Federal Register

Thursday,
October 4, 2001

Part VI

Commodity Futures Trading Commission

Securities and Exchange Commission

17 CFR Parts 1, 41, and 190

17 CFR Part 240

Applicability of CFTC and SEC Customer Protection, Recordkeeping, Reporting, and Bankruptcy Rules and the Securities Investor Protection Act of 1970 to Accounts Holding Security Futures Products; Proposed Rule

COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1, 41 and 190

RIN 3038–AB76

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34–44854; File No. S7–17–01]

RIN 3235–AI32

Applicability of CFTC and SEC Customer Protection, Recordkeeping, Reporting, and Bankruptcy Rules and the Securities Investor Protection Act of 1970 to Accounts Holding Security Futures Products

AGENCIES: Commodity Futures Trading Commission and Securities and Exchange Commission.

ACTION: Joint proposed rules.

SUMMARY: The Commodity Futures Trading Commission (''CFTC'') and the Securities and Exchange Commission (''SEC'') (the ''Commissions'') are proposing rules under the Commodity Exchange Act (''CEA'') and the Securities Exchange Act of 1934 (''Exchange Act'') as part of the process of establishing a joint regulatory framework for persons registered with the CFTC as a futures commission merchant (''FCM'') and registered with the SEC as a broker or dealer (''broker-dealer'') to effect transactions in security futures products for customers. These rules are being proposed pursuant to provisions of the Commodity Futures Modernization Act of 2000 (''CFMA'') that direct the Commissions to address duplicative or conflicting regulations relating to the treatment of customer funds, securities or property involving security futures products applicable to any firm fully-registered with the CFTC as an FCM pursuant to CEA section 4f(a)(1) and fully-registered with the SEC as broker-dealer pursuant to Exchange Act section 15(b)(1). As proposed, the rules would require certain firms conducting business in security futures products to make choices concerning the treatment of accounts trading security futures products and require firms to make disclosure to customers concerning the treatment of their accounts. In addition, the proposed rules are designed to reduce duplicative regulations applicable to firms notice registered with the SEC pursuant to Exchange Act section 15(b)(11). These proposed rules are intended to address certain differences between the CEA and Exchange Act rules.

DATES: Comments must be received on or before November 5, 2001.

ADDRESSES: Comments should be sent to both agencies at the addresses listed below.

CFTC: Comments should be sent to the Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581, Attention: Office of the Secretariat. Comments may be sent by facsimile transmission to (202) 418–5521, or by e-mail to secretary@cftc.gov. Reference should be made to ''Proposed Rule 41.42—Treatment of Customer Funds.''

SEC: Persons wishing to submit written comments should send three copies to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549–0609. Comments also may be submitted electronically at the following e-mail address: rule-comments@sec.gov. All comment letters should refer to File No. S7–17–01; this file number should be included on the subject line if e-mail is used.

Comment letters received will be available for public inspection and copying in the SEC's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549–0102. Electronically submitted comment letters will be posted on the SEC's Internet web site http://www.sec.gov). The SEC does not edit personal identifying information, such as names or e-mail addresses, from electronic submissions. Submit only the information you wish to make publicly available.

FOR FURTHER INFORMATION CONTACT:

CFTC: Lawrence B. Patent, Associate Chief Counsel, Robert B. Wasserman, Associate Director, or Helene D. Schroeder, Special Counsel, Division of Trading and Markets, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581. Telephone: (202) 418–5430. E-mail: (lpatent@cftc.gov); (rwasserman@cftc.gov) or (hschroeder@cftc.gov).

SEC: Michael A. Macchiaroli, Associate Director, at (202) 942–0132; Thomas K. McGowan, Assistant Director, at (202) 942–4886; or Bonnie L. Gauch, Attorney, at (202) 942–0765, Office of Risk Management and Control; and with respect to Exchange Act Rule 10b–10, Catherine McGuire, Chief Counsel, or Theodore R. Lazo, Special Counsel, at (202) 942–0073 Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549–1001.

