule 18f–4(a) (defining the term ''relative VaR test''); proposed rule 18f–4(c)(2)(i); *infra* section II.D.2.b (discussing the 150% limit under the relative VaR test).

[189] *See* proposed rule 18f–4(a) (defining the term ''designated reference index'').

[190] Furthermore, for a blended index, none of the indexes that compose the blended index may be administered by an organization that is an affiliated person of the fund, its investment adviser, or principal underwriter, or created at the request of the fund or its investment adviser, unless the index is widely recognized and used. *See id.*

[191] *See* proposed rule 18f–4(a) (defining the term ''designated reference index''); *see also* Instructions 5 and 6 to Item 27(b)(7)(ii) of Form N–1A (discussing the terms ''appropriate broad-based securities market index'' and ''additional index'').

[192] *See* proposed rule 18f–4(c)(2)(iv).

[193] To the extent a fund discloses in its annual report an ''appropriate broad-based securities market index'' that does not reflect the markets or asset classes in which the fund invests, such a fund may satisfy the performance disclosure requirements of Form N–1A, but it would not satisfy the proposed designated reference index requirement. For example, a fund that pursues its strategy primarily through commodity futures contracts could select the S&P 500 to satisfy its performance disclosure requirement under Form N–1A, but such an index would not satisfy the proposed designated reference index requirement because a commodity fund would not invest in stocks included in the S&P 500 or large cap stocks generally.

[194] If the derivatives risk manager selects a designated reference index that is a blended index, the designated reference index would have to be disclosed as an ''additional index'' (as opposed to an ''appropriate broad-based securities market index'') as defined in the instruction to Item 27 in Form N–1A. Form N–1A defines the term ''appropriate broad-based securities market index'' to mean an index ''that is administered by an organization that is not an affiliated person of the [f]und, its investment adviser, or principal underwriter, unless the index is widely recognized and used.'' *See* Instruction 5 to Item 27(b)(7)(ii) of Form N–1A. A blended index that is administered by the fund's investment adviser, for example, would therefore not qualify as an ''appropriate broad-based securities market index.''

purposes of assessing the fund's leverage risk. Conducting a VaR test on a designated reference index that itself is leveraged would distort the leverage-limiting purpose of the VaR comparison by inflating the volatility of the index that serves as the reference portfolio for the relative VaR test. For example, an equity fund might select as its designated reference index an index that tracks a basket of large-cap U.S. listed equity securities such as the S&P 500. But the fund could not select an index that is leveraged, such as an index that tracks 200% of the performance of the S&P 500. A relative VaR test based on this index would effectively permit additional leveraging inconsistent with the Investment Company Act.[195]

Our proposal would prohibit the designated reference index from being an index administered by an organization that is an affiliated person of the fund, its investment adviser, or its principal underwriter, or created at the request of the fund or its investment adviser. This proposed prohibition would not, however, extend to indexes that are ''widely recognized and used.'' [196] We believe that the indexes permissible under the proposed rule would be less likely to be designed with the intent of permitting a fund to incur additional leverage-related risk.

The proposed rule would require that a fund publicly disclose to its investors in its annual reports the designated reference index. An open-end fund would have to disclose its designated reference index in the fund's annual report as the fund's ''appropriate broad-based securities market index'' or an ''additional index'' that Form N–1A describes in the context of the annual report performance presentation requirements.[197] Form N–2, on the other hand, does not require closed-end funds to disclose a benchmark index for comparing a fund's performance. Nevertheless, some closed-end funds choose to disclose a benchmark index in their annual reports to shareholders. Under the proposed rule, a closed-end fund seeking to satisfy the relative VaR test would have to disclose the fund's designated reference index in its annual report together with a presentation of the fund's performance.[198] In proposing this approach, we considered the role of investor expectations in selecting funds that correspond to investors' desired level of investment risk.[199] We believe that investors could reasonably expect that their fund might exhibit a degree of volatility that is broadly consistent with the volatility of the markets or asset classes in which the fund invests, as represented by the fund's designated reference index. Requiring a fund to select a designated reference index that it publicly discloses would promote the fund's selection of an appropriate index that reflects the fund's portfolio risks and its investor expectations.

Some registered closed-end funds currently elect to provide a Management's Discussion of Fund Performance (''MDFP'') in their annual reports.[200] These registered closed-end funds could disclose their performance relative to the performance of the designated reference index in the fund's MDFP. BDCs that are publicly traded must disclose, in their annual reports filed on Form 10–K, a line graph comparing the yearly percentage change in fund share price with the return of a broad equity market index.[201] A publicly-traded BDC could choose to include its designated reference index in this line graph disclosure.

We recognize the concern that funds could have the incentive to select an inappropriate designated reference index composed of more volatile securities to allow the fund to obtain more leverage risk under the relative VaR test. The proposed rule includes three provisions designed to address this concern. In addition to requiring that the designated reference index reflect the markets or asset classes in which the fund invests, and that the index not be administered by certain affiliated persons or created at the request of the fund or its investment adviser, as described above, the proposed rule would require: (1) The derivatives risk manager to select the designated reference index and to periodically review it; (2) the fund to disclose the designated reference index, relative to its performance, in its annual report, creating the disincentive for a fund to present performance that may be significantly lower than, or not related to, the disclosed index; and (3) the board of directors to receive a written report providing the derivatives risk manager's basis for selecting the designated reference index.[202] These requirements, collectively, are designed to require funds to use designated reference indexes that provide an appropriate baseline for the relative VaR test and to prohibit funds from, instead, selecting indexes solely for the purpose of maximizing the fund's permissible leverage risk under the proposed rule.

We recognize that some (but not all) popular benchmark indexes charge funds a licensing fee for their inclusion in fund prospectuses and annual reports. Funds could incur licensing fees if their derivatives risk managers select a designated reference index whose provider charges such a fee and the fund is not already using the index. We are nevertheless proposing this disclosure requirement because the relative VaR test's ability to limit a fund's leverage risk is directly tied to the appropriateness of its designated reference index. This disclosure requirement is designed to address concerns about inappropriate indexes, as discussed above, by creating the disincentive for a fund to select an inappropriate index because the fund would have to disclose its performance against that index in its annual report and likely would not want to present performance that is significantly lower than, or not related to, the disclosed index.[203] At the same time, the proposed rule provides funds flexibility to use any index that meets the proposed requirements. The proposed rule would provide this flexibility in light of the conditions discussed above

[195] *See supra* section I.B.1. *But see infra* section II.G (discussing leveraged/inverse funds covered by the proposed sales practices rules).

[196] *See* proposed rule 18f–4(a) (defining the term ''designated reference index''). This ''widely recognized and used'' standard has historically been used to permit a fund to employ affiliated-administered indexes for disclosure purposes, when the use of such indexes otherwise would not be permitted. *See supra* note 193.

[197] *See* proposed rule 18f–4(c)(2)(iv); Item 27(b)(7)(ii) of Form N–1A.

See also Instructions to Items 4 and 27(b)(7)(ii) of Form N–1A. Form N–1A provides that ''New Funds,'' as defined in the form, are not required to disclose an appropriate broad-based securities market index and the fund's performance in the annual report because of the fund's limited operating history. *See* Instruction 6 to Item 3 of Form N–1A (defining a ''New Fund'' to mean a ''Fund that does not include in Form N–1A financial statements reporting operating results or that includes financial statements for the Fund's initial fiscal year reporting operating results for a period of 6 months or less''). For the same reason, the proposed rule would provide that a fund would not be required to disclose its designated reference index in the fund's annual report if the fund is a ''New Fund,'' or would meet that definition if it were filing on Form N–1A, at the time the fund files its annual report. *See* proposed rule 18f–4(c)(2)(iv).

[198] *See* proposed rule 18f–4(c)(2)(iv).

[199] To the extent a fund's use of derivatives transactions is part of its principal investment strategy or is a principal risk, it is required to be disclosed as such in the fund's prospectus. *See* Item 4 of Form N–1A; Item 8 of Form N–2.

[200] The Commission recently proposed to amend Form N–2 to require registered closed-end funds to include MDFP disclosure in their annual reports. *See* Securities Offering Reform for Closed-End Investment Companies, Investment Company Act Release No. 33427 (Mar. 20, 2019) [84 FR 14448 (Apr. 10, 2019)], at 14471–72 (''Securities Offering Reform Proposing Release'').

[201] 17 CFR 229.201(e)(1)(i).

[202] *See* proposed rule 18f–4(a), (c)(1)(vi), (c)(2)(iii), (c)(5)(ii)–(iii); *see also supra* sections II.B.3.f, II.C.2.

[203] *See supra* note 201 and accompanying paragraph.

designed to require that a fund use a designated reference index that is appropriate for the relative VaR test.

The 2015 Proposing Release also included a risk-based portfolio limit based on VaR.[204] The 2015 proposal provided that a fund would satisfy its risk-based portfolio limit condition if a fund's full portfolio VaR was less than the fund's ''securities VaR'' (*i.e.,* the VaR of the fund's portfolio of securities and other investments, but excluding any derivatives transactions).[205] Our proposal, however, differs from the 2015 proposal in that the proposed relative VaR test compares the fund's VaR to the VaR of the fund's designated reference index, rather than the fund's ''securities VaR.'' This is because some funds that use derivatives extensively hold primarily cash, cash equivalents, and derivatives. These funds' ''securities VaRs'' would be based primarily on the fund's cash and cash equivalents. As some commenters on the 2015 proposal noted, this would not provide an appropriate comparison for a relative VaR test because the VaR of the cash and cash equivalents would be very low and would not provide a reference level of risk associated with the fund's strategy.[206]

We request comment on the proposed requirements regarding the selection and disclosure of a designated reference index for purposes of compliance with the proposed relative VaR test.

83. Is the proposed definition of the term ''designated reference index'' appropriate? Why or why not? Should the Commission provide additional guidance, or requirements in the proposed rule, addressing when an index reflects the markets or asset classes in which a fund invests? Are there particular types of indexes that would not be appropriate as a designated reference index? Why or why not? If so, what types of indexes and why would they be inappropriate for this purpose?

84. Should the rule require that the designated reference index be an unleveraged index? Should the rule specify with greater particularity what constitutes an unleveraged index? Please explain. Alternatively, should the Commission provide guidance on when an index will be ''leveraged''?

85. Are there other considerations that would present challenges for funds in light of the proposed requirement to select a designated reference index for purposes of the proposed relative VaR test requirement? If so, what?

86. To what extent do funds expect that the requirement to disclose the designated reference index would result in additional licensing fees? Please explain. What consequences would such charges create?

87. Should we change the proposed definition of the term ''designated reference index'' to no longer track in part the definition of an ''appropriate broad-based securities market index'' in Form N–1A (Instruction 5 of Item 27(b)(7)) and allow a derivatives risk manager to select an index administered by an affiliated person of the fund, its investment adviser, or principal underwriter? Should we change the proposed definition to allow a derivatives risk manager to select an index created at the request of the fund or its investment adviser? Is it appropriate to exclude such indexes from the definition of ''designated reference index,'' and is it appropriate that widely recognized and used indexes be carved out from this exclusion, as proposed? Would the proposed exclusion help ensure the selection of indexes that are appropriately designed to create a baseline VaR that approximates the VaR of a fund's unleveraged portfolio? Please explain. Would allowing funds to use indexes that would fall within the proposed exclusion raise concerns that the indexes would not be appropriate, or—if the Commission were to permit the use of such indexes—would the rule's other proposed conditions designed to address this concern work equally well for all indexes? If the Commission were to permit the use of indexes that would fall within the proposed exclusion, would any additional limits on the use of these indexes be appropriate? If so, what limits and why?

88. If we were to further limit or restrict the types of indexes that a fund could select as its designated reference index under the proposed rule, what additional limits would be appropriate? Should we, for example, provide that a fund's designated reference index must meet the definition of an ''appropriate broad-based securities market index'' as defined in Form N–1A? Should we require that the index be widely recognized and used?

89. Similar to UCITS guidelines, should the proposed definition specifically require that the risk profile of the designated reference index be consistent with the fund's investment objectives and policies, as well as investment limits?[207] Why or why not?

90. Should the rule require funds to disclose their designated reference indexes in their annual reports to shareholders, as proposed? Should such disclosure also appear in the fund's prospectus? What reasons, if any, should the designated reference index *not* be an index a fund includes as part of its performance disclosure? Please explain. Should a fund be required to specify that the index it includes in its performance disclosure is the fund's designated reference index, which has been selected for purposes of the fund's compliance with rule 18f–4? If so, what other information or explanations should a fund also have to include (if any), in order to best promote investor understanding of how the fund's designated reference index affects the fund's ability to use leverage, and how this in turn affects the risks associated with an investment in the fund? For example, should a fund also be required to disclose the index's historical (*e.g.,* 1-year) average VaR? What accompanying narrative disclosure would help investors best understand the significance of this information? Would this disclosure be useful to supplement the VaR information that a fund would be required to disclose on Form N–PORT under the proposal?

91. Should the rule permit a fund to compare its portfolio VaR to its ''securities VaR'' for purposes of the rule's relative VaR test, as provided for in the 2015 proposed rule, in addition to its designated reference index?[208] Why or why not? If the relative VaR test permitted a fund to compare its porfolio's VaR against its designated reference index or its ''securities VaR,'' would funds prefer to use their ''securities VaRs''? If so, why? In what circumstances or what fund strategies would ''securities VaR'' be a more or equally appropriate baseline for funds calculating their relative VaR? What benefits or drawbacks are there with respect to this approach? Please explain.

92. For a registered closed-end fund, is the proposed requirement that it must disclose its designated reference index in its annual report together with a presentation of the fund's performance appropriate? Why or why not? What challenges, if any, would the proposed disclosure requirement have for closed-end funds that do not currently disclose their performance relative to a benchmark index in their annual reports? Please explain.

[204] *See* 2015 Proposing Release, *supra* note 2, at section III.B.2.

[205] Under that proposal, a fund that satisfied this VaR test was also required to limit its aggregate exposure—including derivatives exposure—to 300% of the fund's net assets. *See id.*

[206] *See, e.g.,* AlphaSimplex Comment Letter; AQR Comment Letter; ICI Comment Letter I.

[207] *See infra* section II.D.6.c (discussing the UCITS framework).

[208] *See supra* note 204 and accompanying text.

93. For a registered closed-end fund, should we prescribe in rule 18f–4 or Form N–2 where in the fund's annual report it must disclose its designated reference index? Why or why not?

94. What challenges, if any, would a BDC have in disclosing its designated reference index together with its performance in the BDC's annual report? Please explain.

95. Should we also amend Forms N–1A and/or N–2 to require a fund relying on rule 18f–4 and subject to the relative VaR test to disclose its performance relative to the performance of its designated reference index? Would it be helpful to have this requirement both in rule 18f–4 and in the registration forms?

96. What changes should we make to the rule in light of the concern that a fund could have an incentive to select an inappropriate designated reference index to obtain more leverage risk? Is the proposed requirement that the derivatives risk manager select the designated reference index useful for this purpose? Is the proposed requirement that the designated reference index be an appropriate broad-based securities index or an additional index effective for this purpose? Is the proposed requirement that the fund disclose the designated reference index relative to its performance in the annual report useful for this purpose? Is the proposed requirement that the board of directors receive a written report from the derivatives risk manager about the basis for the designated reference index subject to periodic review useful for this purpose? Please explain.

b. 150% Limit Under Proposed Relative VaR Test

We are proposing that a fund's VaR must not exceed 150% of the VaR of the fund's designated reference index.[209] In proposing a 150% limit, we first considered the extent to which a fund could borrow in compliance with the requirements of section 18. For example, a mutual fund with $100 in assets and no liabilities or senior securities outstanding could borrow an additional $50 from a bank. With the additional $50 in bank borrowings, the mutual fund could invest $150 in securities based on $100 of net assets. This fund's VaR would be approximately 150% of the VaR of the fund's designated reference index. The proposed 150% limit would therefore effectively limit a fund's leverage risk related to derivatives transactions similar to the way that section 18 limits a registered open- or closed-end fund's ability to borrow from a bank (or issue other senior securities representing indebtedness for registered closed-end funds) subject to section 18's 300% asset coverage requirement. We recognize that while a fund could achieve certain levels of market exposure through borrowings permitted under section 18, it may be more efficient to obtain those exposures through derivatives transactions. Allowing a fund to have a VaR that is 150% of its designated reference index, rather than a higher or lower relative VaR, is designed to provide what we believe is an appropriate degree of flexibility for funds to use derivatives.

We considered proposing different relative VaR tests for different types of investment companies, tied to the asset coverage requirements applicable to registered open-end funds, registered closed-end funds, and BDCs.[210] Registered closed-end funds, like open-end funds, are only permitted to issue senior securities representing indebtedness under section 18 subject to a 300% asset coverage requirement, although closed-end funds' indebtedness is not limited to bank borrowings.[211] Using the example above, a registered closed-end fund with $100 in assets likewise could only borrow $50. Although registered closed-end funds also are permitted to issue senior securities that are stocks,[212] proposed rule 18f–4 is focused on the indebtedness leverage that derivatives transactions create. We do not believe that a registered closed-end fund's ability to issue preferred stock, for example, suggests that registered closed-end funds should be permitted to obtain additional indebtedness leverage through derivatives transactions.

The Investment Company Act also provides greater flexibility for BDCs to issue senior securities. BDCs, however, generally do not use derivatives or do so only to a limited extent. To help evaluate the extent to which BDCs use derivatives, our staff sampled 48 of the current 99 BDCs by reviewing their most recent financial statements filed with the Commission. The staff's sample included both BDCs with shares listed on an exchange and BDCs whose shares are not listed. The sampled BDCs' net assets ranged from $32 million to $7.4 billion. Of the 48 sampled, 54% did not report any derivatives holdings, and a further 29% reported using derivatives with gross notional amounts below 10% of net assets. A few BDCs used derivatives more extensively, when measured on a gross notional basis, mainly due to interest rate swaps—which likely would have lower adjusted notional amounts if they were converted to ten-year bond equivalents, as the proposed rule would permit.[213] Finally, two of the sampled BDCs used total return swaps to gain a substantial portion of their exposure. We therefore believe that most BDCs either would not use derivatives or would rely on the exception for limited derivatives users.[214]

In addition, the greater flexibility for BDCs to issue senior securities allows them to provide additional equity or debt financing to the ''eligible portfolio companies'' in which BDCs are required to invest at least 70% of their total assets. Derivatives transactions, in contrast, generally will not have similar capital formation benefits for portfolio companies unless the fund's counterparty makes an investment in the underlying reference assets equal to the notional amount of the derivatives transaction. Allowing BDCs to leverage their portfolios with derivatives to a greater extent than other funds therefore would not appear to further the capital formation benefits that underlie BDCs' ability to obtain additional leverage under the Investment Company Act. We also understand that, even when BDCs do use derivatives more extensively, derivatives generally do not play as significant of a role in implementing the BDC's strategy, as compared to many other types of funds that use derivatives extensively. BDCs are required under the Investment Company Act to invest at least 70% of their total assets in ''eligible portfolio companies,'' which may limit the role that derivatives can play in a BDC's portfolio relative to other kinds of funds that would generally execute their strategies primarily through derivatives transactions (*e.g.,* a managed futures fund). For these reasons, and to provide a consistent framework regarding funds' use of derivatives, we believe that it is appropriate to set a single limit on fund leverage risk under the proposed rule for derivatives transactions. The proposed rule would not restrict a fund from issuing senior securities subject to the limits in section 18 to the full extent

[209] *See* proposed rule 18f–4(a) (defining the term ''relative VaR test'').

[210] *See supra* notes 29–32 and accompanying paragraph (discussing asset coverage requirements for different investment company types).

[211] *See supra* note 30 and accompanying text.

[212] *See supra* note 31 and accompanying text.

[213] Our staff did not have access to sufficient information to adjust the notional amounts of the BDCs' interest rate derivatives or options. Some of the 17% of the sampled BDCs with gross notional amounts exceeding 10% of net assets likely would have lower notional amounts after applying these adjustments.

[214] *See infra* section II.E (discussing the proposed exception for limited derivatives users).

permitted by the Investment Company Act.[215]

We request comment on the following aspects of the proposed relative VaR test.

97. Is the proposed relative VaR test requirement appropriate? Why or why not? As proposed, should funds be required to comply with a relative VaR test, rather than an absolute VaR test, except where a designated reference index is unavailable?

98. Should the limit in the proposed relative VaR test be lower or higher than 150% of the VaR of the designated reference index, and if so why? For example, the relative VaR test applicable to UCITS funds allows a UCITS fund to have a relative VaR up to 200% of the VaR of the relevant index.[216] Should rule 18f–4 similarly permit a fund to have a VaR up to 200% of the VaR of its designated reference index? If so, how should the rule incorporate investor protection provisions consistent with section 18? Conversely, should the relative VaR test be set at a lower level, such as 125% of the VaR of the designated reference index? If so, why?

99. Should the proposed relative VaR test incorporate different leverage limit levels according to fund type and corresponding to the asset coverage requirements under the Investment Company Act? Why or why not and how?

100. Are there any challenges in calculating the VaR of the designated reference index? If so, would certain types of funds particularly encounter these challenges, and if so which ones? How should we address any challenges?

101. Are there any fund-type specific challenges to open-end funds, registered closed-end funds, or BDCs complying with the VaR-based limit on fund leverage risk? For example, would registered closed-end funds or BDCs encounter any unique challenges in calculating VaR because of the nature of their investments? If so, what kinds of challenges and how should we address them? Please also explain specifically the nature of any challenges given that a number of financial institutions such as banks and UCITS funds calculate VaR for regulatory purposes, and these institutions' portfolios hold a wide range of assets.

3. Absolute VaR Test

We recognize that, for some funds, the derivatives risk manager may be unable to identify an appropriate designated reference index. For example, some multi-strategy funds manage their portfolios based on target volatilities but implement a variety of investment strategies, making it difficult to identify a single index (even a blended index) that would be appropriate. If a derivatives risk manager is unable to identify an appropriate designated reference index, a fund relying on the proposed rule would be required to comply with the absolute VaR test.[217]

To comply with the proposed absolute VaR test, the VaR of the fund's portfolio must not exceed 15% of the value of the fund's net assets. In proposing an absolute VaR test of 15% of a fund's net assets, we considered the comparison of a fund complying with the absolute VaR test and a fund complying with the relative VaR test. A fund that uses the S&P 500 as its benchmark index, as many funds do, would be permitted to have a VaR equal to 150% of the VaR of the S&P 500 if the fund also used that index as its designated reference index. The Division of Economic and Risk Analysis (''DERA'') staff calculated the VaR of the S&P 500, using the parameters specified in this proposed rule over various time periods. DERA staff's calculation of the S&P 500's VaR since inception, for example, produced a mean VaR of approximately 10.4%, although the VaR of the S&P 500 varied over time.[218] Setting the level of loss in the proposed absolute VaR test at 15% of a fund's net assets would therefore provide approximately comparable treatment for funds that rely on the absolute VaR test and funds that rely on the relative VaR test and use the S&P 500 as their designated reference index during periods where the S&P 500's VaR is approximately equal to the historical mean.

DERA staff analyzed the S&P 500 because funds often select broad-based large capitalization equities indexes such as the S&P 500 for performance comparison purposes, including funds that are not broad-based large capitalization equity funds.[219] Many investors may therefore understand the risk inherent in these indexes as the level of risk inherent in the markets generally.[220] An absolute VaR test set to approximate, or not substantially exceed, this level of risk would therefore often approximate the level of risk that investors may understand, and frequently choose to undertake, through investments in funds. We are proposing a single absolute VaR limit that would apply to open-end funds and registered closed-end funds and BDCs for the same reasons we are proposing that all funds relying on the relative VaR test must limit their VaR to 150% of the VaR of their designated reference index.[221]

The proposed absolute VaR test is also broadly consistent with the European Union regulatory framework that that applies to UCITS funds.[222] Advisers that manage (or have affiliates that manage) UCITS funds may derive some efficiencies from reasonably comparable requirements across jurisdictions.[223] Commenters to the 2015 proposal also generally supported an absolute VaR test.[224]

[215] For purposes of calculating asset coverage, as defined in section 18(h), BDCs have used derivatives transactions' notional amounts, less any posted cash collateral, as the ''amount of senior securities representing indebtedness'' associated with the transactions. We believe this approach—and not the transactions' market values—represents the ''amount of senior securities representing indebtedness'' for purposes of this calculation. Open-end funds cannot enter into derivatives transactions under section 18, absent relief from that section's requirements, because section 18 limits open-end funds' senior securities to bank borrowings. Section 18(c) also limits a registered closed-end fund's ability to enter into derivatives transactions absent such relief.

[216] *See infra* section II.D.6.c (discussing the UCITS framework); *see also* ICI Comment Letter III (suggesting that a Commission rule limiting the use of derivatives by registered investment companies allow funds to use either ex ante stress testing or UCITS VaR for that purpose).

[217] *See supra* note 173 and accompanying text (discussing the proposed requirement for the fund's derivatives risk manager to provide written reports to the fund's board of directors that must include, among other things, the derivatives risk manager's basis for the selection of the designated reference index or, if applicable, an explanation of why the derivatives risk manager was unable to identify a designated reference index appropriate for the fund); *infra* notes 425–426 and accompanying text (discussing proposed recordkeeping requirements for such written reports provided to the fund's board).

[218] DERA staff calculated descriptive statistics for the VaR of the S&P 500 using Morningstar data from March 4, 1957 to June 28, 2019, based on daily VaR calculations, each using three years of prior return data and calculated using historical simulation at a 99% confidence level for a 20-day horizon using overlapping observations.

[219] This is based on staff experience and analysis of data obtained from Morningstar.

[220] Some commenters to the 2015 proposal also expressed the view that the S&P 500 Index is an appropriate risk-based reference point because it is widely used with a risk profile that is well understood and commonly acceptable to investors. *See, e.g.,* AQR Comment Letter; Comment Letter of Millburn Ridgefield Corporation (Mar. 28, 2016).

[221] *See supra* section II.D.2.b.

[222] *See* CESR Global Guidelines, *supra* note 94, at 26. The absolute VaR test for UCITS funds is similar to the proposed absolute VaR test in rule 18f–4, although it sets a 20% limit for UCITS funds, rather than 15% as we propose in rule 18f–4.

[223] *See, e.g.,* ICI Comment Letter III (stating that, in response to the Investment Company Institute's survey, ''45 percent of respondents indicated that it would be only slightly burdensome to implement a UCITS VaR test that used the same parameters as prescribed for UCITS. An additional 34 percent reported that it would be moderately burdensome.'').

[224] *See, e.g.,* ICI Comment Letter I; Franklin Resources Comment Letter; SIFMA Comment Letter; Comment Letter of T. Rowe Price Associates,

Continued

We request comment on the proposed absolute VaR test requirement.

102. Is the proposed absolute VaR test requirement appropriate? Are we correct that in some cases a fund's derivatives risk manager may be unable to identify an appropriate designated reference index? Why or why not? What are examples of funds that would likely use the absolute VaR test because a derivatives risk manager would be unable to identify an appropriate designated reference index? Is it appropriate for these funds to use an absolute VaR test? Why or why not?

103. Should we provide additional guidance on the circumstances under which a fund's derivatives risk manager would be ''unable'' to identify an appropriate index? If so, what guidance should we provide? Should the rule include a different standard than the inability to identify a designated reference index for funds to be able to use the absolute VaR test instead of the relative VaR test? If so, what standard and why? For example, should we identify certain types of fund strategies that may not typically have appropriate reference indexes or for which absolute VaR would otherwise be appropriate? If so, which fund strategies, and how would we keep any list of fund strategies current over time?

104. Should the proposed absolute VaR test include a limit other than 15% of the fund's net assets? Please explain. For example, should it be 12, 18, 20, or 25%? If so, which limit, and why? Would funds using the absolute VaR test manage their VaRs to a certain amount below the limit the Commission sets? If so, to what extent and should we take this into account in determining the appropriate limit under this test? Should we look to different market data in determining an appropriate level of absolute VaR? Which other sources, and why would they be appropriate?

105. For funds that use an absolute VaR test as part of their risk management practices, do risk managers set internal absolute VaR limits, and if so, at what level and why? For funds that currently use both absolute VaR and relative VaR, are the internal limits set at comparable levels? Why or why not? Please describe each internal level set with respect to these two VaR tests. Do certain fund types or strategies more commonly use either absolute VaR or relative VaR for risk management purposes? If so, why?

106. Should the rule include both a relative and absolute VaR test, as proposed, or should it include only a relative VaR test or an absolute VaR test? Why, and which test should the rule include? Should it use a different VaR-based test? If so, which one?

107. Should the rule permit funds to choose which VaR test to comply with regardless of the derivatives risk manager's ability or inability to identify a designated reference index? If so, would this be consistent with investor expectations and section 18?

4. Choice of Model and Parameters for VaR Test

The proposed rule would require that any VaR model a fund uses for purposes of the relative or absolute VaR test take into account and incorporate all significant, identifiable market risk factors associated with a fund's investments.[225] The proposed rule includes a non-exhaustive list of common market risk factors that a fund must account for in its VaR model, if applicable. These market risk factors are: (1) Equity price risk, interest rate risk, credit spread risk, foreign currency risk and commodity price risk; (2) material risks arising from the nonlinear price characteristics of a fund's investments, including options and positions with embedded optionality; and (3) the sensitivity of the market value of the fund's investments to changes in volatility.[226] VaR models are often categorized according to three modeling methods—historical simulation, Monte Carlo simulation, or parametric models.[227] Each method has certain benefits and drawbacks, which may make a particular method more or less suitable, depending on a fund's strategy, investments and other factors. In particular, some VaR methodologies may not adequately incorporate all of the material risks inherent in particular investments, or all material risks arising from the nonlinear price characteristics of certain derivatives.[228] We believe it should be the responsibility of the derivatives risk manager to choose the appropriate VaR model for the fund's portfolio, and the proposed requirement is designed to allow funds to use a VaR model that is appropriate for the fund's investments. Commenters that addressed the same proposed requirement for VaR models in the 2015 proposal generally supported it.[229]

The proposed rule also requires that a fund's VaR model use a 99% confidence level and a time horizon of 20 trading days.[230] We understand that market participants currently using VaR most commonly use 95% or 99% confidence levels and often use time horizons of 10 or 20 days. The proposed confidence level and time horizon requirements also are similar to those in other VaR-based regulatory schemes.[231]

Inc. (Mar. 28, 2016) (''T. Rowe Price Comment Letter'').

[225] *See* proposed rule 18f–4(a) (defining the term ''value-at-risk'' or ''VaR'').

[226] *See id.*

[227] Historical simulation models rely on past observed historical returns to estimate VaR. Historical VaR involves taking a fund's current portfolio, subjecting it to changes in the relevant market risk factors observed over a prior historical period, and constructing a distribution of hypothetical profits and losses. The resulting VaR is then determined by looking at the largest (100 minus the confidence level) percent of losses in the resulting distribution.

Monte Carlo simulation uses a random number generator to produce a large number (often tens of thousands) of hypothetical changes in market values that simulate changes in market factors. These outputs are then used to construct a distribution of hypothetical profits and losses on the fund's current portfolio, from which the resulting VaR is ascertained by looking at the largest (100 minus the confidence level) percent of losses in the resulting distribution.

Parametric methods for calculating VaR rely on estimates of key parameters (such as the mean returns, standard deviations of returns, and correlations among the returns of the instruments in a fund's portfolio) to create a hypothetical statistical distribution of returns for a fund, and use statistical methods to calculate VaR at a given confidence level.

See, e.g., Dowd, *supra* note 177; *see also* Thomas J. Linsmeier & Neil D. Pearson, *Value at Risk,* 56 Journal of Financial Analysts 2 (Mar.–Apr. 2000) (''Linsmeier & Pearson'').

[228] For example, some parametric methodologies may be more likely to yield misleading VaR estimates for assets or portfolios that exhibit non-linear returns, due, for example, to the presence of options or instruments that have embedded optionality (such as callable or convertible bonds). *See, e.g.,* Linsmeier & Pearson, *supra* note 226 (stating that historical and Monte Carlo simulation ''work well regardless of the presence of options and option-like instruments in the portfolio. In contrast, the standard [parametric] delta-normal method works well for instruments and portfolios with little option content but not as well as the two simulation methods when options and option-like instruments are significant in the portfolio.'').

[229] *See, e.g.,* Oppenheimer Comment Letter; CFA Comment Letter.

[230] *See* proposed rule 18f–4(a) (defining the term ''value-at-risk'' or ''VaR'').

We recognize that many market participants today also may calculate VaR over a one-day time horizon. *See also supra* section II.B.3.d (the proposed rule would require calculating a fund's one-day VaR as part of the proposed backtesting requirement). A VaR calculation based on a one-day time horizon can be scaled to a 20-day time horizon. For example, a common VaR model time-scaling technique is to multiply the one-day VaR by the square root of the designated time period (*i.e.,* for the proposed rule it would be the square root of 20). But for funds with returns that are not identically and independently normally distributed, simple time-scaling techniques may be inaccurate. If this inaccuracy results in meaningful underestimation of VaR, this simple time-scaling technique would be inappropriate.

[231] *See, e.g.,* CESR Global Guidelines, *supra* note 94 (providing default VaR calculation standards that require funds that use the relative VaR or absolute VaR approach to calculate VaR using a ''one-tailed confidence interval of 99%''); rule 15c3–1e under the Exchange Act [17 CFR 240.15c3–1e] (Appendix E to 17 CFR 240.15c3–1) (requiring VaR models to use ''a 99 percent, one-tailed confidence level with price changes equivalent to

VaR models that use relatively high confidence levels and longer time horizons—as the proposed rule parameters reflect—result in a focus on more-''extreme'' but less-frequent losses. We propose relatively high confidence level and longer time horizon requirements so that the VaR model is designed to measure, and seek to limit the severity of, these less-frequent but larger losses. This is because a fund's VaR model would be based on a distribution of returns, where a higher confidence level would go further into the tail of the distribution (*i.e.,* more-''extreme'' but less-frequent losses) and a longer time horizon would result in larger losses in the distribution (*i.e.,* losses have the potential to be larger over twenty days when compared, for example, to over one day).

In proposing a higher confidence level and longer time horizon, we considered whether this would result in a VaR model based on fewer data points in comparison to lower confidence levels and shorter time horizons. However, we understand that a longer trading day horizon only results in reduced data points if the fund uses historical simulation and measures historical losses using non-overlapping periods, which our proposal would not require. For example, a fund measuring non-overlapping twenty-day periods, assuming 250 trading days in a year, would expect approximately 12 or 13 data points (250 trading days/20-day time horizons). But if the fund measured the twenty-day periods on a rolling and overlapping basis, it could expect as many as 250 data points where each data point captures the return over the trailing 20 trading days. A fund could use either a non-overlapping or overlapping approach under the proposed rule.

The 2015 proposal similarly specified the particular confidence level and time horizon parameters that funds would use in their VaR models for purposes of the proposed risk-based portfolio limit. These parameters were a 99% confidence level and a time horizon range of not less than 10 and not more than 20 trading days.[232] Comments were mixed but generally supported a confidence level in the range of 95% to 99%.[233] Rather than a time horizon range providing funds discretion to select the number of trading days for which to compute their VaR models, some commenters suggested that the rule should specify a particular number of days.[234] Because our proposal, unlike the 2015 proposal, includes an absolute VaR test, our proposed VaR model parameters reflect commenter suggestions by proposing a confidence level within the generally supported range and proposing a specific VaR model time horizon rather than a range of permissible time horizons.

In addition to specifying the confidence level and time horizon that a fund's VaR model would use, we are also proposing that the fund's chosen VaR model must be based on at least three years of historical market data. We understand that the availability of data is a key consideration when calculating VaR, and that the length of the data observation period may significantly influence the results of a VaR calculation. For example, a shorter observation period means that each observation will have a greater influence on the result of the VaR calculation (as compared to a longer observation period), such that periods of unusually high or low volatility could result in unusually high or low VaR estimates.[235] Longer observation periods, however, can lead to data collection problems, if sufficient historical data is not available.[236] We believe requiring a fund's chosen VaR model to be based on at least three years of historical market data strikes an appropriate balance.

The proposed historical market data requirement would permit a fund to base its VaR estimates on a meaningful number of observations, while also recognizing the concern that requiring a longer historical period could make it difficult for a fund to obtain sufficient historical data to estimate VaR for the instruments in its portfolio.[237] The 2015 proposal would have required three years of market data for funds using historical simulation (but did not require three years of market data for VaR models based on Monte Carlo simulation or parametric methods).[238] A number of commenters supported our approach in the 2015 proposal to require three years of market data for funds using historical simulation.[239] However, some commenters suggested that the rule should require a longer period of historical market data.[240] As discussed above, we believe that three years strikes an appropriate balance. We also are proposing to require funds to use three years of market data for all VaR calculations under the proposed rule—rather than only historical simulation as in the 2015 proposal. We believe this is appropriate because all methods for calculating VaR—not just historical simulation—rely on historical data.

Unlike the 2015 proposal, the proposed rule does not require a fund to apply its VaR model consistently (*i.e.,* the same VaR model applied in the same way) when calculating the VaR of its portfolio and the VaR of its designated reference index.[241] The proposed rule would, however, require that VaR calculations comply with the same proposed VaR definition and its specified model requirements.[242] Our proposal does not include the 2015

a ten business-day movement in rates and prices''). *See also* the Basel Committee on Banking Supervision, *Amendment To The Capital Accord To Incorporate Market Risks* (Jan. 1996), *available at https://www.bis.org/publ/bcbs24.pdf* (contemplating banks' use of internal models for measuring market risk based on a 10-day time horizon); CESR Global Guidelines, *supra* note 94 (specifying generally a 20-day time horizon as a quantitative requirement when calculating VaR for risk measurement and the calculation of global exposure and counterparty risk for UCITS).

[232] 2015 Proposing Release, *supra* note 2, at section III.B.2.b.

[233] *See, e.g.,* AQR Comment Letter; ICI Comment Letter II.

[234] *See, e.g.,* Morningstar Comment Letter; AIMA Comment Letter; AQR Comment Letter; ICI Comment Letter II.

[235] *See* Linsmeier & Pearson, *supra* note 226 (stating that, because historical simulation relies directly on historical data, a danger is that the price and rate changes in the last 100 (or 500 or 1,000) days might not be typical. For example, if by chance the last 100 days were a period of low volatility in market rates and prices, the VAR computed through historical simulation would understate the risk in the portfolio).

[236] *See* Dowd, *supra* note 177 (stating that ''[a] long sample period can lead to data collection problems. This is a particular concern with new or emerging market instruments, where long runs of historical data don't exist and are not necessarily easy to proxy'').

[237] *See* Michael Minnich, *Perspectives On Interest Rate Risk Management For Money Managers And Traders* (Frank Fabozzi, ed.) (1998) (stating that for historical simulation, ''[l]onger periods of data have a richer return distribution while shorter periods allow the VAR to react more quickly to changing market events'' and that ''[t]hree to five years of historical data are typical''); *see also* Darryll Hendricks, *Evaluation of Value-at-Risk Models Using Historical Data,* FRBNY Economic Policy Review (Apr. 1996) (finding that, when using historical VaR, ''[e]xtreme [confidence level] percentiles such as the 95th and particularly the 99th are very difficult to estimate accurately with small samples'' and that the complete dependence of historical VaR models on historical observation data ''to estimate these percentiles directly is one rationale for using long observation periods'').

[238] *See* 2015 Proposing Release, *supra* note 2, at section III.B.2.b; *see also supra* note 177 (discussing historical simulation, Monte Carlo simulation, and parametric methods).

[239] *See, e.g.,* Comment Letter of Abbey Capital (Mar. 28, 2016); AIMA Comment Letter; Comment Letter of Aspect Capital Limited (Mar. 28, 2016); Comment Letter of Intercontinental Exchange (Apr. 15, 2016).

[240] *See, e.g.,* materials attached to the memorandum included in the comment file concerning a meeting between representatives of AlphaSimplex Group LLC and members of the staff of the Division of Investment Management (July 8, 2016); AQR Comment Letter.

[241] *See* 2015 Proposing Release, *supra* note 2, at section III.B.2.b.

[242] *See infra* section II.D.4 (discussing the proposed VaR model requirements).

proposal's model consistency requirement because if the proposed rule required funds to apply the same VaR model to its portfolio and the designated reference index, it could prevent funds from using less-costly approaches. For example, under the proposed approach, in many cases a fund could calculate the VaR of a designated reference index based on the index levels over time without having to obtain access to more-detailed information about the index constituents. A fund also would have the flexibility to obtain the VaR from a third-party vendor instead of analyzing it in-house. A model consistency requirement could preclude these approaches, however, because a fund might not be able apply the same approach to its portfolio. For example, if a fund invested significantly in options, it generally would not be appropriate to use certain parametric VaR models.[243] The fund might instead use Monte Carlo simulation, which is more computationally intensive and takes more time to perform. A model consistency requirement would require the fund to apply the same Monte Carlo simulation model to its unleveraged designated reference index, for which a parametric or other simpler and less costly VaR model might be appropriate.

Although requiring a fund to apply the same VaR model to its portfolio and the designated reference index could result in a more precise comparison of the two values, we do not believe that the additional precision is necessary for the relative VaR test to identify where funds' use of derivatives is more likely to raise the concerns underlying section 18 because the proposed rule would provide certain common parameters for all VaR calculations under the rule. Because a fund's designated reference index must be unleveraged, we believe it is generally unlikely that different VaR models calibrated to these common parameters would produce substantially different results for a fund's designated reference index. Additionally, the derivatives risk manager would be responsible for administering and maintaining the derivatives risk management program, which includes the integrity of the VaR test. On balance, we believe the proposed approach would not materially diminish the efficacy of the proposed relative VaR test while permitting less-costly approaches for funds.

We request comment on the proposed requirements regarding a fund's choice of VaR model, and the required parameters for a VaR model that funds would use under the proposed rule.

108. Should the rule specify a particular VaR model(s) that funds must use (*i.e.,* a historical simulation, Monte Carlo simulation, or parametric methodology)? If so, which methodology (or methodologies) and why?

109. Is the proposed requirement that a fund's VaR model incorporate all significant, identifiable market risk factors associated with a fund's investments appropriate? Why or why not?

110. The proposed rule would provide a non-exhaustive list of risk factors that may be relevant in light of a fund's strategy and investments. Should the final rule include this non-exhaustive list of risk factors? Are risk factors included in the proposed list appropriate? Should we include any additional risk factors to this list? If so, which ones and why?

111. The proposed rule would require a fund to use a 99% confidence level for its VaR model. Is the proposed confidence level appropriate? Should the rule include a different confidence level? If so, which level and why, and if not, why not?

112. The proposed rule would require a fund to use a time horizon of 20 trading days for its VaR model. Is the proposed time horizon appropriate? Should the rule include a different time horizon? If so, which time horizon and why, and if not, why not?

113. The proposed rule would require a fund to use at least three years of historical market data for its VaR model. Is the historical market data requirement appropriate? Should the rule set forth a different length of time for requiring historical market data? Should the requirement be limited to funds using historical simulation? Would funds experience challenges in identifying sufficient data for particular types of investments? If so, which types of investments and how should the rule address these challenges? Please explain.

114. The proposed rule does not include any requirement for third-party validation of a fund's chosen VaR model, either at inception or upon material changes, to confirm that the model is structurally sound and adequately captures all material risks.[244] Should we require third-party validation? Why or why not?

115. Should the rule require a fund's board to approve the VaR model and any material changes to the model? Why or why not?

116. Should the final rule also include a requirement that a fund that uses the relative VaR test apply the same VaR model when calculating the fund's portfolio and the VaR of the designated reference portfolio? Would the requirement to apply the same VaR model to the fund's portfolio and the designated reference portfolio address any concerns that funds could inappropriately manipulate the results of VaR testing under the proposed rule's requirements? What additional cost, if any, would such a requirement impose on funds? Are there other ways that we could prevent such manipulations? To what extent would this requirement promote additional precision in the relative VaR test and would any additional precision increase the efficacy of the test in limiting fund leverage risk? Please explain.

5. Implementation

a. Testing Frequency

The proposed rule would require a fund to determine its compliance with the applicable VaR test at least once each business day.[245] Although we believe that funds would calculate their VaRs at a consistent time each day, which would generally be either in the mornings before markets open or in the evenings after markets close, we do not propose to require one at the exclusion of the other, to allow funds to conduct their VaR tests at the time that is most efficient based on each fund's facts and circumstances. We considered proposing that funds determine compliance with the proposed VaR test at the time of, or immediately after, entering into a derivatives transaction. We recognize, however, that conducting a VaR test on a trade-by-trade basis could present operational challenges for some funds and could limit the fund's choice of VaR modeling. For example, we believe that most funds would be unable to perform computationally-intensive Monte Carlo simulations so frequently based on computing resources and compliance costs. Requiring this VaR calculation each day, in contrast, would provide funds flexibility to use VaR models they believe to be appropriate while also providing for fairly frequent calculations. The 2015 proposal included a testing frequency of

[243] *See supra* note 227 (explaining that some parametric methodologies may be more likely to yield misleading VaR estimates for assets or portfolios that exhibit non-linear returns, due, for example, to the presence of options or instruments that have embedded optionality).

[244] The Global Exposure Guidelines applicable to UCITS' requires such validation. *See* CESR Global Guidelines, *supra* note 94.

[245] Proposed rule 18f–4(c)(2)(ii).

immediately after entering into any senior securities transactions, but many commenters raised concerns about operational complexity related to transaction-by-transaction testing, and instead generally suggested a daily testing frequency.[246]

We believe that determining compliance with the VaR test less frequently than each business day would not be consistent with the purpose of a condition to limit fund leverage risk. Section 18 sets forth certain fund leverage risk protections that are fundamental to protecting investors. If this testing requirement were less frequent than each business day, then a fund could satisfy the condition only on business days requiring a VaR test and modify its trading strategy to circumvent the purpose of the test on other business days. Additionally, we believe that testing each business day is appropriate in light of the potential for market risk factors associated with a fund's investments to change quickly.

We request comment on the proposed frequency of conducting the relative or absolute VaR test.

117. Is the proposed required frequency for conducting the VaR test appropriate? Should the rule require a fund to conduct the required VaR test more frequently or less frequently, such as—respectively—either before or after each transaction, multiple times throughout the day, or on a weekly basis? Why or why not? Should the required frequency vary depending on fund type or whether the fund is conducting an absolute VaR test or relative VaR test? Please explain.

118. Should the rule require funds to conduct the test at the same time each day? If so, why? What compliance or operational challenges, if any, would funds have to conduct the test at the same time each day? Would the absence of such a requirement allow funds to ''game'' the test?

b. Remediation

If a fund determines that it is not in compliance with the applicable proposed VaR test, then under our proposal a fund must come back into compliance promptly and within no more than three business days after such determination.[247] If the fund is not in compliance within three business days, then: (1) The derivatives risk manager must report to the fund's board of directors and explain how and by when (*i.e.,* the number of business days) the derivatives risk manager reasonably expects that the fund will come back into compliance; (2) the derivatives risk manager must analyze the circumstances that caused the fund to be out of compliance for more than three business days and update any program elements as appropriate to address those circumstances; and (3) the fund may not enter into derivatives transactions (other than derivatives transactions that, individually or in the aggregate, are designed to reduce the fund's VaR) until the fund has been back in compliance with the applicable VaR test for three consecutive business days and satisfied the board reporting requirement and program analysis and update requirements.[248]

The proposed three-business-day remediation provision is designed to provide funds with some flexibility in coming back into compliance with the applicable proposed VaR tests. It reflects our view that it would be inappropriate for a fund to purposefully exceed the VaR-based limit on fund leverage risk, but allows funds to take reasonable steps to come back into compliance without harming fund investors. The three-business-day period is designed to provide an appropriate time period to permit remediation efforts because it balances investor protections related to fund leverage risk and potential harm to a fund if it were required to sell assets or unwind transactions even more quickly. This remediation approach is similar to the remediation approach that section 18 of the Investment Company Act provides for asset coverage compliance with respect to bank borrowings, which also includes a three-day period to come back into compliance.[249]

If the fund does not come back into compliance within three business days, the proposed rule would not require the fund to exit its derivatives transactions or make other portfolio adjustments.[250] Although a fund remaining out of compliance with the applicable VaR test raises investor protection concerns related to fund leverage risk, if the proposed rule were to force a fund to exit derivatives transactions immediately at the end of the three-day period, this could harm investors, for example, by requiring the fund to realize trading losses that could have been avoided under a more-flexible approach. The proposed remediation provision reflects the balancing of these multiple investor protection concerns.

Instead of requiring a fund to come back into compliance under these circumstances immediately, the fund must satisfy three requirements before it can enter into derivatives transactions other than those designed to reduce the fund's VaR. First, the derivatives risk manager must report to the fund's board of directors and explain how and by when (*i.e.,* the number of business days) the derivatives risk manager reasonably expects that the fund will come back into compliance.[251] This requirement is designed to facilitate the fund coming back into compliance promptly by requiring the derivatives risk manager to develop a specific course of action to come back into compliance and to facilitate the board's oversight by requiring the derivatives risk manager to report this information to the board.

Second, the derivatives risk manager must analyze the circumstances that caused the fund to be out of compliance for more than three business days and update any program elements as appropriate to address those circumstances.[252] That the fund was unable to come back into compliance with the applicable VaR test within three business days may suggest there are deficiencies in the fund's program. This requires the derivatives risk manager to analyze and update any program elements as appropriate before the fund is able to enter into derivatives transactions other than those designed to reduce VaR.

Finally, a fund may not enter into derivatives transactions (other than those designed to reduce the fund's VaR) until the fund has been back in compliance with the applicable VaR test for at least three consecutive business days and has satisfied the applicable board reporting and program analysis and update requirements.[253] If the proposed rule were to permit a fund that is out of compliance with the limit on fund leverage risk to comply for just one day before entering into derivatives transactions that would increase the fund's market risk, this could potentially lead to some funds having persistently high levels of leverage risk

[246] *See, e.g.,* ICI Comment Letter I; Franklin Resources Comment Letter; SIFMA Comment Letter; AIMA Comment Letter; BlackRock Comment Letter.

[247] *See* proposed rule 18f–4(c)(2)(ii).

[248] *See* proposed rule 18f–4(c)(2)(iii); *see also infra* section II.H.2 (discussing the proposed requirement to submit a confidential report to the Commission if the fund is out of compliance with the applicable proposed VaR test for three business days).

[249] Section 18(f)(1) of the Investment Company Act.

[250] Under the proposed rule, a fund that is not in compliance within three business days also would be required to file a report to the Commission on proposed Form N–RN. *See* proposed rule 18f–4(c)(7); *infra* section II.H.2.

[251] Proposed rule 18f–4(c)(2)(iii)(A).

[252] Proposed rule 18f–4(c)(2)(iii)(B).

[253] Proposed rule 18f–4(c)(2)(iii)(C).

beyond that permitted by the applicable VaR test.

We request comment on the proposed remediation requirement for a fund that is out of compliance with the applicable VaR test.

119. Is the proposed three-business-day remediation provision appropriate? Could such a limited remediation period exacerbate fund or market instability and harm investors? Should the rule require a longer or shorter period, such as one or seven days? Why or why not, and if so, what should the alternative remediation period be? In light of the balancing of investor protection concerns (fund compliance with the VaR-based limit on fund leverage risk and not forcing asset sales or unwinding transactions to comply), is there a more-effective means to structure a remediation provision that balances these concerns? If so, how?

120. Should we change the rule's remediation provision to include an escalating provision that requires longer periods of compliance based on the number of three-day (or more) periods that a fund has been out of compliance? If so, how should we structure such a provision?

121. Should we change the rule to factor in the aggregate number of days in a trailing year that a fund has been out of compliance? What additional remediation consequences should a fund address before entering into derivatives transactions (other than those designed to reduce the fund's VaR)? Please explain.

122. Should the remediation provision provide further or different limitations for a fund that continuously goes in and out of compliance with its VaR test? For example, should the rule provide that such a fund is not permitted to rely on the proposed rule indefinitely or for a set period of time? How should a rule define ''continuously going in and out of compliance''? Should such a fund be subject to a lower VaR requirement? If so, what level of VaR and why? How long should the fund remain subject to any lower VaR requirement? Should the fund be subject to limits on its derivatives exposure?

123. Should the remediation provision, as proposed, require the derivatives risk manager to report to the fund's board of directors that the fund has been out of compliance with the VaR-based limit for more than three consecutive business days? Why or why not? Should the derivatives risk manager be required to explain how the fund will come back into compliance promptly and by when? Should we change the rule to require such a fund to take certain specific actions? Should we change the rule to require fund compliance within a specific time period? If so, how should we change the rule and why?

124. Should the remediation provision, as proposed, require the derivatives risk manager to analyze the circumstances for the fund being out of compliance for more than three business days? Should we change the rule to require specific program updates? Should we change the rule to require a complete program review and update? What challenges would such a remediation requirement impose on funds? What are the benefits of specifying program updates? Under what circumstances, if any, would a fund be out of compliance for more than three business days and not have risk management program elements to update? Please explain.

6. Other Regulatory Approaches To Limiting Fund Leverage Risk

a. Stress Testing

In addition to our proposal to require stress testing as a derivatives risk management program element, we considered a stress testing requirement as a means to limit fund leverage risk in lieu of, or in addition to, the proposed VaR tests. We understand that many funds that use derivatives transactions already conduct stress tests for purposes of risk management.[254]

For example, we considered proposing a single-factor stress test requirement that would enumerate a limited number of shocks, corresponding to different asset classes in which funds commonly invest, and specify the required shock levels for each asset class. Similar to Form PF, the rule could categorize stress testing shocks based on market factors such as equity prices, risk-free interest rates, credit spreads, currency rates, commodity prices, option implied volatilities, default rates for asset-backed securities, and default rates for corporate bonds and credit-default swaps.[255] The rule could also include an ''other,'' general category for which the corresponding shock level would be a specific or otherwise determinable factor based on extreme but plausible market conditions determined by the derivatives risk manager. A fund would ''fail'' this stress test if one of the prescribed shocks would cause the fund to experience a level of loss that we would specify.

We could, for example, specify the shock levels for each market factor based on a certain number of standard deviations from the mean of historical distributions of returns for that factor, such as three or four standard deviations, as a means of establishing standardized shock levels.[256] We could then specify that a fund fails the stress test if any such shock leads to a loss of a certain percentage of the fund's net assets over a single trading day or series of trading days, such as 20% over one trading day. We could determine these metrics based on how funds that do not engage in derivatives, but that have borrowed up to and in compliance with the requirements of section 18, would perform against the stress test. For example, the stress test outer limit could be based on a fund that is not using derivatives but has invested $150 in securities based on $100 of net assets and $50 in bank borrowings. To be consistent with section 18, a fund that uses derivatives and conducts a stress test resulting in losses greater than the stress test losses of this hypothetical bank-borrowing-leveraged fund would fail the single-factor stress test.

This approach would have the benefit of setting forth a comparatively simple-to-conduct test that a broad variety of funds could apply. The challenges of a single-factor stress testing requirement, however, include identifying an appropriate universe of market risk factors for the broad universe of derivatives in which funds invest and strategies they follow, setting the appropriate level of each shock for each factor, and determining the level of losses that would result in a fund ''failing'' the test. Making these determinations would be particularly challenging in a rule that would apply to all funds. Any prescribed shocks and related values could become stale over time and necessarily would not include all of the relevant risk factors for each fund. As funds continue to innovate, there could be funds for which no prescribed shock would be relevant. An approach that looks at a fund's losses in response to changes in a single market risk factor also may not effectively take into account correlations among market risk factors under stressed market conditions. Stress testing is useful as a risk management tool because it

[254] *See, e.g.,* ICI Comment Letter III. While we do not propose to require stress testing as a means for limiting a fund's leverage risk, as discussed above, one element of the proposed program requires stress testing for risk management purposes. *See supra* section II.B.3.c.

[255] Question 42 on Form PF requires some private fund advisers to report the impact on the fund's portfolio from specified changes to the identified market factors.

[256] If normally distributed, shock levels based on historical returns of a market factor that is three standard deviations from the mean of that market factor would correspond to approximately a 99.7% confidence level.

provides a framework for advisers to consider a range of potential scenarios tailored to each fund and refined over time. Its benefits as a limit of fund leverage risk may not be fully realized, however, by single-factor stress testing that includes static values that a rule specifies.[257]

We also considered requiring a multi-factor stress test based on scenario analysis. Rather than a fund applying a single-factor shock to each relevant asset class, this approach would require funds to create a stress test model that takes into account multiple asset classes simultaneously, which a fund would have to identify to tailor the stress test to its fund. The fund would then run numerous scenarios against the model, shocking the multiple asset classes identified, based on a high number of iterations and permutations akin to a Monte Carlo simulation. A multi-factor stress test would result in a matrix or range of estimated potential losses during stressed market conditions because each scenario permutation would create one estimated potential loss calculation. The benefits of multi-factor stress testing include tailoring the stress test to the investment and risk characteristics of a fund's portfolio, which may result in more meaningful derivatives risk management. But in considering a multi-factor stress testing requirement, we would have to consider whether such a framework, if highly particularized, would permit enough long-term flexibility as an applicable regulatory limit on fund leverage risk. For example, the multi-factor stress test could identify specific correlations and assumptions that funds should reflect in their stress tests based on their strategies and investments, or identify specific historical market events to run as scenarios against their stress test model. In addition, if we were to propose a principles-based multi-factor stress testing requirement that would rely on funds to tailor their stress tests, it would present regulatory challenges in determining whether funds were adhering to a limit on fund leverage risk consistent with section 18.

Finally, our proposed VaR-based limit on fund leverage risk, as opposed to stress testing, may better align with section 18's investor protection goals concerning the level of risk in a registered fund. This is because the limitations in section 18 apply under both normal and stressed market conditions.[258] For these reasons, as well as the regulatory design challenges of specifying the universe of asset class shocks and setting their corresponding levels, we are proposing a VaR-based limit on fund leverage risk instead of a stress testing approach to limiting fund leverage risk.

We request comment on stress testing as a means to limit funds' leverage risk.

125. In addition to our proposed stress testing requirement as part of the derivatives risk management program, should the rule require stress testing as a means to limit fund leverage risk in lieu of or in addition to the VaR-based limit on fund leverage risk? Why or why not? Is a stress test an effective means to limit a fund's leverage risk? Please explain. If we were to include a stress testing requirement in addition to a VaR-based limit on fund leverage risk, should we require a fund to comply with both requirements, or should we allow a fund to choose one or the other? If we were to allow funds to comply with either approach, would that result in inconsistent limits across funds and would that be appropriate if so?

126. To measure and/or limit fund leverage risk, do funds currently use VaR tests, stress tests or both? If a fund uses VaR tests but not stress tests (or vice versa), did the fund consider using the other approach as a means to measure and limit its leverage risk? Why or why not?

127. If funds use both VaR tests and stress tests to measure and/or limit fund leverage risk, why do they use both tests? Are there certain fund types or strategies that are better suited for VaR or for stress testing? If so, which ones and why?

128. Should the limit of fund leverage risk focus on normal market conditions, stressed market conditions, or both? Please explain.

129. Should the rule require a single-factor stress test as an alternative to the proposed VaR-based limit on fund leverage risk? If so, what single-factor shocks should the test require? What would the corresponding shock levels be for each factor? Are the example single-factor shocks discussed above appropriate? Please explain. How frequently and on what basis, if at all, do commenters anticipate that the Commission would need to amend a rule that incorporated the enumerated shocks and their corresponding levels?

130. What number of standard deviations from the mean of historical distributions of returns should the single-factor shock levels for each market risk factor be? Would three standard deviations or four standard deviations be appropriate? How should the rule define a failed stress test? Would a loss expressed as a percentage of the fund's net assets over a single trading day or series of trading days be appropriate? What percentage and over what period would be appropriate? Would 20% over one trading day be appropriate? How frequently, if at all, do commenters anticipate that the Commission would need to amend the rule to revise the specified loss level?

131. Should the rule require a multi-factor stress test as an alternative to the proposed VaR-based limit on fund leverage risk? If so, how might the rule include a multi-factor stress testing requirement that permits adequate flexibility and tailoring but could also promote comparability and regulatory consistency in setting a leverage risk limit?

132. Should the single-factor or multi-factor stress testing methods be required as part of the proposed program's stress testing requirement? If so, which one and why?

b. Asset Segregation

We considered applying an asset segregation approach to derivatives transactions, similar to asset segregation under Release 10666, as a tool to limit funds' leverage-related risks.[259] Under this approach, we could require a fund engaging in derivatives transactions to segregate cash and cash equivalents equal in value to the full amount of the conditional and unconditional obligations incurred by the fund (also referred to as ''notional amount segregation''). We could allow funds to segregate additional types of assets beyond cash and cash equivalents subject to prescribed haircuts based on the assets' volatilities. The 2016 DERA Memo, for example, analyzed different risk-based ''haircuts'' that could apply to a broader range of assets.[260] Allowing a broader range of segregated assets would have the effect of allowing funds to take on additional leverage because it would increase a fund's ability to obtain market exposure through a combination of cash, market securities investments, and derivatives transactions. Allowing funds to segregate a broader range of assets, even if subject to haircuts, also may not effectively address all of the section 18 concerns underlying an asset segregation requirement. For example, if

[257] We recognize that these concerns do not apply to all uses of single-factor stress testing. For example, money market fund stress testing does not raise similar concerns in part because of money market funds' common strategies and limited universe of investment holdings. *See* rule 2a–7(g)(8) under the Investment Company Act (requiring periodic stress testing).

[258] *See supra* section I.B.1.

[259] We separately discuss below our consideration of asset segregation as a complement to the proposed limitations on fund leverage risk. *See infra* section II.F.

[260] *See, e.g.,* 2016 DERA Memo, *supra* note 12.

a fund must raise cash to pay a derivatives counterparty by selling a segregated security with unrealized trading losses, then the fund still would realize trading losses on the sale of the security regardless of whether the fund applied haircuts to the value of the security when determining the amount of its segregated assets. The haircuts therefore could help to prevent a fund from defaulting on its derivatives transactions obligations, but may not prevent a fund from realizing trading losses to meet those obligations.

Notional amount segregation, although generally an effective way to limit leverage risk, is a non-risk-sensitive and often more restrictive approach to limiting potential leverage risk as compared to the proposed VaR tests. Notional amount segregation could limit funds' ability to engage in derivatives transactions that may not raise the concerns underlying section 18. For example, if a fund had segregated all available qualifying assets, it would not be permitted to enter into a derivatives transaction that would reduce portfolio risk. The proposed VaR tests would not constrain such a transaction because it would reduce the fund's VaR.

We also considered proposing an approach that would require funds to segregate liquid assets in an amount equal to the fund's daily mark-to-market liability plus a ''cushion amount'' designed to address potential future losses. Requiring funds to segregate liquid assets would indirectly limit a fund's leverage risk because each derivatives transaction and segregation of liquid assets would limit the net assets available for segregation to support additional derivatives. This approach would require segregating a smaller amount of liquid assets than the notional amount segregation approach.[261] In light of the smaller amount of segregated assets, we could provide that only a specified percentage of a fund's assets can be segregated. We could provide, for example, that a fund's segregated amount cannot exceed one-third of its total assets or one-half of its net assets because this is the maximum amount that an open-end fund can owe a bank under section 18.

This approach, however, would raise compliance complexities and may not be as effective as the proposed VaR tests in limiting fund leverage risk. For example, under this approach we would have to define the risk-based ''cushion amount'' funds would segregate. We could define this amount as we proposed in 2015: A reasonable estimate of the potential amount payable by the fund if the fund were to exit the derivatives transaction under stressed conditions.[262] Some commenters suggested determining these amounts could raise compliance challenges.[263] Another approach would be to use the amount of required initial margin, for transactions subject to regulatory initial margin requirements. Not all derivatives transactions are subject to initial margin requirements, however, and these requirements generally vary based on the type of derivatives instrument. An approach that were to allow a fund to have more leverage when trading futures as compared to swaps, for example, would not seem consistent with the concerns underlying section 18.

Requiring funds to segregate liquid assets in an amount equal to the fund's daily mark-to-market liability plus a ''cushion amount'' therefore could introduce unnecessary complexity and compliance costs and may not result in an effective limit on fund leverage. We believe that the proposed VaR-based tests would be a more direct and effective method of limiting fund leverage risk consistent with section 18.

We request comment on asset segregation as an alternative or complement to VaR.

133. Should the rule require asset segregation in lieu of or in addition to the proposed VaR-based limit on fund leverage risk? Is asset segregation equally effective or more effective than the proposed VaR tests in limiting a fund's leverage risk? Why or why not?

134. Are there certain fund types or strategies for which an asset segregation approach would be more effective or appropriate for limiting a fund's leverage risk? Which ones and why?

135. Should the proposed rule require notional amount segregation? What challenges, if any, would funds have with complying with notional amount segregation? Would this be an effective means to limit a fund's leverage risk? If so, how? Please describe.

136. Should the proposed rule require an asset segregation risk-based approach based on the fund's daily mark-to-market liability and ''cushion amount''? Please explain why or why not. If so, how should funds calculate the risk-based cushions? Should we use the approach in the 2015 proposal for risk-based coverage amounts? Would funds encounter challenges in determining stressed conditions for purposes of that analysis? Would that approach lead to consistent segregated amounts across funds for the same or similar investments? Why or why not? Could we provide for greater consistency by prescribing a standardized schedule for computing these amounts based on the volatility of the underlying reference assets? What values should we prescribe? Rather than the approach in the 2015 proposal, should we use the amounts posted to satisfy regulatory margin requirements? Would it be appropriate for different instruments that provide the same economic exposure (*e.g.,* futures and swaps that reference the same index) to have different segregated amounts? Under this approach, how should funds calculate risk-based cushions for transactions that are not subject to regulatory initial margin requirements?

137. Should we use the risk-based cushion amount approach to indirectly limit leverage risk? If so, should we provide that a fund's segregated amount cannot exceed one-third of its total assets, one-half of its net assets, or some other percentage of a fund's total or net assets? Would such an approach be sufficiently risk-sensitive and dynamic? If we were to use such an approach, how should we address derivatives transactions that may require little or no margin or collateral to be posted?

138. Are there other reasons that the proposed rule should include asset segregation? Should the derivatives risk management program specify asset segregation requirements? Would market practices adequately address asset coverage concerns? If not, why?

139. We included an asset segregation requirement as part of the 2015 proposal designed in part to address the asset sufficiency related concerns underlying section 18. Would an asset segregation requirement help to address fund leverage risk and complement the proposed VaR tests? If so, what type of asset sufficiency test?

c. Exposure-Based Test

We considered an exposure-based approach for limiting fund leverage risk. For example, we could design an exposure-based approach that permits a fund to enter into derivatives transactions so long as its derivatives exposure does not exceed a specified percentage of the fund's net assets, such as 50%. This would be similar to an exposure-based test under the European

[261] *See* 2010 ABA Derivatives Report (recommending a risk-adjusted segregated amounts approach); 2011 Concept Release, *supra* note 3, at sections II.B.2, II.C.2 (citing and requesting comment on the 2010 ABA Derivatives Report approach).

[262] *See* 2015 proposed rule 18f–4(c)(9).

[263] We discuss these challenges in more detail below in section II.F. *See also, e.g.,* AAF Comment Letter; Angel; Comment Letter of James J. Angel, Ph.D., CFA (Mar. 28, 2016).

Union guidelines that apply to UCITS funds.[264]

A fund's ''derivatives exposure'' could be defined as in proposed rule 18f–4.[265] A similar approach would be to provide that the sum of a fund's derivatives exposure and the value of its other investments cannot exceed 150% of the fund's net asset value. This latter approach, and particularly if cash and cash equivalents were not included in the calculation, would allow a fund to achieve the level of market exposure permitted for an open-end fund under section 18 using any combination of derivatives and other investments.[266]

This alternative approach would recognize that for most types of derivatives, the notional amount generally serves as a measure of the fund's economic exposure to the underlying reference asset or metric. It also would provide a simple approach because a fund would just add the relevant values rather than having to perform VaR tests.

An exposure-based test does have certain limitations. One drawback to this alternative approach is that a derivative's notional amount does not reflect the way in which the fund uses the derivative and is not a risk measurement. For this reason, an exposure-based approach may be viewed as a relatively blunt measurement. It would not differentiate between derivatives transactions having the same notional amount but different underlying reference assets with potentially very different risks.

There are adjustments to notional amounts available that may better reflect the risk associated with derivatives transactions. One way to attempt to address these drawbacks would be to define the circumstances under which funds could subtract the exposure associated with ''hedging'' and ''netting'' transactions from a fund's derivatives exposure. This would be similar to the ''commitment method'' applicable to UCITS funds.[267] Defining these kinds of transactions can be challenging. For example, determining whether transactions are ''hedges'' can involve an analysis of historical correlations and predicting future price movements of related instruments or underlying reference assets, among other things. Historical correlations also can break down in times of market stress.[268]

Another potential way to modify an exposure-based test would be to adjust the notional amounts that contribute to a fund's derivatives exposure based on the volatility of their underlying reference assets. Some commenters on the 2015 proposal suggested we take this approach, and DERA staff prepared an analysis of commenters' suggestions.[269] This would make an exposure-based test more risk-sensitive, but would not provide the more-comprehensive analysis of portfolio risk that VaR provides. An exposure-based test, even with these various adjustments to notional amounts for purposes of calculating a fund's derivatives exposure, still would be a relatively blunt measurement. For example, this approach could limit certain fund strategies that rely on derivatives more extensively but that do not seek to take on significant leverage risk.

While we do not propose an exposure-based test element as a means for limiting all funds' leverage risk, we are proposing an exposure-based test for limited derivatives users (as discussed below).[270]

We request comment on an exposure-based test as a means to limit funds' leverage risk.

140. Should the rule incorporate an exposure-based approach in addition to, or in lieu of, the proposed VaR-based limit on fund leverage risk? If so, what derivatives exposure amount should this approach permit? For example, should we modify the proposed rule so that a fund would not be required to satisfy either VaR test if the fund limited its derivatives exposure, as defined for purposes of the limited derivatives user exception discussed below, to 50% of a fund's net assets? Should an exposure-based approach focus on a fund's overall gross market exposure and be based on the sum of the fund's derivatives exposure and the value of its other investments, less any cash and cash equivalents? If so, should a fund's gross market exposure be limited to 150% of net assets to allow a fund to achieve the level of market exposure permitted for an open-end fund under section 18 using any combination of derivatives and other investments? Would any of these approaches to implementing an exposure-based limit on fund leverage risk effectively address the potential leverage associated with a fund's derivatives transactions? If so, would funds find it more cost effective or otherwise preferable to have the option to comply with an exposure-based test in lieu of the proposed VaR tests? Please explain.

141. If the rule were to incorporate an exposure-based approach, should we permit funds to make netting and hedging adjustments when calculating their derivatives exposures? If so, why? How should we define permissible

[264] CESR (now known as the European Securities and Markets Authority (''ESMA'')) issued its Guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS (''Global Exposure Guidelines'') in 2010, addressing the implementation of the European Commission's 2009 revised UCITS Directive (''2009 Directive''). *See* CESR Global Guidelines, *supra* note 94, at 9.

A UCITS fund may, instead of complying with the European Union's VaR-based test, satisfy a ''commitment approach.'' The commitment approach provides that a UCITS fund is in compliance with the leverage limits under the guidelines if its derivatives notional amounts (taking into account netting and hedging) do not exceed 100% of the fund's net asset value. *See* 2009 Directive.

[265] Proposed rule 18f–4(a) (defining derivatives exposure to mean the sum of the notional amounts of the fund's derivatives instruments and, in the case of short sale borrowings, the value of the asset sold short. In determining derivatives exposure a fund may convert the notional amount of interest rate derivatives to 10-year bond equivalents and delta adjust the notional amounts of options contracts).

[266] This approach would exclude cash and cash equivalents because they do not meaningfully contribute to a fund's market exposure.

[267] *See, e.g.,* CESR Global Guidelines, *supra* note 94, at 13–14 (defining netting as ''combinations of trades on financial derivative instruments and/or security positions which refer to the same underlying asset, irrespective—in the case of financial derivative instruments—of the contracts' due date; and where the trades on financial derivative instruments and/or security positions are concluded with the sole aim of eliminating the risks linked to positions taken through the other financial derivative instruments and/or security positions'' and hedging as ''combinations of trades on financial derivative instruments and/or security positions which do not necessarily refer to the same underlying asset and where the trades on financial derivative instruments and/or security positions are concluded with the sole aim of offsetting risks linked to positions taken through the other financial derivative instruments and/or security positions'').

[268] In times of extreme market stress, price correlations between asset classes frequently break down. *See* Mico Loretan & William B. English, *Evaluating ''Correlation Breakdowns'' During Periods of Market Volatility,* Federal Reserve System International Finance Working Paper No. 658 (Feb. 2000), *available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=231857* (''[I]n periods of heightened market volatility correlations between asset returns can differ substantially from those seen in quieter markets. The problem of 'correlation breakdown' during periods of greater volatility is well known.''). During periods of stressed conditions, correlations between asset classes with historically weak or inverse correlations may change significantly. *See* Whitney Kisling, *Greed Beats Fear With Stock-Bond Correlation Falling,* Bloomberg (Nov. 22, 2010) (stating that the 30-day correlation between S&P 500 prices and 10-year Treasury yields showed equity and bond markets, typically inversely correlated markets, moving in lockstep after the 2008 financial crisis); *see also A Review of Financial Market Events in Autumn 1998,* Bank for International Settlements, Committee on the Global Financial System (1999), *available at http://www.bis.org/publ/cgfs12.htm* (during the Russian financial crisis in August 1998 the average correlation between five-day changes in yield spreads for 26 instruments in 10 economies rose from 11% in the first half of 1998 to 37% during the height of the crisis).

[269] *See* 2016 DERA Memo, *supra* note 12.

[270] *See* proposed rule 18f–4(c)(3).

netting and hedging transactions? If we permit netting and hedging to be incorporated into the exposure calculation, should the rule include third-party verification to test whether a fund's netting and hedging calculations were reasonable and appropriate? What other provisions could achieve these concerns with netting and hedging? Please describe.

142. If the rule were to incorporate an exposure-based approach, should we permit funds to make risk-sensitive adjustments as discussed in the 2016 DERA Memo? If so, why? How should we define the permissible risk-adjusted notional amounts? If we permit these adjustments to be incorporated into the exposure calculation, should the rule include third-party verification to test whether a fund's adjustments were reasonable and appropriate? What other provisions could achieve these concerns with risk-adjusted notional amounts? Please describe.

143. Are there certain fund types or strategies where an exposure-based test would be more appropriate? If so, which ones and why? Would these fund types or strategies have difficulty conducting either a relative VaR test or absolute VaR test? If so, why would an exposure-based test be less challenging to conduct than a VaR-based test?

144. What challenges, if any, would funds have in conducting an exposure-based test? How could an exposure-based test rule account for these challenges?

145. Do funds currently conduct exposure-based tests as a means of measuring and limiting a fund's leverage risk? If so, which ones and why? Are these exposure-based tests in place of or in addition to VaR-based tests or other risk measurements? Should the rule be modified to require both, and what benefits do funds find when running an exposure-based test and VaR-based test and comparing results? Would these additional compliance burdens result in a more-accurate limit on fund leverage risk? If so, how much so, and what would the additional compliance burdens be?

146. In what ways is the proposed approach to limiting leverage risk superior or inferior to the current regulatory approach or alternative approaches, including the stress testing, asset segregation and exposure-based alternatives discussed herein?

E. Limited Derivatives Users

We are proposing an exception from the proposed rule's risk management program requirement and VaR-based limit on fund leverage risk for funds that use derivatives in a limited manner. Requiring funds that use derivatives only in a limited way to adopt a derivatives risk management program that includes all of the proposed program elements could potentially require funds (and therefore their shareholders) to incur costs and bear compliance burdens that may be disproportionate to the resulting benefits.[271] We recognize that the risks and potential impact of derivatives transactions on a fund's portfolio generally increase as the fund's level of derivatives usage increases and when funds use derivatives for speculative purposes.

The proposed exception would cover two alternative types of limited derivatives use. It would be available to a fund that either limits its derivatives exposure to 10% of its net assets, or that uses derivatives transactions solely to hedge certain currency risks.[272] A fund that relies on the proposed exception would also be required to adopt policies and procedures that are reasonably designed to manage its derivatives risks.[273] We believe that the risks and potential impact of these funds' derivatives use may not be as significant, compared to those of funds that do not qualify for the exception, and that a principles-based policies and procedures requirement would appropriately address these risks. We discuss and request comment on each of the elements of this proposed exception below.

1. Exposure-Based Exception

Under one alternative set of conditions, a fund would be permitted to rely on the limited derivatives user exception if its derivatives exposure does not exceed 10% of its net assets. The proposed rule would generally define the term ''derivatives exposure'' to mean the sum of the notional amounts of the fund's derivatives instruments and, for short sale borrowings, the value of any asset sold short.[274] This definition is designed to provide a measure of the market exposure associated with a fund's derivatives transactions entered into in reliance on proposed rule 18f–4.[275]

We recognize that using notional amounts as a measure of market exposure could be viewed as a relatively blunt measurement in that different derivatives transactions having the same notional amount but different underlying reference assets—for example, an interest rate swap and a credit default swap having the same notional amount—may expose a fund to very different potential investment risks and potential payment obligations. The derivatives exposure threshold in the limited derivatives user exception, however, is not designed to provide a precise measure of a fund's market exposure or to serve as a risk measure, but rather to serve as an efficient way to identify funds that use derivatives in a limited way.

The proposed definition of ''derivatives exposure'' would, however, include two adjustments designed to address certain limitations associated with measures of market exposure that use derivatives' notional amounts without adjustments. Specifically, the proposed rule would permit a fund to convert the notional amount of interest rate derivatives to 10-year bond equivalents and delta adjust the notional amounts of options contracts.[276] Converting interest rate derivatives to 10-year bond equivalents would provide for greater comparability of the notional amounts of different interest rate derivatives that provide similar exposure to changes in interest rates but that have different unadjusted notional amount. In addition, absent this adjustment, short-term interest rate derivatives in particular can produce large unadjusted notional amounts that may not correspond to large exposures to interest rate changes.[277] Permitting funds to convert these and other interest rate derivatives to 10-year bond equivalents is designed to result in adjusted notional amounts that better represent a fund's exposure to interest rate changes. Similarly, permitting delta adjusting of options is designed to provide for a more tailored notional amount that better reflects the exposure that an option creates to the underlying reference asset.

These adjustments are therefore designed to provide for more tailored notional amounts that better reflect the exposure that a derivative creates to the underlying reference asset. Providing these adjustments also would be efficient for funds because the adjustments are consistent with the

[271] The cost burden concern extends to smaller funds as well, which could experience an even more disproportionate cost than larger funds. *See infra* sections III.C.3and V.D.1.c.

[272] *See* proposed rule 18f–4(c)(3)(i)–(ii); *see also infra* sections II.E.1 and II.E.2 (discussing the specific requirements for funds relying on either alternative of the proposed exception).

[273] *See* proposed rule 18f–4(c)(3).

[274] *See* proposed rule 18f–4(a) (defining the term ''derivatives exposure'').

[275] *Id.*

[276] *Id.* Delta refers to the ratio of change in the value of an option to the change in value of the asset into which the option is convertible. A fund would delta adjust an option by multiplying the option's unadjusted notional amount by the option's delta.

[277] *Id.*

reporting requirements in Form PF and Form ADV.[278] We do not believe additional adjustments are necessary for purposes of identifying limited derivatives users. For example, commenters on the 2015 proposal suggested an approach to adjusting notional amounts based on the volatility of the underlying reference assets, and DERA staff analyzed these suggestions.[279] We believe, however, that whether a fund is using derivatives in a limited way for purposes of the limited derivatives user exception should not depend on the volatility of the underlying reference assets, but rather on the extent to which a fund uses derivatives to implement its investment strategy.

The proposed 10% derivatives exposure condition represents a threshold that is designed to exclude funds from the program requirement and the VaR-based limit on fund leverage risk when their derivatives exposure is relatively limited. This proposed threshold is based in part on staff analysis of funds' practices regarding derivatives use. Specifically, DERA staff analyzed funds' use of derivatives based on Form N–PORT filings as of September 2019. As discussed in more detail in section III, these filings covered mutual funds, ETFs, registered closed-end funds, and variable annuity separate accounts registered as management investment companies. Based on this analysis, 59% of funds report no derivatives holdings and 14% of funds report derivatives holdings with gross notional amounts above 50% of NAV.

DERA staff also analyzed the levels of these funds' derivatives exposure after adjusting interest rate derivatives and options, as permitted under the proposed rule. Taking these adjustments into account, DERA staff's analysis showed that 78% of funds have adjusted notional amounts below 10% of NAV; 80% of funds have adjusted notional amounts below 15% of NAV; 81% of funds have adjusted notional amounts below 20% of NAV; and 82% of funds have adjusted notional amounts below 25% of NAV. Although BDCs are not required to file reports on Form N–PORT, our staff separately analyzed a sampling of BDCs, finding that of the sampled BDCs, 54% did not report any derivatives holdings and a further 29% reported using derivatives with gross notional amounts below 10% of net assets.[280]

We recognize that not all funds are currently required to file reports on Form N–PORT.[281] It appears, however, that funds' use of derivatives reflected in the Form N–PORT data is generally consistent with that in the representative sample studied in the White Paper prepared in connection with the 2015 proposal, entitled ''Use of Derivatives by Investment Companies.'' [282] For example, DERA staff compared the percentages of funds in both data sets that reported no derivatives and the percentage with gross notional amounts less than 50% of net assets. These figures were comparable, suggesting that the Form N–PORT data provides a representative sample of current funds, and not just the set of funds currently required to file reports on Form N–PORT.[283] Taking these results into account, we are proposing to permit a fund to operate as a limited derivatives user if its derivatives exposure is below 10% of net assets. DERA staff analysis suggests that most funds either do not use derivatives or do so to a more limited extent, and that setting the derivatives exposure threshold for the limited user exception at 10%, 15%, 20%, or 25%, for example, would result in nearly the same percentages of funds qualifying for the exception. We therefore are proposing a lower threshold of 10% because the lower threshold would result in nearly the same percentage of funds qualifying for the exception based on current practices while potentially providing greater investor protections in the future by requiring funds that exceed the lower 10% threshold to establish a program and comply with the VaR-based limit on fund leverage risk.

The 2015 proposal also included an exception from that proposal's risk management program requirement for funds: (1) Whose notional derivatives exposure does not exceed 50% of net assets; and (2) that do not enter into ''complex derivatives transactions,'' defined in that proposal to include certain path-dependent and non-linear transactions.[284] The 2015 proposal permitted funds to use delta-adjusted notional amounts for options but did not provide an adjustment for interest rate derivatives.

We are proposing a 10% derivatives exposure threshold that takes into account certain adjustments rather than a higher figure, like the 50% threshold we proposed in 2015 that did not include adjustments for interest rate derivatives, because we believe this approach would more effectively identify funds whose derivatives may be effectively managed without a fund needing to establish a derivatives risk management program that includes all of the proposed program elements. A fund with derivatives exposure equal to 50% of net assets, for example, would be at risk of substantial losses, notwithstanding that an open-end fund could borrow an amount equal to 50% of its net assets from a bank.[285] Conversely, if a fund were entering into interest rate derivatives—and especially short-term interest rate derivatives—those transactions' unadjusted notional amounts could cause a fund to exceed the threshold we proposed in 2015 even though the fund's derivatives risks could be less significant than those of

[278] *See, e.g.,* General Instruction 15 to Form PF; Item B.30 of Section 2b of Form PF; Glossary of Terms, Gross Notional Value of Form ADV; Schedule D of Part 1A of Form ADV.

[279] *See* 2016 DERA Memo, *supra* note 12.

[280] *See infra* section III.B.2. As noted above, our staff did not have sufficient information to adjust the notional amounts of the BDCs' interest rate derivatives or options. Some of the 17% of the sampled BDCs with gross notional amounts exceeding 10% of net assets likely would have lower notional amounts after applying these adjustments.

[281] Larger fund groups—funds that together with other investment companies in the same ''group of related investment companies'' have net assets of $1 billion or more as of the end of the most recent fiscal year of the fund—currently are required to file reports on N–PORT. Smaller fund groups must begin to file reports on Form N–PORT by April 30, 2020. While only larger fund groups are currently required to file reports on Form N–PORT, existing filings nevertheless covered 89% of funds representing 94% of assets. *See infra* note 457 and accompanying text.

[282] DERA White Paper, *supra* note 1; *see also* ICI Comment Letter III (regarding a survey related to funds' use of derivatives sent to its member firms, the Investment Company Institute stated ''The survey was distributed to smaller fund complex members, yet relatively few responses were received from these smaller fund members. Based on anecdotal conversations with staff at these member complexes, the smaller fund firms described no to minimal use of derivatives.'').

[283] Specifically, the DERA White Paper observes that 68% of funds held no derivatives and 89% of funds had gross notional amounts less than 50% of net assets. *See* DERA White Paper, *supra* note 1. The respective figures from the N–PORT data were 59% and 86% of funds.

[284] Specifically, the 2015 proposal defined the term ''complex derivatives transaction'' to mean any derivatives transaction for which the amount payable by either party upon settlement date, maturity or exercise: (1) Is dependent on the value of the underlying reference asset at multiple points in time during the term of the transaction; or (2) is a non-linear function of the value of the underlying reference asset, other than due to optionality arising from a single strike price. 2015 proposed rule 18f–4(c)(1).

[285] *See, e.g.,* CFA Comment Letter (stating that the commenter did not believe it was ''appropriate that a fund with 40 or 45 percent notional exposure should be viewed as having a limited amount of exposure obviating the requirement for that fund to implement a formal risk management program'' and that ''Section 18's limit reflects a congressional determination on the level of exposure funds may not exceed; it does not reflect the level of exposure at which funds should begin to establish formal risk management practices'').

other funds that would qualify for the exception. The approach the Commission proposed in 2015 therefore could have permitted some funds to rely on the exception while still taking on significant derivatives risks, while disqualifying other funds whose derivatives transactions may have posed less-significant risks but that had high unadjusted notional amounts. Here, our proposal is designed to address these concerns by proposing a lower derivatives exposure threshold while also allowing funds to adjust interest rate derivatives' notional amounts because the unadjusted values may be more likely to overstate a fund's market exposure.

We also are not proposing to prohibit funds relying on the exception from entering into complex derivatives transactions as we proposed in 2015 because, as discussed in more detail below, we are proposing to require that limited derivatives users manage all of the risks associated with their derivatives transactions, including any complex derivatives transactions. In addition, if these or other complex or exotic derivatives were to embed multiple forms of optionality or other non-linearities such that the fund could not reliably compute the transaction's notional amount, the fund would not be able to confirm that its derivatives exposure is below 10% of the fund's net assets and therefore would not be able to rely on the limited derivatives user exception. Finally, if these complex derivatives transactions were to cause a fund's derivatives exposure to exceed 10% of the fund's net assets—or the fund were to exceed the limit for any other reason—the fund would have to reduce its derivatives exposure promptly or establish a derivatives risk management program and comply with the VaR-based limit on fund leverage risk as soon as reasonably practicable.

We also considered an alternative approach to identifying funds that use derivatives in a limited way based on a fund's disclosure. Specifically, we considered providing that a fund would be a limited derivatives user if its principal investment strategies disclosed in its prospectus do not involve the use of derivatives.[286] A fund that does not identify the use of derivatives in its principal investment strategies should generally be using derivatives less extensively than a fund that does include the use of derivatives as a principal investment strategy. This approach would provide some efficiencies for funds because they already are required to make this disclosure.[287]

This approach would, however, have certain drawbacks. For example, whether a fund's use of derivatives is a principal investment strategy is a facts-and-circumstances-based analysis. Funds that may appear broadly similar could provide different disclosures, leading to less consistency in the application of the derivatives risk management program requirement and in the application of the VaR-based limit on leverage risk.

Taking these considerations into account, we are proposing to look at a uniform metric of a fund's derivatives exposure, rather than at the more fact-specific question of whether a fund views the use of derivatives as a principal investment strategy. We believe the proposed approach should result in more-consistent determinations by funds and would be more appropriate in determining whether a fund should qualify for the limited derivatives user exception.

We request comment on the proposed exposure-based exception.

147. Is it appropriate to permit funds to rely on the limited derivatives user exception if their derivatives exposure does not exceed 10% of their net assets? Why or why not? Should we lower or raise the proposed derivatives exposure threshold, for example to 5% or to 15%? Why or why not? Should we lower it to a *de minimis* amount, such as 1% or 3%, and provide that a fund with derivatives exposure below these levels is not required to adopt policies and procedures designed to manage derivatives risk? Should the threshold vary based on whether a fund is an open-end fund, registered closed-end fund, or BDC? If so, why, and which levels would be appropriate for each kind of fund?

148. The derivatives exposure of certain types of transactions may be difficult to calculate or may change rapidly, which may make it difficult for a fund to consistently comply with the limited derivatives user exception. Should we provide that a fund relying on the limited derivatives user exception may not enter into complex or exotic derivatives transactions, whose risks may not be fully reflected in their notional amounts? If so, what kinds of complex or exotic transactions? For example, should we provide that a fund relying on the exception may not enter into complex derivatives transactions, as defined in the 2015 proposal? Should we only permit a fund to have a more-limited amount of derivatives exposure associated with these transactions, such as 1% or 5% of net assets? Why or why not?

149. Should we prescribe how a fund must calculate its notional amounts, or is that term in the proposed rule sufficiently clear? If we should prescribe the calculation, what should we prescribe? For example, in 2015 the Commission proposed to define a derivatives transaction's notional amount to mean, among other things: (1) The market value of an equivalent position in the underlying reference asset for the derivatives transaction (expressed as a positive amount for both long and short positions); or (2) the principal amount on which payment obligations under the derivatives transaction are calculated. Should we include this definition in rule 18f–4? The 2015 proposal also included specific provisions for calculating a derivatives transaction's notional amount for: (1) Derivatives that provide a return based on the leveraged performance of a reference asset; and (2) derivatives transactions for which the reference asset is a managed account or entity formed or operated primarily for the purpose of investing in or trading derivatives transactions, or an index that reflects the performance of such a managed account or entity.[288] Should we include either or both of these provisions in rule 18f–4? Why or why not? Would funds calculate their notional amounts consistently with these provisions even if they were not included in the rule text because the calculations would be consistent with the way market participants determine

[286] *See, e.g.,* ICI Comment Letter III (stating that an appropriate threshold for limited derivatives users could be whether a fund listed derivatives in its prospectus as a principal investment strategy). Form N–1A requires an open-end fund to disclose its principal investment strategies, including the particular type or types of securities in which the fund principally invests or will invest. *See* Item 9 of Form N–1A. Form N–1A also provides, in part, that ''[i]n determining what is a principal investment strategy, consider, among other things, the amount of the Fund's assets expected to be committed to the strategy, the amount of the Fund's assets expected to be placed at risk by the strategy, and the likelihood of the Fund's losing some or all of those assets from implementing the strategy.'' *See* Instruction 2 to Item 9 of Form N–1A. Form N–2 requires a closed-end fund to concisely describe the fund's investment objectives and policies that will constitute its principal portfolio emphasis, including the types of securities in which the fund invests or will invest principally. *See* Item 8 of Form N–2. The instructions to this item direct the fund to briefly describe the significant investment practices or techniques that the fund employs or intends to employ with several examples, including examples related to derivatives transactions.

[287] *See* ICI Comment Letter III (stating that 92% of the firms surveyed indicated that their firms have funds that list derivatives as a principal investment strategy in their prospectus).

[288] *See* 2015 Proposing Release, *supra* 2, at n.158 and accompanying text.

derivatives transactions' notional amounts?

150. Would funds be able to calculate notional amounts for complex derivatives and, if so, would they reflect the market risk in the transactions? Why or why? If we permit funds to enter into complex derivatives transactions as defined in the 2015 proposal while relying on the limited derivatives user exception, should we require that funds calculate these transactions' notional amounts as the Commission proposed in 2015? That proposal would have provided that the notional amount of a complex derivatives transaction would be the aggregate notional amounts of derivatives transactions (excluding complex derivatives transactions) reasonably estimated to offset substantially all of the market risk of the complex derivatives transaction.

151. For purposes of determining a fund's derivatives exposure, should the proposed rule treat differently derivatives that create synthetic positions where the fund holds cash and cash equivalents with a value equal to the derivative's notional amount less any posted margin? These transactions may not leverage the fund's portfolio because of the fund's holding cash and cash equivalents equal to the notional amount of the derivatives transaction less any posted margin, rather than investing in additional securities or making other investments. Take, for example, a fund with $100 that posts $20 of initial margin to initiate a long position in a swap contract referencing a market index. If the fund posted cash and cash equivalents as initial margin and maintains the remaining $80 in cash and cash equivalents as well, the fund would have a market exposure that would be similar to having invested the fund's $100 in the stocks composing the index. Such a transaction could, however, present other risks, such as counterparty risk. Because these synthetic transactions may not leverage a fund's portfolio, should we permit a fund to exclude these transactions from its derivatives exposure? Conversely, because they can raise other risks, such as counterparty risks, should they be included in derivatives exposure as proposed?

152. Should the rule define limited derivatives users using an alternative methodology other than the proposed threshold tied to derivatives exposure (or, as discussed below, for funds that use derivatives to hedge currency risks)? Why or why not? For example, should the limited derivatives user exception be defined to include funds that do not disclose the use of derivatives as a principal investment strategy in their prospectuses? Would this disclosure-based exception threshold be over- or under-inclusive? Would it lead to less consistency in the requirement to establish a derivatives risk management program and comply with a VaR-based limit on leverage risk and potentially create uncertainty for funds as to when they would qualify for the limited user exception? Why or why not? If this could lead to less consistency, would any additional instructions in funds' registration forms, regarding what a fund should disclose as a principal investment strategy in its prospectus, help mitigate this concern, and if so, what should those instructions be? Is it appropriate to tie an exception to the derivatives risk management program requirement and VaR-based limit on fund leverage risk to a prospectus disclosure requirement? Why or why not?

153. Should the condition that a limited derivatives user's derivatives exposure not exceed 10% of the fund's net assets address exceedances and remediation? Why or why not? For example, as noted above, if a fund's derivatives exposure were to exceed 10% of the fund's net assets, the fund would have to promptly reduce its derivatives exposure or establish a derivatives risk management program and comply with the VaR-based limit on fund leverage risk as soon as reasonably practicable. Should we provide in rule 18f–4 specific time periods for these actions and, if so, which time periods would be appropriate? As an alternative way to address temporary exceedances, should the rule provide that a fund will be a limited derivatives user if it adopts a policy providing that, under normal circumstances, the fund's derivatives exposure will not exceed 10% of the fund's net assets? If so, what should be considered ''normal circumstances''? Would this standard be too subjective such that funds would have substantial derivatives exposures while still qualifying as limited derivatives users? Rather than a policy referring to ''normal circumstances,'' should we require a fund to disclose in its prospectus that it does not expect its derivatives exposure to exceed 10% of the fund's net assets? Should this disclosure also appear in the fund's annual report?

154. Should we prohibit a fund whose derivatives exposure repeatedly exceeds 10% of net assets from relying on the exception again for a period of time? For example, if a fund were to exceed this limit more than two or three times in a year, should we provide that the fund cannot rely on the limited derivatives user exception for one or two years?

155. In calculating derivatives exposure, should we permit a fund to convert the notional amount of interest rate derivatives to 10-year bond equivalents and delta adjust the notional amounts of options contracts, as proposed? Would delta adjusting options raise the concern that a fund's delta-adjusted options exposure would be small, allowing a fund to avoid establishing a program, but could quickly grow in response to large price changes in the option's reference asset? How should we address this concern? Should we permit additional adjustments? Why or why not? If so, what additional adjustments should we permit? For example, should we permit funds to adjust notional amounts based on the volatility of the underlying reference assets? Why or why not?

156. The proposed rule provides that, for a fund to operate as a limited derivatives user under the exposure-based prong, the fund's derivatives exposure must not exceed 10% of net assets. The rule does not, however, prescribe the frequency with which funds must calculate their derivatives exposure to evaluate their compliance. Should we require that a fund calculate its notional amounts daily, or at some other specified frequency? Are there other requirements we should specify regarding a fund's calculation of its derivatives exposure? If so, what are they, and why would these other requirements more accurately address a fund's derivatives exposure?

157. Should we permit a fund to adjust its derivatives exposure for purposes of the proposed exception to account for certain netting and hedging transactions? [289] Why or why not? If so, how should we define netting and hedging transactions for this purpose? How should we prescribe in rule 18f–4 the circumstances under which different derivatives—and particularly derivatives with different reference assets—should be treated as hedged or offsetting? If the rule were to permit funds to exclude hedging or netting transactions from their derivatives exposure, should we require funds to maintain records concerning these transactions to help our staff and fund compliance personnel evaluate if the transactions reasonably could be viewed as hedging or netting? If so, what information should those records reflect? For example, the regulations under section 13 of the Bank Holding Company Act, commonly known as the Volcker Rule, require certain banking entities to maintain certain

[289] *See* paragraph accompanying *supra* notes 266–267.

documentation relating to hedging strategies, including positions and techniques.[290] Should the proposed rule take this or a similar approach? As another example, should we require funds to identify both the asset being hedged or netted and the derivatives transaction used to hedge or net that asset? How should we consider the risk that the historical correlations underlying an adviser's view that assets will have inverse price correlations can break down in times of market stress? How could a standard in the rule be reasonably objective such that funds and our staff could confirm a fund's compliance? Should we permit funds to account for netting but not hedging or vice versa? Why or why not? Would the compliance burden to calculate netting and hedging transactions for purposes of such adjustments justify the benefits of permitting these adjustments? Why or why not? What other challenges could funds face in accounting for netting and hedging transactions that could increase the costs associated with this exercise, or that could negatively affect a fund's ability to assess its derivatives exposure accurately? Could these challenges be mitigated in any way? If so, how?

158. Should we specify in the rule that a fund calculating its derivatives exposure may net any directly-offsetting derivatives transactions that are the same type of instrument and have the same underlying reference asset, maturity and other material terms, as we proposed in 2015? Why or why not?

159. In determining a fund's derivatives exposure, or the level of derivatives exposure a fund may obtain while remaining a limited derivatives user, should we consider other types of investments, like structured notes, that have return profiles that are similar to many derivatives instruments? Take, for example, a fund with derivatives exposure exceeding the proposed 10% threshold by 2% that reallocates that 2% of its net asset value from a derivatives instrument to a structured note with a similar return profile. The fund would be a limited derivatives user on the basis that its derivatives exposure was below the threshold, but would present a similar risk profile to its prior portfolio that exceeded the threshold. Are there circumstances where we should require the fund in this example to include the value of the structured note (or similar investment) in determining its derivatives exposure? If so, which circumstances and what kinds of instruments should be included? As another alternative, should we provide that, when funds that invest in derivatives also invest in structured notes or similar investments, they should be subject to a lower threshold of derivatives exposure to remain a limited derivatives user? If so, what lower level would be appropriate?

2. Currency Hedging Exception

Under the second alternative set of conditions, a fund could rely on the limited derivatives user exception if it limits its use of derivatives transactions to currency derivatives for hedging purposes as specified in the proposed rule.[291] Under this exception, a fund could only use currency derivatives to hedge currency risk associated with specific foreign-currency-denominated equity or fixed-income investments in the fund's portfolio. In addition, the notional amount of the currency derivatives the fund holds could not exceed the value of the instruments denominated in the foreign currency by more than a negligible amount.[292]

The proposed currency hedging exception reflects our view that using currency derivatives solely to hedge currency risk does not raise the policy concerns underlying section 18. While distinguishing most hedging transactions from leveraged or speculative transactions is challenging, we believe that the currency hedging described in the proposed rule is definable because it involves a single risk factor (currency risk) and requires that the derivatives instrument must be tied to specific hedged investments (foreign-currency-denominated securities held by the fund).[293] Although we recognize that most funds that use derivatives do not use them solely to hedge currency risks, these currency hedges are not intended to leverage the fund's portfolio, and conversely could mitigate potential losses.[294]

We also recognize that certain funds hedge all of the foreign currency risk associated with their foreign securities investments. A fund that invests all or substantially all of its assets in foreign securities and currency derivatives to hedge currency risks associated with the foreign securities necessarily would have derivatives exposure exceeding 10% of net asset value. This is because such a fund could have derivatives exposure up to approximately 100% of the fund's net assets to hedge the risks associated with all of its foreign security investments. We therefore are proposing a separate basis for the limited derivatives user exception for currency hedging because certain funds that hedge currency risks would be unable to qualify for the exposure-based limited derivatives user exception discussed above.

Rather than proposing two alternative bases to qualify for the limited derivatives user exception, we considered permitting a fund to qualify as a limited derivatives user if its derivatives exposure does not exceed 10% of net assets, excluding any currency hedges as discussed above. We are not taking this combined approach, however, to preclude a fund that is operating as a limited derivatives user from engaging in a broad range of derivatives transactions that may raise risks that we believe should be managed through a derivatives management program and subject to the proposed VaR-based limit on fund leverage risk.

We request comment on the proposed currency hedging exception.

160. Is the proposed currency risk hedging exception appropriate? Why or why not? Should we modify the proposed exception in any way? Why or why not? For example, should we limit the derivatives exposure of a fund that relies on the currency hedging exception, and if so, what should be that exposure threshold? Should we prescribe the kinds of currency derivatives that a fund may use while relying on the exception? If so, which derivatives should be permitted and which should be prohibited and why? Should the rule refer to other foreign-currency-denominated assets in addition to equity or fixed-income investments? For example, do funds hedge holdings of foreign currencies themselves in addition to foreign-currency-denominated investments?

161. Are there other types of derivatives that funds use that are less likely to raise the policy concerns underlying section 18? If so, which derivatives, and how do funds use them? For instance, we are aware that funds use interest rate derivatives to hedge interest rate risk arising from fixed income investments in their portfolios. Should we modify the proposed hedging-based exception to also include interest rate derivatives that funds use for hedging purposes? Why or why not? If so, what challenges could funds encounter in identifying interest rate derivatives that are used for hedging purposes (instead of for speculation or to accomplish

[290] *See* 17 CFR 255.5(c).

[291] *See* proposed rule 18f-4(c)(3)(ii).

[292] *Id.*

[293] Many hedges are imperfect, which makes it difficult to distinguish purported hedges from leveraged or speculative exposures. *See* 2015 Proposing Release, *supra* 2, at n.238 and accompanying text.

[294] *See infra* section III.C.3 (discussing the number of funds whose current derivatives transactions practices would qualify them for the currency hedging exception).

leveraging)? How could we define interest rate hedging in rule 18f–4 in a way that would allow hedging transactions while not permitting transactions that simply are speculating on the direction of interest rates? How could conditions in the rule help identify interest rate derivatives that funds use for ''true'' hedging? For example, should we require that any interest rate derivative that is treated as a hedge be tied to specific fixed-income securities or groups of specific fixed-income securities in the fund's portfolio? This would be analogous to the proposed nexus between a fund's currency derivatives and the fund's hedged foreign-currency-denominated investments. Should we similarly allow a fund to treat as a hedging transaction an interest rate derivative that converts a fund's fixed rate borrowings to floating rate borrowings or vice versa? To what extent do funds engage in these transactions? For funds that do engage in these transactions, how large are the notional amounts of these transactions, in ten-year bond equivalents, as a percentage of the fund's net assets?

162. Should the rule address what happens if a fund using currency derivatives exceeds the notional amount of the value of the instruments denominated in a foreign currency by more than a negligible amount? If so, how should we address exceedances? Should we provide further guidance on what a negligible amount would be? For example, should we provide guidance or provide in rule 18f–4 that exceedances of 1% or 2%, for example, would be negligible?

163. Should we permit funds that rely on the first alternative set of limited derivatives user conditions (limiting their derivatives exposure to 10% of net assets) to deduct the notional amounts of their currency derivatives used for hedging purposes when calculating their derivatives exposure for purposes of the proposed exception? Why or why not? Should we allow funds to rely on both exceptions at the same time, instead of the exceptions being alternatives? If the exceptions were combined, could that result in funds relying on the limited derivatives user exception developing larger and potentially more complex derivatives portfolios that that may raise risks more appropriately managed through a derivatives management program and subject to the proposed VaR-based limit on fund leverage risk? Why or why not?

3. Risk Management

A fund relying on the limited derivatives user exception would be required to manage the risks associated with its derivatives transactions by adopting and implementing policies and procedures that are reasonably designed to manage the fund's derivatives risks.[295] The requirement that funds relying on the exception manage their derivatives risks recognizes that even a limited use of derivatives can present risks that should be managed.

For example, a fund that uses derivatives solely to hedge currency risks would not be introducing leverage risk, but could still introduce other risks, including counterparty risk and the risk that a fund could be required to sell its investments to meet margin calls. As another example, certain derivatives, and particularly derivatives with non-linear or path-dependent returns, may pose risks that require monitoring even when the derivatives represent a small portion of net asset value. For example, because of the non-linear payout profiles associated with put and call options, changes in the value of the option's underlying reference asset can increase the option's delta, and thus the extent of the fund's derivatives exposure from the option. An options transaction that represented a small percentage of a fund's net asset value can rapidly increase to a larger percentage.

The proposed rule would require funds relying on the limited derivatives user exception to adopt and implement policies and procedures reasonably designed to manage the funds' derivatives risks. Because they would be reasonably designed to address each fund's derivatives risks, these policies and procedures would reflect the extent and nature of a fund's use of derivatives within the parameters provided in the exception. For example, a fund that uses derivatives only occasionally and for a limited purpose, such as to equitize cash, could have limited policies and procedures commensurate with this limited use. A fund that uses more complex derivatives with derivatives exposure approaching 10% of net asset value, in contrast, would need to have policies and procedures tailored to the risks these derivatives could present. These policies and procedures could be more extensive and could include elements similar to those required under the proposed derivatives risk management program.

The 2015 proposal would have required funds relying on that proposal's exception to the derivatives risk management program requirement to manage derivatives risks by determining (and maintaining certain assets to cover) a ''risk-based coverage amount'' associated with the fund's derivatives. This amount represented an estimate of the amount the fund would expect to pay to exit the derivatives transaction under stressed conditions.

The approach we are proposing here is designed to require a fund relying on the limited derivatives user exception to manage all of the risks associated with its derivatives transactions, and not just the risks that an asset segregation requirement could address.[296] Moreover, our proposal is designed to limit derivatives risks by limiting the extent to which a fund can use derivatives while relying on the exception. As discussed above, the 2015 proposal would have permitted funds to obtain substantially greater derivatives exposure—up to 50% of net assets—without establishing a derivatives risk management program. On balance, we believe that the proposed bases for the limited derivatives user exception, together with the requirement that a fund manage any risks its limited use of derivatives presents, would provide both important investor protections and flexibility for funds to use derivatives in a way that is consistent with the policy concerns underlying section 18.

We request comment on the proposed requirement that a fund relying on the limited derivatives user exception manage the risks associated with its derivatives transactions by adopting policies and procedures that are reasonably designed to manage its derivatives risks.

164. Is it appropriate to require funds relying on the limited derivatives user exception to adopt policies and procedures that are reasonably designed to manage their derivatives risks, in lieu of requiring such a fund to adopt a derivatives risk management program that includes all of the proposed program elements and comply with the proposed VaR-based limit on fund leverage risk? Would this requirement effectively address the risks entailed by the levels and types of derivatives use in which a fund that qualifies for the proposed exception might engage?

165. Alternatively, should funds eligible for the proposed limited derivatives user exception be subject to a tailored version of the proposed program requirement (*e.g.,* a program requirement that would specify only certain elements, such as risk identification and assessment, establishing risk guidelines, stress

[295] *See* proposed rule 18f–4(c)(3); *see also* proposed rule 18f–4(a) (definition of ''derivatives risks'') and *supra* note 118 and accompanying text (discussing the proposed definition of ''derivatives risks'').

[296] We discuss the limitations of an asset segregation requirement in section II.F below.

testing, etc.)? If so, if so what should this entail?

166. Either in addition to or in lieu of policies and procedures reasonably designed to manage a fund's derivatives risk, should we require funds relying on the limited derivatives user exception to comply with an asset segregation requirement? Should we use the same approach we proposed in 2015? Should we use that approach but allow funds to segregate a broader range of assets, such as the assets with corresponding haircuts analyzed in the 2016 DERA Memo?

167. Should we require limited derivatives users to publicly disclose that they are limited derivatives users in their prospectus, annual report, or on their website? If so, should we require any particular disclosure to enhance investors' understanding of, for example: (1) The risks of investing in a fund that qualifies as a limited derivatives user under the proposed rule, or (2) such a fund's derivatives risk management practices?

F. Asset Segregation

The Commission and staff have historically taken the position that a fund may appropriately manage the risks that section 18 is designed to address if the fund ''covers'' its obligations in connection with various transactions by maintaining ''segregated accounts.'' [297] Funds' practices regarding the amount of ''cover'' they segregate, and the assets available for segregation, have evolved over time. In addition, different funds have applied those practices in varying ways to derivatives transactions with comparable economic exposures. Moreover, regulatory and contractual margin requirements have developed significantly since the adoption of Release 10666.

The 2015 proposal drew on the Commission's historical approach—and sought to primarily address the Investment Company Act's asset sufficiency concern—by including an asset segregation requirement as part of the 2015 proposed rule.[298] Under the Commission's 2015 proposed approach, a fund relying on the proposed rule, in addition to complying with one of two portfolio limitations, would have had to maintain an amount of ''qualifying coverage assets'' designed to enable a fund to meet its derivatives-related obligations. Under the 2015 proposed rule, a fund would not have been required to segregate a derivative's full notional amount, but instead would have had to segregate qualifying coverage assets (generally cash and cash equivalents) equal to the sum of two amounts: (1) The amount that would be payable by the fund if the fund were to exit the derivatives transaction at the time of determination (the ''mark-to-market coverage amount''), and (2) a reasonable estimate of the potential amount payable by the fund if the fund were to exit the derivatives transaction under stressed conditions (the ''risk-based coverage amount'').[299]

Although commenters generally supported the overarching framework of the 2015 proposed rule's asset segregation requirement, they identified several operational complexities. For example, commenters stated that additional clarity was necessary for funds to determine risk-based coverage amounts, including how funds should determine stressed conditions for this purpose.[300] Commenters also raised questions about how funds could reduce segregated amounts to account for posted initial or variation margin and, more generally, how rule provisions governing coverage amounts would apply to cleared transactions (as opposed to OTC transactions covered by netting agreements).[301] A number of commenters also expressed concerns about the proposed requirement that funds generally segregate cash and cash equivalents.[302] Commenters suggested alternatives to this proposed requirement, including allowing funds to segregate a broader range of assets subject to ''haircuts'' prescribed by the Commission based on the relative volatility of different asset classes.[303]

Our proposal does not include a specific asset segregation requirement because we do not believe that an asset segregation requirement is necessary in light of the proposed rule's requirements, including the requirements that funds establish risk management programs and comply with the proposed VaR-based limit on fund leverage risk. As discussed in more detail above, a fund relying on proposed rule 18f–4 would be required to adopt and implement a written derivatives risk management program that, among other things, would require the fund to: Identify and assess its derivatives risks; put in place guidelines to manage these risks; stress test the fund's portfolio at least weekly; and escalate material risks to the fund's portfolio managers and, as appropriate, the board of directors.[304] These proposed requirements are designed to require a fund to manage all of the risks associated with its derivatives transactions. These include—but are not limited to—the risk that a fund may be required to sell its investments to generate cash to pay derivatives counterparties, which the 2015 proposal's asset segregation was designed to address.

Moreover, the proposed rule would require that a fund's stress testing for purposes of its derivatives management program specifically take into account the fund's payments to derivatives counterparties that could result from losses in stressed conditions. Rather than require a fund to evaluate the amounts it would pay to exit derivatives transactions under stressed conditions on a transaction-by-transaction basis as in the 2015 proposal,[305] our proposal would require funds to conduct portfolio-wide stress tests, taking into account potential payments to counterparties. Although counterparties often require funds to post margin or collateral for individual transactions (or groups of transactions) in order to cover potential loss exposure, the proposed

[297] *See supra* section I.B.2.

[298] *See* 2015 Proposing Release *supra* note 2, at section III.C.

[299] *See id.* at section III.C.2 (discussing the composition of qualifying coverage assets as either: (1) Cash and cash equivalents, or (2) with respect to any derivatives transaction under which the fund may satisfy its obligations under the transaction by delivering a particular asset, that particular asset).

[300] *See, e.g.,* ICI Comment Letter I; BlackRock Comment Letter; Dechert Comment Letter; FSR Comment Letter; Guggenheim Comment Letter.

[301] *See, e.g.,* SIFMA Comment Letter (stating that ''[i]n practice, variation margin and initial margin are often calculated in the aggregate, on a net basis, rather than separately'' and recommending that funds ''be able to get credit for both initial and variation margin posted on a net basis . . .'' rather than limiting the type of coverage amount against which initial or variation margin may be credited); BlackRock Comment Letter (stating that initial and variation margin are used for cleared and OTC derivatives transactions by the clearinghouse and counterparties, respectively, when a derivatives transaction is exited and that distinguishing between the uses of the two types of margin will introduce complexity given that both forms of margin are available to cover potential obligations under derivatives in the event of a party's default).

[302] *See, e.g.,* AIMA Comment Letter; AQR Comment Letter; BlackRock Comment Letter; Dechert Comment Letter; Comment Letter of Eaton Vance Management (Mar. 28, 2016) (''Eaton Vance Comment Letter''); Guggenheim Comment Letter; Comment Letter of JPMorgan (Mar. 28, 2016); Oppenheimer Comment Letter; PIMCO Comment Letter.

[303] *See, e.g.,* Dechert Comment Letter; Eaton Vance Comment Letter; IAA Comment Letter; SIFMA Comment Letter, Guggenheim Comment Letter.

[304] Proposed rule 18f–4(c)(1). Funds that rely on the limited derivatives user exception also would be required to manage the risks associated with their more limited use of derivatives. *See supra* section II.E.

[305] In the 2015 proposal, funds were required to determine qualifying coverage assets on a transaction-by-transaction basis, with the exception that funds could determine the amount of qualifying coverage assets on a net basis for derivatives transactions covered by netting agreements. *See* 2015 proposed rule 18f–4(c)(6) and (9).

rule's stress testing requirement is designed to provide a portfolio-wide assessment of how the fund may respond to stressed conditions and any resulting payment obligations. This portfolio-wide assessment also would be buttressed by the other provisions in the risk management program and the proposed VaR-based limit on fund leverage risk, which are designed to limit a fund's leverage risk and therefore the potential for payments to derivatives counterparties. The 2015 proposal's derivatives risk management program, in contrast, did not include such a portfolio-wide assessment. We believe that the proposed rule's requirements, in their totality, would appropriately address the asset sufficiency risks underlying section 18.

A separate asset segregation requirement, in contrast, may be less effective. As derivatives markets evolve, questions may arise about the amount (and composition) of assets that funds must segregate for novel types of transactions. Although the Commission in 2015 sought to take a principles-based approach to the amount of assets that funds would segregate, many commenters asserted that additional clarity would be necessary to administer this approach. It would be difficult in this context for the Commission to specify the amount of assets that funds should segregate on a transaction-by-transaction basis and to keep any specific requirements current as markets develop. And a principles-based approach to asset segregation, if it does not provide sufficient clarity, may contribute to the kinds of divergent asset segregation practices that exist today, which in turn have led to situations in which funds are not subject to a practical limit on potential leverage that they may obtain through derivatives transactions.[306] By building on current risk management practices and techniques, including VaR and stress testing, the proposed rule is designed to provide a framework that we believe funds can apply to a broad variety of fund types and derivatives uses without our having to specify the operational details that an asset segregation requirement would entail.

We request comment on our proposal not to include a specific asset segregation requirement.

168. Do commenters believe that the proposed rule's requirements discussed above, in their totality, would appropriately address the asset sufficiency risks underlying section 18? If not and commenters believe rule 18f–4 should include an asset segregation requirement, what should that requirement entail? What added benefits would an asset segregation requirement provide that the current proposed rule requirements would not?

169. Should we require funds relying on the limited derivatives user exposure-based exception to segregate assets for purposes of the exception? Why or why not? Would an asset segregation requirement for such limited derivatives users obviate any need for a policies and procedures requirement? Why or why not?

170. Commenters in the 2015 release requested further clarity about the Commission's 2015 proposal to require a principles-based asset segregation regime. What aspect of that proposal required further clarity and why?

G. Alternative Requirements for Certain Leveraged/Inverse Funds and Proposed Sales Practices Rules for Certain Leveraged/Inverse Investment Vehicles

1. Background on Proposed Approach to Certain Leveraged/Inverse Funds

Proposed rule 18f–4 would include an alternative approach for certain funds that seek to provide leveraged or inverse exposure to an underlying index, generally on a daily basis. This alternative approach would be available for a registered investment company that is a ''leveraged/inverse investment vehicle,'' as that term is defined in proposed Exchange Act rule 15*l*–2 and proposed Advisers Act rule 211(h)–1 (which we refer to collectively as the proposed ''sales practices rules,'' as noted above). As discussed below, the proposed sales practices rules would require broker-dealers and investment advisers to engage in due diligence before accepting or placing an order for a customer or client that is a natural person (''retail investor'') to trade a leveraged/inverse investment vehicle, or approving a retail investor's account for such trading. The definition of the term ''leveraged/inverse investment vehicle'' in the proposed sales practices rules would include certain entities that seek, directly or indirectly, to provide investment returns that correspond to the performance of a market index by a specified multiple, or to provide investment returns that have an inverse relationship to the performance of a market index, over a predetermined period of time.[307] The entities included in the proposed scope of the sales practices rules would include registered investment companies and certain exchange-listed commodity- or currency-based trusts or funds. In this release, we refer to the registered investment companies covered by the proposed sales practices rules as ''leveraged/inverse funds'' (which in turn would be subject to the proposed alternative approach under rule 18f–4). We use the proposed sales practices rules' defined term ''leveraged/inverse investment vehicle'' to refer to both such leveraged/inverse funds and to the exchange-listed commodity- or currency-based trusts or funds covered by those rules.

Leveraged/inverse funds, which today are structured primarily as leveraged/inverse ETFs, seek to amplify the returns of an underlying index by a specified multiple or to profit from a decline in the value of their underlying index over a predetermined period of time using financial derivatives.[308] These funds reset periodically and are designed to hedge against or profit from short-term market movements without using margin, and, as such, are generally intended as short-term trading tools.[309] To achieve their targeted returns, leveraged/inverse funds use derivatives extensively. In contrast to other funds that use derivatives as part of their broader investment strategy, leveraged/inverse funds' strategies (and use of derivatives) are predicated on leverage. Accordingly, leveraged/inverse funds raise the issues that section 18 of the

[306] *See supra* sections I.B.2 and I.B.3.

[307] *See* proposed rules 15*l*–2(d) and 211(h)–1(d) (defining the term ''leveraged/inverse investment vehicle''); *see also, e.g.,* ETFs Adopting Release, *supra* note 76, at section II.A.3; rule 6c–11(c)(3) under the Investment Company Act.

[308] *See infra* section III.B for baseline statistics regarding leveraged/inverse ETFs and mutual funds. Leveraged/inverse ETFs operate under Commission orders providing exemptive relief from certain provisions of the Investment Company Act. These orders, however, do not provide exemptive relief from section 18 of the Investment Company Act. Rather, like other funds that use derivative investments, leveraged/inverse ETFs rely upon Release 10666 and operate consistent with the conditions in staff no-action letters and other staff guidance on derivatives transactions. *See infra* section II.L (discussing our proposal to rescind Release 10666, and stating that staff in the Division of Investment Management is reviewing certain of its no-action letters and other guidance to determine which letters and other staff guidance should be withdrawn in connection with any adoption of this proposal).

The Commission recently adopted rule 6c–11 under the Investment Company Act to permit ETFs that satisfy certain conditions to operate without obtaining an exemptive order from the Commission. Rule 6c–11 includes a provision excluding leveraged/inverse ETFs from the scope of that rule. *See infra* section II.G.4 (discussing proposed amendments to rule 6c–11 and proposed rescission of exemptive orders issued to leveraged/inverse ETFs).

[309] *See* Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Investment Advisers Act Release No. 5248 (June 5, 2019) [84 FR 33669 (July 12, 2019)], at text preceding n.39 (''Fiduciary Interpretation'').

Investment Company Act is designed to address.

Leveraged/inverse funds and certain commodity pools following the same strategy also present unique considerations because they rebalance their portfolios on a daily (or other predetermined) basis in order to maintain a constant leverage ratio. This reset, and the effects of compounding, can result in performance over longer holding periods that differs significantly from the leveraged or inverse performance of the underlying reference index over those longer holding periods.[310] This effect can be more pronounced in volatile markets.[311] As a result, buy-and-hold investors in a leveraged/inverse fund who have an intermediate or long-term time horizon—and who may not evaluate their portfolios frequently—may experience large and unexpected losses or otherwise experience returns that are different from what they anticipated.[312]

The Commission's Office of Investor Education and Advocacy and FINRA have issued alerts in the past decade to highlight issues investors should consider when investing in leveraged/inverse funds.[313] In addition, some commenters to the 2015 proposal indicated that at least some segment of investors may hold leveraged/inverse funds for long periods of time, which can lead to significant losses under certain circumstances.[314] FINRA has sanctioned a number of brokerage firms for making unsuitable sales of leveraged/inverse ETFs.[315] More recently, the Commission has brought enforcement actions against investment advisers for, among other things, soliciting advisory clients to purchase leveraged/inverse ETFs for their retirement accounts with long-term time horizons, and holding those securities in the client accounts for months or years.[316]

Most leveraged/inverse funds could not satisfy the limit on fund leverage risk in proposed rule 18f–4 because they provide leveraged or inverse market exposure exceeding 150% of the return or inverse return of the relevant index.[317] These funds therefore would fail the relative VaR test and would not be eligible to use the absolute VaR test.[318] Requiring these funds to comply with the proposed VaR tests therefore effectively would preclude sponsors from offering the funds in their current form. Investors who are capable of evaluating these funds' characteristics and their unique risks, however, may want to use them to meet specific short-term or other investment goals. We therefore are proposing a set of alternative requirements for leveraged/inverse funds designed to address the investor protection concerns that underlie section 18 of the Investment Company Act, while preserving choice for these investors. These requirements, discussed below, are designed to help ensure that retail investors in leveraged/inverse investment vehicles are limited to those who are capable of evaluating the risks these products present. They also would limit the amount of leverage that leveraged/inverse funds subject to rule 18f–4 can obtain to their current levels.

2. Proposed Sales Practices Rules for Leveraged/Inverse Investment Vehicles

As a complement to proposed rule 18f–4, we are proposing sales practices rules under the rulemaking authority provided in Exchange Act section 15(*l*)(2) and Advisers Act section

[310] For example, as a result of compounding, a leveraged/inverse fund can outperform a simple multiple of its index's returns over several days of consistently positive returns, or underperform a simple multiple of its index's returns over several days of volatile returns.

[311] *See* FINRA Regulatory Notice 09–31, Non-Traditional ETFs—FINRA Reminds Firms of Sales Practice Obligations Relating to Leveraged and Inverse Exchange-Traded Funds (June 2009) (''FINRA Regulatory Notice 09–31'') (''Using a two-day example, if the index goes from 100 to close at 101 on the first day and back down to close at 100 on the next day, the two-day return of an inverse ETF will be different than if the index had moved up to close at 110 the first day but then back down to close at 100 on the next day. In the first case with low volatility, the inverse ETF loses 0.02 percent; but in the more volatile scenario the inverse ETF loses 1.82 percent. The effects of mathematical compounding can grow significantly over time, leading to scenarios such as those noted above.'').

[312] *See id.* (reminding member firms of their sales practice obligations relating to leveraged/inverse ETFs and stating that leveraged/inverse ETFs are typically not suitable for retail investors who plan to hold these products for more than one trading session). *See also* Fiduciary Interpretation, *supra* note 308 (stating that ''leveraged exchange-traded products are designed primarily as short-term trading tools for sophisticated investors . . . [and] require daily monitoring . . . .''); Securities Litigation and Consulting Group, *Leveraged ETFs, Holding Periods and Investment Shortfalls,* (2010), at 13 (''The percentage of investors that we estimate hold [leveraged/inverse ETFs] longer than a month is quite striking.''); ETFs Adopting Release, *supra* note 76, at n.78 (discussing comment letters submitted by Consumer Federation of America (urging the Commission to consider additional investor protection requirements for leveraged/inverse ETFs) and by Nasdaq (stating that ''there is significant investor confusion regarding existing leveraged/inverse ETFs' daily investment horizon'')).

[313] SEC Investor Alert and Bulletins, *Leveraged and Inverse ETFs: Specialized Products with Extra Risks for Buy-and-Hold Investors* (Aug. 1, 2009), *available at http://www.sec.gov/investor/pubs/leveragedetfs-alert.htm.* This investor alert, jointly issued by SEC staff and FINRA, followed FINRA's June 2009 alert, which raised concerns about retail investors holding leveraged/inverse ETFs over periods of time longer than one day. *See* FINRA Regulatory Notice 9–31, *supra* note 310.

[314] *See, e.g.,* CFA Comment Letter (''There is evidence that suggests investors are incorrectly using certain alternative investments that use derivatives extensively. For example, despite the fact that double and triple leveraged ETFs are short-term trading vehicles that are not meant to be held longer than one day, a significant number of shares are held for several days, if not weeks.''). *But cf.* Comment Letter of Rafferty Asset Management (Mar. 28, 2016) (asserting that there is no evidence that investors do not understand the leveraged/inverse ETF product, citing, for example, an analysis of eight of its leveraged/inverse ETFs between May 1, 2009 and July 31, 2015, and finding an average implied holding period ranging from 1.18 days to 4.03 days and suggesting, therefore, that investors understand the products are designed for active trading). We note, however, that the analysis relied upon in the Comment Letter of Rafferty Asset Management did not analyze shareholder-level trading activity or provide any information on the distribution of shareholder holding periods.

[315] *See* FINRA News Release, *FINRA Sanctions Four Firms $9.1 Million for Sales of Leveraged and Inverse Exchange-Traded Funds* (May 1, 2012), *available at https://www.finra.org/newsroom/2012/finra-sanctions-four-firms-91-million-sales-leveraged-and-inverse-exchange-traded*; FINRA News Release, *FINRA Orders Stifel, Nicolaus and Century Securities to Pay Fines and Restitution Totaling More Than $1 Million for Unsuitable Sales of Leveraged and Inverse ETFs, and Related Supervisory Deficiencies* (Jan. 9, 2014), *available at https://www.finra.org/newsroom/2014/finra-orders-stifel-nicolaus-and-century-securities-pay-fines-and-restitution-totaling*; FINRA News Release, *FINRA Sanctions Oppenheimer & Co. $2.9 Million for Unsuitable Sales of Non-Traditional ETFs and Related Supervisory Failures* (June 8, 2016), *available at http://www.finra.org/newsroom/2016/finra-sanctions-oppenheimer-co-29-million-unsuitable-sales-non-traditional-etfs. See also* ProEquities, Inc., FINRA Letter of Acceptance, Waiver and Consent (''AWC'') No. 2014039418801 (Aug. 8, 2016), *available at http://disciplinaryactions.finra.org/Search/ViewDocument/66461; Citigroup Global Markets Inc.,* FINRA Letter of AWC No. 20090191134 (May, 1, 2012), *available at http://disciplinaryactions.finra.org/Search/ViewDocument/31714. See also* Regulation Best Interest: The Broker-Dealer Standard of Conduct, Exchange Act Release No. 86031 (June 5, 2019) [84 FR 33318 (July 12, 2019)], at paragraph accompanying nn.593–98 (''Regulation Best Interest: The Broker-Dealer Standard of Conduct''). *See also, e.g., SEC.* v. *Hallas,* No 1:17–cv–2999 (S.D.N.Y. Sept. 27, 2017) (default judgement); *In the Matter of Demetrios Hallas,* SEC. Release No. 1358 (Feb. 22, 2019) (initial decision), Exchange Act Release No 85926 (May 23, 2019) (final decision) (involving a former registered representative of registered broker-dealers purchasing and selling leveraged ETFs and exchange-traded notes for customer accounts while knowingly or recklessly disregarding that they were unsuitable for these customers, in violation of section 17(a) of the Securities Act and section 10(b) and rule 10b–5 thereunder of the Exchange Act).

[316] *See, e.g.,* In the Matter of Morgan Stanley Smith Barney, LLC, Investment Advisers Act Release No. 4649 (Feb. 14, 2017) (settled action).

[317] *See supra* section II.D (discussing the proposed VaR-based limit on fund leverage risk).

[318] *See supra* section II.D (discussing relative and absolute VaR tests under proposed rule 18f–4). In addition, we understand that even if leveraged/inverse funds were to apply the proposed absolute VaR test, many of those funds also would fail that test.

211(h).[319] The proposed sales practices rules would require broker-dealers and investment advisers to exercise due diligence on retail investors before approving retail investor accounts to invest in leveraged/inverse investment vehicles. Specifically, proposed rule 15*l*–2 under the Exchange Act would require a broker-dealer (or any associated person of the broker-dealer) to exercise due diligence to ascertain certain essential facts about a customer who is a retail investor before accepting the customer's order to buy or sell shares of a leveraged/inverse investment vehicle, or approving the customer's account to engage in those transactions.[320] Similarly, proposed rule 211(h)–1 under the Advisers Act would require an investment adviser (or any supervised person of the investment adviser) to exercise due diligence to ascertain the same set of essential facts about a client who is a retail investor before placing an order for that client's account to buy or sell shares of a leveraged/inverse investment vehicle, or approving the client's account to engage in those transactions.[321] Under both of the proposed sales practices rules, a firm could approve the retail investor's account to buy or sell shares of leveraged/inverse investment vehicles only if the firm had a reasonable basis to believe that the investor is capable of evaluating the risks associated with these products.

The proposed sales practices rules are designed to establish a single, uniform set of enhanced due diligence and approval requirements for broker-dealers and investment advisers with respect to retail investors that engage in leveraged/inverse investment vehicle transactions, including transactions where no recommendation or investment advice is provided by a firm. These rules therefore would apply the same due diligence requirements to both broker-dealers and investment advisers.[322] They are designed to help ensure that investors in these funds are limited to those who are capable of evaluating their characteristics—including that the funds would not be subject to all of the leverage-related requirements applicable to registered investment companies generally—and the unique risks they present. Compliance with the proposed rules would not supplant or by itself satisfy other broker-dealer or investment adviser obligations, such as a broker-dealer's obligations under Regulation Best Interest or an investment adviser's fiduciary duty under the Advisers Act.[323]

The approval and due diligence requirements under the proposed rules are modeled after current FINRA options account approval requirements for broker-dealers.[324] Under the FINRA rules governing options, a broker-dealer may not accept a customer's options order unless the broker-dealer has approved the customer's account for options trading.[325] Similarly, the proposed sales practices rules would require that a firm approve a retail investor's account before the retail investor may invest in leveraged/inverse investment vehicles. As such, the proposed sales practices rules, like the FINRA rule, would not require firms to evaluate retail investors' eligibility to transact in these products on a transaction-by-transaction basis. We have generally modeled the proposed rules after the FINRA options account framework in part because leveraged/inverse investment vehicles, when held over longer periods of time, may have certain similarities to options.[326] The options account approval requirements also represent a current framework that can be used in connection with complex products generally.[327] This approach may provide some efficiencies and reduced compliance costs for broker-dealers that already have compliance procedures in place for approving options accounts, although we recognize that these efficiencies and reduced compliance costs would not apply to investment advisers that are not dually registered as, or affiliated with, broker-dealers subject to FINRA rules.

a. Definition of Leveraged/Inverse Investment Vehicle

The proposed sales practices rules would define a ''leveraged/inverse investment vehicle'' to mean a registered investment company or an exchange-listed commodity- or currency-based trust or fund (a ''listed commodity pool''), that seeks, directly or indirectly, to provide investment returns that correspond to the performance of a market index by a specified multiple, or to provide investment returns that have an inverse relationship to the performance of a market index, over a predetermined period of time.[328] Although the scope of this definition extends beyond just ETFs (as defined in rule 6c–11), this definition otherwise is substantively identical to the provision in rule 6c–11 excluding leveraged/inverse ETFs from the scope of that rule. The substantive requirements in the proposed definition in the sales practices rules have the same meaning as the provision in rule 6c–11.[329]

We believe it is appropriate for the scope of the proposed sales practices rules to include leveraged/inverse funds as well as listed commodity pools that follow a similar leveraged or inverse

[319] These provisions provide the Commission with authority to ''where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for brokers, dealers, and investment advisers that the Commission deems contrary to the public interest and the protection of investors.''

[320] Proposed rule 15*l*–2(a). In this release, the term ''firm,'' which collectively refers to Commission-registered broker-dealers and investment advisers, also includes associated persons of such broker-dealers.

[321] Proposed rule 211(h)–1(a). In this release, the term ''firm,'' which collectively refers to Commission-registered broker-dealers and investment advisers, also includes supervised persons of such investment advisers.

[322] Although we expect that the proposed sales practices rules would cover a significant percentage of the retail investors who invest in leveraged/inverse investment vehicles, we recognize that not every purchase or sale of a leveraged/inverse investment vehicle will involve a customer or client of a Commission-registered broker-dealer or investment adviser that would be subject to the proposed sales practices rules.

[323] *See* Regulation Best Interest: The Broker-Dealer Standard of Conduct, *supra* note 314 (discussing broker-dealer obligations when providing a recommendation to a retail customer of any securities transaction or investment strategy involving securities based on the customer's investment profile); Fiduciary Interpretation, *supra* note 308 (discussing an investment adviser's fiduciary duty to its client, and stating that as fiduciaries, investment advisers owe their clients duties of care and loyalty).

[324] *See, e.g.,* FINRA rule 2360(b)(16), (17) (requiring for options accounts, firm approval, diligence and recordkeeping).

[325] FINRA rule 2360(b)(16). The same requirements apply for transactions in index warrants, currency index warrants, and currency warrants. *See* FINRA rules 2352 and 2353. Similar requirements apply for transactions in security futures. *See* FINRA rule 2370(b)(16) (requiring broker-dealer approval and diligence regarding the opening of accounts to trade security futures).

[326] For example, both leveraged/inverse investment vehicles and options provide exposure that is economically equivalent to a dynamically rebalanced inverse or leveraged position in an underlying asset. As a result, both have return characteristics that are more complex than those of the underlying asset, particularly as a leveraged/inverse investment vehicle's leverage multiple and/or holding period increase. *See infra* section III.B.5.

[327] *See* FINRA Regulatory Notice 12–03 (providing, among other things, that FINRA members ''should consider prohibiting their sales force from recommending the purchase of some complex products to retail investors whose accounts have not been approved for options trading'').

[328] *See* proposed rule 15*l*–2(d) and proposed rule 211(h)–1(d).

[329] *See* rule 6c–11(c)(4) (providing that scope of rule 6c–11 does not include ETFs that ''seek, directly or indirectly, to provide investment returns that correspond to the performance of a market index by a specified multiple, or to provide investment returns that have an inverse relationship to the performance of a market index, over a predetermined period of time.''). *See also* ETFs Adopting Release, *supra* note 76, at section II.A.3 (discussing rule 6c–11(c)(4)).

strategy. The same investor protection concerns regarding aligning firms' transaction practices with investors' capability of evaluating the risks of these trading tools apply to this broader category of leveraged/inverse investment vehicles, and not just leveraged/inverse funds specifically.[330] Indeed, we understand that leveraged/inverse funds and listed commodity pools following the same strategy can have virtually identical investment portfolios. Applying the proposed rule to all leveraged/inverse investment vehicles, as defined in the proposed rules, would avoid potential regulatory arbitrage that could result if we were to place different requirements on these products.

We request comment on the definition of the term ''leveraged/inverse investment vehicle'' in the proposed sales practices rules.

171. Is the scope of the proposed definition of the term ''leveraged/inverse investment vehicle'' appropriate? The definition includes a fund that seeks to provide investment returns that have an inverse relationship to the performance of a market index. Do commenters agree that this is appropriate? Should the definition instead only include an inverse fund that seeks investment returns that exceed the inverse performance of a market index by a specified multiple (*e.g.,* −1.5 or lower)? Why or why not? The definition also includes a fund that seeks to provide performance results ''over a predetermined period of time.'' Do commenters agree that this is appropriate? Generally, the extent to which a fund's performance can be expected to deviate from the multiple or inverse multiple of the performance of its index when held over longer periods is larger for funds that track a multiple or inverse multiple of the performance of an index over shorter time intervals, as those funds typically rebalance their portfolios more frequently. Should we specify a time period in the definition and, if so, what time period would be appropriate? For example, should the definition only include a fund that seeks investment returns that correspond to a multiple or inverse multiple of an index over a fixed period of time that is less than a year, a quarter, or a month? Please explain.

172. Do commenters agree with our proposal to include listed commodity pools within the definition? Are we correct that the similarities between the investment strategies and return profiles of listed commodity pools and other leveraged/inverse investment vehicles, such as leveraged/inverse ETFs, warrant including listed commodity pools within the scope of this definition?

173. Are there other types of investments or products that we should include in the leveraged/inverse investment vehicle definition? For example, should we include exchange-traded notes within the scope of the proposed sales practices rules if they have the same or similar return profile as the leveraged/inverse funds and listed commodity pools included in the proposed definition?[331] Are there additional complex financial products, such as those discussed in FINRA Regulatory Notice 12–03 (including, among others, certain structured or asset-backed notes, unlisted REITs, securitized products, and products that offer exposure to stock market volatility), that commenters believe should be subject to the due diligence and account approval requirements that we are proposing for leveraged/inverse investment vehicles?[332]

b. Required Approval and Due Diligence in Opening Accounts

Under the proposed sales practices rules, no firm may accept an order from or place an order for a retail investor to buy or sell shares of a leveraged/inverse investment vehicle, or approve such a retail investor's account to engage in those transactions, unless the firm has complied with certain conditions. Specifically, the proposed rules would require the firm to (1) approve the retail investor's account for buying and selling shares of leveraged/inverse investment vehicles pursuant to a due diligence requirement; and (2) adopt and implement policies and procedures reasonably designed to achieve compliance with the proposed rules.

The proposed due diligence requirement provides that a firm must exercise due diligence to ascertain the essential facts relative to the retail investor, his or her financial situation, and investment objectives. A firm must seek to obtain, at a minimum, certain information about its retail investor's:

- Investment objectives (*e.g.,* safety of principal, income, growth, trading profits, speculation) and time horizon;
- employment status (name of employer, self-employed or retired);
- estimated annual income from all sources;
- estimated net worth (exclusive of family residence);
- estimated liquid net worth (cash, liquid securities, other);
- percentage of the retail investor's liquid net worth that he or she intends to invest in leveraged/inverse investment vehicles; and
- investment experience and knowledge (*e.g.,* number of years, size, frequency and type of transactions) regarding leveraged/inverse investment vehicles, options, stocks and bonds, commodities, and other financial instruments.[333]

Based on its evaluation of this information, the firm would be required specifically to approve or disapprove the retail investor's account for buying or selling shares of leveraged/inverse investment vehicles. If the firm approves the account, the approval must be in writing.

Under the proposed rules, to provide this approval a firm must have a reasonable basis for believing that the retail investor has the financial knowledge and experience to be reasonably expected to be capable of evaluating the risks of buying and selling leveraged/inverse investment vehicles. We are not proposing a bright-line test for this determination. Rather, the determination would be based on all of the relevant facts and circumstances.

The information that a firm would collect includes information about the retail investor's financial status (*e.g.,*

[330] The definition of commodity- or currency-based trusts or funds that we propose to include in the leveraged/inverse investment vehicle definition tracks a definition recently provided by Congress in the Fair Access to Investment Research Act of 2017, Public Law 115–66, 131 Stat. 1196 (2017) (the ''FAIR Act''), which we understand includes the kinds of commodity pools that generally pursue leveraged or inverse investment strategies. Our proposed definition differs from the FAIR Act definition because it would not include a trust or fund that holds only commodities or currencies and does not hold derivatives. Because we believe that trusts or funds that seek to provide a leveraged or inverse return of an index generally would use derivatives to do so, we do not believe it is necessary to include trusts or funds that do not hold derivatives in the proposed definition in the sales practices rules.

[331] The Commission also recently brought and settled an enforcement action against a dually-registered broker-dealer/investment adviser, certain of its supervisory personnel, and one of its registered representatives arising out of that representative's recommending that his customers buy and hold leveraged and inverse exchange-traded funds and exchange traded notes (including allegations that the registered representative recommended that his customers hold a triple-leveraged exchange-traded note for longer than the one-day holding period set forth in the product's prospectus). *See* In the Matter of Cadaret Grant, *et al.,* Exchange Act Release No. 84074 (Sept. 11, 2018) (alleging, among other things, a violation of section 206(4) of the Advisers Act and rule 206(4)–7 thereunder and failure to supervise) (settled action). *See* In the Matter of Cadaret Grant, *et al.,* Exchange Act Release No. 84074 (Sept. 11, 2018) (settled action).

[332] *See* FINRA Regulatory Notice 12–03, *supra* note 326.

[333] *See* proposed rule 15*l*–2(b)(2). For joint accounts, the firm must seek to obtain the information for all participants in joint retail investor accounts.

employment status, income, and net worth (including liquid net worth)); and information about his or her investment objectives generally and his or her anticipated investments in, and experience with, leveraged/inverse investment vehicles (*e.g.,* general investment objectives, percentage of liquid net worth intended for investment in leveraged/inverse investment vehicles, and investment experience and knowledge). This information is designed to provide a comprehensive picture of the retail investor to allow a firm to evaluate whether the retail investor has the financial knowledge and experience to be reasonably expected to be capable of evaluating the risks of buying and selling leveraged/inverse investment vehicles.

While not required under the proposed rules, firms could consider establishing multiple levels of account approvals for a retail investor seeking to trade leveraged/inverse investment vehicles. We understand that broker-dealers set different levels of options account approval depending on the customer's trading experience and financial sophistication.[334] Similarly, a firm may determine that certain leveraged/inverse investment vehicles (*e.g.,* those with lower leverage multiples or that invest in less-volatile asset classes) are more appropriate for a lower level of account approval, while other types of leveraged/inverse investment vehicles may be more appropriate for a higher level of account approval. Any such approaches generally should be addressed in the policies and procedures that the proposed sales practices rules would require a firm to adopt and implement.[335]

The proposed rules' scope with respect to a firm's customer or client is limited to ''a natural person'' or ''the legal representative of a natural person.'' [336] The rules include all natural persons—including high-net worth individuals—to provide the related investor protections to all natural persons. The proposed rules require firms to seek to obtain and to consider information related to a retail investor's net worth as part of their consideration of whether to approve the investor's account for trading in leveraged/inverse investment vehicles. We interpret ''legal representative'' of a natural person to mean non-professional legal representatives of a natural person.[337] This interpretation would exclude institutions and certain professional fiduciaries, but it would include certain legal entities such as trusts that represent the assets of a natural person.[338] This interpretation is designed to provide the protections of the sales practices rules where non-professional persons are acting on behalf of natural persons, but where such professional persons are not regulated financial services industry professionals retained by natural persons to exercise independent professional judgment.[339]

In addition, we are proposing to specify in the sales practices rules that, although the rules would apply to transactions by broker-dealers and investment advisers for retail investors—including those investors who have existing accounts before the rules' compliance date—the sales practices rules would not apply to a position in a leveraged/inverse investment vehicle established before the rules' compliance date. This provision is designed to allow existing investors in leveraged/inverse investment vehicles with open investments as of the rules' compliance date to sell their holdings (or to purchase leveraged/inverse investment vehicles to close out short positions in the leveraged/inverse investment vehicle) without the additional steps we propose to require for their broker-dealer or investment adviser to determine whether to approve the retail investor's account to trade in these products.[340] Absent this provision, the sales practices rules could prevent or delay a retail investor's ability to close or reduce a position in a leveraged/inverse investment vehicle that he or she entered into before firms were required to comply with the rules.

We also do not believe it would be appropriate to apply the sales practices rules only to retail accounts established after the rules' compliance date, because the investor protection concerns underlying the rules would apply equally to pre-existing retail investor accounts. Accordingly, the proposed rules would make clear that, even if a retail investor had already been trading leveraged/inverse investment vehicles, a firm would have to satisfy the due diligence and account approval requirements for that investor's account before the investor could make additional investments in leveraged/inverse investment vehicles.[341]

The proposed sales practices rules also would require firms to adopt and implement written policies and procedures addressing compliance with the applicable sales practices rule.[342] We are not proposing to impose specific requirements for these policies and procedures, provided that they are reasonably designed to achieve compliance with the applicable sales practices rule, including the due diligence and account approval requirements. This requirement, together with the proposed recordkeeping requirements discussed below, is designed to provide comparable policies and procedures and recordkeeping requirements for both broker-dealers and investment advisers.

We request comment on the proposed approval and due diligence requirements for approving retail investors' accounts to trade in shares of leveraged/inverse investment vehicles.

174. Is modeling these rules on FINRA's options rule the appropriate approach? Why or why not?

175. Should the proposed sales practices rules apply to Commission-registered broker-dealers and investment advisers? Why or why not? What challenges, if any, would broker-dealers or investment advisers face complying with the proposed rules, and what compliance burdens would the proposed rules create for broker-dealers and investment advisers? Would compliance burdens be substantially different for investment advisers than for broker-dealers (for example, because of any compliance efficiencies that might result to the extent broker-dealers are already complying with FINRA's

[334] These increasing levels generally track the riskiness of the product or trading strategy; for example, the initial option account approval may permit covered call writing of equity options but higher account approvals would be needed for writing uncovered index options.

[335] *See* proposed rules 15*l*–2(a) and 211(h)–1(a).

[336] *See* proposed rules 15*l*–2(a) and 211(h)–1(a).

[337] *See, e.g.,* Form CRS Relationship Summary, Exchange Act Release No. 34–86032 (June 5, 2019) [84 FR 33492 (July 12, 2019)] (''Form CRS Release''), at n.629 and accompanying text.

[338] *See* Form CRS Release, *supra* note 336, at nn.645–647 and accompanying text (clarifying interpretation of ''legal representative'' of a natural person to cover only non-professional legal representatives (*e.g.,* a non-professional trustee that represents the assets of a natural person and similar representatives such as executors, conservators, and persons holding a power of attorney for a natural person)); Regulation Best Interest: The Broker-Dealer Standard of Conduct, *supra* note 314, at n.237 and accompanying text (defining ''retail customer'').

[339] *See* Form CRS Release, *supra* note 336, at nn.645–647 and accompanying text.

[340] This provision is designed to allow a retail investor to exit a legacy position in a leveraged/inverse investment vehicle, as discussed above, and does not reflect any view on whether any recommendation for these legacy positions was suitable when made.

[341] As discussed above, this evaluation would take into account, among other things, the investor's experience with leveraged/inverse investment vehicles. *See, e.g.,* proposed rules 211(h)–1(b)(2) and 15*l*–2(b)(2).

[342] *See* proposed rule 15*l*–2(a); proposed rule 211(h)–1(a).

rules for approving options accounts), or vice versa? Should we apply proposed Advisers Act rule 211(h)–1 to investment advisers that are registered with one or more states but not registered with the Commission? Why or why not? Should the proposed rule for investment advisers apply equally to advisers with discretionary authority and with non-discretionary authority over client accounts? If the sales practices rule for investment advisers applies to both discretionary and non-discretionary advisory accounts, should we apply different due diligence and account approval requirements based on whether an account is discretionary or non-discretionary? Should the proposed sales practices rules apply to investment advisers, in light of their fiduciary duties to their clients? Why or why not? Should the sales practices rules apply to a broker-dealer if the broker-dealer does not effect transactions in leveraged investment vehicles for retail investors other than transactions resulting from recommendations that are subject to Regulation Best Interest? Why or why not?

176. Should the proposed rules apply to transactions in leveraged/inverse investment vehicles that are directed by a retail investor without any recommendation or advice from a broker-dealer or investment adviser? Why or why not?

177. Should the proposed rules apply on a transaction-by-transaction basis rather than requiring an initial account approval to transact in leveraged/inverse investment vehicles? Why or why not?

178. As proposed, the sales practices rules would require that a firm could provide account approval only if the firm has a reasonable basis for believing that the investor has such knowledge and experience in financial matters that he or she may reasonably be expected to be capable of evaluating the risks of buying and selling leveraged/inverse investment vehicles. Is this account approval standard appropriate? Why or why not? If not, what should the account approval standard be? Should it be tied instead, for example, to an investor's ability to absorb losses, and if so how should a firm assess this?

179. Is the investor information that the proposed rules would require firms to seek to obtain under the rules' due diligence requirements appropriate, and would this information effectively assist in forming a reasonable basis for assessing the investor's knowledge and experience in financial matters as required under the proposed account approval standard? Why or why not? What modifications, if any, should we make to the information items that the proposed rules would require a firm to seek to obtain? Are there any information items that we should remove from the proposed list, or any additional information items that we should include? For example, instead of tracking generally the information elements set forth under FINRA's option rule, should the proposed rules track generally the information set forth in the definition of ''retail customer investment profile'' under Regulation Best Interest (*i.e.,* ''age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the retail customer may disclose to the broker, dealer, or a natural person who is an associated person of a broker or dealer'')? As proposed, should the rules require firms to seek to obtain the percentage of the investments that the retail investor intends to invest in leveraged/inverse investment vehicles? Why or why not?

180. Should the sales practices rules require firms to obtain the specified information, rather than to seek to obtain it? Would a firm be able to form a reasonable basis for believing that a retail investor has such knowledge and experience in financial matters that he or she may reasonably be expected to be capable of evaluating the risks of buying and selling leveraged/inverse investment vehicles if the retail investor provides some, but not all, of the information specified in the sales practices rules?

181. What special procedures, if any, do firms currently undertake in permitting or not permitting retail investors to trade in leveraged/inverse investment vehicles? At account opening? With respect to specific transactions? With respect to concentration limits? Do firms already have approval processes in place designed to evaluate whether their retail investors are reasonably expected to be capable of evaluating the risks of buying and selling leveraged/inverse investment vehicles? If so, do firms distinguish between types of vehicles or trading strategies? Do these practices differ between broker-dealers and investment advisers? If so, please explain the differences.

182. What special procedures, if any, do firms currently undertake in permitting or not permitting retail investors to trade in other types of complex products? Please explain in detail, including products to which such procedures apply and what the approval process entails.

183. The proposed sales practices rules would require that firms' approvals of retail investors' accounts for buying or selling shares of leveraged/inverse investment vehicles be in writing. The proposed rules would not require account disapprovals to be in writing. Should we require account disapprovals also to be in writing? Would such a requirement raise any practical concerns, or other concerns, for firms? In other investor approval contexts, do firms currently put both their approvals and disapprovals in writing?

184. How do broker-dealers apply the options eligibility requirement with respect to clients of investment advisers, if at all, when those advisers submit orders on behalf of their clients? Do broker-dealer practices differ with respect to orders submitted by other types of intermediaries? Please explain.

185. How do broker-dealers currently analyze the information they collect under FINRA rule 2360? Which data elements do broker-dealers find most important and which elements are less important? What standards do broker-dealers apply in determining whether to approve a customer's account on the basis of the information collected?

186. Should the proposed rules require firms to provide specific disclosure as part of the approval process, similar to the options disclosure document that must be provided under FINRA rule 2360? If so, what information should it contain? Should the rules require that receipt of such disclosure be acknowledged?

187. Should the rules require firms to provide retail investors a short, plain-English disclosure generally describing the risks associated with leveraged/inverse investment vehicles as part of the proposed account approval process? For example, before a firm approves a retail investor's account for buying and selling shares of a leveraged/inverse investment vehicle, should the rules require a firm to incorporate and distill into a short disclosure the specific risk factors associated with leveraged/inverse investment vehicles (such as the risks related to compounding and other risks that leveraged/inverse funds disclose in their prospectuses)?

188. Should the rules apply to all customers or clients, and not just natural persons? Should they apply to a different subset of customers or clients and, if so, which ones and why? If the rule were to apply to all customers or clients, including institutional accounts, what changes should we make to the information that firms must collect or to the basis upon which a firm would approve or disapprove the account? Are

there distinctions between institutional investors and natural persons that invest in leveraged/inverse investment vehicles that we should consider? For example, do commenters have data or information on the percentage of leveraged investment vehicles' investors who are natural persons, and how natural persons use these investment products (*e.g.,* how long do these investors hold the products)?

189. As discussed above, we understand that certain purchases or sales of leveraged/inverse investment vehicles do not involve a customer or client of a broker-dealer or investment adviser that would be subject to the proposed sales practices rules.[343] Should the proposed rules apply to these transactions? For example, should the proposed sales practices rule for broker-dealers apply to a mutual fund principal underwriter's transactions with any retail investor who is purchasing fund shares directly from the fund?

190. Should the sales practices rules include different account-approval conditions for different types of leveraged/inverse investment vehicles? For example, should the rules include different conditions for investment vehicles that seek to exceed the performance of a market index by a specified multiple, versus those that provide returns that have an inverse relationship to the performance of a market index? Should the rules include different levels of account approval, such as heightened requirements for investors to transact in leveraged/inverse investment vehicles with higher leverage multiples or that invest in more volatile asset classes? Similarly, should the rules include different levels of account-approval conditions based on a retail investor's trading experience and financial sophistication?

191. Do commenters agree that we should apply the sales practices rules to all retail investors, including those who have opened accounts with an investment adviser or broker-dealer before the rules' compliance date? Should the sales practices rules include exceptions from the due diligence and account approval requirements for retail investors that have already traded in leveraged/inverse investment vehicles as of the rules' compliance date? Should the sales practices rules provide exceptions for retail investors who meet established criteria, such as retail investors who are accredited investors? Why or why not?

192. The proposed rules also would not apply to, and therefore would not restrict a retail investor's ability to close or reduce, a position in a leveraged/inverse investment vehicle established before the rules' compliance date. Do commenters agree that this is appropriate? Are there modifications we should make to the rules so that they would not impede an investor's ability to close or reduce an existing position in a leveraged/inverse investment vehicle? Which modifications and why? Alternatively, should the sales practices rules apply to retail investors with positions in leveraged/inverse investment vehicles established before the rules' compliance date even if they do not seek to make additional purchases or sales of leveraged investment vehicles? If so, how would firms comply, in practice, with the due diligence and account approval requirements for these investors?

193. Do commenters agree with the proposed policies and procedures requirement? Should the rule provide specific requirements for firms' policies and procedures relating to compliance with the sales practices rules?

c. Recordkeeping

Under the proposed sales practices rules, a firm would have to maintain a written record of the investor information that it obtained under the rules' due diligence requirements, the firm's written approval of the retail investor's account for buying and selling shares of leveraged/inverse investment vehicles, and the versions of the firm's policies and procedures that it adopted under the proposed rules that were in place when it approved or disapproved the account. We propose that firms be required to retain these records for a period of not less than six years (the first two years in an easily accessible place) after the date of the closing of the investor's account.[344] We believe that it is appropriate for the proposed rules to include a recordkeeping provision to facilitate compliance, and regulatory oversight of a firm's compliance, with the rules. Also, because an investor account that was approved to trade in leveraged/inverse investment vehicles could remain open with a firm for more than six years, we believe it is appropriate to require that records be preserved for a minimum of six years after the closing of the account, rather than six years after the creation of the records.[345] We believe that this recordkeeping requirement would provide sufficient investor protection and, because it is generally consistent with recordkeeping requirements for broker-dealers and investment advisers, would not impose overly burdensome recordkeeping costs.[346]

We request comment on the recordkeeping requirement in the proposed sales practices rules:

194. Is the proposed recordkeeping requirement appropriate? Why or why not?

195. What changes, if any, should we make to this proposed requirement (*e.g.,* by modifying the types of records that a firm would have to keep)?

196. Does our proposal to apply the same recordkeeping requirement to both broker-dealers and investment advisers raise any specific recordkeeping concerns for either broker-dealers or investment advisers (*e.g.,* do investment advisers believe it would be particularly burdensome to comply with a six-year recordkeeping period)? Should the proposed rules include different requirements for broker-dealers and investment advisers?

197. Is the proposed duration of the recordkeeping provision, including the proposed requirement that the records be maintained for a minimum of six years after the closing of the investor's account, appropriate? Does using the closing of the investor's account as the starting point for the recordkeeping period raise any practical difficulties for firms? Should we lengthen or shorten the required recordkeeping periods? Why or why not?

3. Alternative Provision for Leveraged/Inverse Funds Under Proposed Rule 18f–4

Under proposed rule 18f–4, a fund would not have to comply with the proposed VaR-based leverage risk limit if it: (1) Meets the definition of a ''leveraged/inverse investment vehicle'' in the proposed sales practices rules; (2) limits the investment results it seeks to

[343] *See supra* note 321.

[344] *See* proposed rules 15*l*–2(c) and 211(h)–1(c).

[345] This is consistent with other Commission recordkeeping requirements relating to investor account documentation. *See, e.g.,* rule 17a–4(c) under the Exchange Act (requiring broker-dealers to preserve for a period of not less than six years after the closing of any customer's account any account cards or records relating to the terms and conditions with respect to the opening and maintenance of the account).

[346] *See, e.g., id.; see also* rule 204–2(e)(1) under the Investment Advisers Act (requiring investment advisers to preserve certain records in an easily accessible place for a period of not less than five years from the end of the fiscal year during which the last entry was made on such record, the first two years in an appropriate office of the investment adviser). While we recognize that our existing recordkeeping requirements generally require broker-dealers to preserve records for six years and investment advisers for five years, we believe it would be appropriate for the recordkeeping requirements under the proposed sales practices rule to be consistent, in part because many broker-dealers and investment advisers are dual-registered, and thus are proposing a six-year period for both rules.

300% of the return (or inverse of the return) of the underlying index; and (3) discloses in its prospectus that it is not subject to proposed rule 18f–4's limit on fund leverage risk. We refer to this set of proposed conditions collectively as the ''alternative provision for leveraged/inverse funds.'' A leveraged/inverse fund that satisfies these conditions still would be required to satisfy all of the additional conditions in proposed rule 18f–4 other than the VaR tests, including the proposed conditions requiring a derivatives risk management program, board oversight and reporting, and recordkeeping.[347]

First, the alternative provision for leveraged/inverse funds requires that a leveraged/inverse fund be a ''leveraged/inverse investment vehicle'' as defined in the proposed sales practices rules.[348] As discussed above, the proposed sales practices rules are designed to help ensure that investors in leveraged/inverse investment vehicles are limited to those who are capable of evaluating their general characteristics and the unique risks they present.

Second, the alternative provision for leveraged/inverse funds would limit a leveraged/inverse fund's market exposure by providing that the fund must not seek or obtain, directly or indirectly, investment results exceeding 300% of the return (or inverse of the return) of the underlying index.[349] This limitation reflects the highest leverage level currently permitted by our exemptive orders for leveraged/inverse ETFs.[350] It therefore reflects the maximum amount of leverage in these funds with which investors and other market participants are familiar. To permit leveraged/inverse funds to use a higher level of leverage would heighten the investor protection concerns these funds present, notwithstanding their more limited investor base.[351] Moreover, allowing leveraged/inverse funds to increase their leverage beyond current levels would result in a non-linear increase in the extent of leveraged/inverse funds' rebalancing activity, which may have adverse effects on the markets for the constituent securities as discussed in more detail in sections III.D.1 and III.E.4. For these reasons, and because the Commission does not have experience with leveraged/inverse funds that seek returns above 300% of the return (or inverse of the return) of the underlying index, we are not proposing to permit higher levels of leveraged market exposure for leveraged/inverse funds in this rule.

Third, the alternative provision for leveraged/inverse funds would require a leveraged/inverse fund to disclose in its prospectus that it is not subject to the condition of proposed rule 18f–4 limiting fund leverage risk.[352] This requirement is designed to provide investors and the market with information to clarify that leveraged/inverse funds—which as discussed above, use derivatives extensively—are not subject to rule 18f–4's limit on fund leverage risk.

We request comment on the proposed alternative provision for leveraged/inverse funds.

198. Should the rule include an alternative set of requirements for leveraged/inverse funds? Should leveraged/inverse funds instead be required to meet the proposed requirements for all funds that use derivatives, including the VaR-based limit on fund leverage risk? If commenters agree that we should permit leveraged/inverse ETFs to rely on rule 18f–4 based on an alternative set of requirements, are there additional conditions—either relating to these funds' derivatives risk management or otherwise—that we should consider requiring those funds to satisfy? To what extent would additional limitations or restrictions on leveraged investment vehicles' advertising or marketing materials help to address the investor protection concerns discussed above?

199. Does our proposal to include within the scope of the rule only leveraged/inverse funds that are covered by the proposed sales practices rules, along with the conditions comprising the alternative provision for leveraged/inverse funds, address the investor protection concerns related to leveraged/inverse funds?

200. If leveraged/inverse funds operate pursuant to the proposed alternative provision, should they nonetheless be subject to other requirements in the proposed rule (*e.g.,* the proposed risk management program requirement, board oversight and reporting requirement, and recordkeeping requirement)?

201. Should leveraged/inverse funds relying on the alternative provision be required to disclose in their prospectuses that the fund is not subject to the proposed VaR-based limit on fund leverage risk, as proposed? If so, what would be the most appropriate method of disclosure? In addition to requiring this disclosure under rule 18f–4, should we also include this requirement in Form N–1A? Would it aid practitioners for a leveraged/inverse fund's registration form to specify this requirement?

202. Should a leveraged/inverse fund relying on rule 18f–4 be required to limit the investment results it seeks or obtains to 300% of the return (or inverse of the return) of the underlying index? Would some other threshold be more appropriate? Should the threshold be higher, such as 400%, or lower, such as 150% or 200%?

203. Any registered investment company that operates as a leveraged/inverse fund would be eligible to comply with the proposed alternative provision for leveraged/inverse funds in rule 18f–4. Should we limit the scope of leveraged/inverse funds eligible for this provision to open-end funds, including ETFs?

4. Proposed Amendments to Rule 6c–11 Under the Investment Company Act and Proposed Rescission of Exemptive Relief for Leveraged/Inverse ETFs

Earlier this year, the Commission adopted rule 6c–11, which permits ETFs that satisfy certain conditions to operate without obtaining an exemptive order from the Commission.[353] Rule 6c–11 includes a provision excluding leveraged/inverse ETFs from the scope of ETFs that may rely on that rule.[354] Leveraged/inverse ETFs, therefore, continue to rely on their Commission exemptive orders. In adopting rule 6c–11, the Commission stated that the particular section 18 concerns raised by leveraged/inverse ETFs' use of derivatives distinguish those funds from the other ETFs permitted to rely on that rule, and that those section 18 concerns would be more appropriately addressed in a rulemaking addressing the use of derivatives by funds more broadly.[355] The Commission further stated that leveraged/inverse ETFs are similar in structure and operation to the other types of ETFs that are within the scope of rule 6c–11.[356] The rules we are proposing, rule 18f–4 under the

[347] *See* proposed rule 18f–4(c)(1), (5)–(6).

[348] *See* proposed rule 18f–4(c)(4)(i); proposed rules 15*l*–2(d) and 211(h)–1(d) (defining the term ''leveraged/inverse investment vehicle'').

[349] *See* proposed rule 18f–4(c)(4)(iii).

[350] *See* ETFs Adopting Release, *supra* note 76, at n.75 and accompanying text.

[351] *See also* section III.C.5.

[352] *See* proposed rule 18f–4(c)(4)(ii).

[353] *See* ETFs Adopting Release, *supra* note 76.

[354] *See* rule 6c–11(c)(4).

[355] *See* ETFs Adopting Release, *supra* note 76, at nn.72–75 and accompanying text.

[356] *See id.* at text following n.86. In addition, one sponsor of leveraged/inverse ETFs has stated that its ETFs would prefer to rely on rule 6c–11 over their exemptive orders and that leveraged/inverse ETFs would be able to comply with rule 6c–11 because they are structured and operated in the same manner as other ETFs that fall within the scope of that rule. *See id.* at n.83 and accompanying text.

Investment Company Act and the sales practices rules under the Exchange Act and the Advisers Act, would create an updated and more comprehensive regulatory framework for the use of derivatives by funds, including provisions specifically applicable to leveraged/inverse ETFs. Accordingly, we propose to amend rule 6c–11 to remove the provision excluding leveraged/inverse ETFs from the scope of that rule one year following the publication of the final amendments in the **Federal Register**.

In addition, because the proposed amendments to rule 6c–11 would permit leveraged/inverse ETFs to rely on that rule rather than their exemptive orders, we are proposing to rescind the exemptive orders we have previously issued to leveraged/inverse ETFs. The exemptive relief granted to leveraged/inverse ETFs has resulted in an uneven playing field among market participants because the Commission has permitted only three ETF sponsors to operate leveraged/inverse ETFs and has not granted any exemptive relief for leveraged/inverse ETFs since 2009.[357] We believe that amending rule 6c–11 and rescinding these exemptive orders would promote a more level playing field and greater competition by allowing any sponsor to form and launch a leveraged/inverse ETF subject to the conditions in rules 6c–11 and proposed rule 18f–4, with transactions in the funds subject to the proposed sales practices rules. We propose to rescind these exemptive orders on the effective date of the proposed amendments to rule 6c–11 (one year following the publication of the final rule amendments in the **Federal Register**), to coincide with the compliance date for the sales practices rules and to allow time for broker-dealers and investment advisers to make any adjustments necessary to comply with the proposed sales practices rules. Providing a one-year period for existing leveraged/inverse ETFs also would provide time for them to prepare to comply with rule 6c–11 rather than their exemptive orders.[358]

We request comment on the proposed amendments to rule 6c–11 and rescission of leveraged/inverse ETF exemptive orders.

204. If leveraged/inverse funds are permitted to rely on rule 18f–4, should the Commission amend rule 6c–11 to permit leveraged/inverse funds to operate under that rule, as proposed? Do the requirements of proposed rule 18f–4, together with the proposed sales practices rules, adequately address the section 18 concerns relating to leveraged/inverse funds? Are there are other concerns regarding leveraged/inverse funds that we should consider in determining whether to allow such funds to rely on rule 6c–11?

205. In addition, do commenters agree with our proposal to rescind the existing leveraged/inverse ETF exemptive relief in view of our proposed treatment of leveraged/inverse funds under rule 18f–4 and proposed amendments to rule 6c–11? Are there other approaches to the existing leveraged/inverse ETF exemptive relief that we should consider in view of proposed rule 18f–4 and the proposed sales practices rules?

H. Amendments to Fund Reporting Requirements

We are proposing amendments to the reporting requirements for funds that would rely on proposed rule 18f–4—in particular, amendments to Forms N–PORT, N–LIQUID (which we propose to re-title as ''Form N–RN''), and N–CEN.[359] These proposed amendments are designed to enhance the Commission's ability to oversee funds' use of and compliance with the proposed rules effectively, and for the Commission and the public to have greater insight into the impact that funds' use of derivatives would have on their portfolios.[360] They would allow the Commission and others to identify and monitor industry trends, as well as risks associated with funds' investments in derivatives (including by requiring current, non-public reporting to the Commission when certain significant events related to a fund's leverage risk occur). The proposed amendments also would aid the Commission in evaluating the activities of investment companies in order to better carry out its regulatory functions.

1. Amendments to Form N–PORT

We are proposing to amend Form N–PORT to add new items to Part B (''Information About the Fund''), as well as to make certain amendments to the form's General Instructions.

a. Derivatives Exposure

We are proposing to amend Form N–PORT to include a new reporting item on funds' derivatives exposure.[361] A fund would be required to provide its derivatives exposure as of the end of the reporting period.[362] This information

[357] There are currently two ETF sponsors that rely upon this exemptive relief today. *See supra* note 307 and accompanying text; *infra* note 473 and accompanying text. We also discuss below in section III.E alternative approaches for leveraged/inverse funds, including an approach under which the Commission would rescind the exemptive orders issued to leveraged/inverse ETF sponsors, permit leveraged/inverse funds to operate under rule 6c–11, but require leveraged/inverse funds to comply with rule 18f–4's VaR-based limit on fund leverage risk in lieu of adopting the proposed sales practices rules.

[358] *See* ETFs Adopting Release, *supra* note 76, at text following n.451.

[359] 17 CFR 274.150; 17 CFR 274.223; and 17 CFR 249.330 and 17 CFR 274.101.

[360] The funds that would rely on proposed rule 18f–4 other than BDCs generally are subject to reporting requirements on Form N–PORT. All registered management investment companies, other than registered money market funds and small business investment companies, are (or will be) required to electronically file with the Commission, on a quarterly basis, monthly portfolio investment information on Form N–PORT, as of the end of each month. *See* Investment Company Reporting Modernization Adopting Release, *supra* note 178. As of April 30, 2019, larger fund groups (defined as having $1 billion or more in net assets) have begun submitting reports on Form N–PORT for the period ending March 31, 2019. Smaller fund groups (less than $1 billion in net assets) will begin submitting reports on Form N–PORT by April 30, 2020. *See* Investment Company Reporting Modernization, Investment Company Act Release No. 32936 (Dec. 8, 2017) [82 FR 58731 (Dec. 14, 2017)]. Only information reported for the third month of each fund's fiscal quarter on Form N–PORT will be publicly available (60 days after the end of the fiscal quarter). *See* Amendments to the Timing Requirements for Filing Reports on Form N–PORT, Investment Company Act Release No. 33384 (Feb. 27, 2019) [84 FR 7980 (Mar. 6, 2019)].

Currently, only open-end funds that are not regulated as money market funds under rule 2a–7 under the Investment Company Act are required to file current reports on Form N–LIQUID, under section 30(b) of the Investment Company Act and rule 30b1–10 under the Act. *See* Investment Company Liquidity Risk Management Programs, Investment Company Act Release No. 32315 (Oct. 13, 2016) [81 FR 82142 (Nov. 18, 2016)], at section III.L.2 (''Liquidity Adopting Release''). Our proposal, including proposed amendments to Form N–LIQUID, rule 30b1–10 and proposed rule 18f–4(c)(7), would add new VaR-related items to the form, and would extend the requirement to file current reports with respect to these new items to any fund (including registered open-end funds, registered closed-end funds, and BDCs) that relies on rule 18f–4 and that is subject to the rule's limit on leverage risk.

The funds that would rely on proposed rule 18f–4 other than BDCs generally are subject to reporting requirements on Form N–CEN. Specifically, all registered investment companies, including money market funds but excluding face amount certificate companies, are currently required to file annual reports on Form N–CEN. *See* Investment Company Reporting Modernization Adopting Release, *supra* note 178. Form N–CEN requires these funds to report census-type information including reports on whether a fund relied upon certain enumerated rules under the Investment Company Act during the reporting period. *See, e.g.,* Item C.7 of Form N–CEN.

[361] *See* proposed Item B.9 of Form N–PORT; *see also* proposed amendments to General Instruction E to Form N–PORT (adding a new definition for ''derivatives exposure,'' as defined in proposed rule 18f–4(a),which would permit a fund to convert the notional amounts of interest rate derivatives to 10-year bond equivalents and delta adjust the notional amounts of options contracts).

[362] *See* proposed Item B.9 of Form N–PORT. Just as the proposed definition of ''derivatives transaction'' in rule 18f–4 includes derivatives instruments as well as short sale borrowings, Form

Continued

would be publicly available for the third month of each fund's quarter and would provide market-wide insight into the levels of funds' derivatives exposure to the Commission, its staff, and market participants.[363] It also would allow the Commission and its staff to oversee and monitor compliance with the proposed rule's exception for limited derivatives users.[364]

We seek comment on the Commission's proposed amendments to Form N–PORT requiring reporting of derivatives exposure:

206. Is the proposed requirement that funds report their derivatives exposure on Form N–PORT appropriate? Why or why not? Should we modify the proposed derivatives exposure reporting item in any way? If so, how should we modify this reporting item?

207. Our proposal would make public the information that a fund would report in response to the new derivatives exposure Form N–PORT item. Is there any reason why this information should not be publicly available?

208. Should we require this reporting only from certain funds—for example, those that qualify either as limited derivatives users or leveraged/inverse funds under proposed rule 18f–4—during the reporting period?

209. Should we require funds to report metrics tied to their daily notional amount calculation on Form N–PORT (for example, a fund's highest daily derivatives exposure during the reporting period and the date of its highest exposure, and its median daily derivatives exposure during the reporting period)? Should we only require funds to report these types of metrics if we were also to modify proposed rule 18f–4 to require funds to calculate their notional amounts daily? Would this type of reporting requirement help to mitigate any potential ''window dressing'' concerns about funds' reporting of their derivatives exposure, and/or provide additional beneficial transparency with respect to any particular type of funds (for example, leveraged/inverse funds)? If so, would these benefits outweigh related costs?

b. VaR Information

We are also proposing to amend Form N–PORT to include a new reporting item related to the proposed VaR tests.[365] Information that a fund would report under this new reporting item would be made public for the third month of each fund's quarter.[366] The proposed item would apply to funds that were subject to the proposed VaR-based limit on fund leverage risk during the reporting period.

Funds that are subject to the new VaR-related N–PORT item would have to report their highest daily VaR during the reporting period and its corresponding date, as well as their median daily VaR for the monthly reporting period.[367] Funds subject to the relative VaR test during the reporting period would report the name of the fund's designated reference index, and index identifier.[368] These funds also would have to report the fund's highest daily VaR ratio (that is, the value of the fund's portfolio VaR divided by the VaR of the designated reference index) during the reporting period and its corresponding date, as well as the fund's median daily VaR ratio for the reporting period.[369]

The proposed requirement for a fund to report highest daily VaR (and, for a fund that is subject to the relative VaR test, information about the fund's VaR ratio) is designed to help assess compliance with the proposed rule. These requirements, and the proposed requirement for a fund to report its median daily VaR (and, for a fund that is subject to the relative VaR test, the median VaR ratio) are designed to help identify changes in a fund's VaR over time, and to help identify trends involving a single fund or group of funds regarding their VaRs. The proposed requirement that a fund report information about its designated reference index is designed to help analyze whether funds are using designated reference indexes that meet the rule's requirements, and also to assess any trends in the designated reference indexes that funds select.

A fund also would have to report the number of exceptions the fund identified during the reporting period arising from backtesting the fund's VaR calculation model.[370] This proposed requirement is designed to help analyze whether a fund's VaR model is effectively taking into account and incorporating all significant, identifiable market risk factors associated with a fund's investments, as required by the proposed rule.[371] This information would assist in monitoring for compliance with the proposed VaR tests and also would provide high-level information to market participants, as well as researchers and analysts, to help evaluate the extent to which funds' VaR models, used as part of the proposed VaR tests, are operating effectively. Because this information would be made publicly available on a delayed basis, and would not provide details about backtesting exceptions other than the number of exceptions, we do not believe that this proposed reporting requirement would produce adverse effects such that the reported information should be made non-public.[372]

We seek comment on the Commission's proposed amendments to

N–PORT would require a fund to report exposure associated with derivatives instruments and short sales.

The proposed requirement to report derivatives exposure at the end of the reporting period reflects the form's requirement to report information about funds' portfolio holdings as of the last business day, or last calendar day, of each month. *See* General Instruction A to Form N–PORT. While we are proposing that funds report their highest daily VaR and median daily VaR during the reporting period (*see infra* section II.H.1.b), we are not also proposing that funds report their highest daily derivatives exposure (or median daily derivatives exposure) during the reporting period. This is because proposed rule 18f–4 requires daily calculation of a fund's VaR but does not require a fund to calculate its derivatives exposure daily.

[363] We are not proposing to amend General Instruction F to Form N–PORT, which specifies the information that funds report on Form N–PORT that the Commission does not make publicly available.

While the information for the first two months of a fund's quarter would be non-public, the information for the third month of a fund's quarter would be publicly available. *See supra* note 359.

[364] Under this proposal, a fund would have to indicate whether it is a limited derivatives user on Form N–CEN. *See infra* section II.H.3.

[365] *See* proposed Item B.10 of Form N–PORT. Proposed item B.10 would require that a fund provide the applicable VaR information in accordance with proposed rule 18f–4(c)(2)(ii), which requires a fund to determine compliance with its applicable VaR test at least once each business day.

[366] *See supra* note 362. While the information for the first two months of a fund's quarter would be non-public, the information for the third month of a fund's quarter would be publicly available. *See supra* note 359.

[367] *See* proposed Items B.10.a.–c of Form N–PORT. The proposed form amendments would require each of the reported metrics to be determined in accordance with the requirement under proposed rule 18f–4 to determine the fund's compliance with the applicable VaR test at least once each business day.

[368] *See* proposed Item B.10.d.i.–ii of Form N–PORT.

[369] *See* proposed Item B.10.d.iii.–v of Form N–PORT.

[370] *See* proposed Item B.10.e of Form N–PORT; *see also supra* section II.B.3.d (discussing proposed backtesting requirement); ICI Comment Letter II (discussing UCITS funds being similarly required to report to their primary regulator, on a semi-annual basis, the number of VaR breaks that exceed a specified threshold (a VaR break occurs when the actual one-day loss exceeds that day's VaR), and recommending the Commission require funds to report the number of VaR breaks and the dates on which they occurred).

[371] *See supra* note 151.

[372] *See supra* notes 362, 365. *But see infra* section II.H.2 (discussing adverse effects that might arise from the real-time public reporting of a fund's VaR test breaches under the proposed amendments to Form N–LIQUID).

Information reported for the third month of each fund's fiscal quarter on Form N–PORT will be made publicly available 60 days after the end of the fiscal quarter. *See supra* note 359.

Form N–PORT requiring reporting of VaR information:

210. Are the proposed requirements that funds report VaR information on Form N–PORT, and each of the elements that a fund would have to report under this requirement, appropriate? Why or why not? Should we modify the proposed VaR information reporting item in any way? If so, how should we modify this reporting item?

211. Our proposal would make public all of the information that a fund would report in response to the new VaR information item on Form N–PORT. Is there any reason why this information should not be publicly available? For example, would making this information public lead to harm arising from investor confusion, adverse competitive effects, or for any other reason? If we require that this reported information be made public, is there additional information we should require funds to report to provide contextualization or mitigate any adverse effects that could arise from public disclosure? Should we make non-public some of these disclosures (*e.g.,* portfolio VaR or a fund's designated reference index, or information about backtesting results) but not others? If so, which ones should we make non-public and why?

212. Would any of the proposed N–PORT reporting requirements be more appropriately structured as Form N–CEN reporting requirements, or items to be reported on a current basis on Form N–RN?

213. Is there any additional information related to funds' derivatives exposure or derivatives risk management that we should require funds to report on Form N–PORT? What information and why, and should this reported information be made public?

2. Amendments to Current Reporting Requirements

We are also proposing current reporting requirements for funds that are relying on proposed rule 18f–4. We are proposing to re-title Form N–LIQUID as Form N–RN and to amend this form to include new reporting events for funds that are subject to the proposed VaR-based limit on fund leverage risk.[373] These funds would be required to determine their compliance with the applicable VaR test on at least a daily basis.[374] We are proposing to require these funds to file Form N–RN to report information about VaR test breaches under certain circumstances. Proposed rule 18f–4 would require a fund that has determined that it is not in compliance with the applicable VaR test to come back into compliance promptly and within no more than three business days after such determination.[375] We are therefore proposing that a fund that determines that it is out of compliance with the VaR test and has not come back into compliance within three business days after such determination would file a report on Form N–RN providing certain information regarding its VaR test breaches.[376]

If the portfolio VaR of a fund subject to the relative VaR test were to exceed 150% of the VaR of its designated reference index for three business days, we are proposing to require that such a fund report: (1) The dates on which the fund portfolio's VaR exceeded 150% of the VaR of its designated reference index; (2) the VaR of its portfolio for each of these days; (3) the VaR of its designated reference index for each of these days; (4) the name of the designated reference index; and (5) the index identifier.[377] A fund would have to report this information within one business day following the third business day after the fund has determined that its portfolio VaR exceeds 150% of its designated reference index VaR.[378] Such a fund also would have to file a report on Form N–RN when it is back in compliance with the relative VaR test.[379]

If the portfolio VaR of a fund subject to the absolute VaR test were to exceed 15% of the value of the fund's net assets for three business days, we are proposing to require that such a fund report: (1) The dates the on which the fund portfolio's VaR exceeded 15% of the value of its net assets; (2) the VaR of its portfolio for each of these days; and (3) the value of the fund's net assets for each of these days.[380] A fund would have to report this information within one business day following the third business day that the fund determined that its portfolio VaR exceeds 15% of the value of its net assets. Such a fund also would have to file a report on Form N–RN when it is back in compliance with the absolute VaR test.[381]

The data points, collectively, would aid the Commission in assessing funds' compliance with the VaR tests. In addition, the information would provide staff the ability to assess how long a fund is precluded from entering into derivatives transactions as a consequence of its lack of compliance with its VaR test.

Currently, only registered open-end funds (excluding money market funds) are required to file reports on Form N–LIQUID.[382] We are proposing to amend this form, as well as rule 30b1–10 under the Investment Company Act, to reflect the proposed 18f–4 requirement that all funds that are subject to the relative VaR test or absolute VaR test file current reports regarding VaR test breaches under the circumstances that Form N–RN specifies.[383] The scope of funds that would be subject to the new VaR test breach current reporting requirements would thus include registered open-end funds as well as registered closed-end funds and BDCs. In addition to extending the scope of funds required to respond to Form N–LIQUID, we are proposing to amend the general instructions to the form to reflect the expanded scope and application.[384]

[373] *See* proposed Parts E–G of Form N–RN.

[374] *See supra* section II.D; *see also* proposed rule 18f–4(c)(2).

[375] *See supra* section II.D.5.b.

[376] *See* proposed Parts E and F of Form N–RN.

[377] *See* proposed Part E of Form N–RN.

[378] For example, if the fund were to determine, on the evening of Monday, June 1, that its portfolio VaR exceeded 150% of the fund's designated reference index VaR, and this exceedance were to persist through Tuesday (June 2), Wednesday (June 3), and Thursday (June 4), the fund would file Form N–RN on Friday, June 5 (because 3 business days following the determination on June 1 is June 4, and 1 business day following June 4 is June 5). If the exceedance were to still persist on June 5 (the date that the fund would file Form N–RN), the fund's report on Form N–RN would provide the required information elements for June 1, 2, 3, 4, and 5.

[379] *See* proposed Part G of Form N–RN. The report would include the dates on which the fund was not in compliance with the VaR test, and the current VaR of the fund's portfolio on the date the fund files the report. *See also* proposed rule 18f–4(c)(2)(iii) (providing that a fund must meet specific requirements to be back in compliance).

[380] *See* proposed Part F of Form N–RN.

[381] *See supra* note 378.

[382] *See* General Instruction A.(1) to Form N–LIQUID; *see also* rule 30b1–10 [17 CFR 270.30b1–10].

[383] *See* proposed Form N–RN; *see also* proposed amendments to rule 30b1–10 under the Investment Company Act, and proposed rule 18f–4(c)(7) (requiring a fund that experiences an event specified in the parts of Form N–RN titled ''Relative VaR Test Breaches,'' ''Absolute VaR Test Breaches,'' or ''Compliance with VaR Test'' to file with the Commission a report on Form N–RN within the period and according to the instructions specified in that form).

[384] *See, e.g.,* proposed General Instruction A.(1) to Form N–RN (amending the defined term ''registrant''); proposed General Instruction A.(2) to Form N–RN (amending the submission requirement to clarify application to the new VaR-test-breach-related items); proposed General Instruction A.(3) to Form N–RN (clarifying that only open-end funds required to comply with rule 22e–4 under the Investment Company Act would be required to respond to events occurring in Parts B–D, as applicable, while funds required to comply with the limit on fund leverage risk in proposed rule 18f–4 would be required to respond to events specified in proposed Parts E–G, as applicable); and proposed General Instruction F to Form N–RN (clarifying that the terms used in proposed Parts E–G, unless otherwise specified, would have the same meaning as the terms in proposed rule 18f–4).

We are proposing to require funds to provide this information in a current report because we believe that the Commission should be notified promptly when a fund is out of compliance with the proposed VaR-based limit on fund leverage risk, which in turn we believe could indicate that a fund is experiencing heightened risks as a result of the fund's use of derivatives transactions. VaR test breaches could indicate that a fund is using derivatives transactions to leverage the fund's portfolio, magnifying its potential for losses and significant payments of fund assets to derivatives counterparties. Such breaches also could indicate market events that are drivers of potential derivatives risks or other risks across the fund industry. Either of these scenarios—increased fund-specific risks, or market events that affect funds' risks broadly—may, depending on the facts and circumstances, require attention by the Commission. The proposed current reporting requirement is designed to provide the Commission current information regarding potential increased risks and stress events (as opposed to a requirement to report the same or similar information later, for example on Form N–PORT).[385] The one-business-day time-frame for submitting a report on Form N–RN regarding a fund's VaR test breaches is designed to provide an appropriately early notification to the Commission of potential heightened risks, while at the same time providing sufficient time for a fund to compile and file its report on Form N–RN. This time-frame is also consistent with the current required timing for reporting other events on Form N–LIQUID.[386]

We are cognizant that certain adverse effects might arise from real-time public reporting of a fund's VaR test breaches. For example, publicly disclosing this information could lead to investor confusion. Investors might mistakenly assume that a fund that breached the applicable VaR test actually had suffered substantial losses or that substantial losses necessarily were imminent. Investors might also believe that a fund's failing the VaR test suggests a sudden increase in fund risk when, in some cases, a fund can fail a VaR test—and especially an absolute VaR test—due to changes in market volatility generally. Investors also might believe that a fund's real-time reporting of a VaR test breach necessarily meant that the fund was not complying with applicable regulations. Information about VaR breaches would therefore provide important information to the Commission and its staff for regulatory purposes but could confuse investors and lead them and other market participants to make incorrect assumptions about a fund's relative riskiness. This could have potential adverse effects for funds if investors redeem or sell fund shares as a result. Other market participants also could react to real-time reporting of VaR breaches in ways that could adversely affect funds. For example, if market participants knew on a real-time basis that a fund had breached the applicable VaR test, market participants might seek to anticipate the trading activity the fund might undertake to come back into compliance and engage in predatory trading that could adversely affect the fund. Accordingly, we are proposing to make funds' reports on Form N–RN regarding VaR test breaches (like their reports on this form regarding liquidity-related items) non-public, because we preliminarily believe that public disclosure of this information is neither necessary nor appropriate in the public interest or for the protection of investors.[387]

We seek comment on the Commission's proposed amendments to Form N–LIQUID requiring reporting of certain information regarding a fund's VaR test breaches:

214. Is the proposed new current reporting requirement for funds that are subject to the VaR-based limit on fund leverage risk appropriate? Why or why not? If not, how should the scope of the proposed current reporting requirement be modified? Should we require additional current reporting requirements for funds to report other derivatives-risk-related information? For example, should funds that are limited derivatives users pursuant to the proposed exposure-based exception be required to file current reports if their derivatives exposure were to exceed 10% of their net assets?[388] Should we require a fund to file a current report if it identifies a certain number of exceptions as a result of backtesting its VaR calculation model, and if so, what circumstances should trigger the requirement to file a current report?[389]

215. Is each of the pieces of information that we propose a fund would include in a report about a VaR test breach on proposed Form N–RN appropriate? Why or why not? Should we modify the required information in any way?

216. For a fund that is out of compliance with the VaR test, and is unable to come back into compliance within three business days after its initial determination, the proposed current reporting requirement would require that fund to file a report on Form N–RN providing certain information regarding its VaR test breaches. Is the proposed three-business-day current reporting requirement appropriate? Why or why not? Should the rule require a shorter or longer period, such as one or seven days, before prompting a current reporting requirement? Which time period would be appropriate and why?

217. We are proposing that a fund's reports regarding VaR test breaches on Form N–RN would not be made public. Would there be a benefit to publicly reporting this information, and would it be appropriate to make these disclosures public? Why or why not? Should we make public some of these disclosures but not others? If so, which ones should we make public and why?

218. As an alternative or an addition to the proposed current reporting requirement, should we require funds to report information regarding VaR test breaches on Form N–PORT? Why or why not? If so, should we make public this information reported on Form N–PORT?

219. Should we modify the proposed current reporting requirement to require reporting by certain types of funds and not others? If so which types of funds, and why? For example, should we require BDCs also to report the information that we are proposing them to report on Form N–RN on Form 8–K? Why or why not?

220. As an alternative to amending Form N–LIQUID to require current reporting on VaR test breaches, should we provide a new, separate current reporting form for funds to use to report VaR test breaches (and/or any other current reporting items relating to their derivatives risk management programs under proposed rule 18f–4)? Why or why not?

3. Amendments to Form N–CEN

Form N–CEN currently includes an item that requires a fund to indicate—in a manner similar to ''checking a

[385] *See supra* section II.H.1.b.

[386] *See* General Instruction A of Form N–LIQUID.

[387] *See* proposed General Instruction A.(1) to Form N–RN; *see also* section 45(a) of the Investment Company Act (requiring information in reports filed with the Commission pursuant to the Investment Company Act to be made available to the public, unless we find that public disclosure is neither necessary nor appropriate in the public interest or for the protection of investors).

[388] *See supra* section II.E.1.

[389] *See supra* section II.B.3.d (discussing backtesting requirements in proposed rule 18f–4); *see also supra* section II.H.1.b (discussing proposed requirement to report backtesting results on Form N–PORT).

box''—whether the fund has relied on certain Investment Company Act rules during the reporting period.[390] We are proposing amendments to this item to require a fund to identify whether it relied on proposed rule 18f–4 during the reporting period.[391] We are also proposing amendments to require a fund to identify whether it relied on any of the exceptions from various requirements under the proposed rule, specifically:

- Whether the fund is a limited derivatives user excepted from the proposed rule's program requirement, under either the proposed exception for funds that limit their derivatives exposure to 10% of their net assets or under the exception for funds that limit their derivatives use to certain currency hedging; [392] or
- Whether the fund is a leveraged/inverse fund covered by the proposed sales practices rules that, under proposed rule 18f–4, would be excepted from the proposed limit on fund leverage risk.[393]

Finally, a fund would have to identify whether it has entered into reverse repurchase agreements or similar financing transactions, or unfunded commitment agreements, as provided under the proposed rule.[394] This information would assist the Commission and staff with our oversight functions by allowing us to identify which funds were excepted from certain of the proposed rule's provisions or relied on the rule's provisions regarding reverse repurchase agreements and unfunded commitment agreements.

We seek comment on the Commission's proposed amendments to Form N–CEN:

221. Should we require, as proposed, that funds identify that they relied on rule 18f–4, including whether they are limited derivatives users that are excepted from the proposed program requirement? Why or why not?

222. Should we require, as proposed, that funds identify that they are leveraged/inverse funds that are excepted from the proposed limit on fund leverage risk? Why or why not?

223. Should we require, as proposed, that funds identify that they entered into reverse repurchase agreements or similar financing transactions, or unfunded commitment agreements? Why or why not?

224. Are there other means that funds use to disclose or report information (*e.g.,* prospectus or annual report disclosure in addition to the other disclosure requirements in this proposal) that would be more appropriate for reporting any of the information that the proposed amendments to Form N–CEN would require? Should any of the disclosures required in the proposed amendments to Form N–PORT above be made on Form N–CEN? Why or why not?

4. BDC Reporting

BDCs do not file reports on Form N–CEN or Form N–PORT. We considered proposing to require that BDCs provide the new information that we propose registered funds report on Form N–CEN, and the new information regarding derivatives exposure and VaR that we propose to require funds to report on Form N–PORT, in their annual reports on Form 10–K. BDCs, however, generally do not enter into derivatives transactions or do so to a limited extent.[395] We therefore believe that most BDCs that enter into derivatives transactions would qualify for the limited derivatives user exception (which would make the proposed VaR reporting items on Form N–PORT inapplicable to BDCs). In addition, and as noted above, we understand that even when BDCs do use derivatives more extensively, derivatives generally do not play as significant of a role in implementing the BDC's strategy, as compared to many other types of funds that use derivatives extensively. BDCs are required under the Investment Company Act to invest at least 70% of their total assets in ''eligible portfolio companies,'' which may limit the role that derivatives can play in a BDC's portfolio relative to other kinds of funds that would generally execute their strategies primarily through derivatives transactions (*e.g.,* a managed futures fund). BDCs that would not qualify as limited derivatives users under the proposed rule also would be subject to the proposed new requirement to file current reports regarding VaR test breaches on Form N–RN.[396] Taking these factors into account, we are not proposing additional reporting requirements for BDCs because we believe that the reporting framework we are proposing for BDCs adequately addresses the Commission's ability to monitor BDCs' compliance with the proposed rules, as well as any competitive disparities that could result from disparate reporting requirements among funds that rely on proposed rule 18f–4.[397]

We seek comment on the Commission's proposal to not require BDCs to report on Forms N–PORT or N–CEN:

225. Should we require BDCs to report any of the same information on Form 10–K (or elsewhere, such as in a BDC's prospectus) that we are proposing to require registered investment companies to report on Forms N–CEN and N–PORT? Why or why not? Should we require, for example, that a BDC report its derivatives exposure, whether it is a limited derivatives user, and/or its designated reference index (if applicable)? If so, where? If a BDC uses derivatives and does not qualify as a limited derivatives user, should it have to report information about its derivatives exposure and portfolio VaR on Form N–PORT (or elsewhere)?

226. Should we require BDCs to report on Form 10–K or elsewhere whether they have relied on the rule's provision regarding reverse repurchase agreements and similar financing transactions or unfunded commitment agreements?

I. Reverse Repurchase Agreements

Funds may engage in certain transactions that may involve senior securities primarily as a means of obtaining financing. For example, open-end funds are permitted to borrow money from a bank, provided they maintain a 300% asset coverage ratio.[398] Another common method of obtaining financing is through the use of reverse repurchase agreements. In a reverse repurchase agreement, a fund transfers a security to another party in return for a percentage of the value of the security. At an agreed-upon future date, the fund repurchases the transferred security by paying an amount equal to the proceeds of the initial sale transaction plus interest.[399] A reverse repurchase

[390] *See* Item C.7 of Form N–CEN.

[391] *See* proposed Item C.7.l of Form N–CEN.

[392] *See* proposed Item C.7.l.i.–ii of Form N–CEN; *see also supra* section II.E.

[393] *See* proposed Item C.7.l.iii of Form N–CEN; *see also supra* section II.G.

[394] *See* proposed Item C.7.l.iv–v of Form N–CEN; *see also infra* sections II.I and II.J.

[395] *See supra* section II.D.2.b.

[396] *See supra* section II.H.2.

[397] We have separately proposed to require BDCs to tag their financial statements using Inline XBRL, a structured, machine-readable format, which would provide structured data about BDCs' derivatives and other investments. *See* Securities Offering Reform Proposing Release, *supra* note 199, at section II.H.1. In addition, BDCs are currently required to disclose certain information about their exposures to market risks, including risks that may arise as a result of their derivatives-related activity. *See, e.g.,* Items 303 and 305 of Regulation S–K [17 CFR 229.303 and 229.305].

See also infra section III.D.2 (discussing, among other things, potential competitive effects resulting from BDCs not being subject to the proposed additional reporting requirements on Form N–PORT and Form N–CEN).

[398] *See* section 18(f)(1) of the Investment Company Act.

[399] *See* Release 10666, *supra* note 15, at ''Reverse Repurchase Agreements'' discussion (stating that a

Continued

agreement is economically equivalent to a secured borrowing.[400]

We believe that reverse repurchase agreements and other similar financing transactions that have the effect of allowing a fund to obtain additional cash that can be used for investment purposes or to finance fund assets should be treated for section 18 purposes like a bank borrowing or other borrowing, as they achieve effectively identical results. Accordingly, we are proposing that a fund may engage in reverse repurchase agreements and other similar financing transactions so long as they are subject to the relevant asset coverage requirements of section 18.[401] For example, this would have the effect of permitting an open-end fund to obtain financing by borrowing from a bank, engaging in a reverse repurchase agreement, or any combination thereof, so long as all sources of financing are included when calculating the fund's asset coverage ratio.[402]

Reverse repurchase agreements and similar financing transactions are not treated as derivatives transactions under the proposed rule because they have the economic effects of a secured borrowing, and thus more closely resemble bank borrowings with a known repayment obligation rather than the more-uncertain payment obligations of many derivatives. However, such transactions can have the effect of introducing leverage into a fund's portfolio if the fund were to use the proceeds of the financing transaction to purchase additional investments. In addition, such transactions impose a requirement to return assets at the termination of the agreement, which can raise section 18 asset sufficiency concerns to the extent the fund needs to sell less-liquid securities at a loss to obtain the necessary assets.

Reverse repurchase agreements and similar financing transactions would not be included in calculating a fund's derivatives exposure under the limited derivatives user provisions of the proposed rule. However, if a fund did not qualify as a limited derivatives user due to its other investment activity, any portfolio leveraging effect of reverse repurchase agreements or similar financing transactions would be included and restricted through the proposed VaR-based limit on fund leverage risk. This is because the proposed VaR tests estimate a fund's risk of loss taking into account all of its investments, including the proceeds of reverse repurchase agreements and similar investments the fund purchased with those proceeds.

Securities lending arrangements are structurally similar to reverse repurchase agreements in that, in both cases, a fund transfers a portfolio security to a counterparty in exchange for cash (or other assets). Although these arrangements are structurally similar, under our proposal we would not view a fund's obligation to return securities lending collateral as a ''similar financing transaction'' in the circumstances discussed below. In the 2015 Proposing Release, we sought comment on whether rule 18f–4 should address funds' compliance with section 18 in connection with securities lending.[403] Commenters stated that the staff's current guidance on securities lending forms the basis for funds' securities lending practices and effectively addresses the senior securities implications of securities lending, and thus securities lending practices need not be addressed in the final rule.[404]

Currently, funds that engage in securities lending typically reinvest cash collateral in highly liquid, short-term investments, such as money market funds or other cash or cash equivalents, and funds generally do not sell or otherwise use non-cash collateral to leverage the fund's portfolio.[405] We believe a fund that engages in securities lending under these circumstances is limited in its ability to use securities lending transactions to increase leverage in its portfolio. Accordingly, the proposed rule does not treat a fund's obligation to return securities lending collateral as a financing transaction similar to a reverse repurchase agreement, so long as the obligation relates to an agreement under which a fund engages in securities lending, the fund does not sell or otherwise use non-cash collateral received for loaned securities to leverage the fund's portfolio, and the fund invests cash collateral solely in cash or cash equivalents. If a fund were to engage in securities lending and to invest the cash collateral in securities other than cash or cash equivalents, this may result in leveraging of the fund's portfolio, and we believe this activity would be a ''similar financing transaction'' and should thus be included when calculating a funds asset coverage ratio.

We believe that a fund's obligation with respect to a ''tender option bond'' (''TOB'') financing may be similar to a reverse repurchase agreement in some circumstances. One commenter on the 2015 proposal explained that TOB financings are economically similar to reverse repurchase agreements because a fund employing a TOB trust has in effect used the underlying bond as collateral to secure a borrowing analogous to a fund's use of a security to secure a reverse repurchase agreement.[406] We believe that determining whether a TOB is a similar financing transaction as a reverse repurchase agreement would depend on the facts and circumstances. To the

reverse repurchase agreement may not have an agreed-upon repurchase date, and in that case the agreement would be treated as if it were reestablished each day).

[400] *See, e.g.,* Office of Financial Research, *Reference Guide to U.S. Repo and Securities Lending Markets* (Sept. 9, 2015), *available at https://www.financialresearch.gov/working-papers/files/OFRwp-2015-17_Reference-Guide-to-U.S.-Repo-and-Securities-Lending-Markets.pdf.*

[401] Proposed rule 18f–4(d). Among other things, section 18 prescribes the required amount of asset coverage for a fund's senior securities and provides certain consequences for a fund that fails to maintain this amount. *See, e.g.,* section 18(a) (restrictions on dividend issuance). This provision in rule 18f–4 would not provide any exemptions from the requirements of section 61 for BDCs because that section does not limit a BDC's ability to engage in reverse repurchase or similar transactions in parity with other senior security transactions permitted under that section.

[402] Section 18 states that certain borrowings that are made for temporary purposes (less than 60 days) and that do not exceed 5% of the total assets of the issuer at the time when the loan is made (temporary loans) are not senior securities for purposes of certain paragraphs in section 18. As we noted in Release 10666, reverse repurchase agreements and similar financing transactions could be designed to appear to fall within the temporary loans exception, and then could be ''rolled-over,'' perhaps indefinitely, with such short-term transactions being entered into, closed out, and later re-entered. If substantially similar financing arrangements were being ''rolled over'' in any manner for a total period of 60 days or more, we would treat the later transactions as renewals of the earlier ones, and all such transactions would fall outside the exclusion for temporary loans.

[403] 2015 Proposing Release, *supra* note 2, at paragraph accompanying n.149.

[404] *See, e.g.,* ICI Comment Letter I; Guggenheim Comment Letter; SIFMA Comment Letter; Comment Letter of the Risk Management Association (Mar. 28, 2016). Staff guidance on Securities Lending by U.S. Open-End and Closed-End Investment Companies (Feb. 27, 2014), *available at https://www.sec.gov/divisions/investment/securities-lending-open-closed-end-investment-companies.htm* (providing guidance on certain no-action letters that funds consider when engaging in securities lending and summarizing areas those letters address, including limitations on the amount that may be lent and collateralization for such loans).

[405] *See* ICI, *Securities Lending by Mutual Funds, ETFs, and Closed-End Funds: The Basics* (Sept. 14, 2014), *available at https://www.ici.org/viewpoints/view_14_sec_lending_01* (''[T]he collateral that funds can accept from borrowers must be highly liquid, such as cash, government securities, or bank letters of credit. U.S. regulated funds typically demand cash collateral. . . . In practice, U.S. regulated funds most often invest cash collateral in money market funds.''); SIFMA, *Master Securities Lending Agreement,* section 4.2 (2000), *available at https://www.sifma.org/wp-content/uploads/2017/08/MSLA_Master-Securities-Loan-Agreement-2000-Version.pdf* (generally limiting lenders from re-hypothecating non-cash collateral).

[406] *See* SIFMA Comment Letter.

extent a fund concludes that there are economic similarities between a TOB financing and a reverse repurchase agreement, the fund should treat obligations with respect to the TOB financing as a similar financing transaction under the proposed rule.

We request comment on our proposed approach to reverse repurchase agreements and similar financing transactions under the proposed rule.

227. As proposed, should we treat reverse repurchase agreements and similar financing transactions as economically equivalent to bank borrowings under section 18, and subject them to the same asset coverage requirements? Why or why not?

228. Should we not combine reverse repurchase agreements with bank borrowing and other senior securities under the provision, and instead treat them separately but with the same limit? For example, should we allow a fund to borrow from a bank subject to the 300% asset coverage limit and also separately use reverse repurchase agreements up to a 300% asset coverage limit?

229. Should we instead treat such reverse repurchase agreements and similar financing transactions as derivatives transactions under the proposed rule? Would this have any disparate effects on certain types of funds?

230. Is there a way to distinguish reverse repurchase agreements and similar financing transactions that funds use to leverage their portfolios from instances in which funds use those transactions for other purposes? If so, should we treat such transactions engaged in for leveraging purposes differently than transactions engaged in for other purposes?

231. Should we include securities lending transactions as a similar financing transaction (regardless of how the proceeds are invested) under the proposed provision? Why or why not? Should we define in rule 18f–4 the circumstances under which securities lending would not be treated as a similar financing transaction?

232. Are there other types of transactions that we should identify and treat as similar financing transactions to reverse repurchase agreements that we have not identified above? What are they and why should they be treated accordingly?

J. Unfunded Commitment Agreements

Under unfunded commitment agreements, a fund commits, conditionally or unconditionally, to make a loan to a company or to invest equity in a company in the future.[407] They include capital commitments to a private fund requiring investors to fund capital contributions or to purchase shares upon delivery of a drawdown notice. The proposed rule would therefore define an unfunded commitment agreement to mean a contract that is not a derivatives transaction, under which a fund commits, conditionally or unconditionally, to make a loan to a company or to invest equity in a company in the future, including by making a capital commitment to a private fund that can be drawn at the discretion of the fund's general partner.[408]

The Commission's 2015 proposal would have treated these agreements as ''financial commitment transactions.'' As a result, a fund's obligations under the agreements could not exceed the fund's net asset value.[409] Commenters on the 2015 proposal identified characteristics of these agreements that they believed distinguished unfunded commitments from the derivatives transactions and financial commitment transactions covered by that proposal, which are also covered by re-proposed rule 18f–4.[410] First, commenters stated that a fund often does not expect to lend or invest up to the full amount committed. Second, commenters stated that a fund's obligation to lend is commonly subject to conditions, such as a borrower's obligation to meet certain financial metrics and performance benchmarks, which are not typically present under the types of agreements that the Commission described in Release 10666.[411] Commenters also asserted that unfunded commitment agreements do not give rise to the risks that Release 10666 identified and do not have a leveraging effect on the fund's portfolio because they do not present an opportunity for the fund to realize gains or losses between the date of the fund's commitment and its subsequent investment when the other party to the agreement calls the commitment.[412] These commenters contrasted firm and standby commitment agreements, under which a fund commits itself to purchase a security with a stated price and fixed yield without condition or upon the counterparty's demand.[413] They argued that the firm and standby commitment agreements that Release 10666 describes expose the fund to investment risk during the life of the transaction, because the value of the fund's commitment agreement will change as interest rates change.

We agree that these factors distinguish unfunded commitment agreements from the derivatives transactions covered by proposed rule 18f–4. The derivatives transactions covered by proposed rule 18f–4—including the firm and standby commitment agreements the Commission described in Release 10666—expose the fund to investment risk during the life of the transaction. Derivatives transactions therefore can be used to leverage a fund's portfolio by enabling a fund to magnify its gains and

[407] We understand that the types of funds that enter into unfunded commitment agreements typically include BDCs and registered closed-end funds.

[408] Proposed rule 18f–4(a).

[409] *See* 2015 proposed rule 18f–4(c)(4) (defining ''financial commitment transactions''); 2015 proposed rule 18f–4(b) (permitting funds to engage in financial commitment transactions if the fund maintains qualifying coverage assets with a value equal to at least the fund's aggregate financial commitment obligations); 2015 proposed rule 18f–4(c)(5) (defining a fund's ''financial commitment obligations,'' in part, to mean ''the amount of cash or other assets that the fund is conditionally or unconditionally obligated to pay or deliver under a financial commitment transaction).

[410] Specifically, these commenters generally compared unfunded commitment agreements to firm and standby commitment agreements (which we would in turn interpret the phrase ''or any similar instrument'' in proposed rule 18f–4's definition of ''derivatives transaction'' to include, *see supra* note 91 and accompanying paragraph). *See, e.g.,* Letter of Ares Capital Corporation (Mar. 28, 2016) (''Ares Comment Letter''); Comment Letter of the Small Business Investor Alliance (Mar. 28, 2016) (''SBIA Comment Letter''); Comment Letter of the Center for Capital Markets Competitiveness, U.S. Chamber of Commerce (Mar. 28, 2016); Comment Letter of Skadden, Arps, Slate, Meagher & Flom LLP (Mar. 28, 2016) (''Skadden Comment Letter''); Dechert Comment Letter; Private Equity Growth Capital Council (Mar. 28, 2016) (''PEGCC Comment Letter'').

[411] *See, e.g.,* SBIA Comment Letter; Comment Letter of Hercules Capital (Mar. 29, 2016); *see also, e.g.,* Skadden Comment Letter (contingent loan commitments typically have ''funding conditions that excuse the BDC from funding if the borrower does not continue to satisfy various representations, financial and non-financial metrics and performance conditions . . . [and] cannot result in substantial risk of loss prior to funding because the BDC is not required to fund the loan if the borrower's credit or financial position degenerates meaningfully.'').

[412] *See, e.g.,* PEGCC Comment Letter (distinguishing the agreements that Release 10666 discusses because, while the value of the fund's limited partnership interest may fluctuate based on the amount of capital it invests in the private fund, the fund has no profit or loss on the unfunded commitment); Ares Comment Letter (stating that, in general, unfunded loan commitments do not reflect a bet on interest rate movements because the yields for unfunded loan commitments are determined as a spread over a prevailing market interest rate); *see also* Altegris Comment Letter (explaining that unfunded commitment agreements do not have a potential for ''pyramiding'' because—in contrast to a reverse repurchase agreement—a fund ''receives nothing from the underlying private equity funds in return for its capital commitments and, as a result, its gross assets remain unchanged.'').

[413] *See, e.g.,* SBIA Comment Letter; *see also* Altegris Comment Letter; Ares Comment Letter; Comment Letter of Dechert (Feb. 7, 2016); Skadden Comment Letter.

losses compared to the fund's investment, while also obligating the fund to make a payment to a counterparty. Based on the characteristics of unfunded commitment agreements commenters described, which we understand are typical of these agreements, we do not believe that such unfunded commitment agreements are undertaken to leverage a fund's portfolio. For example, if the yield for an unfunded loan commitment is determined as a spread over a prevailing market interest rate, the agreement creates a risk that the fund would not have liquid assets to fund the loan, but the agreement would not reflect a speculative position on the direction of interest rates.[414] We therefore do not believe that such unfunded commitment agreements generally raise the Investment Company Act's concerns regarding the risks of undue speculation.[415]

Depending on the facts and circumstances, however, an unfunded commitment agreement could raise the asset sufficiency concerns underlying the Investment Company Act.[416] A fund could be required to liquidate other assets to obtain the cash needed to satisfy its obligation under an unfunded commitment agreement if the fund did not have cash on hand to meet its obligation to provide a committed loan or make a committed equity investment. If the fund is unable to meet its obligations, the fund would be subject to default remedies available to its counterparty. For example, if a fund fails to fulfill its commitments to invest in a private fund when called to do so, the fund could be subject to the remedies specified in the limited partnership agreement (or similar document) relating to that private fund. These remedies can have the practical effect of forfeiture of some or all of the fund's investment in the private fund.[417] In these and other circumstances a fund's investors could be harmed if the fund is unable to meet its obligations under an unfunded commitment agreement.

Because unfunded commitment agreements can raise the asset sufficiency concern underlying section 18, but generally do not raise the undue speculation concern associated with derivatives transactions (and reverse repurchase agreements and similar financing transactions), we are proposing to permit a fund to enter into unfunded commitment agreements if it reasonably believes, at the time it enters into such an agreement, that it will have sufficient cash and cash equivalents to meet its obligations with respect to all of its unfunded commitment agreements, in each case as they come due.[418] While a fund should consider its unique facts and circumstances to have such a reasonable belief, the proposed rule would prescribe certain specific factors that a fund must take into account.[419]

First, the proposed rule would require a fund to take into account its reasonable expectations with respect to other obligations (including any obligation with respect to senior securities or redemptions). This is because other obligations can place competing demands on cash a fund otherwise might intend to use to fund an unfunded commitment agreement. Second, the proposed rule would provide that a fund may not take into account cash that may become available from the sale or disposition of any investment at a price that deviates significantly from the market value of those investments. This provision is designed to address the risk that a fund could suffer losses by selling assets to raise cash to fund an unfunded commitment agreement, ultimately having an adverse impact on the fund's investors. Finally, the proposed rule would provide that a fund may not consider cash that may become available from issuing additional equity. Whether a fund would be able to raise capital in the future and the amount of any additional capital would depend on a variety of factors, including future market conditions, that we believe are too speculative to support a fund's reasonable belief that it could fund an unfunded commitment with the proceeds from future sales of the fund's securities. The proposed rule would not preclude a fund from considering the issuance of debt to support a reasonable belief that it could fund an unfunded commitment, as we understand that funds often satisfy their obligations under unfunded commitments through borrowings. Moreover, such borrowings by funds would be limited by section 18's asset coverage requirements, which would limit the extent to which a fund's belief regarding its ability to borrow would allow the fund to enter into unfunded commitment agreements.

To have a reasonable belief, a fund therefore could consider, for example, its strategy, its assets' liquidity, its borrowing capacity under existing committed lines of credit, and the contractual provisions of its unfunded commitment agreements. A fund with unfunded loan commitments, for instance, could evaluate the likelihood that different potential borrowers would meet contractual ''milestones'' that the borrowers would have to satisfy as a condition to the obligation to fund a loan, as well as the amount of the anticipated borrowing. The fund's historical experience with comparable obligations should inform this analysis. Whether a fund has a reasonable belief also could be informed by a fund's assessment of the likeliness that subsequent developments could impair the fund's ability to have sufficient cash and cash equivalents to meet its unfunded commitment obligations.

This proposed approach for unfunded commitment agreements reflects the staff's experience in reviewing and commenting on fund registration statements, which have disclosure regarding the funds' unfunded commitments. These funds have generally represented, in substance, that they reasonably believe that their assets will provide adequate cover to allow them to satisfy all of their unfunded investment commitments, without taking into account any projected securities offerings. In their responses to staff comments, funds also have provided a general explanation as to the process by which they reached this reasonable belief.

Finally, the proposed rule would provide that an agreement that meets the rule's definition of a derivatives transaction is not an unfunded

[414] *Cf.* Release 10666, *supra* note 15, at n.12 (''Commitments to purchase securities whose yields are determined on the date of delivery with reference to prevailing market interest rates are not intended to be included in this general statement of policy. Such commitments neither create nor shift the risk associated with interest rate changes in the marketplace, and in economic reality have no discernible potential for leverage.'').

[415] *See supra* notes 45–47 and accompanying text.

[416] *See id.*

[417] *See, e.g.,* Phyllis A. Schwartz & Stephanie R. Breslow, *Private Equity Funds: Formation and Operation* (June 2015 ed.), at 2–34 (remedies private equity funds may apply in event of investor default include, among other things, the right to charge high interest on late payments, the right to force a sale of the defaulting investor's interest, the right to continue to charge losses and expenses to defaulting investors while cutting off their interest in future profits, and the right to take any other action permitted at law or in equity).

[418] *See* proposed rule 18f–4(e)(1). Because this proposed condition is designed to provide an approach tailored to unfunded commitment agreements, the proposed rule would also provide that these transactions would not be considered for purposes of computing asset coverage under section 18(h). As with our approach to derivatives transactions, applying section 18(h) asset coverage to these transactions appears unnecessary in light of the tailored requirement we are proposing. *See supra* note 66.

[419] The proposed rule would also require the fund to make and maintain records documenting the basis for this belief. *See* proposed rule 18f–4(e)(2); *see also infra* section II.K.

commitment.[420] This is because the proposed rule's treatment of unfunded commitments is predicated on these agreements having characteristics that distinguish them from the derivatives transactions covered by the proposed rule, as discussed above. Because the proposed definition of the term ''derivatives transaction'' includes any instrument that is similar to certain listed derivatives instruments, a contract that is functionally similar to a listed derivatives instrument would be a derivatives transaction and therefore would not qualify for the proposed rule's treatment of unfunded commitment agreements.[421] For example, a fund that enters into a binding commitment to make a loan or purchase a note upon demand by the borrower, with stated principal and term and a fixed interest rate, would appear to have entered into an agreement that is similar to a standby commitment agreement or a written put option.[422] This transaction would expose the fund to investment risk during the life of the transaction because the value of the fund's commitment agreement will change as interest rates change. Such an agreement thus would fall within the proposed rule's definition of ''derivatives transaction'' and would not be an unfunded commitment agreement under the proposed rule.

We request comment on our proposed approach to unfunded commitment agreements.

233. Are unfunded commitment agreements distinguishable from derivatives transactions? Can funds use unfunded commitment agreements for speculation or to accomplish leveraging? If so, how? What types of funds enter into unfunded commitment agreements, and for what purposes?

234. Does funds' use of unfunded commitment agreements raise the undue speculation and/or the assets sufficiency concerns underlying section 18 of the Investment Company Act? Why or why not?

235. Is the proposed approach to unfunded commitment agreements appropriate? Would the proposed approach appropriately address any asset sufficiency concerns that funds' use of unfunded commitment agreements might entail? Why or why not?

236. Is the proposed requirement that a fund must have a ''reasonable belief'' regarding its ability to meet its unfunded commitment obligations, at the time it enters into an unfunded commitment agreement, appropriate? Should the rule instead, or also, require a fund to reassess whether this belief remains reasonable at various points during the period of the unfunded commitment agreement?

237. Are the rule's provisions regarding the factors that a fund must consider in determining whether it has the required ''reasonable belief'' appropriate? Why or why not? Are they sufficiently clear? Should we specify other factors that a fund could consider? Should the rule provide, for example, that a fund may consider potential borrowings only to the extent the fund has committed lines of credit or other committed borrowing capacity? If so, how should we define ''committed'' for this purpose?

238. Under the proposed rule, a fund's reasonable belief that it has sufficient cash to satisfy its unfunded commitments may not be based on cash that may become available from issuing additional equity. Do commenters agree that a fund's ability to raise capital in the future, and the amount of any such additional capital, are based on factors that are too speculative to support a fund's reasonable belief that it could use that capital to fund an unfunded commitment? Are there circumstances in which a fund can expect to raise capital in the future, such as expected inflows from retirement plan platforms, that would not raise the same concerns about supporting a reasonable belief under the proposed rule? Should the rule permit a fund to consider such additional capital as a basis for forming a reasonable belief?

239. Should the rule otherwise limit funds' use of unfunded commitment agreements? If so, how? For example, should the rule specify that funds' unfunded commitment agreements, in the aggregate, may not exceed the fund's net asset value? Or should we adopt different requirements for unfunded commitment agreements for different types of funds, based on their ability to borrow money under the Investment Company Act?[423] Should the rule limit the agreements' counterparties or otherwise restrict the agreements' terms in any way? If so, how? Should we adopt different requirements for unfunded loan commitments, which generally will be contingent upon a borrower meeting certain ''milestones,'' as compared to commitments to invest in a private fund due upon demand by the fund's adviser? If so, which requirements should apply to each type of transaction and why?

240. Should the rule instead treat all—or a specified subset of—unfunded commitment agreements in the same way that it treats derivatives transactions? If a subset of these agreements, should the rule specify that certain characteristics of these agreements are indicative that these agreements are ''similar instruments'' in the proposed rule's definition of ''derivatives transaction''? Should a fund that enters into unfunded commitment agreements, but that otherwise does not use derivatives (or that limits its derivatives exposure, either as the proposed rule specifies in the limited derivative user provisions or otherwise) be subject to the proposed VaR-based limit on fund leverage risk? Should such a fund be exempt from any of the proposed rule's other requirements, and if so, which ones and why?

241. Is the proposed definition of ''unfunded commitment agreement'' clear and appropriate? If not, how should the Commission modify it? Should the Commission clarify any aspect of the definition (*e.g.,* should the Commission further define or provide guidance regarding agreements that involve a commitment to ''make a loan to a company'' or to ''invest equity in a company in the future'')? Would funds experience any challenges in practice differentiating between unfunded commitments, on the one hand, and firm or standby commitment agreements or other transactions included in the definition of ''derivatives transaction,'' on the other? If so, how should the Commission provide additional clarity?

242. Are there other types of transactions that we should identify and treat as similar to unfunded commitment agreements? What are they and why should they be treated accordingly? Are there any transactions that may be viewed as firm or standby commitment agreements, but that commenters believe should be given the same treatment as unfunded commitments under the proposed rule? What kinds of transactions and why?

243. Would any adverse market effects result from the proposed treatment of unfunded commitment agreements? For example, would the proposal lead funds to restructure transactions as unfunded commitment agreements, and if so would this adversely affect investor protection? Would any modifications to the proposed rule, or additional

[420] *See* proposed rule 18f–4(a) (defining the term ''unfunded commitment agreement'').

[421] *See supra* section II.A (discussing proposed definition of ''derivatives transaction'').

[422] *See supra* paragraph accompanying notes 408–412 (discussing factors distinguishing unfunded commitment agreements from the derivatives transactions covered by proposed rule 18f–4).

[423] *See supra* notes 29–32 and accompanying text.

Commission guidance, help mitigate potential adverse market effects?

K. Recordkeeping Provisions

Proposed rule 18f–4 also includes certain recordkeeping requirements. These proposed requirements are designed to provide our staff, and a fund's compliance personnel, the ability to evaluate the fund's compliance with the proposed rule's requirements.

First, the proposed rule would require the fund to maintain certain records documenting the fund's derivatives risk management program. Specifically, for a fund subject to the proposed rule's program requirements, the proposed rule would require the fund to maintain a written record of its policies and procedures that are designed to manage the fund's derivatives risks.[424] The proposed rule would also require a fund to maintain a written record of the results of any stress testing of its portfolio, results of any VaR test backtesting it conducts, records documenting any internal reporting or escalation of material risks under the program, and records documenting any periodic reviews of the program.[425] These records would allow our staff to understand a fund's derivatives risk management program and how the fund administered it.

Second, the proposed rule would require funds to keep records of any materials provided to the fund's board of directors in connection with approving the designation of the derivatives risk manager.[426] The proposed rule would also require a fund to keep records of any written reports provided to the board of directors relating to the program, and any written reports provided to the board that the rule would require regarding the fund's non-compliance with the applicable VaR test.[427] These records would help our staff to understand what was provided to the fund's board while overseeing the fund's program.

Third, for a fund that is required to comply with the proposed VaR-based limit on fund leverage risk, the fund would have to maintain records documenting the fund's determination of: The VaR of its portfolio; the VaR of the fund's designated reference index, as applicable; the fund's VaR ratio (the value of the VaR of the fund's portfolio divided by the VaR of the designated reference index), as applicable; and any updates to any VaR calculation models used by the fund, as well as the basis for any material changes made to those models.[428] These records would provide information on the operation of a fund's VaR test and, for example, would allow our staff to better understand how a fund (and funds generally) implement the proposed VaR tests.

Fourth, the proposed rule would require a fund that is a limited derivatives user to maintain a written record of its policies and procedures that are reasonably designed to manage its derivatives risk.[429] These records would help our staff to understand what policies and procedures that a limited derivatives user has adopted and implemented to address the risks associated with its use of derivatives.

Fifth, the proposed rule would require a fund that enters into unfunded commitment agreements to maintain a record documenting the basis for the fund's belief regarding the sufficiency of its cash and cash equivalents to meet its obligations with respect to its unfunded commitment agreements.[430] A fund must make such a record each time it enters into such an agreement.[431] These records would allow our staff to understand and evaluate funds' determinations regarding their ability to meet their obligations under their unfunded commitment agreements.

Finally, the proposed rule would require funds to maintain the required records for a period of five years.[432] In particular, a fund must retain a copy of its written policies and procedures under the rule that are currently in effect, or were in effect at any time within the past five years, in an easily accessible place.[433] In addition, a fund would have to maintain all other records and materials that the rule would require the fund to keep for at least five years (the first two years in an easily accessible place).[434] The proposed five-year retention period is consistent with the period provided in rule 38a–1(d) and rule 22e–4 under the Investment Company Act. We believe consistency in these retention periods is appropriate because funds currently have compliance-program-related recordkeeping procedures in place incorporating a five-year retention period, which we believe would lessen the proposed new recordkeeping compliance burden to funds, compared to choosing a different, longer retention period.

We request comment on the proposed rule's recordkeeping requirements.

244. Are the proposed recordkeeping provisions appropriate? Are there any other records relating to a fund's derivatives transactions that a fund should be required to maintain? For example, should we also require a fund to maintain written records relating to any action the fund took after exceeding a risk guideline (or any internal reporting that occurred following the exceedance of a risk guideline)?[435] Or, as another example, should we include a provision in the proposed rule that would require a fund that enters into reverse repurchase agreements under proposed rule 18f–4(d) to maintain records documenting the fund's compliance with the applicable asset coverage requirement of section 18? Why or why not? The proposed rule would require a fund to maintain records of the VaR of its portfolio, the VaR of its designated reference index (as applicable), and its VaR ratio. To what extent would the requirement to maintain records of the fund's VaR ratio involve burdens in addition to the requirement to maintain the fund's VaR and the VaR of the designated reference index?

245. Are there feasible alternatives to the proposed recordkeeping requirements that would minimize recordkeeping burdens, including the costs of maintaining the required records, while promoting the goals of providing the Commission and its staff, and a fund's compliance personnel, sufficient information to understand: (1) A fund's derivatives risk management program and how the fund had administered it, (2) how a fund's board oversees the program, (3) the administration and effectiveness of a fund's VaR test, (4) how a limited derivatives user's policies and procedures are designed to address the risks associated with its use of derivatives, and (5) the basis for a fund's determination regarding the sufficiency

[424] Proposed rule 18f–4(c)(6)(i)(A); *see also supra* section II.B.3.

Under proposed rule 18f–4(c)(4), leveraged/inverse funds would be subject to the proposed rule's derivatives risk management program requirement. Such funds would therefore also be subject to the program-related recordkeeping provisions of the proposed rule.

[425] Proposed rule 18f–4(c)(6)(i)(A).

[426] Proposed rule 18f–4(c)(6)(i)(B); *see also supra* section II.C.

[427] *Id.; see also supra* section II.D.5.b.

[428] Proposed rule 18f–4(c)(6)(i)(C); *see also supra* section II.K.

[429] Proposed rule 18f–4(c)(6)(i)(D); *see also supra* section II.K.

[430] Proposed rule 18f–4(e)(2); *see also supra* section II.K.

[431] *Id.*

[432] Proposed rule 18f–4(c)(6)(ii); proposed rule 18f–4(e)(2).

[433] Proposed rule 18f–4(c)(6)(ii)(A); *see also supra* notes 423 and 428 and accompanying text. The retention requirement would apply to both funds that are required to implement a derivatives risk management program and funds that are limited derivatives users under proposed rule 18f–4(c)(3).

[434] Proposed rule 18f–4(c)(6)(ii)(B); proposed rule 18f–4(e)(2).

[435] *See, e.g.,* proposed rule 18f–4(c)(1)(ii), proposed rule 18f–4(c)(1)(v)(A).

of its cash to meet its obligations with respect to unfunded commitment agreements?

246. Are the record retention time periods that we have proposed appropriate? Should we require records to be maintained for a longer or shorter period? If so, for how long?

L. Transition Periods

In view of our proposal for an updated, comprehensive approach to the regulation of funds' derivatives use, we are proposing to rescind Release 10666.[436] In addition, staff in the Division of Investment Management is reviewing its no-action letters and other guidance addressing derivatives transactions and other transactions covered by proposed rule 18f–4 to determine which letters and other staff guidance, or portions thereof, should be withdrawn in connection with any adoption of this proposal. Upon the adoption of any final rule, some of these letters and other staff guidance, or portions thereof, would be moot, superseded, or otherwise inconsistent with the final rule and, therefore, would be withdrawn. If interested parties believe that additional letters or other staff guidance, or portions thereof, should be withdrawn, they should identify the letter or guidance, state why it is relevant to the proposed rule, how it or any specific portion thereof should be treated, and the reason therefor. The staff review would include, but would not necessarily be limited to, all of the staff no-action letters and other staff guidance listed below, including our staff's position regarding TOBs.[437]

- Dreyfus Strategic Investing & Dreyfus Strategic Income (pub. avail. June 22, 1987)
- Merrill Lynch Asset Management, L.P. (pub. avail. July 2, 1996)
- Robertson Stephens Investment Trust (pub. avail. Aug. 24, 1995)
- Claremont Capital Corp (pub. avail. Sept. 16, 1979)
- Emerald Mgt. Co. (pub. avail. Jan. 21, 1978)
- Sanford C. Bernstein (pub. avail. June 25, 1990)
- Hutton Options Trading, L.P. (pub. avail. Feb. 2, 1989)
- Prudential-Bache IncomeVertible Plus Fund (pub. avail. Nov. 20, 1985)
- State Street Income Fund, State Street Balanced Fund (pub. avail. Oct. 21, 1985)
- New England Life Government Securities Trust (pub. avail. Sept. 26, 1985)
- Putnam Option Income Trust II (pub. avail. Sept. 23, 1985)
- Thomson McKinnon Government Securities Fund (pub. avail. Sept. 23, 1985)
- GMO Core Trust (pub. avail. Aug. 19, 1985)
- Bartlett Capital Trust (pub. avail. Aug. 19, 1985)
- Continental Option Income Plus Fund (pub. avail. Aug. 12, 1985)
- Colonial High Yield Securities Trust, Colonial Enhanced Mortgage Trust (pub. avail. July 25, 1985)
- Putnam High Income Government Trust (pub. avail. June 3, 1985)
- Bartlett Management Trust (pub. avail. May 17, 1985)
- Drexel Series Trust—Government Securities Series (pub. avail. Apr. 25, 1985)
- Koenig Tax Advantaged Liquidity Fund (pub. avail. Mar. 27, 1985)
- Colonial Tax-Managed Trust (pub. avail. Dec. 31, 1984)
- Monitrend Fund (pub. avail. Nov. 14, 1984)
- Pilot Fund (pub. avail. Sept. 14, 1984)
- Colonial Government Securities Plus Trust (pub. avail. June 15, 1984)
- Z-Seven Fund (pub. avail. May 21, 1984)
- Pension Hedge Fund (pub. avail. Jan. 20, 1984)
- Steinroe Bond Fund (pub. avail. Jan. 17, 1984)
- IDS Bond Fund (pub. avail. Apr. 11, 1983)
- Safeco Municipal Bond, Inc (pub. avail. Nov. 26, 1982)
- ''Dear Chief Financial Officer'' Letter, from Lawrence A. Friend, Chief Accountant, Division of Investment Management (pub. avail. Nov. 7, 1997)

Accordingly, following a one-year transition period to provide time for funds to prepare to come into compliance with the new rule, funds could only enter into derivatives transactions, reverse repurchase agreements and similar financing transactions, and unfunded commitments to the extent permitted by, and consistent with the requirements of, proposed rule 18f–4 or section 18. At that time, Release 10666 would be rescinded and, as determined appropriate in connection with the staff's review of no-action letters and other staff guidance described in this release, staff no-action letters and other staff guidance, or portions thereof, would be withdrawn.

We similarly propose to provide a one-year compliance period for the sales practices rules to provide time for broker-dealers and investment advisers to bring their operations into conformity with the new rule. We also propose a one-year delay to the effective date of the amendments to rule 6c–11, which would permit leveraged/inverse ETFs to rely on that rule, and to rescind the exemptive orders we have provided to leveraged/inverse ETF sponsors on the effective date of the amendments to rule 6c–11.

We propose that each of the transition periods discussed in this section would run from the date of the publication of any final rule in the **Federal Register**. Accordingly, one year after that date: (1) Any fund that enters into the transactions permitted by rule 18f–4 would do so relying on that rule; (2) broker-dealers and investment advisers would be required to comply with the sales practices rules; and (3) leveraged/inverse ETFs could operate under rule 6c–11 and the current leveraged/inverse ETF sponsors' orders would be rescinded.

We request comment on these transition periods.

247. Do commenters agree that a one-year transition period to provide time for funds to prepare to come into compliance with proposed rule 18f–4 is appropriate? Should the period be shorter or longer?

248. Should we adopt tiered transition periods for smaller entities? For example, should we provide an additional 6 months for smaller entities (or some other shorter or longer period) in any transition period that we provide? Should the transition period be the same for all funds that rely on proposed rule 18f–4 (for example 12 months after any adoption of proposed rule 18f–4, or any shorter or longer period)?

249. Is the proposed one-year compliance period for the sales practices rules appropriate? Why or why not? Is a longer or shorter compliance period necessary to allow investment advisers and broker-dealers to comply with the proposed sales practices rules? Why or why not? If we provide small and large funds a tiered transition period to comply with proposed rule 18f–4, should we similarly implement a tiered compliance period for investment advisers and broker-dealers to comply with the proposed sales practices rules? Why or why not?

250. Would our proposal to rescind the current leveraged/inverse ETF sponsors' exemptive orders on the delayed effective date of the amendments to rule 6c–11 provide sufficient time for the leveraged/inverse

[436] *See supra* section I.C.

[437] *See* Investment Management Staff Issues of Interest, *available at https://www.sec.gov/divisions/investment/issues-of-interest.shtml#tobfinancing; see also* Registered Investment Company Use of Senior Securities—Select Bibliography, *available at https://www.sec.gov/divisions/investment/seniorsecurities-bibliography.htm.*

ETF sponsors to transition to rule 6c–11?

M. Conforming Amendments

Form N–2 requires a closed-end fund to disclose a senior securities table with certain information about any senior securities it has issued.[438] Outstanding senior securities may bear on the likelihood, frequency, and size of distributions from the fund to its investors because section 18 prohibits distributions when a closed-end fund does not have the asset coverage required under that section. Proposed rule 18f–4 would provide that a fund's derivatives transactions and unfunded commitments entered into under the proposed rule would not be considered for purposes of computing section 18 asset coverage.[439] These transactions therefore would not affect a fund's ability under section 18 to make distributions to investors. Registered closed-end funds are already required to disclose extensive information about their derivatives transactions on Form N–PORT. In light of this treatment under proposed rule 18f–4 and the information that is already available regarding registered closed-end funds' derivatives transactions, we are proposing to amend Form N–2 to provide that funds relying on proposed rule 18f–4 would not be required to include their derivatives transactions and unfunded commitment agreements in the senior securities table on Form N–2.[440] Commenters on the 2015 proposal that addressed this topic supported such a conforming amendment with respect to asset coverage calculations and disclosure.[441]

We request comment on the proposed conforming amendment to Form N–2, and other conforming amendments that commenters suggest would be necessary or appropriate.

251. Is the proposed conforming amendment appropriate? We have not proposed to exclude reverse repurchase agreements and similar financing transactions from the senior securities table in Form N–2 because these transactions may bear on the likelihood, frequency, and size of distributions from a fund to its investors. Do commenters agree that this is appropriate? Why or why not? If commenters do not believe that these transactions should be included in the senior securities table, what other disclosure would be appropriate?

252. Rule 22e–4 requires funds subject to the rule, in classifying the liquidity of their portfolios and in determining whether a fund primarily holds highly liquid investments, to take into account the fund's highly liquid investments that it has ''segregated'' to cover certain less liquid investments.[442] Proposed rule 18f–4, however, does not include an asset segregation requirement, and would supersede Release 10666 and related staff guidance. Should we remove any references in rule 22e–4 to ''segregated'' assets (while retaining rule 22e–4's references to assets pledged to satisfy margin requirements)? Is there any other basis on which funds ''segregate'' assets that would warrant our retaining these references?

253. Are there other conforming amendments to any of our other rules or forms that we should make? If so, what rules or forms should be amended and why?

III. Economic Analysis

We are mindful of the costs imposed by, and the benefits obtained from, our rules. Section 3(f) of the Exchange Act and section 2(c) of the Investment Company Act state that when the Commission is engaging in rulemaking under such titles and is required to consider or determine whether the action is necessary or appropriate in (or, with respect to the Investment Company Act, consistent with) the public interest, the Commission shall consider whether the action will promote efficiency, competition, and capital formation, in addition to the protection of investors. Further, section 23(a)(2) of the Exchange Act requires the Commission to consider, among other matters, the impact such rules would have on competition and states that the Commission shall not adopt any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. The following analysis considers, in detail, the potential economic effects that may result from the proposed rule, including the benefits and costs to investors and other market participants as well as the broader implications of the proposal for efficiency, competition, and capital formation.

A. Introduction

Funds today use a variety of derivatives, referencing a range of assets or metrics. Funds use derivatives both to obtain investment exposure as part of their investment strategies and to manage risks. A fund may use derivatives to gain, maintain, or reduce exposure to a market, sector, or security more quickly, or to obtain exposure to a reference asset for which it may be difficult or impractical for the fund to make a direct investment. A fund may use derivatives to hedge interest rate, currency, credit, and other risks, as well as to hedge portfolio exposures.[443] As funds' strategies have become increasingly diverse, funds' use of derivatives has grown in both volume and complexity over the past several decades. At the same time, a fund's derivatives use may entail risks relating to, for example, leverage, markets, operations, liquidity, and counterparties, as well as legal risks.[444]

Section 18 of the Investment Company Act is designed to limit the leverage a fund can obtain through the issuance of senior securities.[445] As discussed above, a fund's derivatives use may raise the investor protections concerns underlying section 18. In addition, funds' asset segregation practices have developed such that funds' derivatives use—and thus funds' potential leverage through derivatives transactions—does not appear to be subject to a practical limit as the Commission contemplated in Release 10666. Accordingly, we continue to be concerned that certain fund asset segregation practices may not address the concerns underlying section 18.[446]

Proposed rule 18f–4 is designed to provide an updated, comprehensive approach to the regulation of funds' use of derivatives and certain other transactions. The proposed rule would permit a fund, subject to certain conditions, to enter into derivatives or other transactions, notwithstanding the prohibitions and restrictions on the issuance of senior securities under section 18 of the Investment Company Act. We believe that the proposed rule's requirements, including the derivatives risk management program requirement and VaR-based limit on fund leverage risk, would benefit investors by mitigating derivatives-related risks, including those that may lead to unanticipated and potentially significant losses for investors.

Certain funds use derivatives in a limited manner, which we believe presents a lower degree of risk or

[438] *See* Item 4.3 of Form N–2.

[439] *See* proposed rule 18f–4(b).

[440] *See* proposed amendment to Instruction 2 of Item 4.3 of Form N–2.

[441] *See, e.g.,* Ares Comment Letter; ICI Comment Letter I.

[442] *See* rule 22e–4(b)(1)(ii)(C); rule 22e–4(b)(1)(iii)(B). A fund would also have to take into account the percentage of its highly liquid investments that it has pledged to satisfy margin requirements. *See id.*

[443] *See supra* section I.A.

[444] *See, e.g., supra* notes 16–17 and accompanying text.

[445] *See supra* section I.B.1.

[446] *See supra* sections I.B.3.

potential impact and generally a lower degree of leverage than permitted under section 18. The proposed rule would provide an exception from the proposed derivative risk management program requirement and VaR-based limit on fund leverage risk for these limited derivatives users. Instead, the proposed rule would require a fund relying on this exception to adopt policies and procedures that are reasonably designed to manage its derivatives risks. Funds with limited derivatives exposure and funds that use derivatives transactions solely to hedge certain currency risk would therefore not be required to incur costs and bear compliance burdens that may be disproportionate to the resulting benefits, while still being required to manage the risks their limited use of derivatives may present.[447]

The proposed rule would also provide an exception from the VaR-based limit on fund leverage risk for certain leveraged/inverse funds in light of the requirements under the proposed sales practices rules that broker-dealers and investment advisers exercise due diligence in approving the accounts of retail investors to invest in these funds, and other conditions for these funds that proposed rule 18f–4 includes.[448] This would allow these funds, which generally could not currently satisfy the proposed VaR-based limit on fund leverage risk, to continue offering their current strategies. The proposed sales practices rules' due diligence and account approval requirements also would apply to accounts of investors in certain exchange-listed commodity- or currency-based trusts or funds, which are not investment companies subject to section 18 but present similar investor protection concerns. We believe the proposed sales practices rules would enhance investor protection by helping to ensure that investors in these funds are limited to those who are capable of evaluating their characteristics—including that the funds would not be subject to all of the leverage-related requirements applicable to registered investment companies generally—and the unique risks they present.

Proposed rule 18f–4 also contains requirements for funds' use of certain senior securities that are not derivatives. Specifically, the proposed rule would permit reverse repurchase agreements and other similar financing transactions if they comply with the asset coverage requirements of section 18; this approach would align the treatment of reverse repurchase agreements and similar financing transactions, for section 18 purposes, with the treatment of bank borrowings and other senior securities transactions subject to section 18's asset coverage requirements.[449] In addition, the proposed rule would permit a fund to enter into unfunded commitment agreements if it reasonably believes, at the time it enters into such an agreement, that it will have sufficient cash and cash equivalents to meet its obligations with respect to all of its unfunded commitment agreements.[450] This requirement is designed to address the concern that a fund may experience losses as a result of having insufficient assets to meet its obligations with respect to these transactions, and we believe that the requirement would benefit investors by mitigating such losses or other adverse effects if a fund is unable to satisfy an unfunded commitment agreement.[451]

This proposal also includes certain recordkeeping requirements and reporting requirements for funds that use derivatives.[452] We expect that the proposed recordkeeping requirements would benefit investors by facilitating fund compliance with the proposed rule and our staff's review of funds' compliance. In addition, we expect that the proposed amendments to Forms N–PORT, N–CEN, and N–RN would further benefit investors by enhancing the Commission's and the public's understanding of the impact of funds' use of derivatives on fund portfolios, and by facilitating the Commission's ability to oversee funds' use of derivatives and compliance with the proposed rules.[453]

B. Economic Baseline

1. Fund Industry Overview

The fund industry has grown and evolved substantially in past decades in response to various factors, including investor demand, technological developments, and an increase in domestic and international investment opportunities, both retail and institutional.[454] As of September 2019, there were 9,788 mutual funds (excluding money market funds) with $21,333 billion in total net assets, 1,910 ETFs organized as an open-end fund or as a share-class of an open-end fund with $3,081 billion in total net assets, 664 registered closed-end funds with 294 billion in total net assets, and 13 variable annuity separate accounts registered as management investment companies on Form N–3 with $224 billion in total net assets. There also were 413 money market funds with $3,392 billion in total net assets.[455] Finally, as of June 2019, there were 99 BDCs with $63 billion in total net assets.[456]

2. Funds' Use of Derivatives

DERA staff analyzed funds' use of derivatives based on Form N–PORT filings as of September 2019. The filings covered 9,074 mutual funds with $19,590 billion in total net assets, 1,711 ETFs with $3,317 billion in total net assets, 565 registered closed-end funds with $327 billion in net assets, and 13 variable annuity separate accounts registered as management investment companies with $219 billion in total net assets.[457] While only larger fund groups are currently required to file reports on Form N–PORT, existing filings nevertheless covered 89% of funds representing 94% of assets.[458]

[447] *See supra* sections I.C and II.E.

[448] *See supra* section II.G.

[449] Similar financing transactions may include securities lending arrangements and TOBs, depending on the particular facts and circumstances of the individual transaction. *See supra* section II.I.

[450] *See supra* section II.J.

[451] We believe that the proposed treatment of unfunded commitment transactions is consistent with general market practices. Therefore, we believe that the proposed requirements for both types of senior securities would not have significant economic effects when measured against this baseline.

[452] *See supra* sections II.C and II.H.

[453] Because leveraged/inverse funds would not be subject to the proposed VaR-based limit on fund leverage risk, these funds would not be subject to the related proposed reporting requirements on Forms N–PORT and N–RN. Leveraged/inverse funds would, however, be subject to the proposed new reporting requirements on funds' derivatives exposure on form N–PORT as well as to the proposed new requirements on Form N–CEN.

[454] *See supra* note 1.

[455] Estimates of the number of registered investment companies and their total net assets are based on a staff analysis of Form N–CEN filings as of September 5, 2019. For open-end funds that have mutual fund and ETF share classes, we count each type of share class as a separate fund and use data from Morningstar to determine the amount of total net assets reported on Form N–CEN attributable to the ETF share class. Money market funds are excluded from the scope of proposed rule 18f–4 but may experience economic effects as a result of being excluded from the rule's scope. We therefore report their number and net assets separately from those of other mutual funds.

[456] Estimates of the number of BDCs and their net assets are based on a staff analysis of Form 10–K and Form 10–Q filings as of June 30, 2019. Our estimate includes BDCs that may be delinquent or have filed extensions for their filings, and it excludes 6 wholly-owned subsidiaries of other BDCs.

[457] The analysis is based on each registrant's latest Form N–PORT filing as of September 23, 2019. Money market funds are excluded from the analysis; they do not file monthly reports on Form N–PORT and are excluded from the scope of proposed rule 18f–4. For open-end funds that have mutual fund and ETF share classes, we count each type of share class as a separate fund and use data from Morningstar to determine the amount of total net assets reported on Form N–PORT attributable to the ETF share class.

[458] *See supra* note 280.

Based on this analysis, 59% of funds reported no derivatives holdings, and a further 27% of funds reported using derivatives with gross notional amounts below 50% of net assets. These results are comparable to and consistent with the findings of the DERA White Paper, which studied a random sample of 10% of funds in 2014.[459]

BDCs do not file Form N–PORT. To help evaluate the extent to which BDCs use derivatives, our staff reviewed the most recent financial statements of 48 of the current 99 BDCs as of September 2019.[460] Based on this analysis, we observe that most BDCs do not use derivatives extensively. Of the sampled BDCs, 54% did not report any derivatives holdings, and a further 29% reported using derivatives with gross notional amounts below 10% of net assets.

3. Current Regulatory Framework for Derivatives

Funds have developed certain general asset segregation practices to ''cover'' their derivatives positions, consistent with the conditions in staff no-action letters and guidance.[461] However, staff has observed that practices vary based on the type of derivatives transaction, and that funds use different practices regarding the types of assets that they segregate to cover their derivatives positions. For purposes of establishing the baseline, we assume that funds generally segregate sufficient assets to at least cover any mark-to-market liabilities on the funds' derivatives transactions, with some funds segregating more assets for certain types of derivatives transactions (sufficient to cover the full notional amount of the transaction or an amount between the transaction's full notional amount and any mark-to-market liability).[462] As the mark-to-market liability of a derivative can be much smaller than the full investment exposure associated with the position, funds' current use of the mark-to-market asset segregation approach, and funds' segregation of any liquid asset, do not appear to place a practical limit on their use of derivatives.[463]

4. Funds' Derivatives Risk Management Practices and Use of VaR Models

There is currently no requirement for funds that use derivatives to have a formalized derivatives risk management program. However, we understand that advisers to many funds whose investment strategies entail the use of derivatives, including leveraged/inverse funds, already assess and manage risks associated with their derivatives transactions to varying extents. In addition, we understand that funds engaging in derivatives transactions have increasingly used stress testing as a risk management tool over the past decade.[464]

We also understand that VaR calculation tools are widely available, and many advisers that enter into derivatives transactions already use risk management or portfolio management platforms that include VaR tools.[465] Advisers to funds that use derivatives more extensively may be particularly likely to currently use risk management or portfolio management platforms that include VaR capability. Moreover, advisers that manage (or that have affiliates that manage) UCITS funds may already be familiar with using VaR models in connection with European guidelines.[466] One commenter submitted the results of a survey based on responses from 24 fund complexes with $13.8 trillion in assets.[467] The results of this survey indicate that 73% of respondents used some form of both VaR and stress testing as derivatives risk management tools.

5. Leveraged/Inverse Investment Vehicles and Leveraged/Inverse Funds

Leveraged/inverse investment vehicles, as defined in the proposed sales practices rules, include leveraged/inverse funds and certain exchange-listed commodity- or currency-based trusts or funds. Currently, there are 164 leveraged/inverse ETFs with $33.9 billion in total net assets; 105 leveraged/inverse mutual funds with $4.9 billion in total net assets; and 17 exchange-listed commodity- or currency-based trusts or funds with $1.2 billion in total net assets.[468]

Leveraged/inverse investment vehicles generally target a daily return (or a return over another predetermined time period) that is a multiple, inverse, or inverse multiple of the return of an underlying index; however over longer holding periods, the realized leverage multiple of the returns of an investment in a leveraged/inverse investment vehicle relative to the returns of its underlying index can vary substantially from the vehicle's daily leverage multiple.

In addition, the returns of leveraged/inverse investment vehicles over longer holding periods share certain features with the returns of holding an option.[469] For example, a call option on an index with a strike price that is much higher than the current index price (*i.e.,* the option is significantly ''out of the money'') is likely to expire worthless. If the option expires worthless, an investor that holds the option until expiry receives no payoff in exchange for their initial investment (the option premium) and therefore experiences a return of −100%. Holding all other factors fixed, the likelihood of this outcome increases with the strike price of the option, and the option is priced accordingly—options that are further out of the money, all else equal, will have lower premiums. At the same time, on the rare occasions when the index price exceeds the strike price at expiration, the investor will earn a high return on his or her initial investment because the initial price paid for a call option is lower when the strike price is higher. While the payoff to holding a leveraged/inverse investment vehicle over long periods generally lacks this strict discontinuous nature (expiring either in the money or out of the money), it is nevertheless similar to that of an option in the sense that, as the vehicle's leverage multiple or investor's holding period increases, the likelihood of experiencing a loss increases (analogous to the option expiring out of the money) while gains, when they do occur, tend to be larger (analogous to the option expiring in the money).[470]

[459] *See* DERA White Paper, *supra* note 1.

[460] *See supra* note 279 and accompanying text.

[461] *See supra* section II.B.2.b.

[462] *See supra* notes 54–55 and accompanying text.

[463] *See supra* section I.B.2.b.

[464] *See also supra* note 145 and accompanying text.

[465] *See also supra* note 179.

[466] *See supra* note 221 and accompanying text.

[467] *See* ICI Comment Letter III. The commenter also indicated that the surveyed ICI member firms accounted for 67% of mutual fund and ETF assets as of June 2019 and that survey responses were submitted by firms ''whose assets under management spanned the spectrum from small to very large.'' However, these representations alone do not provide sufficient information about whether the surveyed firms were representative of all mutual funds and ETFs in terms of the exact distribution of specific characteristics, such as firm size or type of investment strategy.

[468] Estimates of the number of leveraged/inverse mutual funds and leveraged/inverse ETFs and their total net assets are based on a staff analysis of Form N–CEN filings as of September 5, 2019. Estimates of the number of exchange-listed commodity- or currency-based trusts or funds and their total net assets are based on Bloomberg data as of September 20, 2019.

[469] For a technical analysis of the similarities between the returns of leveraged/inverse ETFs over longer holding periods and the returns of holding an option, *see* Division of Economic and Risk Analysis, Economics Note: The Distribution of Leveraged ETF Returns (Nov. 2019), *available at https://www.sec.gov/files/DERA_LETF_Economics_Note_Nov2019.pdf.* The results of that analysis also apply more generally to other types of leveraged/inverse investment vehicles.

[470] In statistical terms, the option returns and returns of holding leveraged/inverse investment vehicles over longer holding periods both exhibit positive skewness.

To achieve the stated leverage multiple, most leveraged/inverse investment vehicles rebalance their exposure to the underlying index daily.[471] This is also similar to options, whose payoffs can be replicated by trading dynamically in the underlying asset and a low-risk bond. For example, call options are economically equivalent to holding a long position in the underlying asset and a short position in a low-risk bond.[472] Both leveraged/inverse investment vehicles and options are therefore economically equivalent to a dynamically rebalanced leveraged/inverse or inverse leveraged/inverse position in the underlying asset or reference index.[473]

The majority of assets held in leveraged/inverse funds are held in leveraged/inverse ETFs. There are currently two ETF sponsors that rely upon exemptive relief from the Commission that permits them to operate leveraged/inverse ETFs.[474] Since 2009, the Commission has not granted leveraged/inverse exemptive relief to any additional sponsors. In addition, leveraged/inverse ETFs are currently excluded from the scope of rule 6c–11, which the Commission adopted earlier this year and which allows ETFs satisfying certain conditions to operate without obtaining an exemptive order from the Commission.[475]

Retail investors predominantly purchase and sell shares of leveraged/inverse investment vehicles through broker-dealers and investment advisers.[476] To the extent that broker-dealers or investment advisers recommend leveraged/inverse investment vehicles to their customers or clients, they should have processes in place to satisfy their obligations to make only suitable recommendations or provide best interest advice, respectively.[477] For example, the basis for an investment adviser's reasonable understanding generally would include, for retail clients of investment advisers, a reasonable inquiry into the client's financial situation, level of financial sophistication, investment experience, and financial goals.[478] When an adviser is assessing whether complex or high-risk products—such as leveraged/inverse funds—are in a retail client's best interest, the adviser should generally apply heightened scrutiny to whether such investments fall within the retail client's risk tolerance and objectives.[479] Broker-dealers also will be required to comply with Regulation Best Interest beginning on June 30, 2020.[480] Broker-dealers complying with Regulation Best Interest will have to exercise reasonable diligence, care, and skill when making a recommendation to a retail customer, including by understanding potential risks, rewards, and costs associated with a recommendation in light of the customer's investment profile.[481]

C. Benefits and Costs of the Proposed Rules and Amendments

The Commission is sensitive to the economic effects that may result from the proposed rules and rule and form amendments, including benefits and costs. Where possible, we have attempted to quantify the likely economic effects; however, we are unable to quantify certain economic effects because we lack the information necessary to provide reasonable estimates. In some cases, it is difficult to predict how market participants would act under the conditions of the proposed rules. For example, we are unable to predict whether the proposed derivatives risk management program requirement and VaR-based limit on fund leverage risk may make investors more or less likely to invest in funds that would be subject to these requirements or the degree to which these requirements may affect the use of derivatives by these funds. Nevertheless, as described more fully below, we are providing both a qualitative assessment and quantified estimate of the economic effects, including the initial and ongoing costs of the additional reporting requirements, where feasible.

Direct costs incurred by funds discussed below may, to some extent, be absorbed by the fund's investment adviser or be passed on to investors in the form of increased management fees. The share of these costs borne by funds, their advisers, and investors depends on multiple factors, including the nature of competition between advisers, and investors' relative sensitivity to changes in fund fees, the joint effects of which are particularly challenging to predict due to the number of assumptions that the Commission would need to make.

1. Derivatives Risk Management Program and Board Oversight and Reporting

Proposed rule 18f–4 would require funds that enter into derivatives transactions and are not limited derivatives users to adopt and implement a derivatives risk management program. The program would provide for the establishment of risk guidelines that must include certain elements, but that are otherwise tailored based on how the fund's use of derivatives may affect its investment portfolio and overall risk profile. The program also would have to include stress testing, backtesting, internal reporting and escalation, and program review elements. The proposed rule would require a fund's board of directors to approve the fund's designation of a derivatives risk manager, who would be responsible for administering the derivatives risk management program. The fund's derivatives risk manager would have to report to the fund's board on the derivatives risk management program's implementation and effectiveness and the results of the fund's stress testing and backtesting.

We understand that advisers to many funds whose investment strategies entail the use of derivatives already assess and manage risks associated with their derivatives transactions.[482] However, proposed rule 18f–4's requirement that funds establish written derivatives risk management programs would create a standardized framework for funds'

[471] Leveraged/inverse investment vehicles that track the returns of an underlying index over time periods that are longer than one day rebalance their portfolios at the end of each such period. Leveraged/inverse investment vehicles use derivatives to achieve their targeted returns.

[472] Conversely, put options are economically equivalent to holding a short position in the underlying and a long position in a low-risk bond—their replicating portfolio consists of an inverse leveraged position in the underlying.

[473] Option replication portfolios need to be rebalanced continuously throughout the day as the price of the underlying asset changes. While the implied rebalancing happens continuously during the trading day for options, leveraged/inverse investment vehicles perform rebalancing trades in the underlying less frequently (daily for most leveraged/inverse investment vehicles).

[474] *See supra* notes 307 and 356. The exemptive orders of the two sponsors that operate leveraged/inverse ETFs permit these sponsors to launch additional funds under the terms and conditions of those orders.

[475] *See supra* notes 352–353 and accompanying text.

[476] *See supra* note 321.

[477] Following the June 30, 2020 compliance date for Regulation Best Interest, broker-dealers will have to provide recommendations in the best interest of their retail customers. *See* Regulation Best Interest: The Broker-Dealer Standard of Conduct, *supra* note 308.

[478] *See, e.g.,* Fiduciary Interpretation, *supra* note 308, at text preceding n.36.

[479] *See id.* at text preceding n.39. The Commission further stated in the Fiduciary Interpretation that leveraged/inverse funds and other complex products ''may not be in the best interest of a retail client absent an identified, short-term, client-specific trading objective and, to the extent that such products are in the best interest of a retail client initially, they would require daily monitoring by the adviser.'' *See id.*

[480] *See* Regulation Best Interest: The Broker-Dealer Standard of Conduct, *supra* note 305.

[481] *See id.* at section II.C.2.

[482] *See supra* section III.B.4.

derivatives risk management by requiring each fund's program to include all of the proposed program elements. To the extent that the resulting risk management activities are more comprehensive than funds' current practices, this may result in more-effective risk management across funds. While the adoption of a derivatives risk management program requirement may not eliminate all derivatives-related risks, including that investors could experience large, unexpected losses from funds' use of derivatives, we expect that investors would benefit from a decrease in leverage-related risks.

Some funds may reduce or otherwise alter their use of derivatives transactions to respond to risks identified after adopting and implementing their risk management programs. In particular, we expect that funds currently utilizing risk management practices that are not tailored to their use of derivatives may decide to make such changes to their portfolios.[483]

The proposed rule would require a fund to reasonably segregate the functions of its derivatives risk management program from those of its portfolio management.[484] This segregation requirement is designed to enhance the program's effectiveness by promoting the objective and independent identification and assessment of derivatives risk.[485] Segregating the functions of a fund's derivatives risk management program from those of its portfolio management may also mitigate the risks of competing incentives between a fund's portfolio managers and its investors.[486]

Finally, to the extent that the periodic stress testing and backtesting requirements of the proposed derivatives risk management program result in fund managers developing a more complete understanding of the risks associated with their use of derivatives, we expect that funds and their investors will benefit from improved risk management.[487] Such benefits would be in addition to benefits derived from the proposed VaR-based limit on fund leverage risk discussed below.[488] VaR analysis, while yielding a simple yet general measure of a fund's portfolio risk, does not provide a complete picture of a fund's financial risk exposures.[489] Complementing VaR analysis with stress testing would provide a more complete understanding of the fund's potential losses under different sets of market conditions. For example, simulating potential stressed market conditions not reflected in historical correlations between fund returns and asset prices observed in normal markets may provide derivatives risk managers with important information pertaining to derivatives risks in stressed environments.[490] By incorporating the potential impact of future economic outcomes and market volatility in its stress test analysis, a fund may be able to analyze future potential swings in its portfolio that may impact the fund's long-term performance. This forward-looking aspect of stress testing would supplement the proposed rule's VaR analysis requirement, which would rely on historical data.

In addition, requiring that a fund backtest the results of its VaR analysis each business day would assist funds in examining the effectiveness of the fund's VaR model. The proposed rule would require that, each business day, the fund compare its actual gain or loss for that business day with the fund's VaR calculated for that day.[491] This comparison would help identify days where the fund's portfolio losses exceed the VaR calculated for that day, as well as systematic over- or under-estimation of VaR suggesting that the fund may not be accurately measuring all significant, identifiable market risk factors.[492]

Proposed rule 18f–4 would also require that a fund's board of directors approve the designation of the fund's derivatives risk manager, taking into account the derivatives risk manager's relevant experience.[493] We anticipate that this requirement, along with the derivatives risk manager's direct reporting line to the board, would result in effective communication between the board and the derivatives risk manager that would enhance oversight of the program to the benefit of the fund and its investors.

Proposed rule 18f–4 would require that the derivatives risk manager provide the fund's board a written report at least once a year on the program's effectiveness as well as regular written reports at a frequency determined by the board that analyze exceedances of the fund's risk guidelines and present the results of the fund's stress tests and backtests.[494] The proposed board reporting requirements may facilitate the board's oversight of the fund and the operation of the derivatives risk management program, to the extent the fund does not have such regular reporting mechanisms already in place. In the event the derivatives risk manager encounters material risks that need to be escalated to the fund's board, the proposed provision that the derivatives risk manager may directly inform the board of these risks in a timely manner as appropriate may help prevent delays in resolving such risks.

Funds today employ a range of different practices, with varying levels of comprehensiveness and sophistication, for managing the risks associated with their use of derivatives.[495] We expect that compliance costs associated with the proposed derivatives risk management program requirement would vary based on the fund's current risk management practices, as well as the fund's characteristics, including in particular

[483] As a consequence of reducing risk, such funds may earn reduced returns.

[484] *See supra* section II.B.2.

[485] *See supra* note 112 and accompanying text. While some portfolio managers may find it burdensome to collaborate with a derivatives risk manager, to the extent that portfolio managers already consider the impact of trades on the fund's portfolio risk, we believe that having the involvement of a derivatives risk manager may typically make a portfolio manager's tasks more rather than less efficient.

[486] For example, portfolio managers of actively-managed funds that are underperforming competing funds may have an incentive to increase risk exposures through use of derivatives in an effort to increase returns. This behavior may result in a fund also increasing risk beyond investor expectations. (For theoretical motivation of such behaviors *see, e.g.,* Keith C. Brown, W.V. Harlow, & Laura T. Starks, *Of Tournaments and Temptations: An Analysis of Managerial Incentives in the Mutual Fund Industry,* 51 Journal of Finance 85 (1996), *available at https://www.onlinelibrary.wiley.com/doi/abs/10.1111/j.1540-6261.1996.tb05203.x*; Judith Chevalier & Glenn Ellison, *Risk-Taking by Mutual Funds as a Response to Incentives,* 105 Journal of Political Economy 1167 (1997), *available at https://www.jstor.org/stable/10.1086/516389?seq=1#metadata_info_tab_contents*).

[487] *See supra* sections II.B.3.c and II.B.3.d; *see also supra* section II.C.2 (discussing the proposed requirements that a fund's derivatives risk manager provide to the fund's board: (1) A written report, at least annually, providing a representation that the program is reasonably designed to manage the fund's derivatives risks and to incorporate the required elements of the program (including a review of the VaR calculation model used by the fund under proposed rule 18f–4(c)(2), and the backtesting required by proposed rule 18f–4(c)(1)(iv)); and (2) a written report, at the frequency determined by the board, regarding any exceedances of the fund's risk guidelines and the results of the fund's stress tests).

[488] *See infra* section III.C.2.

[489] *See id.*

[490] *See supra* section II.B.3.c (proposed rule 18f–4 would require the program to provide for stress testing to ''evaluate potential losses to the fund's portfolio in response to extreme but plausible market changes or changes in market risk factors that would have a significant adverse effect on the fund's portfolio, taking into account correlations of market risk factors as appropriate and resulting payments to derivatives counterparties'').

[491] *See supra* section II.B.3.d.

[492] *See supra* notes 150–151 and accompanying text.

[493] *See supra* section II.C.1.

[494] *See supra* section II.C.2.

[495] *See supra* section III.B.4.

the fund's investment strategy, and the nature and type of derivatives transactions used by the fund.

We understand that VaR models are widely used in the industry and that backtesting is commonly performed in conjunction with VaR analyses. As a result, we believe that many funds that would be required to establish derivatives risk management programs already have VaR models with backtesting in place. Moreover, the proposed rule's derivatives risk management program requirements, including stress testing and backtesting requirements are, generally, high-level and principles-based. As a result, it is likely that many funds' current risk management practices may already be in line with many of the proposed rule's derivatives risk management program requirements or could be readily conformed without material change. Thus, the costs of adjusting funds current' practices and procedures to comply with the parallel requirements of proposed rule 18f–4 may be minimal for such funds.

Certain costs of the proposed derivatives risk management program may be fixed, while other costs may vary with the size and complexity of the fund and its portfolio allocation. For instance, costs associated with purchasing certain third-party data used in the program's stress tests may not vary much across funds. On the other hand, certain third-party services may vary in terms of costs based on the portfolio positions to be analyzed. Further, the extent to which a cost corresponding to the program is fixed or variable may also depend on the third-party service provider.

Larger funds or funds that are part of a large fund complex may incur higher costs in absolute terms but find it less costly, per dollar managed, to establish and administer a derivatives risk management program relative to a smaller fund or a fund that is part of a smaller fund complex. For example, larger funds may have to allocate a smaller portion of existing resources for the program, and fund complexes may realize economies of scale in developing and implementing derivatives risk management programs for several funds.[496]

For funds that do not already have a derivatives risk management program in place that could be readily adapted to meet the proposed rule's requirements without significant additional cost, we estimate that the one-time costs to establish and implement a derivatives risk management program would range from $70,000 to $500,000 per fund, depending on the particular facts and circumstances, including whether a fund is part of a larger fund complex and therefore may benefit from economies of scale. These estimated costs are attributable to the following activities: (1) Developing risk guidelines and processes for stress testing, backtesting, internal reporting and escalation, and program review; (2) integrating and implementing the guidelines and processes described above; and (3) preparing training materials and administering training sessions for staff in affected areas.

For funds that do not already have a derivatives risk management program in place that could be readily adapted to meet the proposed rule's requirements without significant additional cost, based on our understanding, we estimate that the ongoing annual program-related costs that a fund would incur range from 65% to 75% of the one-time costs to establish and implement a derivatives risk management program. Thus, a fund would incur ongoing annual costs that range from $45,500 to $375,000.[497] These estimated costs are attributable to the following activities: (1) Assessing, monitoring, and managing the risks associated with the fund's derivatives transactions; (2) periodically reviewing and updating (A) the program including any models or measurement tools (including any VaR calculation models) to evaluate the program's effectiveness and to reflect changes in risk over time, and (B) any designated reference index to evaluate its appropriateness; (3) providing written reports to the fund's board on the derivatives risk management program's implementation and effectiveness and the results of the fund's stress testing; and (4) additional staff training.

Under the proposed rule, a fund that is a limited derivatives user would not be required to establish a derivatives risk management program.[498] Based on an analysis of Form N–PORT filings, as well as financial statements filed with the Commission by BDCs, we estimate that about 22% of funds that would be subject to the proposed rule, or 2,693 funds total, would be required to implement a risk management program.[499] As many funds belong to a fund complex and are likely to experience economies of scale, we expect that the lower end of the estimated range of costs ($70,000 in one-time costs; $45,500 in annual costs) better reflects the total costs likely to be incurred by those funds.[500] In addition, we believe that many funds already have a derivatives risk management program in place that could be readily adapted to meet the proposed rule's requirements without significant additional cost.[501] However, as we do not have data to determine how many funds already have a program in place that would substantially satisfy the proposed rule's requirements, we over-inclusively assume that all funds would incur a cost associated with this requirement. Based on these assumptions, we provide an upper-end estimate for total industry cost in the first year of $311,041,500.[502]

2. VaR-Based Limit on Fund Leverage Risk

The proposed rule would generally impose a VaR-based limit on fund leverage risk on funds relying on the rule to engage in derivatives transactions.[503] This outer limit would be based on a relative VaR test or, if the fund's derivatives risk manager is unable to identify an appropriate designated reference index, an absolute VaR test. In either case a fund would apply the test at least once each business day. The proposed rule would include an exception from the limit on

[496] Although we believe that many funds have existing risk officers whose role extends to managing derivatives risks, we note that some funds, and in particular smaller funds or those that are part of a smaller fund complex, may not have existing personnel capable of fulfilling the responsibilities of the derivatives risk manager, or may choose to hire a new employee or employees to fulfill this role, rather than assigning that responsibility to a current employee or officer of the fund or the fund's investment adviser. We expect that a fund that would hire new employees would likely incur larger costs compared to a fund that has existing employees that could serve as a fund's derivatives risk manager.

[497] This estimate is based on the following calculations: 0.65 × $70,000 = $45,500; 0.75 × $500,000 = $375,000.

[498] The estimates of the one-time and ongoing costs described in this section include the costs associated with determining whether a fund is a limited derivatives user.

[499] We estimate that about 22% of all funds that would be subject to the proposed rule hold some derivatives and would not qualify as a limited derivatives user under the proposed rule.

[500] A fund that uses derivatives in a complex manner, has existing risk management practices that are not commensurate with such use of derivatives, and may have to hire additional personnel to fulfill the role of derivatives risk manager would be particularly likely to experience costs at the upper end of this range.

[501] One commenter indicated that implementing stress testing, which would be one of the required elements of the proposed derivatives risk management program, would be only slightly burdensome for 27% of respondents to a survey of ICI member firms and would be moderately burdensome for an additional 50% of respondents. *See* ICI Comment Letter III; *see also supra* note 466.

[502] This estimate is based on the following calculation: 2,693 funds × ($70,000 + $45,500) = $311,041,500.

[503] *See supra* section II.D.

fund leverage risk for limited derivatives users and also certain funds that are ''leveraged/inverse investment vehicles,'' as defined in the proposed sales practices rules.[504]

The proposed relative VaR test would limit a fund's VaR to 150% of the VaR of the fund's designated reference index.[505] The designated reference index would have to be unleveraged and reflect the markets or asset classes in which the fund invests.[506] Therefore, the relative VaR test restricts the incremental risk associated with a fund's portfolio relative to a similar but unleveraged investment strategy. In this sense, the relative VaR test restricts the degree to which a fund can use derivatives to leverage its portfolio.

We recognize that the derivatives risk managers of some funds may not be able to identify an appropriate designated reference index.[507] As these funds would not be able to comply with the proposed relative VaR test, the proposed rule would require these funds to comply with the proposed absolute VaR test instead.[508] To comply with the absolute VaR test, the VaR of the fund's portfolio must not exceed 15% of the value of the fund's net assets. The level of loss in the proposed absolute VaR test would provide approximately comparable treatment for funds that rely on the absolute VaR test and funds that rely on the relative VaR test and use the S&P 500 as their designated reference index during periods where the S&P 500's VaR is approximately equal to the historical mean.[509]

One common critique of VaR is that it does not reflect the conditional distribution of losses beyond the specified confidence level.[510] In other words, the proposed VaR tests would not capture the size and relative frequency of losses in the ''tail'' of the distribution of losses beyond the measured confidence level.[511] As a result, two funds with the same VaR level could differ significantly in the magnitude and relative frequency of extreme losses, even though the probability of a VaR breach would be the same for the two funds. To demonstrate this limitation of VaR, we construct a simplified portfolio with an equity investment that also achieves leverage through derivatives. By varying the type of derivatives included in the portfolio, we illustrate that the tail risk varies significantly across portfolios with equal VaR.

The details of the strategy are as follows. Assume a fund has initial assets of $100 in cash. On day t, the manager of the portfolio achieves the additional leverage by writing $ X worth of put options, and then invests the proceeds from the sale of the options and the initial cash balance, *i.e.*, $(100 + X), into the S&P 500 index.[512] For simplicity, we further assume that the underlying asset of the shorted put options is also the S&P 500 index, so that the fund's designated reference index is the S&P 500. The maturity of the put option is assumed to be one month, and the price of the S&P on day t is normalized to $100. On day $t + 1$, the manager buys back the put options and realizes the returns of the strategy. The one-day gross return of the fund can be described mathematically as

$$R_{Fund} = \frac{100 + X}{100} R_M - \frac{X}{100} R_{put},$$

where R_M is the gross one-day return of the S&P 500 index, and $R_{put} = P(t + 1)/P(t)$ is the gross one-day return of the put option, with the price of the put option at time t denoted by $P(t)$. The return of the put option depends on the return of the underlying sset, and the money-ness of the put—the lower the strike price, the more out-of-the-money is the put. In our exercise, we look at three options with three different strike prices, ranging from more out-of-the-money to at-the-money. The strike prices, denoted by K, are equal to K = 92%, K = 96%, and K = 100%, of the current level of the S&P 500 index respectively.[513] Assuming the portfolio manager wants to achieve as much leverage as possible with each of the three options, while still abiding by the proposed limit set by the relative VaR level of 150% at a 99% confidence level, we calculate the amount of puts she would short, the expected returns of the three portfolios, and the relative VaR for confidence levels of 95%, 99%, and 99.9%. In our calculation, the model is calibrated to approximately match the historical return distribution of the S&P 500. Returns are assumed to be normally distributed (for simplicity) with an annualized mean return of 6% and an annual standard deviation of roughly 16%. The latter implies a daily standard deviation of 1%. For simplicity, the risk-free rate is assumed to be zero. The results are in Table 1.

TABLE 1—PORTFOLIO COMPOSITION, RETURNS AND VAR LEVELS

	K = 92% Portfolio	K = 96% Portfolio	K = 100% Portfolio
Portfolio Weight	−0.58%	−0.93%	−1.54%
Number of Contracts	−9.92	−2.05	−0.84
Fund Expected Return	6.68%	7.00%	7.30%
Fund Relative VaR (99%)	1.49	1.49	1.49
Fund Relative VaR (99.9%)	2.14	2.07	2.03

[504] *See supra* sections II.E and II.G.3.

[505] *See supra* section II.D.2.

[506] *See supra* section II.D.2.a. The proposed definition of ''designated reference index'' also includes other requirements, as discussed above. *See id.* For example, a designated reference index could not be administered by an organization that is an affiliated person of the fund, its investment adviser, or principal underwriter, or created at the request of the fund or its investment adviser, unless the index is widely recognized and used.

[507] *See supra* section II.D.3.

[508] Whether a fund complies with the proposed relative or absolute VaR test would depend on whether the fund's derivatives risk manager would be able to identify a designated reference index that is appropriate for the fund taking into account the fund's investments, investment objectives, and strategy. *See id.* We therefore anticipate that industry norms that reflect the availability of an appropriate designated reference index would develop under which funds with similar strategies would generally comply with the same type of VaR test (that is, either the proposed relative VaR test or the proposed absolute VaR test).

[509] *See supra* section II.D.3.

[510] *See supra* note 181 and accompanying text.

[511] The term ''relative frequency'' here refers to the frequency of loss outcomes in the tail of the distribution relative to other loss outcomes that are also in the tail of the distribution. This relative frequency of the loss outcomes together with the magnitude of the associated losses describe the conditional distribution of losses in the tail of the distribution.

[512] This strategy could be implemented by either investing in the constituent securities of the S&P 500 directly or, for example, by investing in an ETF that tracks the S&P 500 index.

[513] Given the historical volatility of the S&P 500—approximately 16% annually, or 1% daily—an 8% daily drop in the price is an 8 standard deviation event. Therefore, an option with a strike price of 92% of the current value of the S&P 500 index could be considered a deep out-of-the-money option.

Relative VaR levels are identical and no greater than 150% for all three portfolios at the 99% confidence level and, as expected, for each portfolio relative VaR is higher for higher confidence levels. However, this example illustrates that relative VaR varies across these portfolio for confidence levels above 99%. The fund writing the more out-of-the-money option ($K = 92\%$) is riskier in the tail of the S&P 500 return distribution (when the S&P 500 drops over the one-day period) than the fund writing the at-the-money option ($K = 100\%$), but the relative VaR level at the 99% confidence level does not reflect this difference.

Figure 1 shows the daily return profile of the three portfolios as a function of daily returns to the S&P 500 index. Along the x-axis are daily returns to the S&P 500 index, ranging from −8% to +8%. The dotted line represents the daily return profile of a portfolio that tracks 1.5 times the returns of the S&P 500 index. The figure shows that the degree of tail risk differs across portfolios. While the returns to all portfolios are equal at the 150% relative VaR limit at a 99% confidence level, returns beyond the 150% relative VaR limit are lower for portfolios that write puts that are further out-of-the-money.

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FIGURE 1: DAILY PORTFOLIO RETURNS

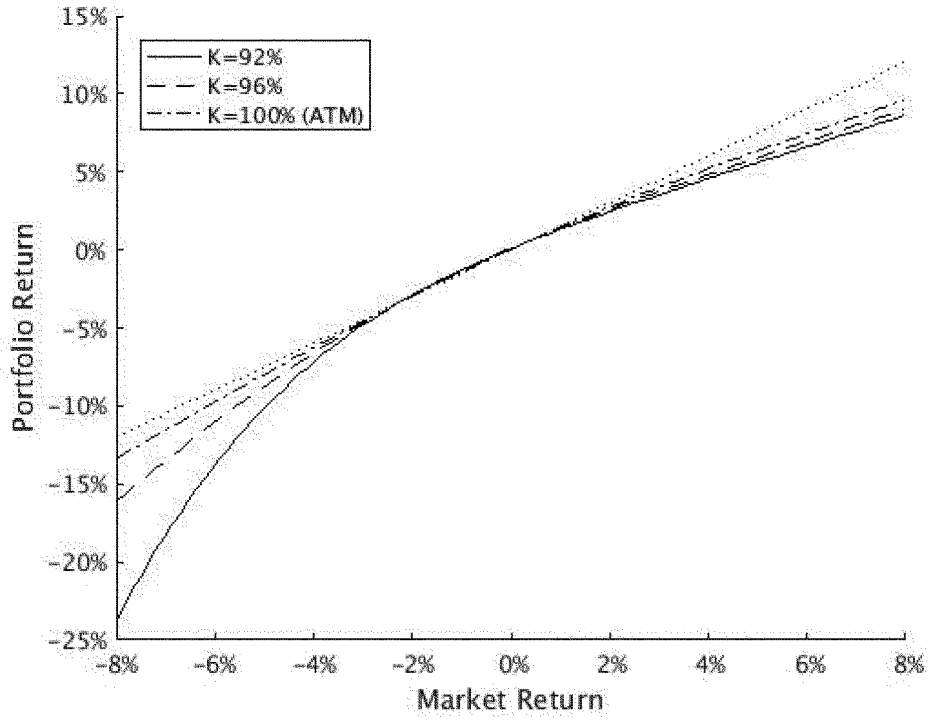
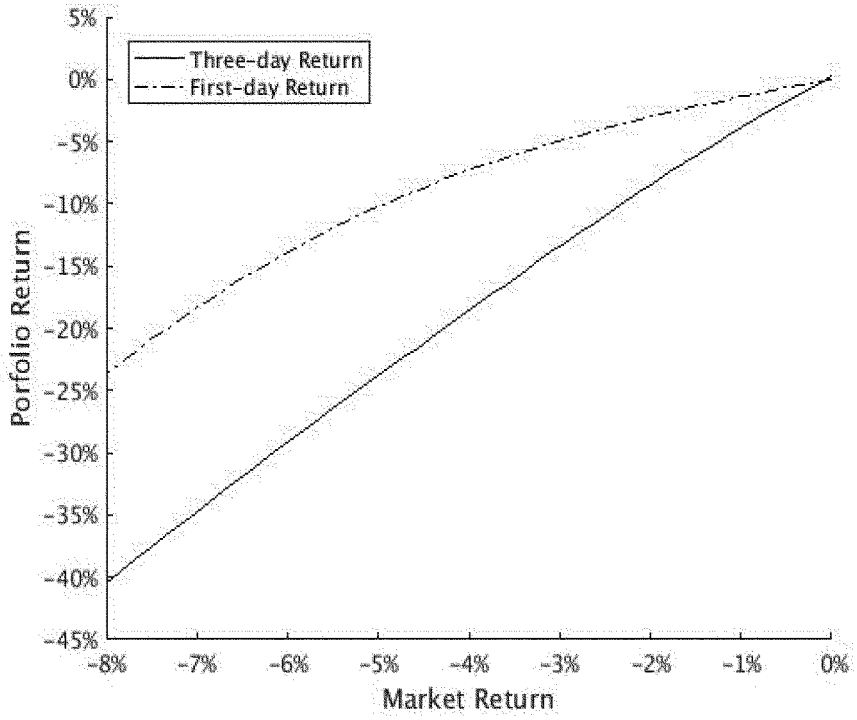


FIGURE 2: THREE-DAY RETURNS WITH DAILY REBALANCING



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We also considered the effect that a decline in the S&P 500 over three consecutive days would have on the fund that is short the put options with a $K = 92\%$ strike price considered above. The proposed rule requires that a fund determine its compliance with the applicable VaR test at least once each business day. In computing three-day returns for the fund, we assume that, as the fund exceeds the relative

VaR test each business day, the fund rebalances its portfolio, at the beginning of each day, to bring the fund back into compliance with the 150% relative VaR limit. The solid line in Figure 2 shows the three-day cumulative return of the fund as a function of the per-day returns of the S&P 500 on the x-axis, which is assumed to be the same for three consecutive days. The dashed curve in Figure 2 shows the corresponding first-day returns of the portfolio for comparison, which are the same as those denoted by the solid line in Figure 1. The figure shows that the three-day cumulative returns shown by the solid curve (in Figure 2) are less than three times the single-day losses shown by the dashed curve. This is a result of the daily rebalancing of the portfolio, which, in this example, reduces the incremental downside risk over time.

As discussed in more detail above, the proposed VaR tests are designed to address the concerns underlying section 18, but they are not a substitute for a fully-developed derivatives risk management program.[514] Recognizing VaR's limitations, the proposed rule also would require the fund to adopt and implement a derivatives risk management program that, among other things, would require the fund to establish risk guidelines and to stress test its portfolio in part because of concerns that VaR as a risk management tool may not adequately reflect tail risks.

DERA staff analyzed the VaR levels of the portfolios of all funds that would be subject to the proposed rule and of certain benchmark indexes as of December 2018 in order to estimate how many of the funds that would be subject to the proposed VaR-based limit on fund leverage risk currently operate in exceedance of that limit.[515] This analysis identified only six funds that would be subject to the proposed limit that DERA staff estimated may fail the relative VaR test. In the case of these six funds, DERA staff calculated the relative VaR test using the primary benchmark disclosed in the funds' prospectuses. To the extent that these funds' derivatives risk managers were to determine that a different index would be more appropriate for purposes of computing the relative VaR test or that no appropriate designated reference index were available, some or all of these funds could be compliant with the VaR-based limit on fund leverage risk either under the relative VaR test with a more appropriate index or under the absolute VaR test.[516] As a result, we estimate that there would only be a very small number of funds, if any, that would have to adjust their portfolios in order to comply with the VaR-based limit on fund leverage risk. This is consistent with the VaR-based limit on fund leverage risk functioning as an outer bound on fund leverage risk.

To the extent that there are funds that would have to adjust their portfolios to comply with the VaR-based limit on fund leverage risk, these funds would incur associated trading costs. If there were a fund that would have to adjust its portfolio so significantly that it could no longer pursue its investment strategy, such a fund may also lose investors or, if it chooses to cease operating, incur costs associated with unwinding the fund.

In addition, funds could be required to adjust their portfolios to comply in the future and, if so, would incur associated trading costs. For example, as market conditions change, a fund's VaR could exceed the proposed limits, especially if a fund relies on the absolute VaR test. The proposed VaR tests also would eliminate the flexibility that funds currently have to leverage their portfolios to a greater extent than the proposed VaR tests would permit. Although funds currently may not be exercising this flexibility, they may nevertheless value the ability to so increase leverage in the future. While, on the one hand, the proposed VaR tests impose costs on funds by restricting the strategies they may employ, the proposed limit on fund leverage risk would benefit fund investors, to the extent that it would prevent these investors from experiencing unexpected losses from a fund's increased risk exposure that are prevented by the proposed VaR-based limit on fund leverage risk.

By establishing a bright-line limit on the amount of leverage risk that a fund can take on using derivatives, the proposed rule may make some funds and their advisers more comfortable with using derivatives. As a result, some funds that currently invest in derivatives to an extent that would result in the fund's VaR being below the proposed limit may react by increasing the extent of their derivatives usage.

The proposed requirement could also indirectly result in changing the amount of investments in funds. On the one hand, the proposed rule could attract additional investment, if investors become more comfortable with funds' general level of riskiness as a result of funds' compliance with an outside limit on fund leverage risk. On the other hand, to the extent that investors currently expect funds to limit their risk to levels below those which the proposed limits would produce (which investors could observe from the required VaR reporting requirements on form N–PORT for funds other than limited derivatives users and leveraged/inverse funds), or investors see funds' general level of riskiness increasing after funds come into compliance with the proposed limits, the proposed limits may result in investors re-evaluating how much risk they are willing to take and reducing their investments in funds. Due to a lack of data regarding current investor expectations about fund risk, however, we are unable to predict which of the two effects would more likely dominate the other.

As the proposed requirements would prevent funds from offering investment strategies that exceed the proposed outer limit on fund leverage risk, those investors who prefer to invest in such funds because they value the increased potential for gains that is generally associated with riskier investment strategies may see their investment opportunities restricted by the proposed rules. As a result, such investors may instead invest in alternative investment vehicles, exchange-traded notes, or structured products, which can provide leveraged market exposure but would not be subject to the VaR-based limit on fund leverage risk of rule 18f–4.[517] Alternatively, such investors, particularly institutional ones, may instead borrow themselves or trade on margin to achieve leverage.

Funds that would be subject to the proposed VaR-based limit on fund leverage risk would incur the cost of determining their compliance with the applicable VaR test at least once each business day. Part of these costs would be associated with obtaining the necessary data required for the VaR calculation. Funds implementing the relative VaR test would likely incur larger data costs compared to funds implementing the absolute VaR test, as

[514] *See supra* note 183 and accompanying text.

[515] This analysis is based on Morningstar data as of December 31, 2018. DERA staff computed the VaR of each fund and that of a reference index using historical simulation from three years of prior daily return data. Staff generally computed the relative VaR test based on a fund's primary prospectus benchmark. In cases where historical return data for the primary prospectus benchmark was not available or where the primary prospectus benchmark did not appear to capture the markets or asset classes in which a fund invests, DERA staff instead used a broad-based unleveraged index that captures a fund's markets or asset classes or a broad-based U.S. equity index.

[516] Based on our analysis, we estimate that only one of the six funds that we identified may fail the proposed relative VaR test would also fail the proposed absolute VaR test.

[517] *See supra* section III.C.5.

the absolute VaR test would require funds to obtain data only for the VaR calculation for the fund's portfolio, whereas the relative VaR test also would require funds to obtain data for the VaR calculation for their designated reference index. In addition, some index providers may charge licensing fees to funds for including indexes in their disclosure documents or for access to information about the index's constituent securities and weightings.[518]

Funds that do not already have systems to perform the proposed VaR calculations in place would also incur the costs associated with setting up these systems or updating existing systems.[519] Both the data costs and the systems costs would likely be larger for funds that use multiple types of derivatives, use derivatives more extensively, or otherwise have more complicated derivatives portfolios, compared to funds with less complicated derivatives portfolios.

Larger funds or funds that are part of a large fund complex may incur higher costs in absolute terms but find it less costly, per dollar managed, to perform VaR tests relative to a smaller fund or a fund that is part of a smaller fund complex. For example, larger funds may have to allocate a smaller portion of existing resources for the VaR test and fund complexes may realize economies of scale in implementing systems to compute VaR. In particular, the costs associated with implementing or updating systems to calculate VaR would likely only be incurred once at the level of a fund complex, as such systems can be used to perform VaR tests for all funds in the complex that are subject to the VaR test requirement. Similarly, larger fund complexes may incur lower costs associated with purchasing data per fund, to the extent that the VaR calculations for multiple funds in the complex partially or completely require the same data.

Under the proposed rule, a fund that holds derivatives that is either a limited derivatives user or a leveraged/inverse fund that complies with the alternative requirements for leveraged/inverse investment vehicles would not be subject to the proposed VaR-based limit on fund leverage risk. Based on an analysis of Form N–PORT filings and financial statements filed with the Commission by BDCs, we estimate that about 19% of funds that would be subject to the proposed rule, or 2,424 funds total, would be required to implement VaR tests.[520] We estimate that the incremental annual cost associated with the VaR test would range from $5,000 to $100,000 per fund, depending on the particular facts and circumstances, including whether the fund currently computes VaR; whether the fund is implementing the relative or absolute VaR test; and whether a fund that is part of a larger complex may be able to realize economies of scale. Funds that currently already compute VaR would be particularly likely to experience costs at the very low end of this range. Assuming that the midpoint of this range reflects the cost to the average fund subject to the VaR requirement, we estimate a total additional annual industry cost of $127,260,000.[521]

In addition, a fund that today or in the future may operate in a manner that would result in the fund's portfolio VaR being just under the proposed limit on fund leverage risk may need to alter its portfolio during periods of increased market volatility in order to avoid falling out of compliance with the proposed limit. We would expect such a scenario to be more likely for a fund that would rely on the absolute VaR test, because the relative VaR test would allow a fund to operate with a higher portfolio VaR when the VaR of its designated reference index increases.

A fund that were to eliminate some of its leverage risk associated with derivatives in order to comply with the proposed VaR-based limit on leverage risk might do so through unwinding or hedging its derivatives transactions or through some other means. These portfolio adjustments may be costly, particularly in conditions of market stress and reduced liquidity. The proposed rule would, however, give a fund the flexibility to mitigate these potential costs by not requiring the fund to exit positions or change its portfolio if it is out of compliance with the VaR test. Instead, the rule would provide that, if a fund has been out of compliance with the applicable VaR test for more than three business days, then: (1) The derivatives risk manager must report to the fund's board of directors and explain how and by when (*i.e.,* the number of business days) the derivatives risk manager reasonably expects that the fund will come back into compliance;[522] (2) the derivatives risk manager must analyze the circumstances that caused the fund to be out of compliance for more than three business days and update any program elements as appropriate to address those circumstances; and (3) the fund may not enter into derivatives transactions other than derivatives transactions that, individually or in the aggregate, are designed to reduce the fund's VaR, until the fund has been back in compliance with the applicable VaR test for three consecutive business days and satisfied the board reporting requirement and program analysis and update requirements.[523] These provisions of the proposed rule collectively would provide some flexibility for a fund that is out of compliance with the VaR test to make any portfolio adjustments, which may allow funds to avoid some of the costs that otherwise could result from forced changes in the fund's portfolio.

3. Limited Derivatives Users

Proposed rule 18f–4 includes an exception from the proposed risk management program requirement and VaR-based limit on fund leverage risk for limited derivatives users.[524] The proposed exception would be available for a fund that either limits its derivatives exposure to 10% of its net assets or uses derivatives transactions solely to hedge certain currency risks and that also adopts and implements policies and procedures reasonably

[518] We understand that industry practices around licensing indexes for regulatory purposes vary widely, with some providers not charging any fees and others charging fees in excess of $10,000 per year.

[519] One commenter indicated that implementing a UCITS VaR test would be only slightly burdensome for 45% of respondents to a survey of ICI member firms and would be moderately burdensome for an additional 34% of respondents. The commenter also indicated that respondents commonly reported that the burden would increase, in some cases very substantially, if a VaR test has different parameters or is more prescriptive than UCITS VaR. *See* ICI Comment Letter III; *see also supra* note 451. As the requirements of the proposed VaR test are generally consistent with existing market practice, including that of UCITs funds, the results of this survey therefore support our view that many funds would likely experience efficiencies in implementing the proposed VaR test.

[520] We estimate that about 19% of all funds that would be subject to the proposed rule hold some derivatives, would not qualify as a limited derivatives user, and are not a leveraged/inverse fund that could comply with the alternative requirements for leveraged/inverse investment vehicles.

[521] This estimate is based on the following calculation: 2,424 funds × 0.5 × ($5,000 + $100,000) = $127,260,000. Some funds may find it more cost effective to restrict their use of derivatives in order to be able to rely on the proposed rule's exception for limited derivatives users compared to complying with the proposed VaR-based limit on fund leverage risk. *See supra* section II.E; *infra* section III.C.3. As we do not have data that would allow us to quantify the costs and benefits that define the tradeoff for any particular fund of changing its use of derivatives in order to qualify for the limited user exception, we are unable to quantify how many funds would make this choice.

[522] Proposed rule 18f–4(c)(2)(iii)(A). *See also infra* section II.H.2 (discussing a report to the Commission regarding the fund being out of compliance with the applicable proposed VaR test for three business days).

[523] *See* proposed rule 18f–4(c)(2)(iii).

[524] *See supra* section II.E.

designed to manage the fund's derivative risks. We expect that the risks and potential impact of these funds' derivatives use may not be as significant, compared to those of funds that do not qualify for the exception.[525] Therefore, we believe that a principles-based policies and procedures requirement would appropriately address these risks.

We believe that investors in funds that use derivatives in a limited manner would benefit from the proposed requirement, which we anticipate would reduce, but not eliminate, the frequency and severity of derivatives-related losses for such funds. In addition, to the extent that the proposed framework is more comprehensive than funds' current practices, the proposed requirement may result in more effective risk management across funds and increased fund industry stability.

For funds that do not already have policies and procedures in place that could be readily adapted to meet the proposed rule's requirements without significant additional cost, we estimate that the one-time costs would range from $1,000 to $100,000 per fund, depending on the particular facts and circumstances, including whether a fund is part of a larger fund complex; the extent to which the fund uses derivatives within the parameters of the limited user exception, including whether the fund uses more complex derivatives; and the fund's current derivatives risk management practices. These estimated costs are attributable to the following activities: (1) Assessing whether a fund is a limited derivatives user; (2) developing policies and procedures reasonably designed to manage a fund's derivatives risks; (3) integrating and implementing the policies and procedures; and (4) preparing training materials and administering training sessions for staff in affected areas.

For funds that do not already have policies and procedures in place that could be readily adapted to meet the proposed rule's requirements without significant additional cost, we estimate that the ongoing annual costs that a fund that is a limited derivatives user would incur range from 65% to 75% of the one-time costs to establish and implement the policies and procedures. Thus, a fund would incur ongoing annual costs that range from $650 to $75,000.[526] These estimated costs are attributable to the following activities: (1) Assessing, monitoring, and managing the risks associated with the fund's derivatives transactions; (2) periodically reviewing and updating a fund's policies and procedures; and (3) additional staff training.

Based on an analysis of Form N–PORT filings, as well as financial statements filed with the Commission by BDCs, we estimate that about 19% of funds that would be subject to the proposed rule, or 2,398 funds total, would qualify as limited derivatives users. Almost all of these funds would be able to rely on the exposure-based exception. While some funds, about 1%, could rely on both the exposure-based exception and the currency hedging exception, only a fraction of 1% of funds would qualify as limited derivatives users solely based on the currency hedging exception.

As many funds belong to a fund complex and are likely to experience economies of scale, we expect that the lower end of the estimated range of costs ($1,000 in one-time costs; $650 in annual costs) better reflects the total costs likely to be incurred by many funds. In addition, we believe that many funds already have policies and procedures in place that could be readily adapted to meet the proposed rule's requirements without significant additional cost. However, as we do not have data to determine how many funds already have such policies and procedures in place that would substantially satisfy the proposed rule's requirements, we assume that all funds would incur a cost associated with this requirement. Based on these assumptions, we over-inclusively estimate a lower bound for the total industry cost in the first year of $751,773.[527]

Some funds may change how they use derivatives in order to qualify for the limited derivatives user exception and thereby avoid the potentially increased compliance cost associated with the proposed derivatives risk management program and VaR-based limit on fund leverage risk. Specifically, a fund with derivatives exposure just below 10% of its net assets may forego taking on additional derivatives positions, or a fund with derivatives exposure just above 10% of its net assets may close out some existing derivatives positions. Similarly, a fund that uses derivatives to hedge certain currency risks may forego or eliminate its use of derivatives for other purposes. As a result, the proposed exception for limited derivatives users may reduce the extent to which some funds use derivatives.[528]

4. Reverse Repurchase Agreements and Similar Financing Transactions

The proposed rule would allow funds to engage in reverse repurchase agreements and other similar financing transactions. However, as these transactions achieve economically identical results to other secured loans, the proposed rule would require that they be treated the same as bank borrowings and other borrowings under section 18. The proposal would therefore require a fund to combine any bank borrowings or other borrowings and reverse repurchase agreements when assessing compliance with the relevant asset coverage requirements of section 18.[529]

Today, funds rely on the asset segregation approach that Release 10666 describes with respect to reverse repurchase agreements, which funds may view as separate from the limitations established on bank borrowings (and other senior securities that are evidence of indebtedness) by the asset coverage requirements of section 18.[530] As a result, the degree to which funds could engage in reverse repurchase agreements may differ under the proposed rule from the baseline. A fund that engages solely in reverse repurchase agreements, or solely in bank borrowings (for example), would be unaffected by the proposed requirement.[531] However, to the extent that a fund engages in both reverse repurchase agreements and bank borrowings (or similar transactions), because we believe these transactions are economically equivalent, they would be combined for purposes of analyzing whether a fund is in compliance with section 18's asset

[525] *See supra* note 270 and accompanying and immediately-following text.

[526] This estimate is based on the following calculations: 0.65 × $1,000 = $650; 0.75 × $100,000 = $75,000.

[527] This estimate is based on the following calculation: 2,398 funds × 0.19 × ($1,000 + $650) = $751,773. This cost estimate assumes that none of the funds that currently do not hold any derivatives would choose to establish and implement policies and procedures reasonably designed to manage the fund's derivatives risks in anticipation of a future limited use of derivatives. Notwithstanding this assumption, we acknowledge some funds that currently do not use derivatives may still choose to establish and implement such policies and procedures prophylactically in order to preserve the flexibility to engage in a limited use of derivatives on short notice.

[528] As we do not have data that would allow us to quantify the costs and benefits that define the tradeoff for any particular fund of changing its use of derivatives in order to qualify for the limited user exception, we are unable to quantify how many funds would make this choice.

[529] *See supra* section II.I.

[530] *See supra* section I.B.2.a.

[531] For example, an open-end fund with no other senior securities outstanding could borrow an amount equivalent to 50% of its net assets using reverse repurchase agreements or bank borrowings under the baseline.

coverage requirement. This may have the effect of limiting the overall scale of these transactions under the proposed requirement compared to the baseline, to the extent that funds today separately analyze their asset coverage requirements with respect to reverse repurchase agreements under Release 10666 and bank borrowings and similar senior securities under section 18.

DERA staff analyzed funds' use of reverse repurchase agreements and borrowings using Form N–PORT filings as well as financial statements filed with the Commission by BDCs. Based on our analysis of Form N–PORT filings, we estimate that about 0.36% of funds that would be subject to the proposed rule, or 45 funds total, used these transactions in combined amounts that exceeded the asset coverage requirement.[532] These funds would have to adjust their use of reverse repurchase agreements, similar financing transactions, or borrowings in order to comply with the proposed rule and may incur associated transactions costs.

In addition, under the proposed rule, if a fund did not qualify as a limited derivatives user due to its other investment activity, any portfolio leveraging effect of reverse repurchase agreements, similar financing transactions, and borrowings would also be restricted indirectly through the VaR-based limit on fund leverage risk. As a result, a fund could be restricted through the VaR-based limit on fund leverage risk from investing the proceeds of borrowings through reverse repurchase agreements to the full extent otherwise permitted by the asset coverage requirements in section 18 if the fund did not qualify as a limited derivatives user.

5. Alternative Requirements for Certain Leveraged/Inverse Funds and Proposed Sales Practices Rules for Certain Leveraged/Inverse Investment Vehicles

The proposed sales practices rules would require a broker-dealer or investment adviser to (1) exercise due diligence in approving a retail investor's account to buy or sell shares of leveraged/inverse investment vehicles before accepting an order from, or placing an order for, such an investor to engage in these transactions; and (2) adopt and implement policies and procedures reasonably designed to achieve compliance with the proposed rules.[533] Additionally, a leveraged/inverse fund that meets the definition of a ''leveraged/inverse investment vehicle'' in the proposed sales practices rules would not have to comply with the VaR-based leverage risk limit under proposed rule 18f–4, provided the fund limits the investment results it seeks to 300% of the return (or inverse of the return) of the underlying index and discloses in its prospectus that it is not subject to the proposed VaR-based limit on fund leverage risk.[534]

These due diligence and approval requirements are designed to address potential investor protection concerns with respect to leveraged/inverse investment vehicles by subjecting retail investors to specific due diligence and account approval requirements by broker-dealers and investment advisers. The proposed rules also are designed to help to ensure that investors in these funds are limited to those who are capable of evaluating their characteristics—including that the funds would not be subject to all of the leverage-related requirements applicable to registered investment companies generally—and the unique risks they present. There is a body of academic literature providing empirical evidence that retail investors may not fully understand the risks inherent in their investment decisions and not fully understand the effects of compounding returns over time.[535] Retail investors could face additional burdens in investing in leveraged/inverse investment vehicles, to the extent that they do not currently possess the requisite capability of evaluating the risks of these products to satisfy the approval requirements implemented by broker-dealers and investment advisers in connection with the proposed rules' due diligence and account approval obligations. However, we expect such retail investors would benefit from the proposed requirement, which we believe would help to ensure that investors in these funds are limited to those who are capable of evaluating the characteristics and unique risks of these products.[536] We acknowledge that these benefits may be reduced, to the extent that they overlap with the effects of investment advisers' or broker-dealers' existing requirements or practices related to a retail investors' suitability for investments in these produces as discussed in section III.B.5 above.

Since the alternative provision for leveraged/inverse funds under proposed rule 18f–4 includes a requirement that a leveraged/inverse fund disclose in its prospectus that it is not subject to the proposed limit on fund leverage risk, both investors and the market would benefit from transparency regarding which funds are exempt from rule 18f–4's limit on fund leverage fund risk. Some investors may value this information to the extent that it helps them make better-informed choices between funds.

The costs that broker-dealers and investment advisers may incur as a result of the proposed sales practices rules would vary depending on the firm. For example, as the proposed requirements are generally modeled after the options account requirements, broker-dealers that already have compliance procedures in place for approving options accounts would likely have reduced compliance costs.[537] In addition, some broker-dealers and investment advisers may incur costs associated with training

[532] In our review of form N–PORT filings, we observed that several of the funds that used reverse repurchase agreements and similar financing transactions (bank borrowings and similar securities) in combined amounts that exceeded 50% of net assets already exceeded the 50% limit for either repurchase agreements, similar financing transactions (bank borrowings and similar securities, or both, when considered separately. In our review of financial statements filed by the Commission by BDCs, we observed that no BDCs exceeded the asset coverage requirement.

[533] *See supra* section II.G.2. The proposed sales practices rules define ''leveraged/inverse investment vehicle'' to mean a registered investment company or an exchange-listed commodity- or currency-based trust or fund that seeks, directly or indirectly, to provide investment returns that correspond to the performance of a market index by a specified multiple, or to provide investment returns that have an inverse relationship to the performance of a market index, over a predetermined period of time. *See* proposed rules 15*l*–2(d) and 211(h)–1(d).

[534] *See supra* section II.G.3. A leveraged/inverse fund that meets these requirements still would be required to satisfy all of the conditions in proposed rule 18f–4 other than the proposed VaR-based limit on fund leverage risk, including the proposed conditions requiring a derivatives risk management program, board oversight and reporting, and recordkeeping.

[535] *See, e.g.,* Annamaria Lusardi & Olivia S. Mitchell, *The Economic Importance of Financial Literacy: Theory and Evidence,* 52 Journal of Economic Literature 5 (2014), *available athttps://www.aeaweb.org/articles?id=10.1257/jel.52.1.5,* which provides a literature review of recent survey-based work indicating that many retail investors have limited financial literacy and, for example, do not always understand the compounding of returns, which may directly apply in the context of the daily compounding feature of leveraged/inverse ETFs. The literature does not address retail investor's inattention to investment risk or the unique dynamics of compounding of daily returns in the context of leveraged/inverse ETFs or other leveraged/inverse investment vehicles specifically, but studies investor inattention to financial products more generally.

[536] The sales practices rules would not apply to a position in a leveraged/inverse investment vehicle established before the rules' compliance date. *See supra* note 339 and associated text. As a result, investors with such existing positions would only be affected by the proposed sales practices rules if they seek to increase an existing or add a new position in a leveraged/inverse investment vehicle.

[537] These efficiencies and the resulting reduced compliance costs would not apply to investment advisers that are not also registered broker-dealers because they are not subject to FINRA rules.

customer-facing personnel and supervisory review of account approval decisions. Investment advisers' and broker-dealers' existing processes, as discussed above in section III.B.5, may reduce the costs that the proposed sales practices rules otherwise would involve to the extent that investment advisers or broker-dealers can build on existing processes in complying with the proposed sales practices rules.

Broker-dealers and investment advisers would incur costs associated with the proposed sales practices rules. We estimate that one-time costs for a broker-dealer or investment adviser related to the due diligence and account approval requirements would range from $7,749 to $12,915 [538] and that one-time costs related to drafting the associated policies and procedures would range from $1,367 to $2,278.[539] Thus, we estimate total one-time costs for a broker-dealer or investment adviser would range from $9,116 to $15,193.[540]

In addition, we estimate that ongoing costs for a broker-dealer or investment adviser related to the due diligence and account approval requirements would range from $1,211 to $2,018 per year,[541] that ongoing costs related to the associated policies and procedures requirement would range from $903 to $1,505 per year,[542] and that ongoing costs related to the associated recordkeeping requirements would range from $157 to $393 per year.[543] Thus, we estimate that total ongoing costs for a broker-dealer or investment adviser would range from $2,271 to $3,915 per year.[544]

As of December 2018, there were 2,766 broker-dealers that reported some sales to retail customer investors.[545] We estimate that 700 of these broker dealers with retail customer accounts (approximately 25%) have retail customer accounts that invest in leveraged/inverse investment vehicles. Our staff further estimates that 715,000 existing customer accounts with such broker-dealers would require account approval for trading in leveraged/inverse investment vehicles and that 10,000 new customer accounts opened each year would require such approval.[546]

In addition, as of December 2018, there were 8,235 investment advisers registered with the Commission having some portion of their business dedicated to retail investors, including either individual high net worth clients or individual non-high net worth clients.[547] We estimate that 2,000 of these investment advisers with retail client accounts (approximately 25%) have retail client accounts that invest in leveraged/inverse investment vehicles. Wefurther estimate that 715,000 existing customer accounts with such investment advisers would require account approval for trading in leveraged/inverse investment vehicles, and that 10,000 new customer accounts opened each year would require such approval.[548]

To the extent that many broker-dealers already have compliance procedures in place for approving options accounts, which is a common industry practice, these broker-dealers would likely have reduced costs associated with the proposed requirements of the sales practices rules. Thus, we estimate that many broker-dealers would incur one-time and ongoing costs that are closer to the low end of the provided ranges, while broker-dealers that cannot take advantage of such efficiencies and many investment advisors would likely experience costs closer to the high end of the provided ranges.[549] We estimate that the total industry cost for the proposed requirements of the sales practice rule in the first year for both broker-dealers and investment advisers would equal $2,377,503,800, which is based on the midpoint of the sum of the ranges for both one-time and ongoing costs.[550] Some broker-dealers and investment advisers may decide to pass

[538] This estimated range is based on the following calculations: (6 hours × $365 (compliance attorney) + 9 hours × $284 (senior systems analyst) + 12 hours × $331 (senior programmer)) = ($2,190 + $2,556 + $3,972) = $8,718 for development and implementation of online client questionnaire; (3 hours × $365 (compliance attorney) + 3 hour × $70 (compliance clerk)) = $1,305 for customer due diligence; and 1 hour × $309 (compliance manager) = $309 for evaluation of client information for account approval/disapproval for a total of $10,332. Assuming a range of +/−25% around the average total of $10,332 gives a range for one-time costs from $10,332 × 75% = $7,749 to $10,332 × 125% = $12,915.

[539] This estimated range is based on the following calculations: (3 hours × $309 (senior manager) + 1 hour × $365 (compliance attorney) + 1 hour × $530 (chief compliance officer)) = ($927 + $365 + $530) = $1,822 for establishing and implementing rule 15*l*–2 policies and procedures. Assuming a range of +/−25% around the average total of $1,822 gives a range for one-time costs from $1,822 × 75% = $1,366.50 to $1,822 × 125% = $2,277.50.

[540] This estimated range is based on the following calculations: $7,749 + $1,366.50 = $9,115.50 for the minimum of the cost range and $12,915 + $2,277.50 = $15,192.50 for the maximum of the cost range.

[541] This estimated range is based on the following calculations: (3 hours × $365 (compliance attorney) + 3 hour × $70 (compliance clerk)) = $1,305 per year for customer due diligence; and 1 hour × $309 (compliance manager) = $309 per year for evaluation of client information for account approval/disapproval for a total of $1,614 per year. Assuming a range of +/−25% around the average total of $1,614 per year gives a range for ongoing costs from $1,614 × 75% = $1,210.50 per year to $1,614 × 125% = $2,017.50 per year.

[542] This estimated range is based on the following calculations: (1 hour × $309 (senior manager) + 1 hour × $365 (compliance attorney) + 1 hour × $530 (chief compliance officer)) = $1,204 per year for reviewing and updating rule 15*l*−2 policies and procedures. Assuming a range of +/–25% around the average total of $1,204 per year gives a range for ongoing costs from $1,204 × 75% = $903 per year to $1,204 × 125% = $1,505 per year.

[543] This estimated range is based on the following calculations: (1 hour × $62 (general clerk) + 1 hour × $95 (senior computer operator)) = $157 per year for the minimum of the cost range and (2.5 hours × $62 (general clerk) + 2.5 hours × $95 (senior computer operator) = ($155 + $237.50)) = $392.50 per year for the maximum of the cost range.

[544] This estimated range is based on the following calculations: ($1,210.50 + $903 + $157) = $2,270.50 per year for the minimum of the cost range and ($2,017.50 + $1,505 + $392.50) = $3,915 per year for the maximum of the cost range.

[545] Our estimate of the number of broker-dealers with retail customers are based on data obtained from Form BD and Form BR as of December 31, 2018.

[546] The number of broker-dealers that have retail client accounts that invest in leveraged/inverse investment vehicles as well as the numbers of existing and new customer accounts with these broker-dealers that would require approval for trading in these products are based on staff experience, as we do not have data that would allow us to determine these numbers more precisely.

[547] Our estimate of the number of investment advisers with retail accounts are based on data obtained from responses to Item 5.D of Form ADV as of December 31, 2018.

[548] The number of investment advisors that have retail client accounts that invest in leveraged/inverse investment vehicles as well as the numbers of existing and new customer accounts with these investment advisers that would require approval for trading in these products are based on staff experience, as we do not have data that would allow us to determine these numbers more precisely.

[549] *See supra* notes 514 and 518.

[550] This estimate is based on the following calculations: (700 broker-dealers + 2,000 registered investment advisers having retail customer accounts that invest in leveraged/inverse investment vehicles) × ($8,718 + $1,822)) = $28,458,000 + ((2 × 715,000) existing customer accounts with broker-dealers and registered investment advisers requiring account approval for trading in leveraged/inverse investment vehicles) × ($1,305 + $309) = $2,308,020,000 for total one-time industry costs to broker-dealers and investment advisers of $2,336,478,000; and ((2 × 10,000) new customer accounts requiring account approval for trading in leveraged/inverse investment vehicles) × ($1,305 + $309) = $32,280,000 + (700 broker-dealers + 2,000 registered investment advisers having retail customer accounts that invest in leveraged/inverse investment vehicles) × $1,204) = $3,250,800 + (10,000 new customer accounts requiring account approval for trading in leveraged/inverse investment vehicles) × ($157 (broker-dealer recordkeeping costs) + $392.50 (investment adviser recordkeeping costs)) = $5,495,000 for total ongoing annual industry costs to broker-dealers and investment advisers of $41,025,800 per year. Total industry cost for proposed requirements of sales practice rule in the first year is $2,336,478,000 + $41,025,800 = $2,377,503,800, which is consistent with being the midpoint of the sum of the ranges for both one-time and ongoing costs discussed in preceding calculations.

these compliance costs on to their customers.[551]

In addition, some leveraged/inverse investment vehicles may lose existing or potential investors as a result of some retail investors not being approved by their broker-dealer or investment adviser to transact in leveraged/inverse investment vehicles or some retail investors being deterred by the time costs and delay introduced by the account-opening procedures. Broker-dealers or investment advisers with a larger fraction of retail customers or clients that can no longer transact in leveraged/inverse investment vehicles as a result of the proposed sales practices rules may experience larger declines in their customer or client base and associated reductions in profits.[552]

It is our understanding that no funds that would meet the definition of a ''leveraged/inverse investment vehicle,'' and that seek returns above 300% of the return (or inverse of the return) of the underlying index, currently exist. Therefore we do not expect any costs associated with existing funds having to alter their investment strategies or business practices to comply with proposed rule 18f–4's alternative requirements for leveraged/inverse funds.

Requiring a leveraged/inverse fund covered by the proposed sales practices rules to limit its exposure to 300% of the return (or inverse of the return) of the underlying index while preventing a fund that does not qualify as a leveraged/inverse investment vehicle from offering investment strategies that exceed the proposed outer limit on fund leverage risk may also have competitive effects, which we discuss in section III.B.5 below. As an alternative to the proposed exposure limit for leveraged/inverse funds, we also discuss the effects of conditioning the exemption for leveraged/inverse funds on compliance with a higher or lower exposure limit in section III.D.1 below.

6. Proposed Amendments to Rule 6c–11 Under the Investment Company Act and Proposed Rescission of Exemptive Relief for Leveraged/Inverse ETFs

Existing leveraged/inverse ETFs rely on exemptive relief, which the Commission has not granted to a leveraged/inverse ETF sponsor since 2009. We are proposing to amend rule 6c-11 to remove the provision excluding leveraged/inverse ETFs from its scope, which would permit fund sponsors to operate a leveraged/inverse ETF under that rule and without obtaining an exemptive order.

The proposed amendments to rule 6c–11 would benefit any fund sponsors seeking to launch leveraged/inverse ETFs that did not obtain the required exemptive relief due to the Commission's moratorium on granting such relief as well as fund sponsors seeking to launch leveraged/inverse ETFs in the future. A fund sponsor planning to seek exemptive relief from the Commission to form and operate a leveraged/inverse ETF would also no longer incur the cost associated with applying for an exemptive order.[553] To the extent that the amendments result in new leveraged/inverse ETFs coming to market, the industry-wide assets under management of leveraged/inverse ETFs could increase and investors that would be eligible under the proposed sales practices rules to invest in leveraged/inverse ETFs could benefit from an increase in investment choices.[554]

Because our proposed amendments to rule 6c–11 would permit leveraged/inverse ETFs to rely on that rule, we also are proposing to rescind the exemptive orders the Commission has previously granted to leveraged/inverse ETFs. As a result, existing and future leveraged/inverse ETFs would operate under a consistent regulatory framework. We believe that the costs to leveraged/inverse ETFs associated with rescinding their existing exemptive relief would be minimal, as we anticipate that all existing leveraged/inverse ETFs would be able to continue operating with only minor adjustments, other than being required to comply with the requirements in rule 6c–11 for additional website disclosures and basket asset policies and procedures.[555]

Additional economic considerations that the proposed treatment of leveraged/inverse ETFs presents with regards to efficiency and competition are discussed below in section III.D.

7. Unfunded Commitment Agreements

The proposed rule would permit a fund to enter into unfunded commitment agreements if it reasonably believes, at the time it enters into such an agreement, that it will have sufficient cash and cash equivalents to meet its obligations with respect to all of its unfunded commitment agreements, in each case as they come due.[556] While a fund should consider its unique facts and circumstances, the proposed rule would prescribe certain specific factors that a fund must take into account in having such a reasonable belief. We believe that the proposed requirements are consistent with current market practices, based on the staff's experience in reviewing and commenting on fund registration statements, which have disclosure regarding their unfunded commitments, as well as representations funds have made to the staff.[557] As a result, we do not believe that the rule's treatment of unfunded commitment agreements represents a change from the baseline, although we acknowledge that there may be some variation in the specific factors that funds consider today, as well as the potential for some variation between those factors and those prescribed in the proposed rule. Because we believe that the proposed approach is consistent with general market practices and we do not have specific granular information to identify differences in funds' current practices relative to the proposed rule, we believe this proposed requirement would not lead to significant economic effects.

8. Recordkeeping

Proposed rule 18f–4 includes certain recordkeeping requirements.[558] Specifically, the proposed rule would

[551] The share of these costs passed on to investors by investment advisers or broker-dealers would depend on multiple factors, including the nature of competition between investment advisers and broker-dealers as well as investors' relative sensitivity to changes in fees, the joint effects of which are inherently impossible to predict. Some broker-dealers offer transactions in certain leveraged/inverse investment vehicles, such as some leveraged/inverse ETFs, without charging commissions. In these cases, broker-dealers may pass on some of the compliance costs associated with the proposed requirements by charging some amount of commission on these trades.

[552] Any such reduction in a broker-dealer's or investment adviser's customer base may be offset to the extent that clients transact in other products with the same broker dealer or investment adviser instead.

[553] In the ETFs Adopting Release, we estimated that the direct cost of a typical fund's application for ETF relief (associated with, for example, legal fees) is approximately $100,000. As exemptive applications for leveraged/inverse ETFs are significantly more complex than those of the average fund, we estimate that the direct costs of an application for leveraged/inverse ETF relief would amount to approximately $250,000. *See* ETFs Adopting Release, *supra* note 76, at nn.537–539 and accompanying text.

[554] The increase in assets under management among leveraged/inverse ETFs could be attenuated, to the extent that proposed rule 15*l*–2's and 211(h)–1's due diligence requirements would lead to a reduction in the number of investors that invest in these funds. *See infra* section III.C.5.

[555] In this section as well as in section III.D below, we have accounted for the costs and benefits to leveraged/inverse ETFs as a result of the removal of the current exclusion of these funds from rule 6c–11. We believe that the additional considerations the Commission analyzed in the ETFs Adopting Release for ETFs other than leveraged/inverse ETFs that were included in the scope of rule 6c–11 at adoption would apply substantially similarly to leveraged/inverse ETFs. *See* ETFs Adopting Release, *supra* note 76.

[556] *See supra* section II.J.

[557] *See supra* discussion in paragraph preceding note 419.

[558] *See supra* section II.K.

require a fund to maintain certain records documenting its derivatives risk management program's written policies and procedures, along with its stress test results, VaR backtesting results, internal reporting or escalation of material risks under the program, and reviews of the program.[559] It would also require a fund to maintain records of any materials provided to the fund's board of directors in connection with approving the designation of the derivatives risk manager and any written reports relating to the derivatives risk management program.[560] A fund that would be required to comply with the proposed VaR test would also have to maintain records documenting the determination of: Its portfolio's VaR; its designated reference index VaR, as applicable; its VaR ratio (the value of the VaR of the Fund's portfolio divided by the VaR of the designated reference index), as applicable; and any updates to any of its VaR calculation models and the basis for any material changes to its VaR models.[561] A fund that would be a limited derivatives user under the proposed rule would have to maintain a written record of its policies and procedures that are reasonably designed to manage derivatives risks.[562] Finally, a fund engaging in unfunded commitment agreements would be required to maintain records documenting the sufficiency of its funds to meet its obligations with respect to all unfunded commitment agreements.[563]

We believe that these proposed requirements would increase the effectiveness of the Commission's oversight of the fund industry, which will, in turn, benefit investors. Further, the requirement to keep records documenting the derivatives risk management program, including records documenting periodic review of the program and reports provided to the board of directors relating to the program, would help our staff evaluate a fund's compliance with the proposed derivatives risk management program requirements. We anticipate that these recordkeeping requirements would generally not impose a large additional burden on funds, as most funds would likely choose to keep such records, even absent the proposed requirement to do so, in order to support their ongoing administration of the proposed derivatives risk management program and their compliance with the associated requirements.

As discussed below in section IV.B.7, our estimated average one-time and ongoing annual costs associated with the recordkeeping requirements take into account the fact that certain funds can rely on the proposed rule's limited derivatives user exception and may incur less extensive recordkeeping costs relative to those funds which may not rely on this exception. Of the estimated 5,091 funds that would be subject to the recordkeeping requirements, we estimate that 2,398 funds would be limited derivatives users. Assuming that both one-time and ongoing annual recordkeeping costs for limited derivatives users are 90% of those for funds that would not qualify as limited derivatives users, we estimate that, on average, each fund that could not rely on the limited user exception would incur a one-time cost of $2,047 [564] and an ongoing cost of $330 per year [565] and each fund that could rely on the exception would incur, a one-time cost of $1,842 [566] and an ongoing cost of $297 per year.[567] We thus estimate that the total industry cost for this requirement in the first year would equal $11,529,656.[568]

9. Amendments to Fund Reporting Requirements

a. Form N–PORT and Form N–CEN

We are proposing to amend Form N–PORT to include a new reporting item on funds' derivatives exposure, which would be publicly available for the third month of each fund's quarter.[569] In addition, we are proposing amendments that would require funds that are subject to the proposed VaR-based limit on fund leverage risk to report certain information related to their VaR.[570] We are also proposing to amend Form N–CEN to require a fund to identify (1) whether it is a limited derivatives user (either under the proposed exception for funds that limit their derivatives exposure to 10% of their net assets or under the exception for funds that limit their derivatives use to certain currency hedging); (2) whether it is a leveraged/inverse investment vehicle as defined in proposed sales practices rules; and (3) whether it has entered into reverse repurchase agreements or similar financing transactions, or unfunded commitment agreements.[571] These additional reporting requirements would not apply to BDCs, which do not file reports on Form N–CEN or Form N–PORT.[572]

To the extent that measures of derivatives exposure, and the other information that we would require funds to report on Forms N–PORT and N–CEN, are not currently available, the proposed requirements that funds make such information available periodically on these forms would improve the ability of the Commission to oversee reporting funds. It also would allow the Commission and its staff to oversee and monitor reporting funds' compliance with the proposed rule and help identify trends in reporting funds' use of derivatives, portfolio VaRs, and their choice of designated reference indexes. The expanded reporting also would increase the ability of the Commission staff to identify trends in investment strategies and fund products in reporting funds as well as industry outliers.[573]

[559] *See* proposed rule 18f–4(c)(i)(A).

[560] *See* proposed rule 18f–4(c)(6)(i)(B).

[561] *See* proposed rule 18f–4(c)(6)(i)(C).

[562] *See* proposed rule 18f–4(c)(6)(i)(D).

[563] *See* proposed rule 18f–4(c)(6)(i)(E).

[564] This estimate is based on the following derivations and calculations: 1.5 hours × $62 (general clerk)/((2,398/5,091) × 90% + ((5,091 − 2,398)/5,091)) = $97.60; and 1.5 hours × $95 (senior computer operator)/((2,398/5,091) × 90% + ((5,091 − 2,398)/5,091)) = $149.54 for a total of $97.60 + $149.54 + ($1,800 for initial external cost burden) = $2,047.14, where (2,398/5,091) is the share of funds that are limited derivatives users and (5,091 − 2,398)/5,091) is the share of funds that are not limited derivatives users.

[565] This estimate is based on the following derivations and calculations: 2 hours × $62 (general clerk)/((2,398/5,091) × 90% + ((5,091 − 2,398)/5,091)) = $130.13; and 2 hours × $95 (senior computer operator)/((2,398/5,091) × 90% + ((5,091 − 2,398)/5,091)) = $199.39 for a total of $130.13 + $199.39 = $329.52, where (2,398/5,091) is the share of funds that are limited derivatives users and (5,091 − 2,398)/5,091) is the share of funds that are not limited derivatives users.

[566] This estimate is based on the following calculations: $2,047.14 × 90% = $1,842.43.

[567] This estimate is based on the following calculations: $329.52 × 90% = $296.57.

[568] This estimate is based on the following calculations: (5,091 − 2,398 = 2,693 funds which cannot rely on the limited derivatives user exception) × ($2,047.14 + $329.52) = $6,400,347.32; and (2,398 funds which can rely on the limited derivatives user exception) × ($1,842.43 + $296.57) = $5,129,309.17 for a total of $11,529,656.48.

[569] *See supra* section II.H.1. While the information for the first two months of a fund's quarter would be non-public, the information for the third month of a fund's quarter would be publicly available. *See supra* note 359.

[570] Specifically, this information would include: (1) The fund's highest daily VaR during the reporting period and its corresponding date; and (2) the fund's median daily VaR for the reporting period. Funds subject to the relative VaR test during the reporting period also would have to report: (1) The name of the fund's designated reference index; (2) the index identifier; (3) the fund's highest daily VaR ratio during the reporting period and its corresponding date; and (4) the fund's median daily VaR ratio for the reporting period. Finally, all funds that are subject to the proposed limit on fund leverage risk also would have to report the number of exceptions that the fund identified as a result of the backtesting of its VaR calculation model. *See id.*

[571] We believe that many of these proposed new reporting items would be inapplicable to most BDCs. *See supra* section II.H.3.

[572] *See supra* section II.H.4.

[573] The structuring of the information in Form N–PORT would improve the ability of Commission staff to compile and aggregate information across all reporting funds, and to analyze individual funds or

Continued

Investors, third-party information providers, and other potential users would also experience benefits from the proposed amendments to Forms N–PORT and N–CEN. Investors and other potential users would have disclosure of additional information that is not currently available in any filings. We believe that the structured data format of this information in Forms N–PORT and N–CEN would allow investors and other potential users to more efficiently analyze portfolio investment information. The additional information, as well as the structure of that information, would increase the transparency of a fund's investment strategies and allow more efficient assessment of reporting funds' potential leverage-related risks.

The amendments to Forms N–PORT and N–CEN would also benefit investors, to the extent that they use the information, to better differentiate funds that are not limited derivatives users or leveraged/inverse funds based on their derivatives usage. For example, investors would be able to more efficiently identify the extent to which such funds use derivatives as part of their investment strategies. Investors, and in particular individual investors, could also indirectly benefit from the additional information in amended Forms N–PORT and N–CEN to the extent that third-party information providers and other interested parties obtain, aggregate, provide, analyze and report on the information. Investors could also indirectly benefit from the additional information in amended Forms N–PORT and N–CEN to the extent that other entities, including investment advisers and broker-dealers, utilize the information to help investors make more informed investment decisions related to funds that provide this information.

As discussed below in section IV.F, our estimated average one-time and ongoing annual costs associated with the amendments to Forms N–PORT take into account the fact that certain funds that are not subject to the proposed VaR-based limit on fund leverage risk in proposed rule 18f–4 would not have to report certain VaR-related information and may incur less extensive reporting costs relative to those funds subject to the limit, which are required to report such VaR-related disclosure information. Of the estimated 5,091 funds that would be subject to the exposure-related disclosure requirement, we estimate that 2,424 funds would also be subject to the VaR-related disclosure requirements. We estimate that, on average, each fund that is not subject to the VaR-related disclosure requirement would incur a one-time cost of $6,982 [574] and an ongoing cost of $2,088 per year [575] and each fund that is subject to the VaR-related disclosure requirement would incur a one-time cost of $8,374 [576] and an ongoing cost of $4,176 per year.[577] We thus estimate that the total industry cost for this reporting requirement in the first year would equal $54,610,890.[578]

As discussed below in section IV.H, we estimate that the average ongoing annual cost for a registered fund to prepare amendments to Form N–CEN is $6.96 per year.[579] We thus estimate that the total industry cost for all registered funds associated with this reporting requirement in the first year is $86,130.[580]

b. Amendments to Current Reporting Requirements

We are also proposing current reporting requirements for funds that are relying on proposed rule 18f–4 and subject to the proposed VaR-based limit on fund leverage risk. Specifically, a fund that is out of compliance with the VaR test for more than three business days would be required to file a non-public report on Form N–RN providing certain information regarding its VaR test breaches and a fund will also be required to file a report when it is back in compliance with its applicable VaR test.[581]

We anticipate that the enhanced current reporting requirements could produce significant benefits. For example, when a fund is out of compliance with the proposed VaR-based limit on fund leverage risk, this may indicate that a fund is experiencing heightened risks as a result of a fund's use of derivatives transactions. Such breaches also could indicate market events that are drivers of potential derivatives risks across the fund industry and therefore complement other sources of information related to such market events for the Commission. As a result, we believe that the proposed current reporting requirement would increase the effectiveness of the Commission's oversight of the fund industry by providing the Commission and staff with current information regarding potential increased risks and stress events, which in turn would benefit investors.

As discussed below in section IV.G, our estimated average cost burdens associated with the amendments to Form N–RN are based on the assumption that, of the estimated 2,424 funds that would be required to comply with either of the VaR tests, the Commission would receive approximately 30 filings per year in response to each of the new VaR-related items proposed to be included in Form N–RN, as amended. We estimate such funds would incur an average cost of $3.49 per year on a per-fund basis [582] to prepare amended Form N–RN. Thus, the estimated total industry cost for this reporting requirement in the first year for funds required to comply with either of the VaR tests is $8,460.[583]

We do not believe there would be any potential indirect costs associated with filing Form N–RN, such as spillover effects or the potential for investor flight due to a VaR test breach (to the extent that investors would leave a fund if they believed a fund's VaR test breaches

a group of funds, and would increase the overall efficiency of staff in analyzing the information.

[574] This estimate is based on the following derivations and calculations: (2 hours × $365 (compliance attorney) + 2 hours × $331 (senior programmer) + ($5,590 for initial external cost burden)) = $6,982 to comply with the new N–PORT requirements of derivatives exposure information in the first reporting quarter of the fiscal year.

[575] This estimate is based on the following derivations and calculations: (3 hours × $365 (compliance attorney) + 3 hours × $331 (senior programmer)) = $2,088 per year to comply with the new N–PORT requirements of derivatives exposure information in the final three reporting quarters of the fiscal year.

[576] This estimate is based on the following derivations and calculations: (4 hours × $365 (compliance attorney) + 4 hours × $331 (senior programmer) + ($5,590 for initial external cost burden)) = $8,374 to comply with the new N–PORT requirements of derivatives exposure and VaR-related information in the first reporting quarter of the fiscal year.

[577] This estimate is based on the following derivations and calculations: (6 hours × $365 (compliance attorney) + 6 hours × $331 (senior programmer)) = $4,176 to comply with the new N–PORT requirements of derivatives exposure and VaR-related information in the final three reporting quarters of the fiscal year.

[578] This estimate is based on the following calculations: (5,091 − 2,424 = 2,667 funds which are not subject to the VaR-related disclosure agreements) × ($6,982 + $2,088) = $24,189,690; and (2,424 funds which are subject to the VaR-related disclosure agreements) × ($8,374 + $4,176) = $30,421,200 for a total of ($24,189,690 + $30,421,200) = $54,610,890.

[579] This estimate is based on the following derivations and calculations: 0.01 hour × $365 (compliance attorney) + 0.01 hour × $331 (senior programmer) = $3.65 + $3.31 = $6.96 per year.

[580] This estimate is based on the following derivations and calculations: (12,375 registered funds required to prepare a report on Form N–CEN as amended) × $6.96 = $86,130.

[581] *See supra* section II.H.2.

[582] This estimate is based on the following derivations and calculations: 0.005 hour × $365 (compliance attorney) + 0.005 hour × $331 (senior programmer) = $1.83 + $1.66 = $3.49 per year on a per-fund basis.

[583] This estimate is based on the following derivations and calculations: (30 filings per year fractionalized across the 2,424 funds per year required to comply with either of the VaR tests) × $3.49 = $8,460.

indicate that a fund has a risk profile that is inconsistent with their investment goals and risk tolerance), because Form N–RN filings would not be publicly disclosed. Because the Form N–RN filing requirements would be triggered by events that are part of a fund's proposed requirement to determine compliance with the applicable VaR test at least daily, any monitoring costs associated with Form N–RN are included in our estimates of the compliance costs for rule 18f–4 above.

10. Money Market Funds

Money market funds are excluded from the scope of proposed rule 18f–4. As we are proposing to rescind Release 10666, however, money market funds would not be able to enter into transactions covered by proposed rule 18f–4, including derivatives transactions and reverse repurchase agreements. As discussed above in section II.A.1, we believe that money market funds currently do not typically engage in derivatives transactions or the other transactions permitted by rule 18f–4.[584] However, to the extent that there are money market funds that do engage in such transactions to increase the efficiency of their portfolio management, these funds would bear the costs associated with losing any such efficiencies.

However, we believe any costs to money market funds that may currently enter into transactions covered by proposed rule 18f–4 would likely be small. Specifically, as discussed above in section II.A.1, we believe that these transactions would generally be inconsistent with a money market fund maintaining a stable share price or limiting principal volatility, and especially if used to leverage the fund's portfolio. Therefore, we do not believe that any fund that may currently engage in these transactions would use them as an integral part of its investment strategy.

D. Effects on Efficiency, Competition, and Capital Formation

This section evaluates the impact of the proposed rules and amendments on efficiency, competition, and capital formation. However, we are unable to quantify the effects on efficiency, competition, and capital formation because we lack the information necessary to provide a reasonable estimate. For example, we are unable to predict how the proposed rules, amendments, and form amendments would change investors' propensity to invest in funds and ultimately affect capital formation. Therefore, much of the discussion below is qualitative in nature, although where possible we attempt to describe the direction of the economic effects.

1. Efficiency

Proposed rule 18f–4 in conjunction with the proposed rescission of Release 10666 may make derivatives use more efficient for certain funds, particularly for those funds that would qualify as limited derivatives users. Specifically, funds' current asset segregation practices may provide a disincentive to use derivatives for which notional amount segregation is the practice, even if such derivatives would otherwise provide a lower-cost method of achieving desired exposures than purchasing the underlying reference asset directly. For example, a fund seeking to sell credit default swaps to take a position in an issuer's credit risk may currently choose not to do so because of the large notional amounts that the fund would segregate for that specific derivatives position. The proposed rule therefore could increase efficiency by mitigating current incentives for funds to avoid use of certain derivatives (even if foregoing the use of those derivatives would entail cost and operational efficiencies).

In addition, the proposed rules and amendments may change the degree to which some funds choose to use derivatives generally or the degree to which funds use certain derivatives over others.[585] Changes in the degree to which certain derivatives are used by funds could affect the liquidity and price efficiency of these derivatives. Although unaddressed in the academic literature, we expect an increase in the use of derivatives to correspond to an increase in derivatives market liquidity as more derivatives contracts may be easily bought or sold in markets in a given period, as well as an increase in price efficiency since information regarding underlying securities (and other factors that affect derivatives prices) may be better reflected in the prices of derivative contracts.

Changes in the degree to which certain derivatives are used could also affect the pricing efficiency and liquidity of securities underlying these derivatives and those of related securities. For example, one paper provides evidence that the introduction of credit default swap contracts decreases the liquidity and price efficiency of the equity security of the issuer referenced in the swap.[586] Conversely, the paper also observes that the introduction of exchange-traded stock option contracts improves the liquidity and price efficiency of the underlying stocks.

The proposed VaR-based limit on fund leverage risk would also establish a bright-line limit on the amount of leverage that a fund can take on using derivatives.[587] To the extent that funds are more comfortable with managing their derivatives exposures to a clear outside limit, the proposed rule could improve the efficiency of fund's portfolio risk management practices.

In addition, the recordkeeping elements of proposed rule 18f–4 would facilitate more efficient evaluation of

[584] Money market funds file monthly reports on Form N–MFP and disclose schedules of portfolio securities held on the form. For each security held, Form N–MFP requires money market funds to disclose the investment category most closely identifying the instrument held from a list of investment categories. *See* Item C.6 of Form N–MFP. However, the form does not contemplate nor include data element categories for transactions covered by proposed rule 18f–4, including derivatives transactions and reverse repurchase agreements. We therefore do not estimate the extent to which money market funds currently rely on these transactions.

[585] Specifically, (1) as discussed in the previous paragraph, funds may transact in more notional-value based derivatives as a result of removing the incentive distortion of notional- vs. market-value asset segregation under funds' current asset segregation practices; (2) new potential funds may reduce their use of derivatives transactions to satisfy the proposed VaR-based limit on fund leverage risk (*see supra* section III.C.2); (3) existing funds may change their use of derivatives transactions to respond to risks identified after adopting and implementing their risk management programs (*see supra* section III.C.1); and (4) both existing and new potential funds may increase their use of derivatives transactions as a result of the exemptive rule's bright-line limits on leverage risk (*see supra* section III.C.2). Overall, the effect of the proposed rules and amendments on funds use of derivatives transactions is ambiguous and depends on the type of derivatives transaction.

[586] This paper analyzed NYSE-listed firms and observed that, all else equal, equity markets become less liquid and equity prices become less efficient when single-name credit default swap contracts are introduced, while the opposite results hold when equity options are listed on exchanges. Ekkehart Boehmer, Sudheer Chava, & Heather E. Tookes, *Related Securities and Equity Market Quality: The Case of CDS,* 50 Journal of Financial and Quantitative Analysis 509 (2015), *available at https://www.cambridge.org/core/journals/journal-of-financial-and-quantitative-analysis/article/related-securities-and-equity-market-quality-the-case-of-cds/08DE66A250F9950FA486AE818D5E0341.* The latter result, that traded equity options are associated with more liquid and efficient equity prices, is consistent with several other academic papers. *See, e.g.,* Charles Cao, Zhiwu Chen, & John M. Griffin, *Informational Content of Option Volume Prior to Takeovers,* 78 Journal of Business 1073 (2005), as well as Jun Pan & Allen M. Poteshman, *The Information in Option Volume for Future Stock Prices,* 19 Review of Financial Studies 871 (2006). The effects described in the literature are based on studies of the introduction of derivative securities and may therefore apply differently to changes in the trading volume of derivatives securities that may occur as a result of the proposed rule.

[587] *See supra* section III.C.2.

compliance with the rule while also providing the Commission with information that may be useful in assessing market risks associated with derivative products. Moreover, the proposed amendments to fund's current reporting requirements could facilitate the Commission's oversight of funds subject to proposed rule 18f–4 with fewer resources, thus making its supervision more efficient.[588]

The amendments to Forms N–PORT and N–CEN would allow investors, to the extent that they use the information, to better differentiate funds that are not limited derivatives users or leveraged/inverse funds based on their derivatives usage.[589] As a result, investors would be able to more efficiently identify the extent to which such funds use derivatives as part of their investment strategies, allowing them to make better-informed investment decisions.

The proposed sales practices rules could also reduce investments in leveraged/inverse investment vehicles, to the extent that some retail investors would not be approved by their broker-dealer or investment adviser to transact in leveraged/inverse investment vehicles or to the extent that some retail investors would be deterred by the time costs and delay introduced by the account-opening procedures.[590] The proposed amendments to rule 6c–11, however, would likely outweigh these effects in the case of leveraged/inverse ETFs and lead to an overall increase in the number and assets under management for these types of funds.

To the extent that the proposed rules would lead to a reduction in investment in leveraged/inverse commodity- or currency-based trusts or funds, the liquidity of these products may decline as a result. Conversely, to the extent that the proposed rules would lead to an overall increase in investments in leveraged/inverse ETFs, the liquidity of these funds may increase as a result. The likely increase in the number, and assets under management, of leveraged/inverse ETFs as a result of the proposed amendments to rule 6c–11 may affect the quality of the markets for underlying securities and derivatives. Specifically, the academic literature to date provides some evidence, albeit inconclusive, that leveraged/inverse ETFs' rebalancing activity may have an impact on the price and volatility of the constituent assets that make up the ETFs. For example, one paper empirically tests whether the rebalancing activity of leveraged/inverse ETFs impacts the price and price volatility of underlying stocks.[591] The authors find a positive association, suggesting that rebalancing demand may affect the price and price volatility of component stocks, and may reduce the degree to which prices reflect fundamental value of the component stocks. As leveraged/inverse ETFs commonly use derivatives to rebalance their portfolios, similar effects could also extend to underlying derivatives, although we are not aware of any academic literature that has examined the effects of leveraged/inverse ETFs' rebalancing activity on derivatives markets. Conversely, another paper argues that the existing literature that studies the effect of leveraged/inverse ETFs' rebalancing activity on the constituent asset prices does not control for the effect of the creation and redemption transactions (*i.e.,* fund flows) by authorized participants.[592] The paper presents evidence that positively leveraged/inverse ETFs tend to have capital flows in the opposite direction of the underlying index, and inverse leveraged/inverse ETFs tend to have capital flows in the same direction as the underlying index, suggesting that investor behavior may attenuate the effect of leveraged/inverse ETFs' rebalancing activity on the prices of underlying securities and derivatives.[593]

2. Competition

Certain aspects of the proposed rules and amendments may have an impact on competition. Certain of these potential competitive effects result from the proposed rule imposing differential costs on different funds. Specifically, (1) large fund complexes may find it less costly to comply per fund with the new requirements of proposed rule 18f–4;[594] (2) funds that would qualify as limited derivatives users would generally incur lower compliance costs associated with the rule than funds that would not qualify for this exception;[595] (3) funds that would comply with the relative VaR test would generally incur higher compliance costs than those that would comply with the absolute VaR test; (4) BDCs are not subject to the additional reporting requirements on Forms N–CEN or N–PORT and would therefore not incur the increased compliance costs that would be imposed on filers of these forms; and (5) leveraged/inverse funds are not subject to several of the additional reporting requirements on Forms N–CEN or N–PORT and would therefore incur a reduced additional burden compared to other funds that are not limited users of derivatives.[596] To the extent that investors believe that the funds that would incur lower compliance burdens and the funds that would incur a higher compliance burden under the rule are substitutes, the rule would result in a competitive advantage for funds with the lower compliance burden to the extent that a lower burden makes such funds materially less costly to operate.

To the extent that the proposed sales practices rules' due diligence and account approval requirements limit certain customers or clients from buying or selling shares of certain leveraged/inverse investment vehicles, such investors may instead opt to invest in another product with a similar risk profile that is not subject to those requirements.[597] Thus, the proposed sales practices rules may generate substitution spillover effects that increase competition between leveraged/inverse investment vehicles within the scope of the rule and other products outside the scope of the rule that provide similar exposures.

Similarly, broker-dealers and investment advisers with a larger fraction of retail customers or clients that can no longer transact in leveraged/inverse investment vehicles as a result of the proposed sales practices rules' due diligence and account approval requirements may experience larger declines in their customer or client base.[598] As a result, broker-dealers and investment advisers that would see a larger reduction in customers or clients may be at a competitive disadvantage

[588] *See supra* section III.C.8.

[589] *See supra* section III.C.9.a.

[590] *See supra* section III.B.5.

[591] *See* Qing Bai, Shaun A. Bond & Brian Hatch, *The Impact of Leveraged and Inverse ETFs on Underlying Real Estate Returns,* 43 Real Estate Economics 37 (2015).

[592] *See* Ivan T. Ivanov & Stephen Lenkey, *Are Concerns About Leveraged ETFs Overblown?,* FEDS Working Paper No. 2014–106 (2014).

[593] The literature we are aware of focuses on leveraged/inverse ETFs and does not study similar effects of leveraged/inverse mutual funds, although both types of funds generally engage in similar rebalancing activity. To the extent that similar effects may be attributable to leveraged/inverse mutual funds and that any increase in leveraged/inverse ETF assets would be (at least partially) offset by a decrease in leveraged/inverse mutual fund assets, this may ameliorate the overall effect on the price and volatility of constituent assets.

[594] *See supra* section III.C.2.

[595] *See supra* section III.C.3.

[596] *See supra* section III.C.2.

[597] Some investors that are not approved to buy or sell leveraged/inverse investment vehicles may opt to move their capital into exchange-traded notes or other products with a similar risk profile. Conversely, some investors may transact in leveraged/inverse investment vehicles without involving a broker-dealer or investment adviser that would be subject to the proposed sales practices rules, although this is uncommon. *See supra* note 321.

[598] Any such reduction in a broker-dealer's or investment adviser's customer base may be offset to the extent that clients transact in other products with the same broker dealer or investment adviser instead. *See supra* section III.C.5.

compared to broker-dealers and investment advisers that would see only a smaller reduction in customers or clients or no reduction at all.

The Commission has not provided exemptive relief to new prospective sponsors of leveraged/inverse ETFs since 2009.[599] The proposed amendments to rule 6c–11 would allow other leveraged/inverse ETFs to enter the leveraged/inverse ETF market, likely leading to more competition among leveraged/inverse ETFs and between leveraged/inverse ETFs and other products that investors may perceive as substitutes, such as leveraged/inverse mutual funds. This increase in competition could be significant, as the leveraged/inverse ETF market is very concentrated; currently, only two fund sponsors operate leveraged/inverse ETFs.[600] In addition, fees for leveraged/inverse ETFs and substitute products, such as leveraged/inverse mutual funds, could fall as a result of any such increase in competition.

3. Capital Formation

Certain aspects of the proposed rules and amendments may have an impact on capital formation. Certain of these effects may arise from a change in investors' propensity to invest in funds. On the one hand, investors may be more inclined to invest in funds as a result of increased investor protection arising from any decrease in leverage-related risks. On the other hand, some investors may reduce their investments in certain funds that may increase their use of derivatives in light of the bright-line VaR-based limit on fund leverage risk.[601] Additionally, some investors may re-evaluate their desire to invest in funds generally as a result of the increased disclosure requirements, with some investors deciding to invest more and other investors deciding to invest less. While we are unable to determine whether the proposed rules and amendments would lead to an overall increase or decrease in fund assets, to the extent the overall fund assets change, this may have an effect on capital formation.

The proposed rule may also decrease the use of reverse repurchase agreements, similar financing transactions, or borrowings by some funds, or reduce some funds' ability to invest the borrowings obtained through reverse repurchase agreements.[602] To the extent that this restricts a fund's ability to obtain financing to invest in debt or equity securities, capital formation may be reduced.

In addition, the proposed sales practices rules may reduce capital formation in asset markets directly connected with covered leveraged/inverse investment vehicles. By restricting the accounts of customers or clients seeking to buy or sell shares of a leveraged/inverse investment vehicle, the proposed rules may produce net capital outflows from retail investors. However, the size of this effect would depend on the number of retail investors that would no longer be approved to buy or sell shares of leveraged/inverse investment vehicles and any other investments these retail investors would make in lieu of investing in leveraged/inverse investment vehicles.

E. Reasonable Alternatives

1. Alternative Implementations of the VaR Tests

a. Different Confidence Level or Time Horizon

Proposed rule 18f–4 would require that a fund's VaR model use a 99% confidence level and a time horizon of 20 trading days.[603] We could alternatively require a different confidence level and/or a different time horizon for the VaR test.

As discussed above in section II.D.4, market participants calculating VaR most commonly use 95% or 99% confidence levels and often use time horizons of 10 or 20 days. The proposed VaR parameters therefore represent a confidence level and time horizon at the high end of what is commonly used. Compared to requiring a lower confidence level and a shorter time horizon, the proposed parameters result in a VaR test that is designed to measure, and therefore limit the severity of, less frequent but larger losses. The cost of calculating VaR does not vary based on how the model is parametrized, meaning the proposed confidence level and time horizon would not lead to larger compliance costs for funds compared to the alternatives we considered. A lower confidence level or shorter time horizon may be less effective at placing a VaR-based outer limit on fund leverage risk associated with larger losses and would not result in cost savings for funds.

b. Absolute VaR Test Only

To establish an outer limit for a fund's leverage risk, the proposed rule would generally require a fund engaging in derivatives transactions to comply with a relative VaR test; the fund could instead comply with an absolute VaR test only if the derivatives risk manager is unable to identify an appropriate designated reference index for the fund. As an alternative, we could require all funds that would be subject to the proposed VaR-based limit on fund leverage risk to comply with an absolute VaR test.

Use of an absolute VaR test would be less costly for some funds that would be required to comply with the relative VaR test under the proposed rule, including because the relative VaR test may require some funds to pay licensing costs associated with the use of the reference index.[604] In addition, use of an absolute VaR test would reduce the compliance challenge for fund risk managers who have difficulty identifying a designated reference index; however, this benefit would be limited for funds that have an existing or easy-to-identify benchmark.

On the other hand, the absolute VaR test is a static measure of fund risk in the sense that the implied limit on a fund's VaR will not change with the VaR of its designated reference index. The absolute VaR test is therefore less suited for measuring leverage risk and limiting the degree to which a fund can use derivatives to leverage its portfolio, as measuring leverage inherently requires comparing a fund's risk exposure to that of an unleveraged point of reference.[605] An additional implication of this aspect of an absolute VaR test is that a fund may fall out of compliance with an absolute VaR test just because the market it invest in becomes more volatile even though the degree of leverage in the fund's portfolio may not have changed. Overall, we believe that permitting funds to rely on an absolute VaR test only in those instances when a designated reference index is unavailable is justified.

c. Choice of Absolute or Relative VaR Tests

As another alternative, we could allow derivatives risk managers to choose between an absolute and a relative VaR limit, depending on their preferences and without regard to whether a designated reference index is available. Such an alternative would offer derivatives risk managers more flexibility than the proposed rule and

[599] *See supra* text following note 473.

[600] The increase in competition among leveraged/inverse ETFs could be attenuated, to the extent that proposed rule 15*l*–2's and 211(h)–1's due diligence requirements would limit the number of investors that invest in these funds. *See supra* section III.C.5.

[601] *See supra* section III.C.2.

[602] *See supra* section III.C.4.

[603] *See supra* section II.D.4.

[604] *See supra* section III.C.2.

[605] *Id.*

could reduce compliance costs for funds, to the extent that derivatives risk managers would choose the VaR test that is cheaper to implement for their particular fund. However, this alternative may result in less uniformity in the outer limit on funds' leverage risk across the industry, as individual derivatives risk managers would have the ability to choose between VaR-based tests that could provide for different limits on fund leverage risk. Funds that invest in assets with a low VaR, for example, could obtain significantly more leverage under an absolute VaR test because the VaR of the fund's designated reference index would be low; as a result, investors in these funds would be less protected from leverage-related risks compared to the proposed rule.

d. Optional Relative VaR Test Using a Fund's ''Securities VaR''

As another alternative, we could allow funds relying on the relative VaR test to compare the fund's VaR to its ''securities VaR'' (*i.e.,* the VaR of the fund's portfolio of securities and other investments, but excluding any derivatives transactions), rather than the VaR of the fund's designated reference index, depending on the derivatives risk manager's preferences and without regard to whether a designated reference index is available.[606]

While such an alternative would offer derivatives risk managers more flexibility than the proposed rule, we believe that it would not be easier to implement or lead to cost savings for a significant number of funds. Conversely, the alternative VaR test based on a fund's ''securities VaR'' would provide an incentive for some funds to invest in volatile, riskier securities that would increase the fund's ''securities VaR,'' thereby reducing the test's effectiveness at limiting fund leverage risk. As a result, investors in these funds would be less protected from leverage-related risks compared to the proposed rule.

e. Third-Party Validation of a Fund's VaR Model

The proposed rule does not require third-party validation of a fund's chosen VaR model. As an alternative, we could require that a fund obtain third-party validation of its VaR model, either at inception or in connection with any material changes to the model, to independently confirm that the model is structurally sound and adequately captures all material risks.[607] While such a requirement could help ensure funds' compliance with the proposed VaR-based limit on fund leverage risk, this incremental benefit may not justify the potentially significant additional costs to funds associated with third-party validation of the fund's VaR model.[608]

2. Alternatives to the VaR Tests

a. Stress Testing

As an alternative to the proposed VaR-based limit on fund leverage risk, we could require a stress testing approach. As discussed above in section II.D.6.a, we understand that many funds that use derivatives transactions already conduct stress testing for purposes of risk management. However, we do not believe that a stress testing approach would impose significantly lower costs on funds compared to a VaR-based approach, with the exception of those funds that already conduct stress testing but not VaR testing.[609]

In addition, as also discussed in section II.D.6.a above, it would be challenging for the Commission to specify a set of asset class shocks, their corresponding shock levels, and, in the case of multi-factor stress testing, assumptions about the correlations of the shocks, in a manner that applies to all funds and does not become stale over time. While we could also prescribe a principles-based stress testing requirement, we believe that the flexibility such an approach would give to individual funds over how to implement the test would render it less effective than the proposed VaR test at establishing an outer limit on fund leverage risk.

Finally, stress testing generally focuses on a narrower and more remote range of extreme loss events compared to VaR analysis. As a result, a limit on fund leverage risk based on stress testing would likely be less effective at limiting fund leverage risk during more normal conditions and protecting investors from unexpected losses resulting from less extreme scenarios.

b. Asset Segregation

As another alternative, we could require an asset segregation approach in lieu of the proposed VaR-based limit on fund leverage risk. For example, we could consider an approach similar to the Commission's position in Release 10666, under which a fund engaging in derivatives transactions would segregate cash and cash equivalents equal in value to the full amount of the conditional and unconditional obligations incurred by the fund (also referred to as ''notional amount segregation''). Such an approach could also permit a fund to segregate a broader range of assets, subject to haircuts.[610] Alternatively, we could require funds to segregate liquid assets in an amount equal to the fund's daily mark-to-market liability plus a ''cushion amount'' designed to address potential future losses.

As discussed above in section II.D.6.b, we believe that asset segregation approaches have several drawbacks as a means for limiting fund leverage risk, compared to the proposed VaR tests. For example, notional amount segregation is not risk-sensitive and could restrict derivatives transactions that would reduce portfolio risk. Similarly, segregation of liquid assets in an amount equal to the fund's daily mark-to-market liability plus a ''cushion amount'' would be difficult to implement in a manner that is applied uniformly across all funds and types of derivatives. In addition, asset segregation approaches raise certain compliance complexities that may not make them significantly less costly to implement for funds than the proposed VaR tests.[611]

In conjunction with the proposed VaR-based limit, we could also require a fund relying on the proposed rule to maintain an amount of ''qualifying coverage assets'' designed to enable a fund to meet its derivatives-related obligations. As discussed above, we believe that the proposed rule's requirements, including the requirements that funds establish risk management programs and comply with the proposed VaR-based limit on fund leverage risk, would address the risk that a fund may be required to realize trading losses by selling its investments to generate cash to pay derivatives counterparties.

[606] The 2015 Proposing Release also included a risk-based portfolio limit based on VaR, which provided that a fund would satisfy its risk-based portfolio limit condition if a fund's full portfolio VaR was less than the fund's ''securities VaR.'' *See* 2015 Proposing Release, *supra* note 2, at section III.B.2.

[607] *See also supra* note 243.

[608] We note that the UCITS regime requires third-party validation of funds' VaR models; as a result, these additional costs could be mitigated for fund that are part of a complex that also includes UCITS funds. *See supra* note 243.

[609] *See also* ICI Comment Letter III (stating that, ''depending on the type of fund managed and whether the fund currently employs the test for risk management purposes, some respondents viewed a stress loss test as being more burdensome to implement, while others viewed a VaR test as being more burdensome to implement.'').

[610] The 2016 DERA Memo, for example, analyzed different risk-based ''haircuts'' that could apply to a broader range of assets. *See, e.g.,* 2016 DERA Memo, *supra* note 12.

[611] *See supra* section II.D.6.b.

c. Exposure-Based Test

We alternatively considered proposing an exposure-based approach for limiting fund leverage risk in lieu of the proposed VaR test. An exposure-based test could limit a fund's derivatives exposure, as defined in the proposed rule, to a specified percentage of the fund's net assets. For example, we considered proposing that a fund limit its derivatives exposure to 50% of net assets. This would allow a fund to add to its portfolio an amount of derivatives exposure equal to the amount that an open-end fund could borrow from a bank. A similar approach would be to provide that the sum of a fund's derivatives exposure and the value of its other investments cannot exceed 150% of its net asset value. This latter approach, and particularly if cash and cash equivalents were not included in the calculation, would allow a fund to achieve the level of market exposure permitted for an open-end fund under section 18 using any combination of derivatives and other investments.

While an exposure-based test may be simpler and therefore less costly to implement for the typical fund than the proposed VaR tests, an exposure-based test has certain limitations compared to VaR tests, as discussed in detail in section above. One limitation is that measuring derivatives exposure based on notional amounts would not reflect how derivatives are used in a portfolio, whether to hedge or gain leverage, nor would it differentiate derivatives with different risk profiles. Various adjustments to the notional amount are available that may better reflect the risk associated with the derivatives transactions, although even with these adjustments the measure would remain relatively blunt. For example, an exposure-based limit could significantly limit certain strategies that rely on derivatives more extensively but that do not seek to take on significant leverage risk.

Some of the limitations of an exposure-based approach could be addressed, however, if rule 18f–4 were to provide an exposure-based test as an optional alternative to the proposed VaR tests, rather than as the sole means of limiting fund leverage risk. Under this second alternative, funds with less complex portfolios might choose to rely on an exposure-based test because it would be simpler and impose lower compliance costs than the proposed VaR tests. Furthermore, if we provided that the sum of a fund's derivatives exposure and the value of its other investments cannot exceed 150% of its net asset value, funds below this threshold would generally also pass the proposed relative VaR test.[612] Conversely, funds with more complex portfolios that rely on derivatives more extensively but that do not seek to take on significant leverage risk might choose to rely on the proposed VaR test. As the proposed rule would already except limited derivatives users from the VaR-based limit on fund leverage risk, however, we do not believe that also giving funds the option of relying on an exposure-based limit on fund leverage risk would be necessary or that it would significantly reduce the compliance burden associated with the rule.

3. Stress Testing Frequency

Proposed rule 18f–4 would require funds that enter into derivatives transactions and are not limited derivatives users to adopt and implement a derivatives risk management program that includes stress testing, among other elements. The proposed rule would permit a fund to determine the frequency of stress tests, provided that the fund must conduct stress testing at least weekly.

As an alternative to the weekly requirement, we considered both shorter and longer minimum stress testing frequencies. On the one hand, more frequent stress testing would reflect changes in risk for fund strategies that involve frequent and significant portfolio turnover. In addition, more frequent stress testing may reflect increases in market stress in a timelier manner. On the other hand, given the forward-looking nature of stress testing, we expect that most funds would take foreseeable changes in market conditions and portfolio composition into account when conducting stress testing. In addition, more frequent stress testing may impose an increased cost burden on funds, although we would expect any additional cost burden to be small, to the extent that funds perform stress testing in an automated manner. Overall, we preliminarily believe that the proposed minimum weekly stress testing appropriately balances the anticipated benefits of relatively frequent stress testing against the burdens of administering stress testing.

Another alternative would be to permit a fund to determine its own stress testing frequency without the proposed rule prescribing a minimum stress testing frequency. This approach would provide maximum flexibility to funds regarding the frequency of their stress tests, and would reduce compliance costs for funds that determine that stress testing less frequently than weekly is warranted in light of their own particular facts and circumstances. However, allowing funds to individually determine the frequency with which stress tests are conducted could result in some funds stress testing their portfolios too infrequently to provide timely information to the fund's derivatives risk manager and board. Taking these considerations into account, we are proposing to require weekly stress tests, rather than less frequent testing, to provide for consistent and reasonably frequent stress testing by all funds that would be required to establish a derivatives risk management program.

4. Alternative Exposure Limits for Leveraged/Inverse Funds

A fund that meets the definition of a ''leveraged/inverse investment vehicle'' in the proposed sales practices rules would not have to comply with the VaR-based leverage risk limit under proposed rule 18f–4, provided the fund limits the investment results it seeks to 300% of the return (or inverse of the return) of the underlying index and discloses in its prospectus that it is not subject to the proposed limit on fund leverage risk.[613] Alternatively, we could condition the exemption on compliance with a higher or lower exposure limit.

Over longer holding periods, the realized leverage multiple of the returns of an investment in a leveraged/inverse fund relative to the returns of its underlying index can vary substantially from the fund's daily leverage multiple.[614] All else equal, this effect becomes stronger as the fund's leverage multiple increases. The extent of a leveraged/inverse fund's rebalancing activity likewise increases as the fund's leverage multiple increases.[615] Therefore, the effects of leveraged/inverse funds' rebalancing activity on the constituent asset prices may be heightened if a significant number of leveraged/inverse funds were to increase their leverage beyond the levels currently observed in markets and,

[612] A fund that limited the sum of its derivatives exposure and the value of its other investments to 150% of its net asset value would generally also pass the proposed relative VaR test, provided that derivatives notionals are either not adjusted or only adjusted for delta in the case of options.

[613] *See supra* section II.G.3.

[614] *See supra* section III.B.5.

[615] The rebalancing demand of a leveraged/inverse fund is a function of the fund's assets, the realized return of its reference index, and is proportional to the term , where denotes the fund's leverage multiple. (*See, e.g.,* Minder Cheng & Ananth Madhavan, *The dynamics of leveraged/inverse and inverse exchange-traded funds,* 7 Journal of Investment Management 4 (2009).) As a result, increasing a fund's leverage multiple increases its rebalancing demand more than linearly.

conversely, could be diminished if a significant number of leveraged/inverse funds were to reduce their leverage below current levels.

While permitting a higher exposure limit may benefit fund sponsors to the extent that some sponsors would bring funds with higher leverage multiples to market, we are concerned that a higher exposure limit would heighten the investor protection concerns these funds present. Conversely, limiting leveraged/inverse funds' exposure could reduce the concerns these funds present, but could reduce investor choice relative to the baseline given that leveraged/inverse funds today operate with levels of leverage up to the exposure limit we propose. Allowing funds to continue to obtain this level of leverage, subject to the additional requirements in proposed rule 18f–4 and in light of the proposed sales practices rules, is designed to address the investor protection concerns that underlie section 18, while preserving choice for retail investors who are capable of evaluating their characteristics and unique risks. For these reasons, and because the Commission does not have experience with leveraged/inverse funds that seek returns above 300% of the return (or inverse of the return) of the underlying index, we are not proposing to permit higher levels of leveraged/inverse market exposure for leveraged/inverse funds in this rule. We also are not proposing a lower exposure limit for these funds in light of the investor protections that we believe proposed rule 18f–4 and the sales practices rules would provide.[616]

5. No Sales Practices Rules and No Separate Exposure Limit for Leveraged/Inverse Funds

The proposed rules would require a leveraged/inverse fund that meets the definition of a ''leveraged/inverse investment vehicle'' to limit its investment results to 300% of the return (or inverse of the return) of the underlying index and would require a broker-dealer or investment adviser to exercise due diligence in approving a retail investor's account to buy or sell shares of leveraged/inverse investment vehicles, as well as implement policies and procedures reasonably designed to achieve compliance with the proposed rules.[617] In lieu of the proposed sales practices rules and associated exception from the VaR-based limit on fund leverage risk, we could alternatively require leveraged/inverse funds to comply with the proposed relative VaR test.

Existing leveraged/inverse ETFs and mutual funds generally could comply with the proposed relative VaR test only if they restricted the investment results they seek to 150% of the return (or inverse of the return) of the underlying index. Therefore, under this alternative, leveraged/inverse funds that seek investment results in excess of this limit would either have to significantly change their investment strategy or liquidate. Given that existing fund sponsors frequently offer leveraged/inverse funds with various target multiples referencing the same index, we would expect that this alternative would reduce the number of leveraged/inverse funds.

Compared to the proposal, this alternative would also restrict choice for investors that prefer to invest in leveraged/inverse funds that pursue investment results in excess of 150% of the return (or inverse of the return) of the underlying index and who would satisfy the due diligence and approval requirements adopted by their broker-dealer or investment adviser in connection with the proposed rule.

At the same time, the alternative could result in increased investor protection for investors in these funds compared to the proposal. While investors' access to leveraged/inverse funds would not be subject to the proposed sales practice rules under this alternative (and investment advisers and broker-dealers would not incur the associated compliance costs), these funds would be required to limit their exposure to 150% of the return (or inverse of the return) of the underlying index, thereby reducing the potential consequences for leveraged/inverse fund investors who are not capable of evaluating their return characteristics and ameliorating the associated investor protection concerns. Conversely, the alternative would reduce protection for investors in leveraged/inverse commodity- and currency-based trusts or funds, as those funds would be subject to neither the 150% exposure limit nor the proposed sales practices rules.

Finally, because leveraged/inverse funds would no longer be able to offer exposures above 150% of the return (or inverse of the return) of the underlying index, the alternative may ameliorate the concerns associated with the rebalancing activity of leveraged/inverse ETFs, which decreases with the targeted leverage multiple of these funds.[618] As discussed above in section D.1, however, while the literature observes that leveraged/inverse ETFs' rebalancing activity may have an adverse impact on the prices and volatility of the constituent assets that make up leveraged/inverse ETFs, the literature, overall, is not definitive.

Overall, we believe that preserving investor choice justifies providing leveraged/inverse funds an exemption from the proposed VaR-based limit on fund leverage risk, particularly in light of the proposed sales practices rules, which we believe would help to ensure that investors in these funds are limited to those who are capable of evaluating the characteristics and risks of these products.[619]

6. Enhanced Disclosure

As an alternative to the requirements in rule 18f–4, such as the proposed derivatives risk management program and the VaR-based limit on fund leverage risk, we could consider addressing the risks associated with funds' use of derivatives through enhanced disclosures to investors with respect to a fund's use of derivatives and the resulting derivatives-related risks.[620] While an approach focused on enhanced disclosures could result in greater fund investment flexibility, such an approach may be less effective than the proposed rule in addressing the purposes and concerns underlying section 18 of the Investment Company Act. Section 18 itself imposes a specific limit on the amount of senior securities that a fund may issue, regardless of the level of risk introduced or the disclosure that a fund provides regarding those risks. Absent additional requirements to limit leverage or potential leverage, requiring enhancement to derivatives disclosure alone would not appear to provide any limit on the amount of leverage a fund may obtain. Indeed, the degree to which funds use derivatives varies widely between funds. As a result, an approach focused solely on enhanced disclosure requirements may not provide a sufficient basis for an exemption from the requirements of section 18 of the Investment Company Act.

[616] *See supra* section II.G.3.

[617] *See supra* sections II.G.3 and II.G.2.

[618] *See supra* sections III.D.1 and III.E.4. While the literature focuses on leveraged/inverse ETFs, the results may apply similarly to leveraged/inverse mutual funds.

[619] *See also supra* note 535.

[620] *See, e.g.,* Comment Letter of the Fixed Income Market Structure Advisory Committee on proposed rule 6c–11 under the Investment Company Act (Oct. 29, 2018) (recommending that the Commission consider future rulemaking regarding ''leveraged ETP'' investor disclosure requirements).

F. Request for Comments

The Commission requests comment on all aspects of this initial economic analysis, including whether the analysis has: (1) Identified all benefits and costs, including all effects on efficiency, competition, and capital formation; (2) given due consideration to each benefit and cost, including each effect on efficiency, competition, and capital formation; and (3) identified and considered reasonable alternatives to the proposed new rules and rule amendments. We request and encourage any interested person to submit comments regarding the proposed rules, our analysis of the potential effects of the proposed rules and proposed amendments, and other matters that may have an effect on the proposed rules. We request that commenters identify sources of data and information as well as provide data and information to assist us in analyzing the economic consequences of the proposed rules and proposed amendments. We also are interested in comments on the qualitative benefits and costs we have identified and any benefits and costs we may have overlooked. In addition to our general request for comments on the economic analysis associated with the proposed rules and proposed amendments, we request specific comment on certain aspects of the proposal:

254. Are we correct that many funds already have a derivatives risk management program in place that could be readily adapted to meet the proposed rule's requirements without significant additional cost? If so, for how many funds would this be true?

255. The proposed rule does not include any requirement for third-party validation of a fund's chosen VaR model, either at inception or upon material changes, to confirm that the model is structurally sound and adequately captures all material risks.[621] How costly would such a requirement be to funds? What would the benefits of such a requirement be?

256. Are we correct that many funds that use derivatives in a limited manner already have in place policies and procedures that are reasonably designed to address their derivatives that could be readily adapted to meet the proposed rule's requirements without significant additional cost? If so, for how many funds would this be true?

257. How many broker-dealers provide customers the ability to buy or sell interests in leveraged/inverse investment vehicles? How many investment advisers place orders to buy or sell leveraged/inverse investment vehicles for their advisory clients? How many retail investor accounts with broker-dealers and investment advisers trade leveraged/inverse investment vehicles?

258. How many current investors in leveraged/inverse investment vehicles would likely not be approved to buy or sell these products under the proposed sales practices rules' due diligence and account approval requirements?

259. If we provided that the sum of a fund's derivatives exposure and the value of its other investments cannot exceed 150% of its net asset value, funds below this threshold would generally also pass the proposed relative VaR test. How many funds would be likely to rely on such an exposure-based test if exempted funds that satisfied this limit from the proposed VaR tests?

IV. Paperwork Reduction Act Analysis

A. Introduction

Proposed rule 18f–4, proposed rule 15*l*–2, and proposed rule 211(h)–1 would result in new ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 (''PRA'').[622] In addition, the proposed amendments to rule 6c–11 under the Investment Company Act, as well as to Forms N–PORT, Form N–LIQUID (which would be renamed Form N–RN), and N–CEN would affect the collection of information burden under those rules and forms.[623]

The titles for the existing collections of information are: ''Form N–PORT'' (OMB Control No. 3235–0731); ''Form N–LIQUID'' (OMB Control No. 3235–0754); ''Form N–CEN'' (OMB Control No. 3235–0730); and ''Rule 6c–11 under the Investment Company Act of 1940, Exchange-traded funds'' (OMB Control No. xxxx–xxxx). The titles for the new collections of information would be: ''Rule 18f–4 under the Investment Company Act of 1940, Use of Derivatives by Registered Investment Companies and Business Development Companies,'' ''Rule 15*l*–2 under the Securities Exchange Act of 1934, Broker and Dealer Sales Practices for Leveraged/Inverse Investment Vehicles,'' and ''Rule 211(h)–1 under the Investment Advisers Act of 1940, Investment Adviser Sales Practices for Leveraged/Inverse Investment Vehicles.'' The Commission is submitting these collections of information to the Office of Management and Budget (''OMB'') for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently-valid control number.

The Commission published notice soliciting comments on the collection of information requirements in the 2015 Proposing Release and submitted the proposed collections of information to OMB for review and approval in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11.[624] The Commission received comments on the 2015 proposal's collection of information burden regarding the 2015 proposal's trade-by-trade determination of compliance with portfolio limits.[625] These comments were considered but did not form the basis of our burden estimates because we do not propose a trade-by-trade determination of compliance with the proposed VaR-based tests.

We discuss below the collection of information burdens associated with proposed rule 18f–4, proposed rule 15*l*–2, proposed rule 211(h)–1, as well as proposed amendments to rule 6c–11 and Forms N–PORT, N–LIQUID, and N–CEN.

B. Proposed Rule 18f–4

Proposed rule 18f–4 would permit a fund to enter into derivatives transactions, notwithstanding the prohibitions and restrictions on the issuance of senior securities under section 18 of the Investment Company Act.

Proposed rule 18f–4 would generally require a fund that relies on the rule to enter into derivatives transactions to: Adopt a derivatives risk management program; have its board of directors approve the fund's designation of a derivatives risk manager and receive direct reports from the derivatives risk manager about the derivatives risk management program; and require a fund to comply with a VaR-based test designed to limit a fund's leverage risk consistent with the investor protection purposes underlying section 18.

[621] *See also supra* note 243.

[622] 44 U.S.C. 3501–3520.

[623] We do not believe that the proposed conforming amendment to Form N–2, to reflect a clarification that funds do not have to disclose in their senior securities table the derivatives transactions and unfunded commitment agreements entered into in reliance on proposed rule 18f–4, makes any new substantive recordkeeping or information collection within the meaning of the PRA. Accordingly, we do not revise any burden and cost estimates in connection with this proposed amendment.

[624] *See* 2015 Proposing Release, *supra* note 2.

[625] *See, e.g.,* Vanguard Comment Letter; Invesco Comment Letter; *see also supra* note 245 and accompanying text.

Proposed rule 18f–4 includes an exception from the risk management program requirement and limit on fund leverage risk if a fund is a ''limited derivatives user'' that either limits its derivatives exposure to 10% of its net assets or it uses derivatives transactions solely to hedge certain currency risks. A fund relying on the proposed exception would be required to adopt policies and procedures that are reasonably designed to manage its derivatives risks. Proposed rule 18f–4 also includes alternative requirements for a leveraged/inverse fund not subject to the proposed VaR-based leverage risk limit, if such a fund: (1) Meets the definition of a ''leveraged/inverse investment vehicle'' in the proposed sales practices rules; (2) limits the investment results it seeks to 300% of the return (or inverse of the return) of the underlying index; and (3) discloses in its prospectus that it is not subject to proposed rule 18f–4's limit on fund leverage risk.[626] Proposed rule 18f–4 also would require a fund to adhere to certain recordkeeping requirements that are designed to provide the Commission's staff, and the fund's board of directors and compliance personnel, the ability to evaluate the fund's compliance with the proposed rule's requirements.

The respondents to proposed rule 18f-4 would be registered open- and closed-end management investment companies and BDCs.[627] We estimate that 5,091 funds would likely rely on rule 18f–4.[628] Compliance with proposed rule 18f–4 would be mandatory for all funds that seek to engage in derivatives transactions in reliance on the rule, which would otherwise be subject to the restrictions of section 18. To the extent that records required to be created and maintained by funds under the rule are provided to the Commission in connection with examinations or investigations, such information would be kept confidential subject to the provisions of applicable law.

1. Derivatives Risk Management Program

Proposed rule 18f–4 would require certain funds relying on the rule to adopt and implement a written derivatives risk management program, which would include policies and procedures reasonably designed to manage the fund's derivatives risks. The proposal would require a fund's program to include the following elements: (1) Risk identification and assessment; (2) risk guidelines; (3) stress testing; (4) backtesting; (5) internal reporting and escalation; and (6) periodic review of the program.[629] Under the proposed rule, the derivatives risk manager is responsible for administering the derivatives risk management program and its policies and procedures. Certain funds relying on the proposed rule would not be subject to the program requirement.[630] We estimate that 2,693 funds would likely be subject to the program requirement.[631] Below we estimate the initial and annual ongoing burdens associated with initial documentation of the program, and any revision (and related documentation) of the derivatives risk management program arising from the periodic review of the program. In addition to the initial burden to document the program, including policies and procedures reasonably designed to manage the fund's derivatives risks, we estimate that a fund relying on the proposed rule would have an ongoing burden associated with the proposed periodic review requirements to evaluate the program's effectiveness and to reflect changes in the fund's derivatives risks over time. Below we estimate the initial and annual ongoing burdens associated with documentation and any review and revision of funds' programs including their policies and procedures.

Table 2 below summarizes the proposed PRA initial and ongoing annual burden estimates associated with the derivatives risk management program requirement under proposed rule 18f–4. We do not estimate that there will be any initial or ongoing external costs associated with the derivatives risk management program requirement.

TABLE 2—DERIVATIVES RISK MANAGEMENT PROGRAM PRA ESTIMATES

	Internal initial burden hours	Internal annual burden hours [1]		Wage rate [2]	Internal time costs
Proposed Estimates					
Written derivatives risk management program development.	12	4	×	$357 (derivatives risk manager)	$1,428
	12	4	×	$466 (assistant general counsel)	1,864
	12	4	×	$365 (compliance attorney)	1,460
Periodic review and revisions of the program.	0	2	×	$357 (derivatives risk manager)	714
	0	2	×	$466 (assistant general counsel)	932
	0	2	×	$365 (compliance attorney)	730
Total annual burden per fund		18			7,128
Number of funds		× 2,693			× 2,693

[626] *See* proposed rule 18f–4(c)(4); *supra* section II.G.3.

[627] *See* proposed rule 18f–4(a) (defining ''fund'').

[628] *See supra* notes 467, 498 and accompanying text, and paragraph following note 525 (2,693 funds that would be subject to the proposed derivatives risk management program and limit on fund leverage risk requirements + 2,398 funds relying on the limited derivatives user exception and complying with the related limited derivatives user requirements).

The Commission's estimates of the relevant wage rates in the tables below are based on salary information for the securities industry compiled by the Securities Industry and Financial Markets Association's Office Salaries in the Securities Industry 2013. The estimated wage figures are modified by Commission staff to account for an 1,800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits, overhead, and adjusted to account for the effects of inflation. *See* Securities Industry and Financial Markets Association, Report on Management & Professional Earnings in the Securities Industry 2013 (''SIFMA Report'').

[629] *See* proposed rule 18f–4(c)(1)(i)–(vi); *supra* section II.A.2 (discussing the proposed derivatives risk management program requirement).

[630] A fund that is a limited derivatives user would not be required to comply with the proposed program requirement. Funds that are limited derivatives users would be required to adopt policies and procedures that are reasonably designed to manage its derivatives risks. *See* proposed rule 18f–4(c)(3); *infra* section IV.B.6 (discussing limited derivatives users).

[631] *See supra* notes 498, 627 and accompanying text.

TABLE 2—DERIVATIVES RISK MANAGEMENT PROGRAM PRA ESTIMATES—Continued

	Internal initial burden hours	Internal annual burden hours [1]	Wage rate [2]	Internal time costs
Total annual burden		48,474		19,195,704

Notes:
1. For "Written Derivatives Risk Management Program Development," these estimates include initial burden estimates annualized over a three-year period.
2. *See supra* note 627.

2. Board Oversight and Reporting

The proposed rule would require: (1) A fund's board of directors to approve the designation of the fund's derivatives risk manager,[632] (2) the derivatives risk manager to provide written reports to the board regarding the program's implementation and effectiveness,[633] and (3) the derivatives risk manager to provide written reports describing any exceedances of the fund's guidelines and the results of the fund's stress testing and backtesting.[634] We estimate that 2,693 funds would be subject to these requirements.[635]

Table 3 below summarizes the proposed PRA initial and ongoing annual burden estimates associated with the board oversight and reporting requirements under proposed rule 18f–4. We do not estimate that there will be any initial or ongoing external costs associated with the board oversight and reporting requirements.

TABLE 3—BOARD OVERSIGHT AND REPORTING PRA ESTIMATES

	Internal initial burden hours	Internal annual burden hours [1]		Wage rate [2]	Internal time costs
Proposed Estimates					
Approving the designation of the derivatives risk manager.	3	1	×	$17,860 (combined rate for 4 directors) [2]	$17,860
Derivatives risk manager written reports [3]		8	×	$357 (derivatives risk manager)	2,856
		1	×	$17,860 (combined rate for 4 directors)	17,860
Total annual burden per fund		10			11,786
Number of funds		× 2,693			× 2,693
Total annual burden		26,930			31,739,698

Notes:
1. For "Approving the Designation of the Derivatives Risk Manager," this estimate includes initial burden estimates annualized over a three–year period.
2. *See supra* notes 627.
3. *See supra* notes 631–632 and accompanying text.

3. Disclosure Requirement Associated With Limit on Fund Leverage Risk

The proposed rule would also generally require funds relying on the rule to comply with an outer limit on fund leverage risk based on VaR. This outer limit would be based on a relative VaR test that compares the fund's VaR to the VaR of a "designated reference index." If the fund's derivatives risk manager is unable to identify an appropriate designated reference index, the fund would be required to comply with an absolute VaR test.[636] Under the proposed rule, a fund must disclose its designated reference index in its annual report.[637] We estimate that 2,424 funds would be subject to this disclosure requirement.[638]

Table 4 below summarizes the proposed PRA initial and ongoing annual burden estimates associated with the disclosure requirement associated with the proposed limit on fund leverage risk. We do not estimate that there will be any paperwork-related initial or ongoing external costs associated with this proposed disclosure requirement.

[632] *See* proposed rule 18f–4(c)(5)(i); *supra* section II.C (discussing the proposed board oversight and reporting requirements).

[633] *See* proposed rule 18f–4(c)(5)(ii); *supra* section II.C.

[634] *See* proposed rule 18f–4(c)(5)(iii); *supra* section II.C. Burdens associated with reports to the fund's board of directors of material risks arising from the fund's derivatives transactions, as described in proposed rule 18f–4(c)(1)(v), are discussed above in *supra* section IV.B.1.

[635] *See supra* notes 498, 627 and accompanying text.

[636] The collections of information burdens for disclosure requirements associated with the proposed limit on fund leverage risk are reflected in the PRA for proposed rule 18f–4 and not in the funds' applicable disclosure forms because the burden arises from the proposed rule. The Paperwork Reduction Act analysis for the funds' applicable disclosure forms will not reflect the collections of information burdens for disclosure requirements associated with the proposed limit on fund leverage risk.

A fund that is a leveraged/inverse investment vehicle, as defined in the proposed sales practices rules, would not be required to comply with the proposed VaR-based limit on fund leverage risk. Broker–dealers and investment advisers would be required to approve retail investors' accounts to purchase or sell shares in these funds. *See infra* sections IV.C and IV.D (discussing leveraged/inverse investment vehicles and leveraged/inverse funds covered by the sales practices rules). The proposed rule also would provide an exception from the proposed VaR tests for funds that use derivatives to a limited extent or only to hedge currency risks. *See infra* sections IV.B.5 (discussing the proposed rule's provisions regarding limited derivatives users).

VaR test burdens related to recordkeeping and reporting are reflected in the recordkeeping section below, and also in the Forms N–PORT, N–CURRENT, and N–CEN burdens discussed below. *See infra* sections IV.F, IV.G, and IV.H.

[637] *See* proposed rule 18f–4(c)(2)(iv).

[638] *See supra* notes 519–520 and accompanying text.

TABLE 4—DISCLOSURE REQUIREMENT ASSOCIATED WITH LIMIT ON FUND LEVERAGE RISK PRA ESTIMATES

	Internal initial burden hours	Internal annual burden hours		Wage rate [1]	Internal time costs
Proposed Estimates					
Disclosure of designated reference index ..	0	.5	×	$309 (compliance manager)	$154.50
	0	.5	×	365 (compliance attorney)	182.50
Total annual burden per fund		1 hour			337
Number of funds		× 2,424			× 2,424
Total annual burden		2,424			816,888

Notes:
1. *See supra* note 627.

4. Disclosure Requirement for Leveraged/Inverse Funds

Under the proposed rule, a fund would not have to comply with the proposed VaR-based leverage risk limit if it: (1) Meets the definition of a ''leveraged/inverse investment vehicle'' in the proposed sales practices rules; (2) limits the investment results it seeks to 300% of the return (or inverse of the return) of the underlying index; and (3) discloses in its prospectus that it is not subject to proposed rule 18f–4's limit on fund leverage risk.[639] We estimate that 269 funds would be subject to the proposed prospectus disclosure requirement for leveraged/inverse funds.[640]

Table 5 below summarizes the proposed PRA initial and ongoing annual burden estimates associated with the disclosure requirement in the proposed rule's alternative provision for leveraged/inverse funds. We do not estimate that there will be any initial or ongoing external costs associated with this proposed disclosure requirement.

TABLE 5—DISCLOSURE REQUIREMENT ASSOCIATED WITH LEVERAGED/INVERSE FUNDS PRA ESTIMATES

	Internal initial burden hours	Internal annual burden hours		Wage rate [1]	Internal time costs
Proposed Estimates					
Leveraged/inverse fund prospectus disclosure.	0	.25	×	$309 (compliance manager)	$77
	0	.25	×	365 (compliance attorney)	91
Total annual burden per fund		1			168
Number of funds		× 269			× 269
Total annual burden		269			45,192

Notes:
1. *See supra* note 627.

5. Disclosure Changes for Money Market Funds

Money market funds are excluded from the scope of the rule and could not rely on proposed rule 18f–4 to enter into derivatives transactions or other transactions addressed in the proposed rule.[641] To the extent a money market fund currently discloses in its prospectus that it may use any of these transactions—even if it is not currently entering into these transactions—money market funds would be subject to the burdens associated with making disclosure changes to their prospectuses. We estimate that 413 funds could be subject to such disclosure changes on account of money market funds' exclusion from the proposed rule.[642]

Table 6 below summarizes the proposed PRA initial and ongoing annual burden estimates associated with disclosure changes that money market funds could make because of their exclusion from proposed rule 18f–4.[643] We do not estimate that there will be any initial or ongoing external costs associated with this disclosure change requirement.

[639] *See* proposed rule 18f–4(c)(4); *supra* section II.G (discussing the alternative requirements for leveraged/inverse funds).

[640] *See supra* note 467 and accompanying text (164 leveraged/inverse ETFs + 105 leveraged mutual funds).

[641] *See* proposed rule 18f–4(a) (defining the term ''Fund'' to ''. . . not include a registered open-end company that is regulated as a money market fund''); *supra* section II.A.1 (discussing the exclusion of money market funds from the scope of the proposed rule).

[642] *See supra* note 454 and accompanying text. This likely overestimates the total number of funds subject to these disclosure changes, because we believe that money market funds currently do not typically engage in derivatives transactions or the other transactions addressed by proposed rule 18f–4. *See supra* section II.A.1.

[643] These per-fund burden estimates likely overestimate the total burden associated with these disclosure changes. *See supra* note 641.

TABLE 6—DISCLOSURE CHANGES FOR MONEY MARKET FUNDS PRA ESTIMATES

	Internal initial burden hours	Internal annual burden hours		Wage rate [1]	Internal time costs
Proposed Estimates					
Money market prospectus disclosure changes.	.75	.25	×	$309 (compliance manager)	$77
	.75	.25	×	$365 (compliance attorney)	91
Total annual burden per fund		.5			168
Number of funds		× 413			× 413
Total annual burden		207			69,384

Notes:
1. *See supra* note 627.

6. Policies and Procedures for Limited Derivatives Users

Proposed rule 18f–4 would require funds relying on the limited derivatives user provisions to adopt and implement written policies and procedures reasonably designed to manage the fund's derivatives risks.[644] Only funds that limit their derivatives exposure to 10% of their net assets or that use derivatives transactions solely to hedge certain currency risks would be permitted to rely on these provisions. We estimate that 2,398 funds would be subject to the limited derivatives users requirements.[645] In addition to the initial burden to document the policies and procedures, we estimate that limited derivatives users would have an ongoing burden associated with any review and revisions to its policies and procedures to ensure that they are ''reasonably designed'' to manage the fund's derivatives risks. Below we estimate the initial and annual ongoing burdens associated with documentation and any review and revision of the limited derivatives users' policies and procedures.

Table 7 below summarizes the proposed PRA initial and ongoing annual burden estimates associated with the policies and procedures requirement for limited derivatives users under proposed rule 18f–4. We do not estimate that there will be any initial or ongoing external costs associated with the policies and procedures requirement for limited derivatives users.

TABLE 7—POLICIES AND PROCEDURES FOR LIMITED DERIVATIVES USERS PRA ESTIMATES

	Internal initial burden hours	Internal annual burden hours [1]		Wage rate [2]	Internal time costs
Proposed Estimates					
Written policies and procedures	3	1	×	$329 (senior manager) [4]	$329
	3	1	×	$365 (compliance attorney) [4]	365
Review of policies and procedures	0	.25		$329 (senior manager) [4]	82.25
	0	.25		$365 (compliance attorney) [4]	91.25
Total annual burden per fund		2.5			867.50
Number of funds		× 2,398			× 2,398
Total annual burden		5,995			2,080,265

Notes:
1. For "Written Policies and Procedures," these estimates include initial burden estimates annualized over a three-year period.
2. *See supra* note 627.

7. Recordkeeping Requirements

Proposed rule 18f–4 would require a fund to maintain certain records documenting its derivatives risk management program's written policies and procedures, along with its stress test results, VaR backtesting results, internal reporting or escalation of material risks under the program, and reviews of the program.[646] The proposed rule would also require a fund to maintain records of any materials provided to the fund's board of directors in connection with approving the designation of the derivatives risk manager and any written reports relating to the derivatives risk management program.[647] A fund that is required to comply with the proposed VaR test would also have to maintain records documenting the determination of: Its portfolio VaR; the VaR of its designated

[644] *See* proposed rule 18f–4(c)(3); *supra* section II.E (discussing the proposed policies and procedures requirement for limited derivatives users).

[645] *See supra* paragraph following note 525.

[646] *See* proposed rule 18f–4(c)(6)(i)(A); *supra* section II.K (discussing the proposed recordkeeping requirements).

[647] *See* proposed rule 18f–4(c)(6)(i)(B).

reference indexes, as applicable; its VaR ratio (the value of the VaR of the Fund's portfolio divided by the VaR of the designated reference index), as applicable; and any updates to any of its VaR calculation model and the basis for any material changes to its VaR model.[648] A fund that is a limited derivatives users under the proposed rule would have to maintain a written record of its policies and procedures that are reasonably designed to manage derivatives risks.[649] A fund engaging in unfunded commitment agreements would be required to maintain records documenting the sufficiency of its funds to meet its obligations with respect to all unfunded commitment agreements.[650]

We estimate that 5,091 funds would be subject to the recordkeeping requirements.[651] Below we estimate the average initial and ongoing annual burdens associated with the recordkeeping requirements. This average takes into account that some funds such as limited derivatives users may have less extensive recordkeeping burdens than other funds that use derivatives more substantially.

Table 8 below summarizes the proposed PRA estimates associated with the recordkeeping requirements in rule 18f–4.

TABLE 8—RECORDKEEPING PRA ESTIMATES

	Internal initial burden hours	Internal annual burden hours [1]	Wage rate [2]	Internal time costs	Initial external cost burden	Annual external cost burden
Proposed Estimates						
Establishing recordkeeping policies and procedures.	1.5	.5	$62 (general clerk)	$31	$1,800	$600
	1.5	.5	$95 (senior computer operator)	47.50		
Recordkeeping	0	2 ×	62 (general clerk)	31	0	0
	0	2 ×	$95 (senior computer operator)	47.50		
Total annual burden per fund		5		157		600
Number of funds		× 5,091		× 5,091		5,091
Total annual burden		25,455		799,287		3,054,600

Notes:
1. For "Establishing Recordkeeping Policies and Procedures," these estimates include initial burden estimates annualized over a three-year period.
2. *See supra* note 627.

8. Proposed Rule 18f–4 Total Estimated Burden

As summarized in Table 9 below, we estimate that the total hour burdens and time costs associated with proposed rule 18f–4, including the burden associated with documenting the derivatives risk management program, board oversight and reporting, disclosure requirements associated with the proposed VaR tests, disclosure requirements associated with the alternative requirements for leveraged/inverse funds, policies and procedures development for limited derivatives users, and recordkeeping, amortized over three years, would result in an average aggregate annual burden of 109,754 hours and an average aggregate annual monetized time cost of $54,761,797. We also estimate that, amortized over three years, there would be external costs of $3,054,600 associated with this collection of information. Therefore, each fund that relies on the rule would incur an average annual burden of approximately 20.56 hours, at an average annual monetized time cost of approximately $10,757, and an external cost of $600 to comply with proposed rule 18f–4.[652]

TABLE 9—PROPOSED RULE 18f–4 TOTAL PRA ESTIMATES

	Internal hour burden	Internal burden time cost	External cost burden
Derivatives risk management program	48,474	$19,195,704	$0
Board oversight and reporting	26,930	31,739,698	0
Disclosure requirement associated with limit on fund leverage risk	2,424	816,888	0
Disclosure requirement associated with alternative requirements for leveraged/inverse funds	269	45,192	0
Disclosure changes for money market funds	207	69,384	0
Policies and procedures for limited derivatives users	5,995	2,080,265	0
Recordkeeping requirements	25,455	799,287	3,054,600
Total annual burden	109,754	54,746,418	3,054,600
Number of funds	÷ 5,091	÷ 5,091	÷ 5,091
Average annual burden per fund	20.56	10,754	600

[648] *See* proposed rule 18f–4(c)(6)(i)(C).

[649] *See* proposed rule 18f–4(c)(6)(i)(D).

[650] *See* proposed rule 18f–4(e)(2).

[651] *See supra* notes 467, 498 and accompanying text, and paragraph following note 525 (2,693 funds that would be subject to the proposed derivatives risk management program and limit on fund leverage risk requirements + 2,398 funds relying on the limited derivatives user exception and complying with the related limited derivatives user requirements).

[652] These per-fund burden estimates likely overestimate the total burden of proposed rule 18f–4 because not all funds (*e.g.,* limited derivatives users) would incur the various burdens set forth in the table.

C. Proposed Rule 15l–2: Sales Practices Rule for Broker-Dealers

Proposed rule 15*l*–2 would impose burdens on registered broker-dealers relating to investments in leveraged/inverse investment vehicles by their retail customers.[653] The proposed rule is designed to address investor protection concerns relating to leveraged/inverse investment vehicles by helping to ensure that retail investors in these products are capable of evaluating their characteristics and the unique risks they present. The collections of information under proposed rule 15*l*–2, discussed below, would assist the Commission with its accounting, auditing and oversight functions. The respondents to the proposed rule would be broker-dealers registered under the Exchange Act with retail customers that transact in leveraged/inverse investment vehicles. Compliance with proposed rule 15*l*–2 would be mandatory for all such broker-dealers. To the extent that records required to be created and maintained by broker-dealers under the proposed rule are provided to the Commission in connection with examinations or investigations, such information would be kept confidential subject to the provisions of applicable law.

We estimate that, as of December 31, 2018, there were approximately 2,766 broker-dealers registered with the Commission that reported some sales to retail customer investors.[654] We further estimate that 700 of those broker dealers with retail customer accounts (approximately 25%) have retail customer accounts that invest in leveraged/inverse investment vehicles.

1. Due Diligence and Account Approval

Under proposed rule 15*l*–2, before accepting an order from a customer that is a natural person (or the legal representative of a natural person) to buy or sell shares of a leveraged/inverse investment vehicle, or approve such a customer's account to engage in those transactions, the broker-dealer must approve the customer's account to engage in those transactions in accordance with the proposed rule.[655] To make this determination, the broker-dealer must exercise due diligence to ascertain certain facts about the customer, his or her financial situation, and investment objectives. To comply with this due diligence requirement, the broker-dealer must seek to obtain certain information described in the proposed rule. This proposed rule is modeled, in large part, after the FINRA rule requiring due diligence and account approval for retail investors to trade in options. Based on our understanding of how broker-dealers comply with the FINRA options account requirements, we believe that a common way for broker-dealers to comply with this due diligence obligation would be to utilize in-house legal and compliance counsel, as well as in-house computer and website specialists, to create an online form for customers to provide the required information for approval of their accounts to trade in leveraged/inverse investment vehicles. We also believe that a portion of the due diligence would be performed by individuals associated with a broker-dealer or by telephone or in-person meetings with investors. Based on our understanding of current broker-dealer practices, we do not believe there would be any initial or ongoing external costs associated with the proposed broker-dealer due diligence requirement.

Currently, there are 105 leveraged/inverse mutual funds, 164 leveraged/inverse ETFs, and 17 exchange-listed commodity- or currency-based trusts or funds that meet the definition of ''leveraged/inverse investment vehicle'' under the proposed rule.[656] Accordingly, there are 286 leveraged/inverse investment vehicles in total for which a broker-dealer would be required to approve a retail customer's account before the customer could transact in the shares of those vehicles. Based on our experience with broker-dealers and leveraged/inverse investment vehicles, we estimate that each of these leveraged/inverse investment vehicles is held by approximately 2,500 separate retail investor accounts held by registered broker dealers, for a total of 715,000 existing accounts requiring approval to trade in leveraged/inverse investment vehicles. We further estimate that approximately 10,000 new retail accounts will be opened each year requiring approval to trade in leveraged/inverse investment vehicles.[657]

Table 10 below summarizes our initial and ongoing PRA burden estimates associated with the due diligence and account approval requirements in proposed rule 15*l*–2. Based on our understanding of current broker-dealer practices, we do not estimate that there will be any initial or ongoing external costs associated with the proposed due diligence and account approval requirements.

TABLE 10—PROPOSED RULE 15*l*–2 DUE DILIGENCE AND ACCOUNT APPROVAL PRA ESTIMATES

	Internal initial burden hours	Internal annual burden hours [1]		Wage rate [2]	Internal time costs	Initial external cost burden	Annual external cost burden
Proposed Estimates							
Development and implementation of customer due diligence.	6	2	×	$365 (compliance attorney)	$730		
	9	3	×	284 (senior systems analyst)	852		
	12	4	×	331 (senior programmer)	1,324		
Annual burden per broker-dealer		9			2,906		
Estimated number of affected broker-dealers.		700			700		
Total burden (I)		6,300			2,034,200		
Customer due diligence	3	1	×	365 (compliance attorney)	365		
	3	1 hour	×	70 (compliance clerk)	70		
Evaluation of customer information for account approval/disapproval.	1	.33	×	$309 (compliance manager)	101.97		

[653] Specifically, the proposed sales practices rules (proposed rule 15*l*–2, as well as proposed rule 211(h)–1 under the Advisers Act), would require broker-dealers and investment advisers to engage in due diligence before accepting or placing an order for a retail investor to trade a leveraged/inverse investment vehicle or approving an investor's account for such trading. *See supra* section II.G.2.

[654] Our estimates relating to retail sales by broker-dealers are based on data obtained from Form BD and Form BR. *See also supra* note 543 and accompanying text.

[655] *See supra* section II.G.2.b.

[656] *See supra* note 467 and accompanying text.

[657] *See supra* note 545 and accompanying text.

TABLE 10—PROPOSED RULE 15*l*–2 DUE DILIGENCE AND ACCOUNT APPROVAL PRA ESTIMATES—Continued

	Internal initial burden hours	Internal annual burden hours [1]	Wage rate [2]	Internal time costs	Initial external cost burden	Annual external cost burden
Total annual burden per customer account.	7	2.33		536.97		
Estimated number of affected customer accounts.		[3] × 248,333.33		× 248,333.33	× 248,333.33	× 248,333.33
Total burden (II)		578,616.66		$133,347,548		
Total annual burden (I + II)		584,916.66		135,381,748	$0	$0

Notes:
1. Includes initial burden estimates annualized over a three-year period.
2. *See supra* note 627.
3. We estimate that 715,000 existing customer accounts with broker-dealers would require the proposed rule 15*l*–2 account approval for trading in leveraged/inverse investment vehicles, and that 10,000 new customer accounts opened each year would require such approval. Accordingly, we believe that over a three-year period, a total of 745,000 accounts will require approval, which when annualized over a three-year period, equals 248,333.33 accounts per year.

2. Policies and Procedures

Proposed rule 15*l*–2 requires broker-dealers to adopt and implement policies and procedures reasonably designed to achieve compliance with the proposed rule's provisions.[658] We believe that broker-dealers likely would establish these policies and procedures by adjusting their current systems for implementing and enforcing compliance policies and procedures. While broker-dealers already have policies and procedures in place to address compliance with other Commission rules (among other obligations), they would need to update their existing policies and procedures to account for rule 15*l*–2. To comply with this obligation, we believe that broker-dealers would use in-house legal and compliance counsel to update their existing policies and procedures to account for the requirements of rule 15*l*–2. For purposes of these PRA estimates, we assume that broker-dealers would review the policies and procedures that they would adopt under proposed rule 15*l*–2 annually (for example, to assess whether the policies and procedures continue to be ''reasonably designed'' to achieve compliance with the proposed rule). We therefore have estimated initial and ongoing burdens associated with the proposed policies and procedures requirement. As discussed above, we estimate that approximately 700 broker dealers have retail customer accounts that invest in leveraged/inverse investment vehicles. We do not estimate that there will be any initial or ongoing external costs associated with the proposed policies and procedures requirement.

Table 11 below summarizes our initial and ongoing annual PRA burden estimates associated with the policies and procedures requirement in proposed rule 15*l*–2.

TABLE 11—PROPOSED RULE 15*l*–2 POLICIES AND PROCEDURES PRA ESTIMATES

	Internal initial burden hours	Internal annual burden hours [1]		Wage rate [2]	Internal time costs
Proposed Estimates					
Establishing and implementing rule 15*l*–2 policies and procedures.	3	1	×	$309 (compliance manager)	$309.00
	1	0.33	×	365 (compliance attorney)	$20.45
	1	0.33	×	530 (chief compliance officer)	174.90
Reviewing and updating rule 15*l*–2 policies and procedures.		1	×	309 (compliance manager)	309.00
		1	×	365 (compliance attorney)	365.00
		1	×	530 (chief compliance officer)	530.00
Total annual burden per broker-dealer		4.66			1,808.35
Number of affected broker-dealers		× 700			× 700
Total annual burden		3,262			1,265,845

Notes:
1. Includes initial burden estimates annualized over a three-year period.
2. *See supra* note 627.

3. Recordkeeping

Under proposed rule 15*l*–2, a broker-dealer would have to maintain a written record of the information that it obtained under the rule 15*l*–2 due diligence requirement and its written approval of the customer's account, as well as the firm's policies and procedures, for a period of not less than six years (the first two years in an easily accessible place) after the date of the closing of the client's account.[659] To comply with this obligation, we believe that broker-dealers would use in-house personnel to compile and maintain the relevant records. We do not estimate that there will be any initial or ongoing external costs associated with this requirement.

Table 12 below summarizes our PRA initial and onging annual burden estimates associated with the recordkeeping requirement in proposed rule 15*l*–2.

[658] *See supra* section II.G.2.b.

[659] *See supra* section II.G.2.c.

TABLE 12—PROPOSED RULE 15*l*–2 RECORDKEEPING PRA ESTIMATES

	Internal initial burden hours	Internal annual burden hours		Wage rate [1]	Internal time costs
Proposed Estimates					
Recordkeeping	0	1	×	$62 (general clerk)	$62
	0	1	×	$95 (senior computer operator)	95
Total annual burden per broker-dealer	0	2			157
Number of affected broker-dealers	× 700	× 700			× 700
Total annual burden	0	1,400			109,900

Notes:
1. *See supra* note 627.

4. Proposed Rule 15*l*–2 Total Estimated Burden

As summarized in Table 13 below, we estimate that the total hour burdens and time costs associated with proposed rule 15*l*–2, including the burden associated with the due diligence and account approval requirement, the policies and procedures requirement, and the recordkeeping requirement, would result in an average aggregate annual burden of 589,578.66 hours and an average aggregate time cost of $136,757,493. Therefore, each broker-dealer would incur an annual burden of approximately 842.26 hours, at an average time cost of approximately $195,367.85, to comply with proposed rule 15*l*–2.

TABLE 13—PROPOSED RULE 15*l*–2 TOTAL PRA ESTIMATES

	Internal initial burden hours	Internal burden time cost	External cost burden
Due diligence and account approval	584,916.66	$135,381,748	$0
Policies and procedures	3,262	1,265,845	0
Recordkeeping	1,400	109,900	0
Total annual burden	589,578.66	136,757,493	0
Number of affected broker-dealers	÷ 700	÷ 700	÷ 700
Average annual burden per affected broker-dealer	842.26	195,367.85	0

D. Proposed Rule 211(h)–1: Sales Practices for Registered Investment Advisers

Proposed 211(h)–1 would impose burdens on registered investment advisers relating to investments in leveraged/inverse investment vehicles by their retail clients.[660] Proposed rule 211(h)–1 is designed to address investor protection concerns relating to leveraged/inverse investment vehicles by helping to ensure that retail investors in these products are capable of evaluating their characteristics and the unique risks they present. The Commission also believes that the collections of information under proposed rule 211(h)–1, discussed below, would assist the Commission with its accounting, auditing and oversight functions.

The respondents to the proposed rule would be investment advisers registered under the Advisers Act that place orders for retail clients to invest in leveraged/inverse investment vehicles. Compliance with proposed rule 211(h)–1 would be mandatory for all such investment advisers. To the extent that records required to be created and maintained by investment advisers under the proposed rule are provided to the Commission in connection with examinations or investigations, such information would be kept confidential subject to the provisions of applicable law.

We estimate that, as of December 31, 2018, approximately 8,235 investment advisers registered with the Commission have some portion of their business dedicated to retail investors, including either individual high net worth clients or individual non-high net worth clients.[661] Based on our experience with registered investment advisers, we further estimate that 2,000 of these investment advisers with retail client accounts (approximately 25%) have retail client accounts that invest in leveraged/inverse investment vehicles. As such, the investment advisers for those client accounts would be subject to the requirements of proposed rule 211(h)–1.[662]

1. Due Diligence and Account Approval

Under proposed rule 211(h)–1, before placing an order for the account of a client that is a natural person (or the legal representative of a natural person) to buy or sell shares of a leveraged/inverse investment vehicle, or approving such a client's account to engage in those transactions, the investment adviser must approve the client's account to engage in those transactions in accordance with the proposed rule.[663] To make this determination, the adviser must exercise due diligence to ascertain certain facts about the client, his or her financial situation, and investment objectives. To

[660] *See supra* note 652.

[661] Based on responses to Item 5.D of Form ADV.

[662] *See supra* note 547 and accompanying paragraph.

[663] *See* proposed rule 211(h)–1; *supra* section II.G.2.

comply with this due diligence requirement, the investment adviser must seek to obtain certain information described in the proposed rule. Based on our understanding of how broker-dealers comply with the FINRA options account requirements, as discussed above (which we assume, for purposes of this PRA estimate, that investment advisers could model their compliance programs after), we believe that investment advisers likely would comply with this due diligence obligation by utilizing in-house legal and compliance counsel, as well as in-house computer and website specialists, to create an online form for clients to complete with the required information for approval of their accounts to trade in leveraged/inverse investment vehicles.[664] We also believe that a portion of the due diligence would be performed by individuals associated with an investment adviser by telephone or in-person meetings with investors.

Currently, there are 105 leveraged/inverse mutual funds, 164 leveraged/inverse ETFs, and 17 exchange-listed commodity- or currency-based trusts or funds that meet the definition of ''leveraged/inverse investment vehicle'' under the proposed rule.[665] Accordingly, there are 286 leveraged/inverse investment vehicles in total for which an investment adviser would be required to approve a retail client's account before the client could transact in the shares those vehicles. Based on our experience with registered investment advisers, we estimate that each of these leveraged/inverse investment vehicles is held by approximately 2,500 separate retail investor accounts held by investment advisers, for a total of 715,000 existing accounts requiring approval to trade in leveraged/inverse investment vehicles. Based on our experience, we further estimate that approximately 10,000 new retail accounts will be opened each year requiring approval to trade in leveraged/inverse investment vehicles.[666]

Table 14 below summarizes our initial and ongoing PRA burden estimates associated with the due diligence requirement in proposed rule 211(h)–1. We do not estimate that there will be any initial or ongoing external costs associated with the proposed due diligence and approval requirements.

TABLE 14—PROPOSED RULE 211(h)–1 DUE DILIGENCE AND ACCOUNT APPROVAL PRA ESTIMATES

	Internal initial burden hours	Internal annual burden hours [1]		Wage rate [2]	Internal time costs	Initial external cost burden	Annual external cost burden
Proposed Estimates							
Development and implementation of client due diligence.	6	2	×	$365 (compliance attorney)	$730	$0	$0
	9	3	×	$284 (senior systems analyst)	852		
	12	4	×	$331 (senior programmer)	1,324		
Annual burden per investment adviser.		9			2,906		
Estimated number of affected investment advisers.		2,000			2,000		
Total burden (I)		18,000			5,812,000		
Client due diligence	3	1	×	$365 (compliance attorney)	365		
	3	1	×	$70 (compliance clerk)	70		
Evaluation of client information for account approval/disapproval.	1	.33		$309 (compliance manager)	101.97		
Total annual burden per client account.	7	2.33			536.97		
Estimated number of affected client accounts.		[3] × 248,333.33			× 248,333.33		
Total burden (II)		578,616.66			133,347,548		
Total annual burden (I + II)		596,616.66			139,159,548	0	0

Notes:
1. Includes initial burden estimates annualized over a three-year period.
2. *See supra* note 627.
3. We estimate that 715,000 existing client accounts with registered investment advisers would require the proposed rule 211(h)–1 account approval for trading in leveraged/inverse investment vehicles, and that 10,000 new client accounts opened each year would require such approval. Accordingly, we believe that over a three-year period, a total of 745,000 client accounts would require approval, which when annualized over a three-year period, is 248,333.33 accounts per year.

2. Policies and Procedures

Proposed rule 211(h)–1 requires investment advisers to adopt and implement policies and procedures reasonably designed to achieve compliance with the proposed rule's provisions.[667] We believe that investment advisers likely would establish these policies and procedures by adjusting their current systems for implementing and enforcing compliance policies and procedures. While investment advisers already have policies and procedures in place to address compliance with other Commission rules (among other obligations), they would need to update their existing policies and procedures to account for rule 211(h)–1. To comply with this obligation, we believe that investment advisers would use in-house legal and compliance counsel to update their existing policies and procedures to account for the requirements of rule 211(h)–1. For purposes of these PRA estimates, we assume that investment advisers would review the policies and procedures that they would adopt under proposed rule 211(h)–1 annually (for example, to assess whether the policies and procedures continue to be ''reasonably designed'' to achieve compliance with the proposed rule, and in compliance with Advisers Act rule 206(4)–7(b)). We therefore have estimated initial and ongoing burdens associated with the proposed policies and procedures requirement. We do not estimate that there will be any initial or

[664] *See supra* paragraph accompanying note 654.
[665] *See supra* note 467 and accompanying text.
[666] *See supra* note 547 and accompanying text.
[667] *See supra* section II.G.2.b.

ongoing external costs associated with the proposed policies and procedures requirement.

Table 15 below summarizes our PRA estimates associated with the policies and procedures requirement in proposed rule 211(h)–1.

TABLE 15—PROPOSED RULE 211(h)–1 POLICIES AND PROCEDURES PRA ESTIMATES

	Internal initial burden hours	Internal annual burden hours [1]		Wage rate [2]	Internal time costs
Proposed Estimates					
Establishing and implementing rule 211(h)–1 policies and procedures.	3	1 hour	×	$309 (compliance manager)	$309
	1	0.33	×	$365 (compliance attorney)	120.45
	1	0.33	×	$530 (chief compliance officer)	174.90
Reviewing and updating rule 211(h)–1 policies and procedures.		1		$309 (compliance manager)	309
		1		$365 (compliance attorney)	365
		1		$530 (chief compliance officer)	530
Total annual burden per investment adviser.		4.66			1,808.35
Number of affected investment advisers		× 2,000			× 2,000
Total annual burden		9,320			3,616,700

Notes:
1. Includes initial burden estimates annualized over a three-year period.
2. *See supra* note 627.

3. Recordkeeping

Under the proposed rule, a registered investment adviser would have to maintain a written record of the information that it obtained under the rule 211(h)–1 due diligence requirement and its written approval of the client's account for buying or selling shares of leveraged/inverse investment vehicles, as well as the firm's policies and procedures, for a period of not less than six years (the first two years in an easily accessible place) after the date of the closing of the client's account.[668] To comply with this obligation, we believe that investment advisers would use in-house personnel to compile and maintain the relevant records. We do not estimate that there will be any initial or ongoing external costs associated with this requirement.

Table 16 below summarizes our PRA estimates associated with the recordkeeping requirement in proposed rule 211(h)–1.

TABLE 16—PROPOSED RULE 211(h)–1 RECORDKEEPING PRA ESTIMATES

	Internal initial burden hours	Internal annual burden hours [1]		Wage rate [2]	Internal time costs
Proposed Estimates					
Recordkeeping	0	2.5	×	$62 (general clerk)	$155
	0	2.5	×	$95 (senior computer operator)	237.50
Total annual burden per investment adviser.	0	5			392.50
Number of affected investment advisers	× 2,000	× 2,000			× 2,000
Total annual burden	0	10,000			785,000

Notes:
1. Includes initial burden estimates annualized over a three-year period.
2. *See supra* note 627.

4. Proposed Rule 211(h)–1 Total Estimated Burden

As summarized in Table 17 below, we estimate that the total hour burdens and time costs associated with proposed rule 211(h)–1, including the burden associated with the due diligence and account approval requirement, the policies and procedures requirement, and the recordkeeping requirement, would result in an average aggregate annual burden of 615,936.66 hours and an average aggregate time cost of $143,561,248. Therefore, each investment adviser would incur an annual burden of approximately 307.97 hours, at an average time cost of approximately $71,780.62 to comply with proposed rule 211(h)–1.

[668] *See supra* section II.G.2.c.

TABLE 17—PROPOSED RULE 211(h)–1 TOTAL ESTIMATED PRA BURDEN

	Internal initial burden hours	Internal burden time cost	External cost burden
Due diligence and account approval	596,616.66	$139,159,548	$0
Policies and procedures	9,320	3,616,700	0
Recordkeeping	10,000	785,000	0
Total annual burden	615,936.66	143,561,248	0
Number of affected investment advisers	÷ 2,000	÷ 2,000	÷ 2,000
Average annual burden per investment adviser	307.97	71,780.62	0

E. Rule 6c–11

We recently adopted rule 6c–11, which permits ETFs that satisfy certain conditions to operate without first obtaining an exemptive order from the Commission.[669] The rule is designed to create a consistent, transparent, and efficient regulatory framework for such ETFs and facilitate greater competition and innovation among ETFs. Rule 6c–11 includes a provision excluding leveraged/inverse ETFs from the scope of ETFs that may rely on that rule. To promote a level playing field among ETFs, and in view of the other conditions we are proposing to place on leveraged/inverse ETFs under proposed rule 18f–4 and on transactions in leveraged/inverse ETFs' securities under proposed rule 15*l*–2 and 211(h)–1, we are proposing to amend rule 6c–11 to permit leveraged/inverse ETFs to rely on that rule. Because we believe this proposed amendment would increase the number of funds relying on rule 6c–11, we are updating the PRA analysis for rule 6c–11 to account for any burden increases that would result from this increase in respondents to that rule. We are not updating the rule 6c–11 PRA analysis in any other respect.

Rule 6c–11 requires an ETF to disclose certain information on its website, to maintain certain records, and to adopt and implement certain written policies and procedures. The purpose of these collections of information is to provide useful information to investors who purchase and sell ETF shares in secondary markets and to allow the Commission to better monitor reliance on rule 6c–11 and will assist the Commission with its accounting, auditing and oversight functions.

The respondents to rule 6c–11 will be ETFs registered as open-end management investment companies other than share class ETFs and non-transparent ETFs. This collection will not be mandatory, but will be necessary for those ETFs seeking to operate without individual exemptive orders, including all ETFs whose existing exemptive orders will be rescinded. Information provided to the Commission in connection with staff examinations or investigations will be kept confidential subject to the provisions of applicable law.

Under current PRA estimates, 1,735 ETFs would be subject to these requirements. The current PRA estimates for rule 6c–11 include 74,466.2 total internal burden hours, $24,771,740.10 in internal time costs, and $1,735,000 in external time costs.

We continue to believe that the current annual burden and cost estimates for rule 6c–11 are appropriate, but estimate that the proposed amendment to rule 6c–11 would result in an increase in the number of respondents. Specifically, we estimate that an additional 164 ETFs (all leveraged/inverse ETFs) would rely on rule 6c–11, resulting in an increase in the number of respondents to 1,899 ETFs.[670] Table 18 below summarizes these revisions to the estimated annual responses, burden hours, and burden-hour costs based on the proposed amendment to rule 6c–11.

TABLE 18—RULE 6c–11 PRA ESTIMATES

	Previously estimated annual internal hour burden [1]	Updated estimated annual internal hour burden [2]	Previously estimated annual internal burden time cost	Updated estimated annual internal time burden cost	Previously estimated annual external cost burden	Updated estimated annual external cost burden
Website disclosure	33,398.75	36,555.75	$10,717,945.15	$11,731,053.51	$1,735,000	$1,899,000
Recordkeeping	8,675	9,495	680,987.50	745,357.50	0	0
Policies and procedures	32,392.45	35,454.33	13,372,807.45	14,636,865.33	0	0
Total annual burden	74,466.2	81,505.08	24,771,740.10	27,113,276.34	1,735,000	1,899,000
Number of affected ETFs	÷ 1,735	÷ 1,899	÷ 1,735	÷ 1,899	÷ 1,735	÷ 1,899
Average annual burden per ETF	42.92	42.92	14,277.66	14,277.66	1,000	1,000

Notes:
1. The previously estimated burdens and costs in this table are based on an estimate of 1,735 ETFs relying on rule 6c–11.
2. The updated estimated burdens and costs in this table are based on an estimate of 164 leveraged/inverse ETFs that would rely on rule 6c–11 pursuant to the proposed amendment to that rule, for a total estimate of 1,899 ETFs that would rely on rule 6c–11.

[669] *See supra* notes 352–355 and accompanying text.

[670] *See supra* note 467 and accompanying text.

F. Form N–PORT

We are proposing to amend Form N–PORT to add new items to Part B (''Information About the Fund''), as well as to make certain amendments to the form's General Instructions.

Form N–PORT, as amended, would require funds to provide information about their derivatives exposure.[671] We estimate that 5,091 funds would be subject to this exposure-related disclosure requirement.[672]

In addition, funds that are subject to the limit on fund leverage risk in proposed rule 18f–4 would have to report certain VaR-related information, including: (1) The fund's highest daily VaR during the reporting period and its corresponding date; and (2) the fund's median daily VaR for the reporting period. Funds subject to the relative VaR test during the reporting period also would have to report: (1) The name of the fund's designated reference index, (2) the index identifier, (3) the fund's highest daily VaR ratio during the reporting period and its corresponding date; and (4) the fund's median daily VaR ratio for the reporting period.[673] Finally, all funds that are subject to the proposed limit on fund leverage risk also would have to report the number of exceptions that the fund identified as a result of the backtesting of its VaR calculation model.[674] We estimate that 2,424 funds would be subject to these VaR-related disclosure requirements.[675]

Preparing reports on Form N–Port is mandatory for all management investment companies (other than money market funds and small business investment companies) and UITs that operate as ETFs and is a collection of information under the PRA. The information required by Form N–Port must be data-tagged in XML format. Responses to the reporting requirements will be kept confidential, subject to the provisions of applicable law, for reports filed with respect to the first two months of each quarter; the third month of the quarter will not be kept confidential, but made public sixty days after the quarter end. Form N–Port is designed to assist the Commission its regulatory, disclosure review, inspection, and policymaking roles, and to help investors and other market participants better assess different fund products.[676]

Based on current PRA estimates, we estimate that funds prepare and file their reports on Form N–Port either by (1) licensing a software solution and preparing and filing the reports in house, or (2) retaining a service provider to provide data aggregation, validation and/or filing services as part of the preparation and filing of reports on behalf of the fund. We estimate that 35% of funds subject to the proposed N–Port filing requirements would license a software solution and file reports on Form N–Port in house, and the remainder would retain a service provider to file reports on behalf of the fund.

Table 19 below summarizes our PRA initial and ongoing annual burden estimates associated with the proposed amendments to Form N–Port.

TABLE 19—FORM N–PORT PRA ESTIMATES

	Internal initial burden hours	Internal annual burden hours [1]		Wage rate [2]	Internal time costs	Initial external cost burden	Annual external cost burden
Proposed Estimates							
Report derivatives exposure information.	2	[3] 4.33	×	$365 (compliance attorney).	$1,580	.....	.....
	2	4.33	×	$331 (senior programmer).	1,433	.....	.....
Total new burden for derivatives exposure information.	.....	8.66		.....	3,013	.....	.....
Number of funds for derivatives exposure information.		× 5,091			× 5,091		
Total new annual burden for derivatives exposure information (I).	.....	44,088		.....	15,339,183	.....	.....
Report VaR-related information.	2	4.33	×	$365 (compliance attorney).	1,580	$5,490	$4,210
	2	4.33	×	$331 (senior programmer).	1,433	.....	.....
Total new burden for VaR-related information.	.....	8.66		.....	3,013	.....	.....
Number of funds for VaR-related information.		× 2,424			× 2,424		

[671] *See* proposed Item B.9 of Form N–PORT; *supra* section II.H.1.a.

[672] *See supra* notes 467, 498 and accompanying text, and paragraph following note 525 (2,693 funds that would be subject to the proposed derivatives risk management program and limit on fund leverage risk requirements + 2,398 funds relying on the limited derivatives user exception and complying with the related limited derivatives user requirements).

[673] *See* proposed Item B.10 of Form N–Port; *supra* section II.H.1.b.

[674] *See id.*

[675] *See supra* paragraph following note 525.

[676] The specific purposes for each of the new proposed reporting items are discussed in section II.H.1 *supra.*

TABLE 19—FORM N–PORT PRA ESTIMATES—Continued

	Internal initial burden hours	Internal annual burden hours [1]	Wage rate [2]	Internal time costs	Initial external cost burden	Annual external cost burden
Total new annual burden for VaR-related information (II).	.....	20,992	.....	7,303,512	.....	.....
Total new annual burden (I + II).	.....	65,080	.....	22,642,695	.....	[4] 21,433,110
Current burden estimates	.....	1,803,826	.....	.....	.....	103,776,240
Revised burden estimates.	.....	1,868,906	.....	.....	.....	125,209,350

Notes:
1. Includes initial burden estimates annualized over a three-year period.
2. *See supra* note 627. These PRA estimates assume that the same types of professionals would be involved in the proposed reporting requirements that we believe otherwise would be involved in preparing and filing reports on Form N–PORT.
3. This estimate assumes that, annually after the initial 2 hours to comply with the new N–PORT requirements, each of a compliance attorney and a senior programmer would incur 1 burden hours per filing associated with the new reporting requirements. The estimate of 4.33 hours is based on the following calculation: ((2 hours for the first filing × 1 = 2) + (3 additional filings in year 1 × 1 hour for each of the additional 3 filings in year 1 = 3) + (4 filings in years 2 and 3 × 1 hour per filing × 2 years) = 8)/3 = 4.33.
4. This estimate is based on the following calculation: $4,210 (average costs for funds reporting the proposed information on Form N–PORT) * 5,091 funds (which includes funds reporting derivative exposure information and VaR-related information).

G. Form N–RN

We are proposing to amend Form N–LIQUID (which we propose to re-title as ''Form N–RN'') to add new current reporting requirements for funds subject to the proposed VaR-based limit on fund leverage risk pursuant to proposed rule 18f–4.[677] Specifically, a fund that determines that it is out of compliance with the VaR test and has not come back into compliance within three business days after such determination would have to file a non-public report on Form N–RN providing certain information regarding its VaR test breaches.[678] If the portfolio VaR of a fund subject to the relative VaR test were to exceed 150% of the VaR of its designated reference index for three business days, a fund would have to report: (1) The dates on which the fund portfolio's VaR exceeded 150% of the VaR of its designated reference index; (2) the VaR of its portfolio for each of these days; (3) the VaR of its designated reference index for each of these days; (4) the name of the designated reference index; and (5) the index identifier. If the portfolio VaR of a fund subject to the absolute VaR test were to exceed 10% of the value of the fund's net assets for three business days, a fund would have to report: (1) The dates on which the fund portfolio's VaR exceeded 10% of the value of its net assets; (2) the VaR of its portfolio for each of these days; and (3) the value of the fund's net assets for each of these days.

In addition, if a fund that has filed Part E or Part F of Form N–RN to report it has breached its applicable VaR test, has come back into compliance with either the relative VaR test or the absolute VaR test, as applicable, it must file a report on Form N–RN to indicate that.[679] Specifically, a fund must report the dates on which its portfolio VaR exceeded, as applicable, 150% of the VaR of its designated reference index (if the fund is subject to the relative VaR test under proposed rule 18f–4(c)(2)(i)) or exceeded 15% of the value of its net assets (if the fund is subject to the absolute VaR test under proposed rule 18f–4(c)(2)(ii)).[680] Furthermore, a fund must also report the current VaR of its portfolio.[681]

A fund would have to report information for either VaR test breach, within one business day following the third business day after the fund has determined that its portfolio VaR exceeds either of the VaR test thresholds, as applicable. Similarly, a fund that has come back into compliance with its applicable VaR test would have to file such a report within one business day. We estimate that 2,424 funds per year would be required to comply with either of the VaR tests, and the Commission would receive approximately 30 filing(s) per year in response to each of the new VaR-related items that we proposed to include on Form N–RN, as amended.[682]

Under the proposed amendments to Form N–RN, preparing a report on this form would be mandatory for any fund that is out of compliance with its applicable VaR test for more than three business days, as described above, and for any fund that has come back into compliance with its applicable VaR test. A report on Form N–RN is a collection of information under the PRA. The VaR test breach information provided on Form N–RN, as well as the information a fund provides when it has come back into compliance, would enable the Commission to receive information on events that could impact funds' leverage-related risk more uniformly and efficiently and would enhance the Commission's oversight of funds when significant fund and/or market events occur. The Commission would be able to use the newly required information that funds would provide on Form N–RN in its regulatory, disclosure review, inspection, and policymaking roles. Responses to the reporting requirements and this collection of information would be kept confidential, subject to provisions of applicable law.

Table 20 below summarizes our PRA initial and ongoing annual burden estimates associated with the proposed amendments to funds' current reporting requirement. Staff estimates there will

[677] *See supra* section II.H.2.

[678] This requirement would be implemented through the proposed amendments to rule 30b1–10 under the Investment Company Act, and proposed rule 18f–4(c)(7). For purposes of this PRA analysis, the burden associated with the proposed amendments to rule 30b1–10 and proposed rule 18f–4(c)(7) is included in the collection of information requirements for Form N–RN.

[679] *See* proposed Part G of Form N–RN.

[680] *Id.*

[681] *Id.*

[682] This estimate is similar to the Commission's estimates of the number of reports that funds, in the aggregate, would submit annually in response to the liquidity-related items of Form N–LIQUID. *See* Liquidity Adopting Release, *supra* note 359, at nn.1281–1283 and accompanying paragraph. *See also supra* paragraph following note 525.

be no external costs associated with this collection of information. We further assume similar hourly and cost burdens, as well as similar response rates, for responses to either a breach of the absolute VaR test or the relative VaR test.

TABLE 20—FORM N–RN PRA ESTIMATES

	Internal initial burden hours	Internal annual burden hours		Wage rate [1]	Internal time costs
Proposed Estimates					
Relative or absolute VaR test breach reports	0	[2] 0.005	×	$365 (compliance attorney)	$1.83
	0	0.005	×	$331 (senior programmer)	1.66
Total new annual burden per fund		0.01			3.49
Number of funds		× 2,424			× 2,424
Total new annual burden		24			8,460
Current burden estimates		941			
Revised burden estimates		965			

Notes:
1. *See supra* note 627. These PRA estimates assume that the same types of professionals would be involved in the proposed reporting requirements that we believe otherwise would be involved in preparing and filing reports on Form N–LIQUID.
2. This estimate is based on the assumption that, of the 2,424 funds that would be required to comply with either of the VaR tests, on average the Commission would receive 30 reports regarding a relative or absolute VaR test breach and that compliance attorney and senior programmer would each spend 30 minutes as part of preparing and submitting this report.

H. Form N–CEN

We are proposing to amend Form N–CEN to require a fund to identify whether it relied on proposed rule 18f–4 during the reporting period.[683] Form N–CEN is a structured form that requires registered funds to provide census-type information to the Commission on an annual basis. The proposed amendments also would require a fund to identify whether it relied on any of the exemptions from various requirements under the proposed rule, specifically: (1) Whether the fund is a limited derivatives user excepted from the proposed rule's program requirement, under either of the proposed exception's alternatives (either a funds that limits its derivatives exposure to 10% of its net assets, or a fund that uses derivatives transactions solely to hedge certain currency risks); or (2) whether it is a leveraged/inverse investment fund covered by the proposed sales practices rules that, under proposed rule 18f–4, would be excepted from the proposed limit on fund leverage risk. Finally, a fund would have to identify whether it has entered into reverse repurchase agreements or similar financing transactions, or unfunded commitment agreements, as provided under the proposed rule.

Preparing a report on Form N–CEN, as amended, would be mandatory for all registered funds. Responses would not be kept confidential. We estimate that 12,375 funds would be subject to these disclosure requirements.[684]

The purpose of Form N–CEN is to satisfy the filing and disclosure requirements of section 30 of the Investment Company Act, and of amended rule 30a–1 thereunder. The information required to be filed with the Commission assures the public availability of the information and is designed to facilitate the Commission's oversight of registered funds and its ability to monitor trends and risks.

Table 21 below summarizes our PRA initial and ongoing annual burden estimates associated with the proposed amendments to Form N–CEN based on current Form N–CEN practices and burdens associated with minor amendments to the form. Staff estimates there will be no external costs associated with this collection of information.

TABLE 21—FORM N–CEN PRA ESTIMATES

	Internal initial burden hours	Internal annual burden hours		Wage rate [1]	Internal time costs
Proposed Estimates					
Reporting derivatives-related fund census information.	0	0.01	×	$365 (compliance attorney)	$3.7
	0	0.01	×	$331 (senior programmer)	3.3
Total new annual burden per fund		0.02			7
Number of funds		× 12,375			× 12,375

[683] *See supra* section II.H.3.

[684] *See supra* section III.B.1 (9,788 mutual funds + 1,910 ETFs organized as an open-end fund or as a share-class of an open-end fund + 664 registered closed-end funds + 13 variable annuity separate accounts registered as management investment companies on Form N–3).

TABLE 21—FORM N–CEN PRA ESTIMATES—Continued

	Internal initial burden hours	Internal annual burden hours	Wage rate [1]	Internal time costs
Total new annual burden		248		86,625
Current burden estimates		74,425		
Revised burden estimates		74,673		

Notes:
1. *See supra* note 627. These PRA estimates assume that the same types of professionals would be involved in the proposed reporting requirements that we believe otherwise would be involved in preparing and filing reports on Form N–CEN.
2. This estimate assumes each fund reporting on Form N–CEN would spend 1 to 2 minutes reporting these new data elements.

I. Request for Comments

We request comment on whether these estimates are reasonable. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments in order to: (1) Evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility; (2) evaluate the accuracy of the Commission's estimate of the burden of the proposed collections of information; (3) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (4) determine whether there are ways to minimize the burden of the collections of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons wishing to submit comments on the collection of information requirements of the proposed rules and amendments should direct them to the OMB, Attention Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to, Vanessa Countryman, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090, with reference to File No. S7–24–15. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this release; therefore a comment to OMB is best assured of having its full effect if OMB receives it within 30 days after publication of this release. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7–24–15, and be submitted to the Securities and Exchange Commission, Office of FOIA Services, 100 F Street NE, Washington, DC 20549–2736.

V. Initial Regulatory Flexbility Analysis

This Initial Regulatory Flexibility Analysis has been prepared in accordance with section 3 of the Regulatory Flexibility Act.[685] It relates to proposed rules 18f–4, 15*l*–2, 211(h)–1, and proposed amendments to Forms N–PORT, N–LIQUID (which we propose to re-title as ''Form N–RN''), and N–CEN.[686]

A. Reasons for and Objectives of the Proposed Actions

The Commission is proposing new rules 18f–4, 211(h)–1, and 15*l*–2, amendments to rule 6c–11, as well as amendments to Forms N–PORT, N–LIQUID, and N–CEN. These proposed rules, and proposed rule and form amendments, are designed to address the investor protection purposes and concerns underlying section 18 of the Investment Company Act and to provide an updated and more comprehensive approach to the regulation of funds' use of derivatives and the other transactions covered by proposed rule 18f–4.[687]

Proposed rule 18f–4 is designed to provide an updated, comprehensive approach to the regulation of funds' use of derivatives and certain other transactions, generally through the implementation of a derivatives risk management program, limits on fund leverage risk, board oversight and reporting, and related recordkeeping requirements.[688] The proposed sales practices rules are designed to address certain specific considerations raised by certain leveraged/inverse investment vehicles by requiring registered broker-dealers and investment advisers to satisfy due diligence and account approval requirements.[689] Finally, the proposed amendments to Forms N–PORT, N–LIQUID, and N–CEN are designed to enhance the Commission's ability to effectively oversee the use by funds, broker-dealers and investment advisers of the proposed rules and to provide the Commission and the public with greater insight into the impact that funds' use of derivatives may have on their portfolios.[690]

All of these requirements are discussed in detail in section II of this release. The costs and burdens of these requirements on small funds, investment advisers, and broker-dealers are discussed below as well as above in our Economic Analysis and Paperwork Reduction Act Analysis, which discuss the applicable costs and burdens on all funds, investment advisers, and broker-dealers.[691]

B. Legal Basis

The Commission is proposing new rule 18f–4 under the authority set forth in sections 6(c), 12(a), 18, 31(a), 38(a), and 61 of the Investment Company Act of 1940 [15 U.S.C. 80a–6(c), 80a–12(a), 80a–18, 80a–30(a), 80a–37(a), and 80a–60]. The Commission is proposing amendments to rule 6c–11 under the authority set forth in sections 6(c), 22(c), and 38(a) of the Investment Company Act [15 U.S.C. 80a–6(c), 22(c), and 80a–37(a)]. The Commission is proposing new rule 15*l*–2 under the authority set forth in sections 3, 3(b), 3E, 10, 15(l), 15F, 17, 23(a), and 36 of the Securities Exchange Act of 1934 [15 U.S.C. 78c, 78c(b), 78c–5, 78j, 78o(l), 78o–10, 78q, 78w(a), and 78mm]. The Commission is proposing new rule 211(h)–1 under the authority set forth in sections 206, 206A, 208, 211(a), and 211(h), and of the Investment Advisers Act of 1940 [15 U.S.C. 80b–6, 80b–6a, 80b–8, 80b–11(a), and 80b–11(h)]. The Commission is

[685] 5 U.S.C. 603.

[686] As discussed above, the proposed conforming amendment to Form N–2 does not change the Form N–2 collection of information. *See supra* note 622. We also do not believe there to be any reporting, recordkeeping, or compliance burden associated with this proposed conforming amendment.

[687] *See supra* section I.B (discussing the requirements of section 18, and as well as Congress' concerns underlying the limits of section 18).

[688] *See supra* section II.A.2.

[689] *See supra* section II.G.

[690] *See supra* section II.H.

[691] *See supra* sections III and IV. These sections also discuss the professional skills that we believe compliance with the proposed rules, and proposed rule and form amendments would entail.

proposing amendments to Form N–PORT, Form N–LIQUID (which we propose to re–title as ''Form N–RN''), Form N–CEN, and Form N–2 under the authority set forth in sections 8, 18, 30, and 38 of the Investment Company Act of 1940 [15 U.S.C. 80a–8, 80a–18, 80a–29, 80a–37, 80a–63], sections 6, 7(a), 10 and 19(a) of the Securities Act of 1933 [15 U.S.C. 77f, 77g(a), 77j, 77s(a)], and sections 10, 13, 15, 23, and 35A of the Exchange Act [15 U.S.C. 78j, 78m, 78o, 78w, and 78ll].

C. Small Entities Subject to Proposed Rules

For purposes of Commission rulemaking in connection with the Regulatory Flexibility Act, an investment company is a small entity if, together with other investment companies in the same group of related investment companies, it has net assets of $50 million or less as of the end of its most recent fiscal year (a ''small fund'').[692] Commission staff estimates that, as of June 2019, approximately 42 registered open-end mutual funds, 8 registered ETFs, 33 registered closed-end funds, and 16 BDCs (collectively, 99 funds) are small entities.[693]

For purposes of Commission rulemaking in connection with the Regulatory Flexibility Act, a broker-dealer is a small entity if it: (1) Had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to rule 17a–5(d) under the Exchange Act, or, if not required to file such statements, had total capital (net worth plus subordinated liabilities) of less than $500,000 on the last business day of the preceding fiscal year (or in the time that it has been in business, if shorter); and (2) it is not affiliated with any person (other than a natural person) that is not a small business or small organization.[694] Commission staff estimates that, as of June 30, 2019, there are approximately 942 broker-dealers that may be considered small entities.[695]

Under Commission rules, and for the purposes of the Advisers Act and the Regulatory Flexibility Act, a registered investment adviser generally is a small entity if it: (1) Has assets under management having a total value of less than $25 million; (2) did not have total assets of $5 million or more on the last day of the most recent fiscal year; and (3) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more, or any person (other than a natural person) that had total assets of $5 million or more on the last day of its most recent fiscal year.[696] We believe that proposed rule 211(h)–1 would not affect most investment advisers that are small entities (''small advisers''). Many small advisers would not be affected because they are registered with one or more state securities authorities and not with the Commission. Under section 203A of the Advisers Act, many small advisers are prohibited from registering with the Commission and are regulated by state regulators.[697] Of those advisers that are registered with the Commission, we estimate based on IARD data that as of June 30, 2019, approximately 470 SEC-registered investment advisers are small entities under the RFA.[698] Of these, we estimate that 171 registered investment advisers are small entities that provide advice to individual clients.[699]

D. Projected Reporting, Recordkeeping, and Other Compliance Requirements

1. Proposed Rule 18f–4

a. Derivatives Risk Management Program, and Board Oversight and Reporting

Proposed rule 18f–4 would generally require a fund relying on the rule—including small entities, but not including funds that are limited derivatives users—to adopt and implement a derivatives risk management program.[700] This risk management program would include policies and procedures reasonably designed to assess and manage the risks of the fund's derivatives transactions.[701] The program requirement is designed to permit a fund to tailor the program's elements to the particular types of derivatives that the fund uses and related risks, as well as how those derivatives impact the fund's investment portfolio and strategy. The proposal would require a fund's program to include the following elements: (1) Risk identification and assessment; (2) risk guidelines; (3) stress testing; (4) backtesting; (5) internal reporting and escalation; and (6) periodic review of the program. The proposed rule also would require: (1) A fund's board of directors to approve the designation of the fund's derivatives risk manager and (2) the derivatives risk manager to provide written reports to the board regarding the program's implementation and effectiveness, including describing any exceedances of the fund's guidelines and the results of the fund's stress testing and backtesting.[702]

As discussed above, we estimate that the one-time operational costs necessary to establish and implement a derivatives risk management program would range from $70,000 to $500,000 per fund, depending on the particular facts and circumstances and current derivatives risk management practices of the fund.[703] We also estimate that each fund would incur ongoing program-related costs that range from 65% to 75% of the one-time costs necessary to establish and implement a derivatives risk management program.[704] Thus, we estimate that a fund would incur ongoing annual costs associated with proposed rule 18f–4 that would range from $45,500 to $375,000.[705] We estimate that approximately 22% of funds would be required to implement a derivatives risk management program, including board oversight.[706] We

[692] *See* rule 0–10(a) under the Investment Company Act [17 CFR 270.0–10(a)].

[693] This estimate is derived an analysis of data obtained from Morningstar Direct as well as data reported to the Commission for the period ending June 2019.

[694] *See* rule 0–10(c)(1)–(2) under the Exchange Act [17 CFR 240.0–10(c)(1)(2)].

[695] This estimate is derived from an analysis of data for the period ending June 30, 2019 obtained from Financial and Operational Combined Uniform Single (FOCUS) Reports that broker-dealers generally are required to file with the Commission and/or SROs pursuant to rule 17a–5 under the Exchange Act [17 CFR 240.17a–5].

[696] *See* rule 0–7(a) under the Advisers Act [17 CFR 275.0–7(a)].

[697] 15 U.S.C. 80b–3a.

[698] Based on SEC registered investment adviser responses to Item 12 of Form ADV.

[699] Based on SEC-registered investment adviser responses to Items 5.D.(1)(a)–(b), 5.D.(3)(a)–(b), 5.F and 12 of Form ADV. These responses indicate that: The investment adviser has clients that are high net worth individuals and/or individuals other than high net worth individuals; the investment adviser has regulatory assets under management attributable to clients that are high net worth individuals and/or individuals other than high net worth individuals; and that the investment adviser is a small entity. Firms that are registered as a broker-dealer and an investment adviser are counted in both the total number of small investment advisers and small broker-dealers that would be subject to the new requirements. We believe that counting these firms twice is appropriate because of any additional burdens of complying with the rules with respect to both their advisory and brokerage businesses.

[700] *See supra* section II.A.2; proposed rule 18f–4(c)(1).

[701] *See* proposed rule 18f–4(a).

[702] *See supra* sections II.C and III.C.1.

[703] *See supra* section III.C.1. This section, along with sections IV.B.1 and IV.B.2, also discusses the professional skills that we believe compliance with this aspect of the proposal would entail.

[704] *Id.*

[705] *Id.*

[706] These are funds that would not be considered limited derivatives users under the proposed rule. *See supra* sections II.E, III.C.1, IV.B.1 and IV.B.2; *infra* section V.D.1.c.

similarly estimate—applying to small funds the same estimated percentage of funds that would implement a derivatives risk management program—that approximately 22% of small funds (approximately 22 small funds) would establish a derivatives risk management program.[707]

There are different factors that would affect whether a smaller fund incurs program-related costs that are on the higher or lower end of the estimated range. For example, we would expect that smaller funds—and more specifically, smaller funds that are not part of a fund complex—may not have existing personnel capable of fulfilling the responsibilities of the proposed derivatives risk manager, or may choose to hire a derivatives risk manager rather than assigning that responsibility to a current officer (or officers) of the fund's investment adviser who is not a portfolio manager. Also, while we would expect larger funds or funds that are part of a large fund complex to incur higher program-related costs in absolute terms relative to a smaller fund or a fund that is part of a smaller fund complex, we would expect a smaller fund to find it more costly, per dollar managed, to comply with the proposed program requirement because it would not be able to benefit from a larger fund complex's economies of scale.[708]

b. Limit on Fund Leverage Risk

Proposed rule 18f–4 would also generally require a fund relying on the rule—including small entities, but not including funds that are limited derivatives users or that are certain leveraged/inverse funds that the rule describes—to comply with an outer limit on fund leverage risk based on VaR.[709] This outer limit would be based on a relative VaR test that compares the fund's VaR to the VaR of a designated reference index. If the fund's derivatives risk manager is unable to identify an appropriate designated reference index, the fund would be required to comply with an absolute VaR test.[710] Under the proposed rule, a fund must disclose its designated reference index in its annual report.[711] This proposed requirement is designed to limit fund leverage risk consistent with the investor protection purposes underlying section 18.

As discussed above, we estimate that the one-time operational costs necessary to establish and implement a VaR calculation model consistent with the proposed limit on fund leverage risk would range from $5,000 to $100,000 per fund, depending on the particular facts and circumstances and current derivatives risk management practices of the fund.[712] We estimate that approximately 19% of funds would be required to comply with the proposed limit on fund leverage risk.[713] We similarly estimate—applying to small funds the same estimated percentage of funds overall that would comply with this requirement—that approximately 19% of small funds (approximately 19 small funds) would be required to comply with the proposed limit on fund leverage risk.[714]

There are multiple factors that could affect whether the costs that smaller funds would incur in complying with the proposed limit on fund leverage risk would be on the lower versus higher end of this estimated range. To the extent that funds (including smaller funds) have already established and implemented portfolio VaR testing practices and procedures, these funds would incur fewer costs relative to those funds that have not already established and implemented VaR-based analysis in their risk management. If as a result of fewer resources, a smaller fund, and more specifically a smaller fund not part of a fund complex, hired a third-party vendor to comply with the VaR-based limit on fund leverage risk, this could increase costs of complying with the proposed limit for those funds. Finally, costs would vary based on factors such as whether the fund uses multiple types of derivatives or uses derivatives more extensively, whether the fund would be implementing the absolute VaR test versus the relative VaR test, and whether (for a fund that uses the relative VaR test) the fund uses a designated reference index for which the index provider charges a licensing fee.[715]

c. Requirements for Limited Derivatives Users

Proposed rule 18f–4 includes an exception from the proposed rule's risk management program requirement and limit on fund leverage risk for ''limited derivatives users.'' [716] The proposed exception would be available to a fund that either limits its derivatives exposure to 10% of its net assets, or that uses derivatives transactions solely to hedge certain currency risks. Any fund that relies on the proposed exception—small funds as well as large funds—would also be required to adopt policies and procedures that are reasonably designed to manage its derivatives risks. We expect that the risks and potential impact of these funds' derivatives use may not be as significant, compared to those of funds that do not qualify for the exception, and that a principles-based policies and procedures requirement would appropriately address these risks. These ''reasonably designed'' policies and procedures would have a scope that that reflects the extent and nature of a fund's use of derivatives within the parameters that the proposed exception provides.

As discussed above, we estimate that the one-time costs to establish and implement policies and procedures reasonably designed to manage a fund's derivative risks would range from $1,000 to $100,000 per fund, depending on the particular facts and circumstances and current derivatives risk management practices of the fund.[717] We also estimate that the ongoing annual costs that a fund that is a limited derivatives user would incur range from 65% to 75% of the one-time costs to establish and implement the policies and procedures. Thus, we estimate that a fund would incur ongoing annual costs associated with the proposed limited derivatives user exception that would range from $650 to $75,000.[718] We anticipate that larger funds that are limited derivatives users—or limited derivatives user funds that are part of a large fund complex—would likely experience economies of scale in complying with the proposed requirements for limited derivatives users that smaller funds would not

[707] *See supra* sections III.C.1 and V.C. We estimate that there are 99 small funds that meet the small entity definition. *See supra* note 692 and accompanying text. 99 small funds × 22% = approximately 22 funds that are small entities.

[708] *See supra* section III.C.1.

[709] *See supra* sections II.D, II.E, and II.G.

[710] *See supra* sections II.D.2, II.D.3.

[711] Proposed rule 18f–4(c)(2)(iv).

[712] *See supra* section III.C.2. This section, along with section IV.B.3, also discusses the professional skills that we believe compliance with this aspect of the proposal would entail.

[713] *See supra* section III.C.2. This estimate excludes both: (1) Limited derivatives users, and (2) funds that are leveraged/inverse investment vehicles under the proposed sales practices rules. *Id.; see also supra* sections II.E, II.G, III.C.2, III.C.3, III.C.5, and IV.B.3; *infra* section V.D.1.c.

[714] *See supra* sections III.C.2 and V.C. We estimate that there are 99 small funds that meet the small entity definition. *See supra* note 692 and accompanying text. 99 small entities × 19% = approximately 19 funds that are small entities.

[715] *See supra* note 202 and accompanying paragraph; note 517 and accompanying sentence.

[716] *See supra* section II.E; proposed rule 18f–4(c)(3)(i)–(ii).

[717] *See supra* section III.C.3 (discussing the one-time range of costs for implementing the limited derivatives user requirements under proposed rule18f–4 and the variables impacting a fund incurring costs at the lower or higher end of the estimated cost range). This section, along with section IV.B.6, also discusses the professional skills that we believe compliance with this aspect of the proposal would entail.

[718] *Id.*

necessarily experience.[719] Thus, smaller funds that are limited derivatives users could incur costs on the higher end of the estimated range. However, a smaller fund whose derivatives use is limited could benefit from the proposed limited derivatives user exception, because it would not be required to adopt a derivatives risk management program (including all of the proposed program elements), and therefore such a fund could potentially avoid incurring costs and bearing compliance burdens that may be disproportionate to any benefits.[720]

We estimate that approximately 19% of funds that use derivatives would qualify for the limited derivatives user exception.[721] We would expect some small funds to fall within the proposed limited derivatives user exception.[722] However, not all small funds that use derivatives would necessarily qualify as limited derivatives users. We estimate—applying to small funds the same estimated percentage of funds overall that would qualify as limited derivatives users—that approximately 19% of small funds that use derivatives (approximately 19 small funds) would comply with the proposed requirements for limited derivatives users under the proposed rule.[723]

d. Reverse Repurchase Agreements and Unfunded Commitment Agreements

Proposed rule 18f–4 would permit a fund to engage in reverse repurchase agreements and other similar financing transactions so long as they are subject to the relevant asset coverage requirements of section 18.[724] Because funds are required to rely on the asset segregation approach in Release 10666, the degree to which funds could engage in reverse repurchase agreements under the proposal would generally be the same as under current practice. Therefore we do not estimate a significant compliance burden—either for small funds that engage in reverse repurchase agreements or for larger funds—associated with the proposed provisions regarding reverse repurchase agreements in rule 18f–4.[725] For large and small funds subject to the proposed limit on fund leverage risk, any portfolio leveraging effect of reverse repurchase agreements or similar financing transactions would be included and restricted through the proposed VaR-based limits, and therefore would incrementally affect the costs associated with complying with these limits.[726]

The proposed rule also includes a provision that codifies an approach for funds' participation in unfunded commitment agreements in light of the concerns underlying section 18.[727] Proposed rule 18f–4 would permit a fund to enter into unfunded commitment agreements if it reasonably believes, at the time it enters into such agreement, that it will have sufficient cash and cash equivalents to meet its obligations with respect to all of its unfunded commitment agreements, in each case as they come due. The proposed rule would prescribe factors that a fund must consider in forming such a reasonable belief. If a fund enters into unfunded comment agreements in compliance with this requirement, the proposed rule specifies that unfunded commitment agreements will not be considered for purposes of computing asset coverage, as defined in section 18(h) of the Investment Company Act. This proposed approach for unfunded commitment agreements reflects the staff's experience in reviewing and commenting on fund registration statements, as discussed above.[728] We therefore do not expect that the proposed approach would result in significant costs to small or large funds because we believe the proposed approach is generally consistent with the current practices of funds that enter into unfunded commitment agreements.

e. Recordkeeping

Proposed rule 18f–4 includes certain recordkeeping provisions that are designed to provide the Commission's staff, and the fund's board of directors and compliance personnel, the ability to evaluate the fund's compliance with the proposed rule's requirements.[729] The proposed rule would require a fund to maintain certain records documenting its derivatives risk management program, including a written record of: (1) Its policies and procedures designed to manage the fund's derivatives risks, (2) the results of any stress testing of its portfolio, (3) the results of any VaR test backtesting it conducts, (4) records documenting any internal reporting or escalation of material risks under the program, and (5) records documenting any periodic reviews of the program.[730]

Second, the proposed rule would also require a fund to maintain a written record of any materials provided to the fund's board of directors in connection with approving the designation of the derivatives risk manager. The proposed rule would also require a fund to keep records of any written reports provided to the board of directors relating to the program, and any written reports provided to the board that the rule would require regarding the fund's non-compliance with the applicable VaR test.[731]

Third, a fund that is required to comply with the proposed VaR test would also have to maintain written records documenting the determination of: Its portfolio VaR; the VaR of its designated reference index, as applicable; its VaR ratio (the value of the VaR of the Fund's portfolio divided by the VaR of the designated reference index), as applicable; and any updates to the VaR calculation models used by the fund, as well as the basis for any material changes made to those models.[732]

Fourth, the proposed rule would require a fund that is a limited derivatives user to maintain a written record of its policies and procedures that are reasonably designed to manage its derivatives risks.[733]

Finally, a fund that enters into unfunded commitment agreements would be required to maintain a records documenting the basis for the fund's belief regarding the sufficiency of its cash and cash equivalents to meet its obligations with respect to its unfunded commitment agreements.[734] A record must be made each time a fund enters into such an agreement.[735]

As discussed above, we estimate that the average one-time recordkeeping costs for funds that would not qualify as limited derivatives users would be $2,047 per fund, depending on the particular facts and circumstances and current derivatives risk management practices of the fund.[736] We also

[719] *See supra* note 707 and accompanying text.

[720] *See supra* section II.E.

[721] *Id.* This estimate excludes both: (1) Funds that would comply with the derivatives risk management program, and (2) funds that would be leveraged/inverse investment vehicles under proposed rule 15*l*–2. *See also supra* sections II.A.2, II.E, II.G, III.C.1, III.C.3, III.C.5, IV.B.4, and V.D.1.a.

[722] *Id.; see also supra* section III.C.3.

[723] *Id.; see also supra* sections III.C.3 and V.C. We estimate that there are 99 small funds that meet the small entity definition. *See supra* note 692 and accompanying text. 99 small entities × 19% = approximately 19 funds that are small entities.

[724] *See supra* section II.I.

[725] *See supra* section III.C.4.

[726] *See supra* section II.I.

[727] *See supra* section II.J.

[728] *See id.*

[729] *See supra* section II.K.

[730] *See* proposed rule 18f–4(c)(6)(i)(A).

[731] *See* proposed rule 18f–4(c)(6)(i)(B).

[732] *See* proposed rule 18f–4(c)(6)(i)(C).

[733] *See* proposed rule 18f–4(c)(6)(i)(D).

[734] *See* proposed rule 18f–4e)(2); *see also supra* note 429 and accompanying text.

[735] *Id.; see also supra* note 430 and accompanying text.

[736] *See supra* section III.C.8. This section, along with section IV.B.7, also discusses the professional skills that we believe compliance with this aspect of the proposal would entail.

estimate that such a fund would incur an average ongoing annual recordkeeping costs of $330.[737] We further estimate that the one-time and ongoing annual recordkeeping costs for a limited derivatives user to be 90% of those for funds that do not qualify as limited derivatives users.[738] Thus, for each fund that could rely on the limited derivatives user exception, we estimate a one-time cost of $1,842 and an ongoing cost of $297 per year.[739] To the extent that we estimate that small funds would be subject to the various provisions of the proposed rule that would necessitate recordkeeping requirements, as discussed above, these small funds also would be subject to the associated proposed recordkeeping requirements. Therefore, we estimate that: 22% of small funds (approximately 22 small funds) would have to comply with the program-related recordkeeping requirements and requirements regarding materials provided to the fund's board; 19% of small funds (approximately 19 small funds) would have to comply with requirements to maintain records of compliance with the proposed VaR test; and 19% of small funds (approximately 19 funds) would have to comply with the recordkeeping requirements for limited derivatives users.[740]

A fund's recordkeeping-related costs will vary, depending on the provisions of proposed rule 18f–4 that the fund relies on. For example, funds that are required to adopt derivatives risk management programs, versus funds that are limited derivatives users under the proposed rule, would be subject to different recordkeeping requirements. However, while small funds' recordkeeping burdens would vary based on the provisions of the proposed rule that a fund relies on, their recordkeeping burdens would not vary solely because they are small funds. We do not anticipate that larger funds, or funds that are part of a large fund complex, would experience any significant economies of scale related to the proposed recordkeeping requirements.

2. Proposed Amendments to Forms N–PORT, N–LIQUID, and N–CEN

a. Proposed Amendments to Form N–PORT

The proposed amendments to Form N–PORT would require funds to report information about their derivatives exposure, and also—as applicable for funds that are subject to the proposed rule 18f–4 VaR-based limit on fund leverage risk—to report certain VaR-related information.[741] These proposed amendments would provide market-wide insight into the levels of reporting funds' derivatives exposure to the Commission, its staff, and market participants at the specific points in time covered by the reporting. They also would help the Commission and its staff assess compliance with proposed rule 18f–4.

All funds that file Form N–PORT would have to provide information regarding their derivatives exposure on this form. We estimate that 41% of small funds that file Form N–PORT (approximately 34 small funds) use derivatives, and thus only these funds would have substantive information to report in response to this new exposure-related disclosure requirement.[742]

In addition, funds that are subject to the proposed limit on fund leverage risk would have to report: (1) The fund's highest daily VaR during the reporting period and its corresponding date; and (2) the fund's median daily VaR for the reporting period. Funds subject to the relative VaR test during the reporting period also would have to report: (1) The name of the fund's designated reference index, (2) the index identifier, (3) the fund's highest daily VaR ratio during the reporting period and its corresponding date; and (4) the fund's median daily VaR ratio for the reporting period. A fund would be required to determine its compliance with its applicable VaR test once each business day.[743]

All funds that are subject to the proposed limit on fund leverage risk also would have to report the number of exceptions that the fund identified as a result of the backtesting of its VaR calculation model. We estimate that 19% of small funds (approximately 16 small funds) would be subject to these VaR-related disclosure requirements.[744]

We estimate that each fund that reports information in response to the proposed VaR-related disclosure requirements on Form N–PORT would incur a one-time cost of $2,784 and an ongoing cost of $4,176 per year, and each fund that is not subject to the VaR-related disclosure requirement would incur a one-time cost of $1,392 and an ongoing cost of $2,088 per year.[745] Notwithstanding the economies of scale experienced by large versus small funds, we would not expect the costs of compliance associated with the new Form N–PORT requirements to be meaningfully different for small versus large funds. The costs of compliance would vary only based on fund characteristics tied to their derivatives use. For example, a fund that uses derivatives extensively would incur more costs to calculate its derivatives exposure than a fund that does not use derivatives extensively.[746] And a fund that is a limited derivatives user, or that otherwise is not subject to the proposed VaR test, would not incur any costs to comply with the proposed new VaR-related N–PORT items.[747]

b. Proposed Amendments to Form N–LIQUID

We are proposing to re-title Form N–LIQUID as Form N–RN, and amend this form to include new reporting events for funds that are subject to proposed rule 18f–4's limit on fund leverage risk.[748] The proposed amendments would require funds subject to the limit on fund leverage risk to report information

[737] *Id.*

[738] *Id.*

[739] *Id.*

[740] *See supra* sections III.C.1, III.C.2, III.C.3, V.D.1.a, V.D.1.b, and V.D.1.c.

[741] *See supra* section II.H.1; *see also* proposed Items B.9 and B.10 of Form N–PORT.

[742] *See supra* sections V.C, V.D.1.a, and V.D.1.c. Because BDCs do not file reports on Form N–PORT, we deduct the number of BDCs from the total number of small funds that we estimate (99 small funds − 16 BDCs that are small entities = 83 small funds that file reports on Form N–PORT). *See supra* note 692 and accompanying text.

We estimate that approximately 22% of funds would be subject to the proposed rule's derivatives risk management program requirements and approximately 19% of funds would be subject to either of the limited derivatives user exceptions, with funds from both groups subject to reporting requirements on Form N–PORT. *See supra* notes 706, 720, and accompanying text. Although both of these estimated percentages include BDCs, we note that the total number of BDCs relative to the number of registered open- and closed-end funds is small, and therefore our estimates do not adjust these percentages to reflect the fact that BDCs do not file Forms N–PORT. *See supra* section III.B.1. Therefore, we estimate the total number of small funds subject to the proposed Form N–PORT requirements as follows: 83 small funds that file reports on Form N–PORT × (22% + 19% = 41%) = 34 small funds.

[743] *See supra* note 364.

[744] We estimate 83 small funds that file reports on Form N–PORT. *See supra* note 741.

We estimate that approximately 19% of funds would be subject to the proposed limit on fund leverage risk. *See supra* note 712 and accompanying text. Although this estimated percentage include BDCs, we note that the total number of BDCs relative to the number of registered open- and closed-end funds is small, and therefore our estimate does not adjust this percentage to reflect the fact that BDCs do not file Forms N–PORT. *See supra* section III.B.1. Therefore, we estimate the total number of small funds that would make VaR-related disclosures on Form N–PORT as follows: 83 small funds that file reports on Form N–PORT × 19% = approximately 16 small funds.

[745] *See supra* section III.C.9.a.; *see also supra* section IV.F (discussing the professional skills that we believe compliance with this aspect of the proposal would entail).

[746] *See supra* note 714.

[747] *See* proposed Item B.10 to Form N–PORT.

[748] *See supra* section II.H.2.

about VaR test breaches under certain circumstances. These proposed current reporting requirements are designed to aid the Commission in assessing funds' compliance with the VaR tests, and to provide staff the ability to assess how long a fund is precluded from entering into derivatives transactions as a consequence of its lack of compliance with its VaR test. We are proposing to require funds to provide this information in a current report because we believe that the Commission should be notified promptly when a fund is out of compliance with the proposed VaR-based limit on fund leverage risk (and also when it has come back into compliance with its applicable VaR test). We believe this information could indicate that a fund is experiencing heightened risks as a result of a fund's use of derivatives transactions, as well as provide the Commission insight about the duration and severity of those risks, and whether those heightened risks are fund-specific or industry-wide.

As discussed above, we estimate that each fund subject to the proposed new current reporting requirements would incur an average cost of $10 per year to prepare amended Form N–RN.[749] We estimate that approximately 19 registered open- and closed-end funds, and BDCs, are small entities that would be required to report VaR test related information on Form N–RN.[750] Because the proposed amendments to Form N–RN would require both large and small funds to report VaR test breaches, the burden to report is not associated with fund size, and consequently, we would not expect the costs of compliance with the new Form N–RN requirements to be meaningfully different for small versus large funds.

c. Proposed Amendments to Form N–CEN

The proposed amendments to Form N–CEN would require a fund to identify whether it relied on proposed rule 18f–4 during the reporting period.[751] The proposed amendments also would require a fund to identify whether it relied on any of the exemptions from various requirements under the proposed rule, specifically: (1) Whether the fund is a limited derivatives user excepted from the proposed rule's program requirement, under either of the proposed exception's alternatives (either a funds that limits its derivatives exposure to 10% of its net assets, or a fund that uses derivatives transactions solely to hedge certain currency risks); or (2) whether it is a leveraged/inverse fund covered by the proposed sales practices rules that, under proposed rule 18f–4, would be excepted from the proposed limit on fund leverage risk. Finally, a fund would have to identify whether it has entered into reverse repurchase agreements or similar financing transactions, or unfunded commitment agreements, as provided under the proposed rule.[752] The proposed amendments to Form N–CEN are designed to assist the Commission and staff with our oversight functions by allowing us to identify which funds were excepted from certain of the proposed rule's provisions or relied on the rule's provisions regarding reverse repurchase agreements and unfunded commitment agreements.

As discussed above, we estimate that each fund subject to the proposed new Form N–CEN reporting requirements would incur on average an ongoing annual cost of $6.96 per year.[753] We estimate that approximately 34 registered open- and closed-end funds are small entities that would be subject to the proposed new Form N–CEN reporting requirements.[754] Notwithstanding any economies of scale experienced by large versus small funds, we would not expect the costs of compliance with the new Form N–CEN requirements to be meaningfully different for small versus large funds.

3. Proposed Sales Practices Rules

The proposed sales practices rules under the Exchange Act and the Advisers Act would require a firm to exercise due diligence in determining whether to approve the account of a retail investor to buy or sell shares of a leveraged/inverse investment vehicle before accepting an order from, or placing an order for, the retail investor to engage in these transactions.[755] Under the proposed sales practices rules, no firm may accept an order from or place an order for a retail investor to buy or sell shares of a leveraged/inverse investment vehicle, or approve such an investor's account to engage in those transactions, unless the firm has complied with certain conditions.

Specifically, the proposed sales practices rules would require the firm to: (1) Approve the retail investor's account for buying and selling shares of leveraged/inverse investment vehicles pursuant to a due diligence requirement; and (2) adopt and implement policies and procedures reasonably designed to achieve compliance with the proposed rules.[756] The proposed sales practices rules' due diligence requirements provide that a firm must exercise due diligence to ascertain the essential facts relative to the retail investor, his or her financial situation, and investment objectives. A firm must seek to obtain, at a minimum, certain specified information about the retail investor. The proposed sales practices rules also include recordkeeping requirements relating to the information that the firm obtained through its due diligence, the firm's approval or disapproval of the retail investor's account for buying and selling shares of leveraged/inverse investment vehicles (account approvals must be in writing), and the firm's policies and procedures that it adopted pursuant to those rules.[757]

The proposed sales practices rules are designed to establish a uniform set of enhanced due diligence and account approval requirements for all leveraged/inverse investment vehicle transactions, including transactions where no recommendation or investment advice is provided by a firm. They also are designed in part to help to ensure that

[749] *See supra* section III.C.9.b; *see also supra* section IV.G (discussing the professional skills that we believe compliance with this aspect of the proposal would entail).

[750] This estimate is based on an estimate that 16 small registered open- and closed-end funds would make VaR-related disclosures on Form N–PORT (*see supra* note 743 and accompanying text), plus 3 BDCs (16 total small BDCs (*see supra* note 692 and accompanying text) × 19% (our estimate of the percentage of funds subject to a VaR-based limit on fund leverage risk, *see supra* note 712 and accompanying text) = approximately 3 BDCs). Thus, 16 small registered open- and closed-end funds + 3 BDCs = 19 funds.

[751] *See supra* section II.H.3.

[752] *See* proposed Item C.7.l.iv–v of Form N–CEN; *see also supra* section II.I and II.J; proposed rule 18f–4(d); and proposed rule 18f–4(e).

[753] *See supra* section III.C.9.a; *see also supra* section IV.H (discussing the professional skills that we believe compliance with this aspect of the proposal would entail).

[754] Because BDCs do not file reports on Form N–CEN, we deduct the number of BDCs from the total number of small funds that we estimate (99 small funds − 16 BDCs that are small entities = 83 small funds that file reports on Form N–CEN). *See supra* note 692 and accompanying text.

The estimate of 34 funds is based on the percentage of funds we believe would be subject to the proposed derivatives risk management program requirement (22% of funds, *see supra* note 498 and accompanying text) plus the percentage of funds we believe would qualify as limited derivatives users (19% of funds, *see supra* note 720 and accompanying text). We estimate that 83 small funds that file reports on Form N–CEN (99 total small funds less 16 small BDCs) × 41% (22% + 19%) = 34 small funds subject to the proposed Form N–CEN reporting requirements. To the extent that there are funds that either (1) would not adopt a derivatives risk management program or (2) would not qualify as limited derivatives user, but that would rely on the rule's provisions with respect to reverse repurchase agreements or unfunded commitment agreements, this analysis might underestimate the number of funds that would be subject to the new Form N–CEN reporting requirements.

[755] *See supra* section II.G.1.

[756] *See supra* section II.G.2.b.

[757] *See supra* section II.G.2.c.

investors in these funds are limited to those who understand their characteristics—including that these funds would not be subject to all of the leverage-related requirements applicable to registered investment companies generally—and the unique risks they present.

As discussed above, we estimate that each broker-dealer subject to proposed rule 15*l*–2, and each investment adviser subject to proposed rule 211(h)–1, would incur total one-time costs that would range from $9,115.50 to $15,192.50 to comply with the proposed rules, and total ongoing costs that would range from $2,270.50 to $3,915 per year to comply with the proposed rules.[758] We estimate that approximately 236 broker-dealers and 43 registered investment advisers are small entities that would be subject to the proposed sales practices rules.[759]

The costs that broker-dealers and investment advisers may incur as a result of the proposed sales practices rules would vary depending on the firm and the due diligence requirements that the firm adopts as a result of the proposed rules' requirements.[760] We expect that economies of scale among larger firms could result in cost reductions for larger firms. Compliance costs could, however, be different across firms with relatively smaller or larger numbers of retail investors as customers or clients.[761]

4. Proposed Amendments to Rule 6c–11

We are proposing to amend rule 6c–11 to remove the provision excluding leveraged/inverse ETFs from the scope of that rule and to newly permit leveraged/inverse ETFs to rely on that rule.[762] Rule 6c–11 permits ETFs that satisfy certain conditions to operate without obtaining an exemptive order from the Commission.[763] The rule is designed to create a consistent, transparent, and efficient regulatory framework for such ETFs and facilitate greater competition and innovation among ETFs. As a consequence of our proposed amendment to rule 6c–11, and proposal to rescind the exemptive orders we have previously issued to leveraged/inverse ETFs, these proposed amendments would newly permit leveraged/inverse ETFs to come within scope of the rule's exemptive relief.

Currently, there are 73 leveraged/inverse ETFs.[764] As a result of the proposed amendments, we would expect the number of funds relying on rule 6c–11 to increase, and we estimate that all 73 leveraged/inverse ETFs would newly seek to use rule 6c–11. We also estimate, for purposes of this Regulatory Flexibility Act analysis, that approximately 1 of these leveraged/inverse ETFs would be a small leveraged/inverse ETF that would seek to rely on rule 6c–11.[765] We do not estimate our amendments to rule 6c–11 would change the estimated per-fund cost burden associated with rule 6c–11, but we do believe the number of funds using the rule, as a result of our amendment, would now increase.[766] The costs associated with complying with rule 6c–11 are discussed in the ETFs Adopting Release.[767]

E. Duplicative, Overlapping, or Conflicting Federal Rules

Commission staff has not identified any federal rules that duplicate, overlap, or conflict with proposed Investment Company Act rule 18f–4, proposed Exchange Act rule 15*l*–2, proposed Advisers Act rule 211(h)–1, or the proposed amendments to Form N–PORT, Form N–LIQUID, and Form N–CEN.

We recognize that other broker-dealer or investment adviser obligations require these entities to engage in due diligence with respect to transactions they recommend to customers or clients. The proposed sales practices rules, in contrast, would apply regardless of whether a broker-dealer or investment adviser recommends that a customer or client buy or sell leveraged/inverse investment vehicles. We therefore do not believe that the sales practices rules would conflict with existing broker-dealer or investment adviser obligations, and believe that any overlap or duplication should be limited because a broker-dealer or investment adviser could consider the information it collects in connection with the sales practices rules in connection with the due diligence the broker-dealer or investment adviser conducts in connection with other, existing obligations for recommended transactions.

F. Significant Alternatives

The Regulatory Flexibility Act directs the Commission to consider significant alternatives that would accomplish our stated objectives, while minimizing any significant economic impact on small entities. We considered the following alternatives for small entities in relation to our proposal: (1) Exempting funds, broker-dealers, and registered investment advisers that are small entities from the proposed reporting, recordkeeping, and other compliance requirements, to account for resources available to small entities; (2) establishing different reporting, recordkeeping, and other compliance requirements or frequency, to account for resources available to small entities; (3) clarifying, consolidating, or simplifying the compliance requirements under the proposal for small entities; and (4) using performance rather than design standards.

1. Proposed Rule 18f–4

We do not believe that exempting small funds from the provisions in proposed rule 18f–4 would permit us to achieve our stated objectives. Because proposed rule 18f–4 is an exemptive rule, it would require funds to comply with new requirements only if they wish to enter into derivatives or certain other transactions.[768] Therefore, if a

[758] *See supra* notes 539 and 543 and accompanying text. This discussion, along with sections IV.C and IV.D *supra,* also discusses the professional skills that we believe compliance with this aspect of the proposal would entail.

[759] We estimate there are currently 942 small broker-dealers. *See supra* note 694 and accompanying text. We further estimate that 700 broker-dealers (or 25% of all 2,766 broker-dealers registered with the Commission) have retail customer accounts that invest in leveraged/inverse investment vehicles. *See supra* section III.C.5. Our estimate of 236 broker-dealers is based on the following calculation: 942 small broker dealers × 25% = approximately 236 small broker-dealers that have retail customer accounts that invest in leveraged/inverse investment vehicles.

We estimate that there are currently 470 SEC-registered investment advisers that are small entities. *See supra* note 697 and accompanying text. Of these, we estimate that 171 provide advice to individual clients, and could therefore be subject to the proposed new sales practices rules under the Advisers Act. *See supra note* 698 and accompanying text. We further estimate that 2,000 investment advisers (or approximately 25% of the 8,235 investment advisers that are registered with the Commission and offer some part of their business to retail investors) have retail client accounts that invest in leveraged/inverse investment vehicles. *See supra* sections III.C.5 and IV.D. Our estimate of 43 investment advisers is based on the following calculation: 171 small investment advisers that provide advice to individual clients × 25% = approximately 43 small investment advisers that have retail client accounts that invest in leveraged/inverse investment vehicles.

[760] *See supra* section III.C.5 (discussing costs and benefits of proposed sales practices rules).

[761] *See supra* section II.G.2.b (discussing required approval and due diligence for retail investors' accounts to trade shares of leveraged/inverse investment vehicles under the proposed sales practices rules).

[762] *See supra* section II.G.4.

[763] *Id.*

[764] *See supra* note 467.

[765] This estimate is based on the following calculation: 8 small ETFs/1,190 total ETFs = approximately 0.67% of ETFs that are small ETFs. *See supra* sections III.B.1 and V.C. 0.67% of 73 leveraged/inverse ETFs = approximately 1 leveraged/inverse ETF.

[766] *See supra* section IV.E.

[767] *See* ETFs Adopting Release, *supra* note 76, at section IV.

[768] *See supra* sections II.D.6 and III.E.

small entity does not enter into derivatives or such other transactions as part of its investment strategy, then the small entity would not be subject to the provisions of proposed rule 18f–4. In addition, a small fund whose derivatives use is limited could benefit from the proposed limited derivatives user exception, because it would not be required to adopt a derivatives risk management program (including all of the proposed program elements).

We estimate that 59% of all funds do not have any exposure to derivatives or such other transactions.[769] This estimate indicates that many funds, including many small funds, would be unaffected by the proposed rule. However, for small funds that would be affected by our proposed rule, providing an exemption for them could subject investors in small funds that invest in derivatives or engage in such other transactions to a higher degree of risk than investors to large funds that would be required to comply with the proposed elements of the rule.

The undue speculation concern expressed in section 1(b)(7) of the Investment Company Act, and the asset sufficiency concern reflected in section 1(b)(8) of the Act—both of which the proposed rule is designed to address—apply to both small as well as large funds. As discussed throughout this release, we believe that the proposed rule would result in investor protection benefits, and these benefits should apply to investors in smaller funds as well as investors in larger funds. We therefore do not believe it would be appropriate to exempt small funds from the proposed rule's program requirement or VaR-based limit on fund leverage risk, or to establish different requirements applicable to funds of different sizes under these provisions to account for resources available to small entities. We believe that all of the proposed elements of rule 18f–4 should work together to produce the anticipated investor protection benefits, and therefore do not believe it is appropriate to except smaller funds because we believe this would limit the benefits to investors in such funds.

We also do not believe that it would be appropriate to subject small funds to different reporting, recordkeeping, and other compliance requirements or frequency. Similar to the concerns discussed above, if the proposal included different requirements for small funds, it could raise investor protection concerns for investors in small funds including subjecting small fund investors to a higher degree of risk if the small fund uses derivatives transactions. We also believe that all fund investors will benefit from enhanced Commission monitoring and oversight of the fund industry, which we anticipate will result from the disclosure and reporting requirements.

We do not believe that clarifying, consolidating, or simplifying the compliance requirements under the proposal for small funds would permit us to achieve our stated objectives. Again, this approach would raise investor protection concerns for investors in small funds using derivatives transactions. However, as discussed above, the proposed rule contains an exception for limited derivatives users that we anticipate would subject funds that qualify for this exception to fewer compliance burdens. We recognize that the risks and potential impact of derivatives transactions on a fund's portfolio generally increase as the fund's level of derivatives usage increases and when funds use derivatives for speculative purposes. Therefore the proposed rule would entail a less significant compliance burden for funds—including small funds—that choose to limit their derivatives usage in the manner that the proposed exception specifies. The proposal, therefore, does include provisions designed to consider the requirement burdens based on the fund's use of derivatives (rather than the size of the fund).

The costs associated with proposed rule 18f–4 would vary depending on the fund's particular circumstances, and thus the proposed rule could result in different burdens on funds' resources. In particular, we expect that a fund that pursues an investment strategy that involves greater derivatives risk may have greater costs associated with its derivatives risk management program. For example, a fund that qualifies as a limited derivatives user under the proposed rule would be exempt from the proposed requirements to adopt and implement a derivatives risk management program, and to adhere to the proposed rule's VaR-based limit on fund leverage risk. The costs of compliance with the proposed rule would vary even for limited derivatives users, as these funds would be required to adopt policies and procedures that are ''reasonably designed'' to manage their derivatives risks. Thus, to the extent a fund that is a small entity faces relatively little derivatives risk, we believe it would incur relatively low costs to comply with the proposed rule. However, we believe that it is appropriate to correlate the costs associated with the proposed rule with the level of derivatives risk facing a fund, and not necessarily with the fund's size in light of our investor protection objectives.

Finally, with respect to the use of performance rather than design standards, the proposed rule generally uses performance standards for all funds relying on the proposed rule, regardless of size. We believe that providing funds with the flexibility with respect to investment strategies and use of derivatives transactions is appropriate, as well as the derivatives risk management program design. However, the proposed rule also uses design standards with respect to certain requirements such as complying with the VaR-based limit on fund leverage risk and the specified program elements in the derivatives risk management program. For the reasons discussed above, we believe that this use of design standards is appropriate to address investor protection concerns, particularly the concerns expressed in sections 1(b)(7), 1(b)(8), and 18 of the Investment Company Act.

2. Proposed Sales Practices Rules

Similarly, we do not believe that exempting any subset of broker-dealers or registered investment advisers, including those firms that are small entities, from the provisions in the proposed sales practices rules would permit us to achieve our stated investor protection objectives. We also do not believe that it would be desirable to establish different requirements applicable to firms of different sizes under the proposed sales practices rules to account for resources available to small entities, to consolidate or simplify the compliance requirements under the proposal for small entities, or to use performance standards rather than design standards for small entities.

We do not believe exempting small broker-dealers and investment advisers from the proposed sales practices rules would serve the interest of investors. As we discussed above, leveraged/inverse investment vehicles present unique considerations, and the proposed sales practices rules are designed in part to address the investor protection concerns leveraged/inverse funds present.[770] The proposed sales practices rules would permit broker-dealers and investment advisers to accept or place orders to buy or sell shares of a ''leveraged/inverse investment vehicle'' only for investors that they have approved for those transactions, based on certain required

[769] *See supra* note 458 and accompanying paragraph.

[770] *See supra* section II.G.

criteria.[771] Exempting smaller broker-dealer and investment adviser firms would create a regulatory gap, whereby larger funds would be required to comply with the proposed sales practices rules' due diligence requirements to determine whether to approve the account of retail investor to buy or sell shares of a leveraged/inverse investment vehicle, and small entities would not need to conduct this same diligence.

As discussed above, we believe that this limitation on leveraged/inverse investment vehicles' investor base would help provide that investors in these vehicles understand the characteristics of these vehicles and the unique risks they present.[772] Providing different requirements or simplifying the requirements for small entities would dilute these investor protection benefits for customers or clients of small entities. We do not believe that the investor protection benefits of the proposed sales practices rules should depend on whether an investor is transacting through a small or a large firm. Furthermore, a broker-dealer or investment adviser would have to comply with the applicable proposed rule's requirements only if it transacts with retail investors in the shares of leveraged/inverse investment vehicles.[773]

Finally, we are not proposing performance standards rather than design standards for smaller entities. We believe that subjecting smaller entities to different standards under the proposed rules could lead to inconsistency in how investors would transact in leveraged/inverse investment vehicles, depending on whether the investor has a relationship with a large or small broker-dealer or investment adviser. This would be inconsistent with the regulatory and investor protections purposes of the proposed rules and could subject investors who interact with small firms to a higher degree of risk than investors who interact with larger firms. It could also circumvent the proposed rules' ability to establish a uniform set of enhanced due diligence and approval requirements for all leveraged/inverse investment vehicle transactions, and to address the investor protection concerns underlying section 18 for leveraged/inverse funds by limiting their investor base.

3. Proposed Amendments to Forms N–PORT, N–LIQUID, and N–CEN

We do not believe that the interests of investors would be served by exempting funds that are small entities from the proposed disclosure and reporting requirements. We believe that the form amendments are necessary to help identify and provide the Commission, staff, investors, and other market participants timely information about funds that comply with proposed rule 18f–4, and to realize the anticipated benefits of the proposed reporting requirements.[774] Exempting small funds from coverage under all or any part of the proposed form amendments could compromise the effectiveness of the required disclosures, which the Commission believes would not be consistent with its goals of industry oversight and investor protection. We believe that all fund investors, including investors in small funds, would benefit from disclosure and reporting requirements that would permit them to make investment choices that better match their risk tolerances. We also believe that all fund investors would benefit from enhanced Commission monitoring and oversight of the fund industry, which we anticipate would result from the proposed disclosure and reporting requirements.

For similar reasons, we do not believe that the interests of investors would be served by establishing different reporting, recordkeeping, or other compliance requirements for small funds. We considered providing small funds simplified compliance or disclosure requirements. However, we believe this too would subject investors in small funds that invest in derivatives to a higher degree of risk and information asymmetry than investors to large funds that would be required to comply with the proposed disclosure requirements. We also note that registered open- and closed-end management investment companies, including those that are small entities, have already updated their systems and have established internal processes to prepare, validate, and file reports on Forms N–PORT and N–CEN (or will do so shortly).[775] For funds that will be required to file reports on Form N–RN, the vast majority of them are open-end funds, which already are required to submit the form upon specified events. With respect to the additional registered closed-end funds and BDCs newly required to file reports on Form N–RN, we do not believe they would need more time to comply with the new reporting requirements, given the limited set of reporting requirements they would be subject to and the relatively low burden we estimate of filing reports on Form N–RN.

We also do not believe that the interests of investors would be served by clarifying, consolidating, or simplifying the compliance requirements under the proposal for small funds. Small funds are as vulnerable to the same potential risks associated with their derivatives use as larger funds are, and therefore we believe that simplifying or consolidating the proposed reporting requirements for small funds would not allow us to meet our stated objectives. Moreover, we believe many of the proposed disclosure requirements involve minimal burden. For example, the Form N–CEN ''checking a box'' reporting requirement is completed on an annual basis.

Finally, we did not prescribe performance standards rather than design standards for small funds because we believe this too could diminish the ability of the proposed rules to achieve their intended regulatory purpose by creating inconsistent reporting requirements between small and large funds, and weakening the benefits of the proposed reporting requirement for investors in small funds.

4. Rule 6c–11

Rule 6c–11 is designed to modernize the regulatory framework for ETFs and to create a consistent, transparent, and efficient regulatory framework.[776] The Commission's full Regulatory Flexibility Act Analysis regarding rule 6c–11, including analysis of significant alternatives, appears in the 2019 ETFs Adopting Release and the 2018 ETFs Proposing Release.[777] Our analysis of alternatives for small leveraged/inverse ETFs here is consistent with the Commission's analysis of alternatives for small ETFs in those releases.

[771] *See* proposed rule 15*l*–2(b).

[772] *See supra* section II.G.

[773] We estimate that approximately 236 broker-dealers and 43 registered investment advisers are small entities that would be subject to the proposed sales practices rules. *See supra* note 758 and accompanying text.

Broker-dealers and investment advisers that would have to comply with the proposed sales practices rules also might currently have processes in place that would provide efficiencies in complying with the proposed rules. *See supra* note 536 and accompanying text.

[774] *See supra* section III.C.9.

[775] *See supra* note 359 (discussing, among other things, Form N–PORT compliance dates and noting that the funds that would rely on proposed rule 18f–4 (if adopted) other than BDCs generally are subject to reporting requirements on Form N–CEN); *see also* Investment Report Modernization Adopting Release *supra* note 178, at section II.H.

[776] *See* ETFs Adopting Release, *supra* note 76, at section I.

[777] *See id.* at section VI; *see also* Exchange-Traded Funds, Investment Company Act Release No. 10515 (June 28, 2018) [83 FR 37332 (July 31, 2018)] (''ETFs Proposing Release''), at section V.

We do not believe that permitting or requiring different treatment for any subset of leveraged/inverse ETFs, including small leveraged/inverse ETFs, under the proposed amendments to rule 6c–11, and the rule's related recordkeeping, disclosure and reporting requirements, would permit us to achieve our stated objectives. Similarly, we do not believe that we can establish simplified or consolidated compliance requirements for small leveraged/inverse ETFs under the proposed amendments to rule 6c–11 without compromising our objectives. The Commission discussed the bases for this determination (with respect to ETFs other than leveraged/inverse ETFs) in more detail in the ETFs Proposing Release and the ETFs Adopting Release, and we are extending that analysis to leveraged/inverse ETFs in this Initial Regulatory Flexibility Act Analysis. In addition, we do not believe it would be appropriate to exempt small leveraged/inverse ETFs from the proposed amendments to rule 6c–11 (or to establish different disclosure, reporting, or recordkeeping requirements, or simplified or consolidated compliance requirements under rule 6c–11 for these entities) because of the particular risks that leveraged/inverse ETFs may present.[778] We also do not think it would be appropriate to establish different requirements under rule 6c–11 for small leveraged/inverse ETFs, which could produce a competitive advantage for these funds compared to larger leveraged/inverse ETFs (and compared to other ETFs that rely on the rule). This would conflict with our goals of creating a consistent, transparent, and efficient regulatory framework for ETFs and to facilitate greater competition and innovation among ETFs.

G. Request for Comment

The Commission requests comments regarding this analysis. We request comment on the number of small entities that would be subject to our proposal and whether our proposal would have any effects that have not been discussed. We request that commenters describe the nature of any effects on small entities subject to our proposal and provide empirical data to support the nature and extent of such effects. We also request comment on the estimated compliance burdens of our proposal and how they would affect small entities.

[778] *See supra* section II.G.1.

VI. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 (''SBREFA''), the Commission must advise OMB whether a proposed regulation constitutes a ''major'' rule. Under SBREFA, a rule is considered ''major'' where, if adopted, it results in or is likely to result in:

- An annual effect on the economy of $100 million or more;
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment, or innovation.

We request comment on whether our proposal would be a ''major rule'' for purposes of SBREFA. We solicit comment and empirical data on:

- The potential effect on the U.S. economy on an annual basis;
- Any potential increase in costs or prices for consumers or individual industries; and
- Any potential effect on competition, investment, or innovation.

Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

VII. Statutory Authority

The Commission is proposing new rule 18f–4 under the authority set forth in sections 6(c), 12(a), 18, 31(a), 38(a), and 61 of the Investment Company Act of 1940 [15 U.S.C. 80a–6(c), 80a–12(a), 80a–18, 80a–30(a), 80a–37(a), and 80a–60]. The Commission is proposing amendments to rule 6c–11 under the authority set forth in sections 6(c), 22(c), and 38(a) of the Investment Company Act [15 U.S.C. 80a–6(c), 22(c), and 80a–37(a)]. The Commission is proposing new rule 15*l*–2 under the authority set forth in sections 3, 3(b), 3E, 10, 15(l), 15F, 17, 23(a), and 36 of the Securities Exchange Act of 1934 [15 U.S.C. 78c, 78c(b), 78c–5, 78j, 78o(l), 78o–10, 78q, 78w(a), and 78mm]. The Commission is proposing new rule 211(h)–1 under the authority set forth in sections 206, 206A, 208, 211(a), and 211(h), and of the Investment Advisers Act of 1940 [15 U.S.C. 80b–6, 80b–6a, 80b–8, 80b–11(a), and 80b–11(h)]. The Commission is proposing amendments to Form N–PORT, Form N–LIQUID (which we propose to re-title as ''Form N–RN''), Form N–CEN, and Form N–2 under the authority set forth in sections 8, 18, 30, and 38 of the Investment Company Act of 1940 [15 U.S.C. 80a–8, 80a–18, 80a–29, 80a–37, 80a–63], sections 6, 7(a), 10 and 19(a) of the Securities Act of 1933 [15 U.S.C. 77f, 77g(a), 77j, 77s(a)], and sections 10, 13, 15, 23, and 35A of the Exchange Act [15 U.S.C. 78j, 78m, 78o, 78w, and 78ll].

Text of Rules and Forms

List of Subjects

17 CFR Parts 240 and 249

Brokers, Fraud, Reporting and recordkeeping requirements, Securities.

17 CFR Parts 270 and 274

Investment companies, Reporting and recordkeeping requirements, Securities.

17 CFR Part 275

Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, title 17, chapter II of the Code of Federal Regulations is proposed to be amended as follows:

* * * * *

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

■ 1. The authority citation for part 240 is amended by adding a subauthority for Section 240.15*l*–2 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, 78l, 78m, 78n, 78n–1, 78o, 78o–4, 78o–10, 78p, 78q, 78q–1, 78s, 78u–5, 78w, 78x, 78dd, 78ll, 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 240.15*l*–2 is also issued under Pub. L. 111–203, sec. 913, 124 Stat. 1376, 1827 (2010).

* * * * *

■ 2. Section 240–15*l*–2 is added to read as follows:

§ 240.15*l*–2 Broker and dealer sales practices for leveraged/inverse investment vehicles.

(a) *Required approval of customer account.* No broker or dealer registered or required to be registered under the Securities Exchange Act of 1934, or any associated person of the broker or dealer, may accept an order from a customer that is a natural person (or the legal representative of a natural person) to buy or sell shares of a leveraged/inverse investment vehicle unless the broker or dealer has approved such a customer's account to engage in those transactions and has adopted and implemented policies and procedures reasonably designed to achieve compliance with this section. Any

approval of a customer's account for buying or selling leveraged/inverse investment vehicles must be effected as provided in paragraph (b).

(b) *Diligence in approving accounts.* (1) In determining whether to approve a customer's account to buy or sell leveraged/inverse investment vehicles, the broker or dealer must exercise due diligence to ascertain the essential facts relative to the customer, his or her financial situation, and investment objectives, including, at a minimum, the information specified in paragraph (b)(2) of this section (and must seek to obtain information for all participants in a joint account). Based upon this information, the broker or dealer must specifically approve or disapprove the customer's account for buying and selling shares of leveraged/inverse investment vehicles. An approval of a customer account must be in writing. A broker or dealer may provide this approval if the broker or dealer has a reasonable basis for believing that the customer has such knowledge and experience in financial matters that he or she may reasonably be expected to be capable of evaluating the risks of buying and selling leveraged/inverse investment vehicles.

(2) A broker or dealer must seek to obtain the following information at a minimum regarding the customer:

(i) Investment objectives (*e.g.,* safety of principal, income, growth, trading profits, speculation) and time horizon;

(ii) Employment status (name of employer, self-employed or retired);

(iii) Estimated annual income from all sources;

(iv) Estimated net worth (exclusive of family residence);

(v) Estimated liquid net worth (cash, liquid securities, other);

(vi) Percentage of the customer's estimated liquid net worth that he or she intends to invest in leveraged/inverse investment vehicles; and

(vii) Investment experience and knowledge (*e.g.,* number of years, size, frequency and type of transactions) regarding leveraged/inverse investment vehicles, options, stocks and bonds, commodities, and other financial instruments.

(c) *Recordkeeping.* A broker or dealer must maintain a written record of the information that it obtained under paragraph (b) of this section and, if applicable, its written approval of the customer's account, as well as the versions of the firm's policies and procedures required under paragraph (a) that were in place when it approved or disapproved the customer's account, for a period of not less than six years (the first two years in an easily accessible place) after the date of the closing of the customer's account.

(d) *Definitions.* For purposes of this section:

Associated person of the broker dealer means any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such broker or dealer, or any employee of such broker or dealer, except that any person associated with a broker or dealer whose functions are solely clerical or ministerial shall not be included in the meaning of such term for purposes of section 15(b) of the Exchange Act (other than paragraph (6) thereof).

Commodity- or Currency-Based Trust or Fund means a trust or other person:

(1) Issuing securities in an offering registered under the Securities Act of 1933 (15 U.S.C. 77a *et seq.*) and which class of securities is listed for trading on a national securities exchange;

(2) The assets of which consist primarily of derivative instruments that reference commodities or currencies, or interests in the foregoing; and

(3) That provides in its registration statement under the Securities Act of 1933 (15 U.S.C. 77a *et seq.*) that a class of its securities are purchased or redeemed, subject to conditions or limitations, for a ratable share of its assets.

Leveraged/inverse investment vehicle means a registered investment company (including any separate series thereof), or commodity- or currency-based trust or fund, that seeks, directly or indirectly, to provide investment returns that correspond to the performance of a market index by a specified multiple, or to provide investment returns that have an inverse relationship to the performance of a market index, over a predetermined period of time.

(e) *Transition.* This section applies to all customers of the broker or dealer, including customers who have opened accounts with the broker or dealer before the compliance date for this section, provided that this section does not apply to, and therefore will not restrict a customer's ability to close or reduce, a position in a leveraged/inverse investment vehicle that a customer established before the compliance date of this section.

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

■ 3. The authority citation for part 270 continues to read, in part, as follows:

Authority: 15 U.S.C. 80a–1 *et seq.,* 80a–34(d), 80a–37, 80a–39, and Pub. L. 111–203, sec. 939A, 124 Stat. 1376 (2010), unless otherwise noted.

* * * * *

Section 270.6c–11 is also issued under 15 U.S.C. 80a–6(c) and 80a–37(a).

* * * * *

§ 270.6c–11 [Amended]

■ 4. Amend § 270.6c–11 by removing paragraph (c)(4).

■ 5. Section 270.18f–4 is added to read as follows:

§ 270.18f–4 Exemption from the requirements of section 18 and section 61 for certain senior securities transactions.

(a) *Definitions.* For purposes of this section:

Absolute VaR test means that the VaR of the fund's portfolio does not exceed 15% of the value of the fund's net assets.

Derivatives exposure means the sum of the notional amounts of the fund's derivatives instruments and, in the case of short sale borrowings, the value of the asset sold short. In determining derivatives exposure a fund may convert the notional amount of interest rate derivatives to 10-year bond equivalents and delta adjust the notional amounts of options contracts.

Derivatives risks means the risks associated with a fund's derivatives transactions or its use of derivatives transactions, including leverage, market, counterparty, liquidity, operational, and legal risks and any other risks the derivatives risk manager (or, in the case of a fund that is a limited derivatives user as described in paragraph (c)(3) of this section, the fund's investment adviser) deems material.

Derivatives risk manager means an officer or officers of the fund's investment adviser responsible for administering the program and policies and procedures required by paragraph (c)(1) of this section, provided that the derivatives risk manager:

(1) May not be a portfolio manager of the fund, or if multiple officers serve as derivatives risk manager, may not have a majority composed of portfolio managers of the fund; and

(2) Must have relevant experience regarding the management of derivatives risk.

Derivatives transaction means:

(1) Any swap, security-based swap, futures contract, forward contract, option, any combination of the foregoing, or any similar instrument (''derivatives instrument''), under which a fund is or may be required to make any payment or delivery of cash or other assets during the life of the instrument

or at maturity or early termination, whether as margin or settlement payment or otherwise; and

(2) Any short sale borrowing.

Designated reference index means an unleveraged index that: (1) Is selected by the derivatives risk manager and that reflects the markets or asset classes in which the fund invests; (2) is not administered by an organization that is an affiliated person of the fund, its investment adviser, or principal underwriter, or created at the request of the fund or its investment adviser, unless the index is widely recognized and used; and (3) is an ''appropriate broad-based securities market index'' or an ''additional index,'' as defined in the instruction to Item 27 in Form N–1A [17 CFR 274.11A]. In the case of a blended index, none of the indexes that compose the blended index may be administered by an organization that is an affiliated person of the fund, its investment adviser, or principal underwriter, or created at the request of the fund or its investment adviser, unless the index is widely recognized and used.

Fund means a registered open-end or closed-end company or a business development company, including any separate series thereof, but does not include a registered open-end company that is regulated as a money market fund under § 270.2a–7.

Relative VaR test means that the VaR of the fund's portfolio does not exceed 150% of the VaR of the designated reference index.

Unfunded commitment agreement means a contract that is not a derivatives transaction, under which a fund commits, conditionally or unconditionally, to make a loan to a company or to invest equity in a company in the future, including by making a capital commitment to a private fund that can be drawn at the discretion of the fund's general partner.

Value-at-risk or *VaR* means an estimate of potential losses on an instrument or portfolio, expressed as a percentage of the value of the portfolio's net assets, over a specified time horizon and at a given confidence level, provided that any VaR model used by a fund for purposes of determining the fund's compliance with the relative VaR test or the absolute VaR test must:

(1) Take into account and incorporate all significant, identifiable market risk factors associated with a fund's investments, including, as applicable:

(i) Equity price risk, interest rate risk, credit spread risk, foreign currency risk and commodity price risk;

(ii) Material risks arising from the nonlinear price characteristics of a fund's investments, including options and positions with embedded optionality; and

(iii) The sensitivity of the market value of the fund's investments to changes in volatility;

(2) Use a 99% confidence level and a time horizon of 20 trading days; and

(3) Be based on at least three years of historical market data.

(b) *Derivatives transactions.* If a fund satisfies the conditions of paragraph (c) of this section, the fund may enter into derivatives transactions, notwithstanding the requirements of sections 18(a)(1), 18(c), 18(f)(1), and 61 of the Investment Company Act (15 U.S.C. 80a–18(a)(1), 80a–18(c), 80a–18(f)(1), and 80a–60), and derivatives transactions entered into by the fund in compliance with this section will not be considered for purposes of computing asset coverage, as defined in section 18(h) of the Investment Company Act (15 U.S.C. 80a–18(h)).

(c) *Conditions.* (1) *Derivatives risk management program.* The fund adopts and implements a written derivatives risk management program (''program''), which must include policies and procedures that are reasonably designed to manage the fund's derivatives risks and to reasonably segregate the functions associated with the program from the portfolio management of the fund. The program must include the following elements:

(i) *Risk identification and assessment.* The program must provide for the identification and assessment of the fund's derivatives risks. This assessment must take into account the fund's derivatives transactions and other investments.

(ii) *Risk guidelines.* The program must provide for the establishment, maintenance, and enforcement of investment, risk management, or related guidelines that provide for quantitative or otherwise measurable criteria, metrics, or thresholds of the fund's derivatives risks. These guidelines must specify levels of the given criterion, metric, or threshold that the fund does not normally expect to exceed, and measures to be taken if they are exceeded.

(iii) *Stress testing.* The program must provide for stress testing to evaluate potential losses to the fund's portfolio in response to extreme but plausible market changes or changes in market risk factors that would have a significant adverse effect on the fund's portfolio, taking into account correlations of market risk factors and resulting payments to derivatives counterparties. The frequency with which the stress testing under this paragraph is conducted must take into account the fund's strategy and investments and current market conditions, provided that these stress tests must be conducted no less frequently than weekly.

(iv) *Backtesting.* The program must provide for backtesting of the results of the VaR calculation model used by the fund in connection with the relative VaR test or the absolute VaR test by, each business day, comparing the fund's gain or loss with the corresponding VaR calculation for that day, estimated over a one-trading day time horizon, and identifying as an exception any instance in which the fund experiences a loss exceeding the corresponding VaR calculation's estimated loss.

(v) *Internal reporting and escalation.* (A) *Internal reporting.* The program must identify the circumstances under which persons responsible for portfolio management will be informed regarding the operation of the program, including exceedances of the guidelines specified in paragraph (c)(1)(ii) of this section and the results of the stress tests specified in paragraph (c)(1)(iii) of this section.

(B) *Escalation of material risks.* The derivatives risk manager must inform in a timely manner persons responsible for portfolio management of the fund, and also directly inform the fund's board of directors as appropriate, of material risks arising from the fund's derivatives transactions, including risks identified by the fund's exceedance of a criterion, metric, or threshold provided for in the fund's risk guidelines established under paragraph (c)(1)(ii) of this section or by the stress testing described in paragraph (c)(1)(iii) of this section.

(vi) *Periodic review of the program.* The derivatives risk manager must review the program at least annually to evaluate the program's effectiveness and to reflect changes in risk over time. The periodic review must include a review of the VaR calculation model used by the fund under paragraph (c)(2) of this section (including the backtesting required by paragraph (c)(1)(iv) of this section) and any designated reference index to evaluate whether it remains appropriate.

(2) *Limit on fund leverage risk.* (i) The fund must comply with the relative VaR test or, if the derivatives risk manager is unable to identify a designated reference index that is appropriate for the fund taking into account the fund's investments, investment objectives, and strategy, the absolute VaR test.

(ii) The fund must determine its compliance with the applicable VaR test at least once each business day. If the fund determines that it is not in compliance with the applicable VaR test, the fund must come back into compliance promptly and within no

more than three business days after such determination.

(iii) If the fund is not in compliance with the applicable VaR test within three business days:

(A) The derivatives risk manager must report to the fund's board of directors and explain how and by when (*i.e.,* number of business days) the derivatives risk manager reasonably expects that the fund will come back into compliance;

(B) The derivatives risk manager must analyze the circumstances that caused the fund to be out of compliance for more than three business days and update any program elements as appropriate to address those circumstances; and

(C) The fund may not enter into any derivatives transactions (other than derivatives transactions that, individually or in the aggregate, are designed to reduce the fund's VaR) until the fund has been back in compliance with the applicable VaR test for three consecutive business days and has satisfied the requirements set forth in paragraphs (c)(2)(iii)(A) and (B) of this section.

(iv) If the fund is complying with the relative VaR test, an open-end fund must disclose in its annual report the fund's designated reference index as the fund's ''appropriate broad-based securities market index'' or an ''additional index,'' as defined in the instruction to Item 27 in Form N–1A [17 CFR 274.11A], and a registered closed-end fund or business development company must disclose its designated reference index in the annual report, together with a presentation of the fund's performance relative to the designated reference index. A fund is not required to include this disclosure in an annual report if the fund is a ''New Fund,'' as defined in Form N–1A [17 CFR 274.11A], or would meet that definition if it were filing on Form N–1A [17 CFR 274.11A], at the time the fund files the annual report.

(3) *Limited derivatives users.* A fund is not required to adopt a program as prescribed in paragraph (c)(1) of this section, or comply with the limit on fund leverage risk in paragraph (c)(2) of this section, if the fund adopts and implements policies and procedures reasonably designed to manage the fund's derivatives risks and:

(i) The fund's derivatives exposure does not exceed 10 percent of the fund's net assets; or

(ii) The fund limits its use of derivatives transactions to currency derivatives that hedge the currency risks associated with specific foreign-currency-denominated equity or fixed-income investments held by the fund, provided that the currency derivatives are entered into and maintained by the fund for hedging purposes and that the notional amounts of such derivatives do not exceed the value of the hedged instruments denominated in the foreign currency (or the par value thereof, in the case of fixed-income investments) by more than a negligible amount.

(4) *Leveraged/inverse funds.* A fund is not required to comply with the limit on fund leverage risk in paragraph (c)(2) of this section if:

(i) The fund is a leveraged/inverse investment vehicle as defined in § 240.15*l*–2 and § 275.211(h)–1;

(ii) The fund discloses in its prospectus that it is not subject to the limit on fund leverage risk in paragraph (c)(2) of this section; and

(iii) The fund does not seek or obtain, directly or indirectly, investment results exceeding 300% of the return (or inverse of the return) of the underlying index.

(5) *Board oversight and reporting.* (i) *Approval of the derivatives risk manager.* A fund's board of directors, including a majority of directors who are not interested persons of the fund, must approve the designation of the derivatives risk manager, taking into account the derivatives risk manager's relevant experience regarding the management of derivatives risk.

(ii) *Reporting on program implementation and effectiveness.* On or before the implementation of the program, and at least annually thereafter, the derivatives risk manager must provide to the board of directors a written report providing a representation that the program is reasonably designed to manage the fund's derivatives risks and to incorporate the elements provided in paragraphs (c)(1)(i) through (vi) of this section. The representation may be based on the derivatives risk manager's reasonable belief after due inquiry. The written report must include the basis for the representation along with such information as may be reasonably necessary to evaluate the adequacy of the fund's program and, for reports following the program's initial implementation, the effectiveness of its implementation. The written report also must include the derivatives risk manager's basis for the selection of the designated reference index or, if applicable, an explanation of why the derivatives risk manager was unable to identify a designated reference index appropriate for the fund.

(iii) *Regular board reporting.* The derivatives risk manager must provide to the board of directors, at a frequency determined by the board, a written report regarding the derivatives risk manager's analysis of any exceedances described in paragraph (c)(1)(ii) of this section, the results of the stress testing conducted under paragraph (c)(1)(iii) of this section, and the results of the backtesting conducted under paragraph (c)(1)(iv) of this section since the last report to the board. Each report under this paragraph must include such information as may be reasonably necessary for the board of directors to evaluate the fund's response to any exceedances and the results of the fund's stress testing.

(6) *Recordkeeping.* (i) *Records to be maintained.* A fund must maintain a written record documenting, as applicable:

(A) The fund's written policies and procedures required by paragraph (c)(1) of this section, along with:

(1) The results of the fund's stress tests under paragraph (c)(1)(iii) of this section;

(2) The results of the backtesting conducted under paragraph (c)(1)(iv) of this section;

(3) Records documenting any internal reporting or escalation of material risks under paragraph (c)(1)(v)(B) of this section; and

(4) Records documenting the reviews conducted under paragraph (c)(1)(vi) of this section.

(B) Copies of any materials provided to the board of directors in connection with its approval of the designation of the derivatives risk manager, any written reports provided to the board of directors relating to the program, and any written reports provided to the board of directors under paragraph (c)(2)(iii)(A) of this section.

(C) Any determination and/or action the fund made under paragraphs (c)(2)(i)–(ii) of this section, including a fund's determination of: The VaR of its portfolio; the VaR of the fund's designated reference index, as applicable; the fund's VaR ratio (the value of the VaR of the Fund's portfolio divided by the VaR of the designated reference index), as applicable; and any updates to any VaR calculation models used by the fund and the basis for any material changes thereto.

(D) If applicable, the fund's written policies and procedures required by paragraph (c)(3) of this section.

(ii) *Retention periods.* (A) A fund must maintain a copy of the written policies and procedures that the fund adopted under paragraphs (c)(1) or (c)(3) of this section that are in effect, or at any time within the past five years were in effect, in an easily accessible place.

(B) A fund must maintain all records and materials that paragraphs (c)(6)(i)(A)*(1)–(4)* and (c)(6)(i)(B)–(D) of this section describe for a period of not less than five years (the first two years in an easily accessible place) following each determination, action, or review that these paragraphs describe.

(7) *Current reports.* A fund that experiences an event specified in the parts of Form N–RN [referenced in 17 CFR 274.223] titled ''Relative VaR Test Breaches,'' ''Absolute VaR Test Breaches,'' or ''Compliance with VaR Test'' must file with the Commission a report on Form N–RN within the period and according to the instructions specified in that form.

(d) *Reverse repurchase agreements.* A fund may enter into reverse repurchase agreements or similar financing transactions, notwithstanding the requirements of sections 18(c), and 18(f)(1) of the Investment Company Act, if the fund complies with the asset coverage requirements of section 18 and combines the aggregate amount of indebtedness associated with the reverse repurchase agreement or similar financing transaction with the aggregate amount of any other senior securities representing indebtedness when calculating the asset coverage ratio.

(e) *Unfunded commitment agreements.* (1) A fund may enter into an unfunded commitment agreement, notwithstanding the requirements of sections 18(a), 18(c), 18(f)(1), and 61 of the Investment Company Act, if the fund reasonably believes, at the time it enters into such agreement, that it will have sufficient cash and cash equivalents to meet its obligations with respect to all of its unfunded commitment agreements, in each case as they come due. In forming a reasonable belief, the fund must take into account its reasonable expectations with respect to other obligations (including any obligation with respect to senior securities or redemptions), and may not take into account cash that may become available from the sale or disposition of any investment at a price that deviates significantly from the market value of those investments, or from issuing additional equity. Unfunded commitment agreements entered into by the fund in compliance with this section will not be considered for purposes of computing asset coverage, as defined in section 18(h) of the Investment Company Act (15 U.S.C. 80a–18(h)).

(2) For each unfunded commitment agreement that a fund enters into under paragraph (e)(1) of this section, a fund must document the basis for its reasonable belief regarding the sufficiency of its cash and cash equivalents to meet its unfunded commitment agreement obligations, and maintain a record of this documentation for a period of not less than five years (the first two years in an easily accessible place) following the date that the fund entered into the agreement.

■ 6. Revise § 270.30b1–10 to read as follows:

§ 270.30b1–10 Current report for open-end and closed-end management investment companies.

Every registered open-end management investment company, or series thereof, and every registered closed-end management investment company, but not a fund that is regulated as a money market fund under § 270.2a–7, that experiences an event specified on Form N–RN, must file with the Commission a current report on Form N–RN within the period and according to the instructions specified in that form.

PART 274—FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

■ 7. The general authority for part 274 continues to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a–8, 80a–24, 80a–26, 80a–29, and Pub. L. 111–203, sec. 939A, 124 Stat. 1376 (2010), unless otherwise noted.

* * * * *

■ 8. Amend Form N–2 (referenced in §§ 239.14 and 274.11a–1) by revising instruction 2. to sub-item ''3. *Senior Securities*'' of ''Item 4. Financial Highlights'' to read as follows:

Note: The text of Form N–2 does not, and this amendment will not, appear in the *Code of Federal Regulations.*

Form N–2

* * * * *

Item 4. Financial Highlights

* * * * *

3. Senior Securities

* * * * *

Instructions

* * * * *

2. Use the method described in section 18(h) of the 1940 Act [15 U.S.C. 80a–18(h)] to calculate the asset coverage to be set forth in column (3). However, in lieu of expressing asset coverage in terms of a ratio, as described in section 18(h), express it for each class of senior securities in terms of dollar amounts per share (in the case of preferred stock) or per $1,000 of indebtedness (in the case of senior indebtedness). A fund should not consider any derivatives transactions, or any unfunded commitment agreements, that it enters into in compliance with rule 18f–4 under the Investment Company Act [17 CFR 270.18f–4] for purposes of computing asset coverage.

* * * * *

■ 9. Amend Form N–CEN (referenced in §§ 249.330 and 274.101) by adding new Item C.7.l. to read as follows:

Note: The text of Form N–CEN does not, and this amendment will not, appear in the *Code of Federal Regulations.*

FORM N–CEN

ANNUAL REPORT FOR REGISTERED INVESTMENT COMPANIES

* * * * *

Item C.7. * * *

l. Rule 18f–4 (17 CFR 270.18f–4): __

i. Is the Fund excepted from the rule 18f–4 (17 CFR 270.18f–4) program requirement under rule 18f–4(c)(3)(i) (17 CFR 270.18f–4(c)(3)(i))? ____

ii. Is the Fund excepted from the rule 18f–4 (17 CFR 270.18f–4) program requirement under rule 18f–4(c)(3)(ii) (17 CFR 270.18f–4(c)(3)(ii))? ____

iii. Is the Fund a leveraged/inverse fund covered by rule 15l–2 under the Exchange Act (17 CFR 240.15l–2) or rule 211(h)–1 under the Investment Advisers Act of 1940 (17 CFR 275.211(h)–1) that, under rule 18f–4(c)(4) (17 CFR 270.18f–4(c)(4)), is excepted from the requirement to comply with the limit on leverage risk described in rule 18f–4(c)(2) (17 CFR 270.18f–4(c)(2))? ____

iv. Has the Fund entered into any reverse repurchase agreements or similar financing transactions under rule 18f–4(d) (17 CFR 270.18f–4(d))? ____

v. Has the Fund entered into any unfunded commitment agreements under rule 18f–4(e) (17 CFR 270.18f–4(e))? ____

* * * * *

■ 10. Amend Form N–PORT (referenced in § 274.150) by:

■ a. Adding to General Instruction E. ''Definitions'' in alphabetical order, the following definitions:

■ i. ''Absolute VaR Test'';

■ ii. ''Designated Reference Index'';

■ iii. ''Derivatives Exposure'';

■ iv. ''Relative VaR Test'';

■ v. ''Value-at-risk'';

■ vi. ''VaR Ratio''; and

■ b. Adding Items B.9 and B.10.

The additions read as follows:

Note: The text of Form N–PORT does not, and this amendment will not, appear in the *Code of Federal Regulations.*

Form N–PORT

MONTHLY PORTFOLIO INVESTMENTS REPORT

* * * * *

GENERAL INSTRUCTIONS

* * * * *

E. Definitions

* * * * *

''Absolute VaR Test'' has the meaning defined in rule 18f–4(a) [17 CFR 270.18f–4(a)].

* * * * *

''Derivatives Exposure'' has the meaning defined in rule 18f–4(a) [17 CFR 270.18f–4(a)].

* * * * *

''Designated Reference Index'' has the meaning defined in rule 18f–4(a) [17 CFR 270.18f–4(a)].

* * * * *

''Relative VaR Test'' has the meaning defined in rule 18f–4(a) [17 CFR 270.18f–4(a)].

* * * * *

''Value-at-risk'' or VaR has the meaning defined in rule 18f–4(a) [17 CFR 270.18f–4(a)].

* * * * *

''VaR Ratio'' means the value of the Fund's portfolio VaR divided by the VaR of the Designated Reference Index.

* * * * *

PART B. * * *

Item B.9 Derivatives Exposure. Report as a percentage of the Fund's net asset value:

a. Derivatives Exposure.
   i. Exposure from derivatives instruments.
   ii. Exposure from short sales.

Item B.10 VaR Information. For Funds subject to the limit on fund leverage risk in rule 18f–4(c)(2) [17 CFR 270.18f–4(c)(2)], provide the following information, as determined in accordance with the requirement under rule 18f–4(c)(2)(ii) to determine the fund's compliance with the applicable VaR test at least once each business day:

a. Highest daily VaR during the reporting period.
b. Date of highest daily VaR during the reporting period.
c. Median daily VaR during the reporting period.
d. For Funds that were subject to the Relative VaR Test during the reporting period, provide:
   i. Name of the Fund's Designated Reference Index.
   ii. Index Identifier for the Fund's Designated Reference Index.
   iii. Highest VaR Ratio during the reporting period.
   iv. Date of highest VaR Ratio during the reporting period.
   v. Median VaR Ratio during the reporting period.
e. Backtesting Results. Number of exceptions that the Fund identified as a result of its backtesting of its VaR calculation model (as described in rule 18f–4(c)(1)(iv) [17 CFR 270.18f–4(c)(1)(iv)] during the reporting period.

* * * * *

■ 11. Revise § 274.223, its sectional heading, and Form N–LIQUID (referenced in § 274.223) and its title to read as follows:

§ 274.223 Form N–RN, Current report, open- and closed-end investment company reporting.

This form shall be used by registered open-end management investment companies, or series thereof, and closed-end management investment companies, or series thereof, to file reports pursuant to § 270.18f–4(c)(7) and § 270.30b1–10 of this chapter.

Note: The text of Form N–RN does not, and this amendment will not, appear in the *Code of Federal Regulations.*

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM N–RN

CURRENT REPORT FOR REGISTERED MANAGEMENT INVESTMENT COMPANIES AND BUSINESS DEVELOPMENT COMPANIES

Form N–RN is to be used by a registered open-end management investment company or series thereof, but not including a fund that is regulated as a money market fund under rule 2a–7 under the Act (17 CFR 270.2A–7) (a ''registered open-end fund''), a registered closed-end management investment company (a ''registered closed-end fund''), or a closed-end management investment company that has elected to be regulated as a business development company (a ''business development company''), to file current reports with the Commission pursuant to rule 18f–4 and rule 30b1–10 under the Investment Company of 1940 Act [15 U.S.C. 80a] (''Act'') (17 CFR 270.18f–4; 17 CFR 270.30b1–10). The Commission may use the information provided on Form N–RN in its regulatory, disclosure review, inspection, and policymaking roles.

GENERAL INSTRUCTIONS

A. Rules as to Use of Form N–RN

(1) Form N–RN is the reporting form that is to be used for current reports of registered open-end funds (not including funds that are regulated as money market funds under rule 2a–7 under the Act), registered closed-end funds, and business development companies (together, ''registrants'') required by, as applicable, section 30(b) of the Act and rule 30b1–10 under the Act, as well as rule 18f–4 under the Act. The Commission does not intend to make public information reported on Form N–RN that is identifiable to any particular registrant, although the Commission may use Form N–RN information in an enforcement action.

(2) Unless otherwise specified, a report on this Form N–RN is required to be filed, as applicable, within one business day of the occurrence of the event specified in Parts B–G of this form. If the event occurs on a Saturday, Sunday, or holiday on which the Commission is not open for business, then the one business day period shall begin to run on, and include, the first business day thereafter.

(3) For registered open-end funds required to comply with rule 22e–4 under the Investment Company Act [17 CFR 270.22e–4], complete Parts B–D of this form, as applicable. For registrants that rely on rule 18f–4 of the Act [17 CFR 270.18f–4], complete Parts E–G of this form, as applicable.

B. Application of General Rules and Regulations

The General Rules and Regulations under the Act contain certain general requirements that are applicable to reporting on any form under the Act. These general requirements should be carefully read and observed in the preparation and filing of reports on this form, except that any provision in the form or in these instructions shall be controlling.

C. Information To Be Included in Report Filed on Form N–RN

Upon the occurrence of the event specified in Parts B–G of Form N–RN, as applicable, a registrant must file a report on Form N–RN that includes information in response to each of the items in Part A of the form, as well as each of the items in the applicable Parts B–G of the Form.

D. Filing of Form N–RN

A registrant must file Form N–RN in accordance with rule 232.13 of Regulation S–T (17 CFR part 232). Form N–RN must be filed electronically using

the Commission's Electronic Data Gathering, Analysis and Retrieval System (''EDGAR'').

E. Paperwork Reduction Act Information

A registrant is not required to respond to the collection of information contained in Form N–RN unless the form displays a currently valid Office of Management and Budget (''OMB'') control number. Please direct comments concerning the accuracy of the information collection burden estimate and any suggestions for reducing the burden to the Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. 3507.

F. Definitions

(1) References to sections and rules in this Form N–RN are to the Investment Company Act (15 U.S.C. 80a), unless otherwise indicated. Terms used in this Form N–RN have the same meaning as in the Investment Company Act, rule 22e–4 under the Investment Company Act (for Parts B–D of the Form), or rule 18f–4 under the Investment Company Act (for Part E–G of the Form), unless otherwise indicated. In addition, as used in this Form N–RN, the term registrant means the registrant or a separate series of the registrant, as applicable.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM N–RN

CURRENT REPORT FOR REGISTERED MANAGEMENT INVESTMENT COMPANIES AND BUSINESS DEVELOPMENT COMPANIES

PART A. General Information

Item A.1. Report for [mm/dd/yyyy].
Item A.2. CIK Number of registrant.
Item A.3. EDGAR Series Identifier.
Item A.4. Securities Act File Number, if applicable.
Item A.5. Provide the name, email address, and telephone number of the person authorized to receive information and respond to questions about this Form N–RN.

PART B. Above 15% Illiquid Investments

If more than 15 percent of the registrant's net assets are, or become, illiquid investments that are assets as defined in rule 22e–4, then report the following information:

Item B.1. Date(s) on which the registrant's illiquid investments that are assets exceeded 15 percent of its net assets.
Item B.2. The current percentage of the registrant's net assets that are illiquid investments that are assets.
Item B.3. Identification of illiquid investments. For each investment that is an asset that is held by the registrant that is considered illiquid, disclose (1) the name of the issuer, the title of the issue or description of the investment, the CUSIP (if any), and at least one other identifier, if available (*e.g.,* ISIN, Ticker, or other unique identifier (if ticker and ISIN are not available)) (indicate the type of identifier used), and (2) the percentage of the fund's net assets attributable to that investment.

PART C. At or Below 15% Illiquid Investments

If a registrant that has filed Part B of Form N–RN determines that its holdings in illiquid investments that are assets have changed to be less than or equal to 15 percent of the registrant's net assets, then report the following information:

Item C.1. Date(s) on which the registrant's illiquid investments that are assets fell to or below 15 percent of net assets.
Item C.2. The current percentage of the registrant's net assets that are illiquid investments that are assets.

PART D. Assets That Are Highly Liquid Investments Below the Highly Liquid Investment Minimum

If a registrant's holdings in assets that are highly liquid investments fall below its highly liquid investment minimum for more than 7 consecutive calendar days, then report the following information:

Item D.1. Date(s) on which the registrant's holdings of assets that are highly liquid investments fell below the fund's highly liquid investment minimum.

PART E. Relative VaR Test Breaches

If a registrant is subject to the relative VaR test under rule 18f–4(c)(2)(i) [17 CFR 270.18f–4(c)(2)(i)], and the fund determines that it is not in compliance with the relative VaR test and has not come back into compliance within 3 business days after such determination, provide:

Item E.1. The dates on which the VaR of the registrant's portfolio exceeded 150% of the VaR of its designated reference index.
Item E.2. The VaR of the registrant's portfolio on the dates each exceedance occurred.
Item E.3. The VaR of the registrant's designated reference index on the dates each exceedance occurred.
Item E.4. The name of the registrant's designated reference index.
Item E.5. The index identifier for the registrant's designated reference index.

PART F. Absolute VaR Test Breaches

If a registrant is subject to the absolute VaR test under rule 18f–4(c)(2)(i) [17 CFR 270.18f–4(c)(2)(i)], and the fund determines that it is not in compliance with the absolute VaR test and has not come back into compliance within 3 business days after such determination, provide:

Item F.1. The dates on which the VaR of the registrant's portfolio exceeded 15% of the value of the registrant's net assets.
Item F.2. The VaR of the registrant's portfolio on the dates each exceedance occurred.
Item F.3. The value of the registrant's net assets on the dates each exceedance occurred.

PART G. Compliance with VaR Test

If a registrant that has filed Part E or Part F of Form N–RN has come back into compliance with either the relative VaR test or the absolute VaR test, as applicable, then report the following information:

Item G.1. Dates on which the VaR of the registrant's portfolio exceeded, as applicable, 150% of the VaR of its designated reference index (if the registrant is subject to the relative VaR test under rule 18f–4(c)(2)(i) [17 CFR 270.18f–4(c)(2)(i)]) or 15% of the value of the registrant's net assets (if the registrant is subject to the absolute VaR test under rule 18f–4(c)(2)(i) [17 CFR 270.18f–4(c)(2)(i)]).
Item G.2. The current VaR of the registrant's portfolio.

PART H. Explanatory Notes (if any)

A registrant may provide any information it believes would be helpful in understanding the information reported in response to any Item of this Form.

SIGNATURES

Pursuant to the requirements of the Investment Company Act of 1940, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

(Registrant)
Date _____

_____
(Signature) *
* Print name and title of the signing officer under his/her signature.

* * * * *

PART 275—RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

■ 12. The authority citation for part 275 continues to read, in part, and the subauthority for Section 275.211h–1 is added to read as follows:

Authority: 15 U.S.C. 80b–2(a)(11)(G), 80b–2(a)(11)(H), 80b–2(a)(17), 80b–3, 80b–4, 80b–4a, 80b–6(4), 80b–6a, and 80b–11, unless otherwise noted.

* * * * *

Section 275.211(h)–1 is also issued under sec. 913, Pub. L. 111–203, 124 Stat. 1827–28 (2010).

* * * * *

■ 13. Section 275.211(h)–1 is added to read as follows:

§ 275.211(h)–1 Investment adviser sales practices for leveraged/inverse investment vehicles.

(a) *Required approval of client account.* No investment adviser registered or required to be registered under the Advisers Act, or any supervised person of the investment adviser, may place an order for the account of an advisory client that is a natural person (or the legal representative of a natural person) to buy or sell shares of a leveraged/inverse investment vehicle unless the investment adviser has approved such a client's account to engage in those transactions and has adopted and implemented policies and procedures reasonably designed to achieve compliance with this section. Any approval of a client's account for buying or selling leveraged/inverse investment vehicles must be effected as provided in paragraph (b).

(b) *Diligence in approving accounts.* (1) In determining whether to approve a client's account to buy or sell leveraged/inverse investment vehicles, the investment adviser must exercise due diligence to ascertain the essential facts relative to the client, his or her financial situation, and investment objectives, including, at a minimum, the information specified in paragraph (b)(2) of this section (and must seek to obtain information for all participants in a joint account). Based upon this information, the investment adviser must specifically approve or disapprove the client's account for buying and selling shares of leveraged/inverse investment vehicles. An approval of a client account must be in writing. An investment adviser may provide this approval if the investment adviser has a reasonable basis for believing that the client has such knowledge and experience in financial matters that he or she may reasonably be expected to be capable of evaluating the risks of buying and selling leveraged/inverse investment vehicles.

(2) An investment adviser must seek to obtain the following information at a minimum regarding the client:

(i) Investment objectives (*e.g.,* safety of principal, income, growth, trading profits, speculation) and time horizon;

(ii) Employment status (name of employer, self-employed or retired);

(iii) Estimated annual income from all sources;

(iv) Estimated net worth (exclusive of family residence);

(v) Estimated liquid net worth (cash, liquid securities, other);

(vi) Percentage of the client's estimated liquid net worth that he or she intends to invest in leveraged/inverse investment vehicles; and

(vii) Investment experience and knowledge (*e.g.,* number of years, size, frequency and type of transactions) regarding leveraged/inverse investment vehicles, options, stocks and bonds, commodities, and other financial instruments.

(c) *Recordkeeping.* An investment adviser must maintain a written record of the information that it obtained under paragraph (b) of this section and, if applicable, its written approval of the client's account, as well as the versions of the firm's policies and procedures required under paragraph (a) that were in place when it approved or disapproved the client's account, for a period of not less than six years (the first two years in an easily accessible place) after the date of the closing of the client's account.

(d) *Definitions.* For purposes of this section:

Commodity- or currency-based trust or fund means a trust or other person:

(1) Issuing securities in an offering registered under the Securities Act of 1933 (15 U.S.C. 77a *et seq.*) and which class of securities is listed for trading on a national securities exchange;

(2) The assets of which consist primarily of derivative instruments that reference commodities or currencies, or interests in the foregoing; and

(3) That provides in its registration statement under the Securities Act of 1933 (15 U.S.C. 77a *et seq.*) that a class of its securities are purchased or redeemed, subject to conditions or limitations, for a ratable share of its assets.

Leveraged/inverse investment vehicle means a registered investment company (including any separate series thereof), or commodity- or currency-based trust or fund, that seeks, directly or indirectly, to provide investment returns that correspond to the performance of a market index by a specified multiple, or to provide investment returns that have an inverse relationship to the performance of a market index, over a predetermined period of time.

Supervised person means any partner, officer, director (or other person occupying a similar status or performing similar functions), or employee of an investment adviser, or other person who provides investment advice on behalf of the investment adviser.

(e) *Transition.* This section applies to all clients of the investment adviser, including clients who have opened accounts with the investment adviser before the compliance date for this section, provided that this section does not apply to, and therefore will not restrict the ability to close or reduce, a client's position in a leveraged/inverse investment vehicle that a client established before the compliance date of this section.

By the Commission.

Dated: November 25, 2019.

Eduardo A. Aleman,

Deputy Secretary.

VIII. APPENDIX A

Note: Appendix A will not appear in the Code of Federal Regulations. Feedback Flier: Funds' Use of Derivatives

We are proposing a new regulatory approach for funds' use of derivatives. This includes proposed rule 18f–4 under the Investment Company Act of 1940, a new exemptive rule designed to address the investor protection purposes and concerns underlying section 18 of the Act and to provide an updated and more comprehensive approach to the regulation of funds' use of derivatives. The proposal also includes certain new proposed reporting requirements relating to funds' derivatives use. More information about our proposal is available at *https://www.sec.gov/rules/proposed/2019/34-87607.pdf.*

We are particularly interested in learning what small funds think about the requirements of proposed new rule 18f–4 and the proposed new reporting requirements. Hearing from small funds could help us learn how the proposed rule and new reporting requirements would affect these entities, and evaluate how we could address any unintended consequences resulting from the cost and effort of regulatory compliance while still promoting investor protection. We would appreciate your feedback on any or all of the following questions.

All of the following questions are optional, including any questions that ask about identifying information. *Please note that responses to these questions—including any other general identifying information you provide—will be made public.*

Item 1: General Identifying Information

Instructions: At your option, you may include general identifying information that would help us contextualize your other feedback on the proposal. This information could include responses to the following questions, as well as any other general identifying information you would like to provide. Responses to these items—like responses to the other items on this Feedback Flier—will be made public.

a. How big is the fund in terms of net asset value? (This may be expressed in a range, for example, $40 million–$50 million.)
b. What is/are the principal investment strategy/strategies of the fund?
c. Does the fund use derivatives transactions (as defined in the proposed rule) to pursue the fund's principal investment strategy/strategies? [Y/N]
d. Is the fund part of a fund complex? [Y/N]
e. Please include any additional general identifying information that you wish to provide, that could add context for your other feedback on the proposal.

Item 2: Derivatives Risk Management Program

Instructions: If you believe the fund would be required to adopt and implement a derivatives risk management program under the proposed rules, please answer the following questions. If you do not believe so, please proceed to Item 4.

a. The proposed derivatives risk management program requirement would include the following seven elements. In the following chart, please indicate which of the proposed program elements you think would be the most expensive for the fund to implement and which would be least expensive to implement, by ranking the following elements from one (1)—most expensive—through seven (7)—least expensive—using each number only once. If you have any comments about the factors informing your analysis, please include.

Derivatives risk management program elements	Rank by cost (1—most expensive; 7—least expensive) Use each number once	Comments
(a) Risk identification and assessment		
(b) Risk guidelines		
(c) Stress testing		
(d) Backtesting		
(e) Internal reporting and escalation		
(f) Periodic review of the program		
(g) Board reporting and oversight		

b. Implementation timing.
(1.) How many months do you think it would take the fund to adopt and implement a derivatives risk management program (check one box)?

6 months–12 months	12 months–18 months	18 months–24 months	>24 months
[ ]	[ ]	[ ]	[ ]

(2.) If the response above is more than 12 months, what would help to shorten that time period?
(3.) Please provide any explanatory notes that you would like to include.

c. Implementation cost.
(1.) Approximately how much do you think it would cost the fund to implement a derivatives risk management program (in terms of combined internal and external costs) (check one box)?

Estimated cost ($)			
$0–$150,000	$150,001–$350,000	$350,001–$500,000	>$500,000
[ ]	[ ]	[ ]	[ ]

(2.) Please include any explanatory notes that you would like to provide. These could describe, for example, how a fund that is part of a fund complex might share these costs, any particular cost considerations for a fund that uses sub-advisers, or the extent to which the estimated costs would arise from internal versus external costs (such as those associated with third-party service providers).
d. To the extent that the fund is a sub-advised fund, would any of the proposed program elements present any particular challenges for the fund to implement in light of its advisory structure? If so please explain.

Item 3: Limit on Fund Leverage Risk

Instructions: The proposed rule would require certain funds to comply with a limit on fund leverage risk based on value at risk (''VaR''). The following questions relate to this proposed requirement.

a. Does the fund currently use VaR testing? [Y/N]
b. Implementation cost.
(1.) If you anticipate that, if the proposed rules were adopted, the fund would have to comply with the VaR testing requirement, approximately how much do you think it would cost the fund to implement the proposed VaR test requirements (in terms of combined internal and external costs) (check one box)?

Estimated cost ($)			
$0–$25,000	$25,001–$50,000	$50,001–$75,000	>$75,000
[ ]	[ ]	[ ]	[ ]

(2.) Please include any explanatory notes that you would like to provide. These could describe, for example, how a fund that is part of a fund complex might share these costs, any particular cost considerations for a fund that uses sub-advisers, or the extent to which the estimated costs would arise from internal versus external costs (such as those associated with third-party service providers).

c. Use of relative VaR test and absolute VaR test.

(1.) Would the fund anticipate that it would use the proposed relative VaR test or the proposed absolute VaR test (check one box)?

Relative VaR test	Absolute VaR test
[ ]	[ ]

(2.) If you anticipate that you would use the proposed relative VaR test, and you already disclose a benchmark index for performance disclosure, do you anticipate that the index would also qualify as a designated reference index under the proposed rule? [Y/N]

d. To the extent that the fund is a sub-advised fund, would the proposed limit on fund leverage risk present any particular challenges for the fund to implement in light of its advisory structure? If so please explain.

Item 4: Limited Derivatives Users

Instructions: If you believe the fund would qualify as a limited derivatives user under the proposed rule, please answer the following questions. If you do not believe so, please proceed to question 5.

a. Please state which basis for the proposed limited derivatives user exception you think the fund would seek to rely on (check one box):

Exposure-based test (The fund's derivatives exposure does not exceed 10% of the fund's net asset value)	Currency hedging exception (The fund only uses derivatives for currency hedging purposes as specified in the proposed rule)
[ ]	[ ]

b. Should the rule include any other bases for a fund to qualify as a limited derivatives user? What alternative approach and why?

c. Implementation cost.

(1.) Approximately how much do you think it would cost the fund to adopt and implement policies and procedures reasonably designed to manage its derivatives risks (in terms of combined internal and external costs) (check one box)?

Estimated cost ($)				
$0–$25,000	$25,001–$50,000	$50,001–$75,000	$75,001–$100,000	>$100,000
[ ]	[ ]	[ ]	[ ]	[ ]

(2.) Please include any explanatory notes that you would like to provide.

Item 5: Recordkeeping

a. Approximately how much would it cost the fund to comply with the proposed recordkeeping requirements associated with rule 18f–4 (in terms of combined internal and external costs)?

b. Should we modify any of the proposed recordkeeping requirements, and if so, how?

Item 6: Reporting Requirements

a. Approximately how much would it cost the fund to comply with the proposed new requirements for reporting on Form N–PORT, Form N–CEN, and Form N–RN (in terms of combined internal and external costs)?

b. Should we modify any of the proposed reporting requirements, and if so, how?

Item 7: Other Feedback on Proposed Rule 18f–4 and Proposed New Reporting Requirements

Instructions: Please include any other additional suggestions or comments about proposed rule 18f–4, and/or the proposed new reporting requirements, that you would like to provide.

We will post your feedback on our website. Your submission will be posted without change; we do not redact or edit personal identifying information from submissions. You should only make submissions that you wish to make available publicly.

If you are interested in more information on the proposal, or want to provide feedback on additional questions, click here. Comments should be received on or before March 24, 2020

Thank You!

Other Ways to Submit Your Feedback
You also can send us feedback in the following ways (include the file number S7–24–15 in your response):

Print Your Responses and Mail
Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090

Print a PDF of Your Responses and Email
Use the printer friendly page and select a PDF printer to create a file you can email to: *rule-comments@sec.gov*

Print a Blank Copy of This Flier, Fill it Out, and Mail
Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090

IX. APPENDIX B

Note: Appendix B will not appear in the Code of Federal Regulations. Feedback Flier: Sales Practices Rules for Transacting in Shares of Leveraged/Inverse Investment Vehicles

We are proposing two new sales practices rules—rule 15*l*–2 under the Securities Exchange Act of 1934, and Rule 211(h)–1 under the Investment Advisers Act of 1940—that would require a broker, dealer, or

registered investment adviser to exercise due diligence in approving a retail customer's or client's account to buy or sell shares of certain ''leveraged/inverse investment vehicles.'' More information about our proposal is available at *https://www.sec.gov/rules/proposed/2019/34-87607.pdf.*

We are particularly interested in learning what small broker-dealers and investment advisers think about the proposed new sales practices rules' requirements. Hearing from these smaller firms could help us learn how our proposed rules would affect them, and evaluate how we could address any unintended consequences resulting from the cost and effort of regulatory compliance while still promoting investor protection. We would appreciate your feedback on any or all of the following questions.

All of the following questions are optional, including any questions that ask about identifying information. *Please note that responses to these questions—including any other general identifying information you provide—will be made public.*

Item 1: General Identifying Information

Instructions: At your option, you may include general identifying information that would help us contextualize your other feedback on the proposal. This information could include responses to the following questions, as well as any other general identifying information you would like to provide. Responses to these items—like responses to the other items on this Feedback Flier—will be made public.

a. Is the firm a Commission-registered investment adviser or a broker-dealer?

b. What is the size of the firm in terms of:

(1.) The number of retail investors (as defined in the release)?

(2.) For Investment Advisers, regulatory assets under management?

(3.) For broker-dealers, regulatory net capital?

(4.) Other (please specify)?

c. Please include any additional general identifying information that you wish to provide, that could add context to your other feedback on the proposal.

d. Does the firm accept orders from or place orders for the accounts of retail investors to buy or sell shares of leveraged/inverse investment vehicles (as defined in the proposed sales practices rules)?

Item 2: Cost To Comply With the Proposed Due Diligence and Account Approval Requirements

a. What do you expect the cost to your firm would be in order to comply with these proposed requirements (in terms of combined internal and external costs)?

(1.) For an investment adviser (check one box):

Estimated cost ($)		
$0–$5,000	$5,001–$10,000	>$10,000
[ ]	[ ]	[ ]

(2.) For a broker-dealer (check one box):

Estimated cost ($)		
$0–$25,000	$25,001–$50,000	>$50,000
[ ]	[ ]	[ ]

b. Are there any less expensive alternatives to the proposed requirements you can suggest that would still preserve the proposed rules' intended investor protection safeguards?

Item 3: Other Feedback on Proposed Sales Practices Rules

Instructions: Please include any other additional suggestions or comments about the proposed sales practices rules that you would like to provide.

We will post your feedback on our website. Your submission will be posted without change; we do not redact or edit personal identifying information from submissions. You should only make submissions that you wish to make available publicly.

If you are interested in more information on the proposal, or want to provide feedback on additional questions, click here. Comments should be received on or before March 24, 2020.

Thank You!

Other Ways to Submit Your Feedback

You also can send us feedback in the following ways (include the file number S7–24–15 in your response):

Print Your Responses and Mail

Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090

Print a PDF of Your Responses and Email

Use the printer friendly page and select a PDF printer to create a file you can email to: *rule-comments@sec.gov*

Print a Blank Copy of This Flier, Fill it Out, and Mail

Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090

[FR Doc. 2020–00040 Filed 1–23–20; 8:45 am]

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LIST OF PUBLIC LAWS

Note: No public bills which have become law were received by the Office of the Federal Register for inclusion in today's **List of Public Laws**.

Last List January 22, 2020

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