SUPPLEMENTARY INFORMATION:

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I. Introduction

The CFMA,[1] which became law on December 21, 2000, amended the CEA and the Exchange Act to permit the trading of single stock and narrow-based stock index [2] futures (''security futures'') [3] and to establish a framework for the joint regulation by the CFTC and the SEC of security futures products [4] (''SFPs''). In addition, the CFMA amended the CEA and the Exchange Act to require that the CFTC and SEC consult with each other regarding regulations with which firms that are ''fully-registered'' with both the CFTC [5] and the SEC [6] (''Full FCM/Full BDs'') must comply, and issue such rules, regulations, or orders as are necessary to avoid duplicative or conflicting regulations applicable to such firms with respect to the treatment of customer funds, securities, or property, maintenance of books and records, financial reporting, or other financial responsibility rules, involving security futures products.[7] The relevant provisions of the CFMA will become effective no sooner than one year from the date of the enactment of the CFMA (December 21, 2001).[8]

In order to avoid conflicting or duplicative regulation, the Commissions are proposing new rules that would permit a Full FCM/Full BD to choose (or let its customers choose) whether an account in which SFPs are held will be treated as a futures account subject to the segregation requirements of the CEA, or as a securities account subject to Exchange Act Rule 15c3–3 (''Rule 15c3–3'') and the Securities Investor Protection Act of 1970 (''SIPA'').[9] The Commissions are also proposing new rules that would require certain firms that engage in an SFP business: To establish written policies stating how customer SFP positions will be held; to make certain disclosures to customers regarding the nature and applicability of the protections that may be available to customers pursuant to the segregation requirements of the CEA, or the provisions of Rule 15c3–3 and SIPA; and to obtain a signed acknowledgement from each customer stating that the customer understands which regulatory scheme governs the account in which SFPs are held, and that the account will not be protected under the alternative regulatory scheme. These disclosure and acknowledgement requirements are intended to address any confusion that might arise as to whether the segregation requirements of the CEA or the provisions of Rule 15c3–3 and SIPA provisions apply to an account in which SFPs are held. To facilitate this rule change, the Commissions are also proposing new definitions for the terms ''futures account'' [10] and ''securities account.'' [11]

Separately, the Commissions are proposing to amend existing rules or add additional requirements designed to assure that the above-mentioned changes correspond with the existing regulatory structure. Specifically, the CFTC is proposing to amend its basic risk disclosure rule to require the above disclosures to customers concerning the segregation requirements and the provisions of Rule 15c3–3 and SIPA, and to amend the Part 190 bankruptcy rules to recognize differences in the treatment of futures accounts and securities accounts holding SFPs. The SEC is proposing to amend its Rule 15c3–3 definition of ''customer,'' [12] and to amend Rules 17a–3, 17a–4, 17a–5, 17a–7, 17a–11, and 17a–13 [13] to avoid duplicative regulation for certain FCMs registered with the SEC pursuant to section 15(b)(11) and the rules adopted by the SEC,[14] as well as for Full FCM/Full BDs, and to clarify the length of time that records required to be created pursuant to new section (o) of Rule 15c3–3 must be maintained.

II. Background

A. Security Futures Products

Generally, the term ''security future'' means a contract of sale for future delivery of a single security or of a narrow-based security index, including any interest therein or based on the value thereof, except exempted securities (with the exclusion of municipal securities) and certain agreements, contracts, or transactions excluded from the CEA.[15] Except as otherwise provided in a rule, regulation, or order issued jointly by the SEC and CFTC, a security future must be based upon common stock or such other equity securities as the SEC and the CFTC jointly determine appropriate.[16] Further, the term ''security futures product'' means a security future or any put, call, straddle, option, or privilege on any security future.[17]

The CFMA amended the Exchange Act definitions of ''security'' and ''equity security'' to include ''security future'' and ''any security future on any [stock or similar security],'' respectively.[18] In addition, definitions of the terms ''security future'' [19] and ''security futures product'' [20] were added to the Exchange Act and the CEA. Pursuant to these changes, a security futures product is both a security and a future and, therefore, is subject to the jurisdiction of the CFTC and the SEC.

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[1] Appendix E of Pub. L. No. 106–554, 114 Stat. 2763 (2000).

[2] CEA section 1a(25)(A) (7 U.S.C. 1a(25)(A)) and Exchange Act section 3(a)(55)(B) and (C) (15 U.S.C. 78c(a)(55)(B) and (C)). *See also* Exchange Act Release No. 44724 (August 20, 2001), 66 FR 44489 (August 23, 2001).

[3] The term ''security future'' means a contract of sale for future delivery of a single security or of a narrow-based security index, including any interest therein or based on the value thereof, except an exempted security under Section 3(a)(12) of the Exchange Act as in effect on the date of enactment of the Futures Trading Act of 1982 (other than any municipal security as defined in Section 3(a)(29) as in effect on the date of enactment of the Futures Trading Act of 1982). The term ''security future'' does not include any agreement, contract, or transaction excluded from the CEA under Sections 2(c), (d), (f), or (g) of the CEA (as in effect on the date of enactment of the CFMA) or Title IV of the CFMA. CEA section 1a(31) (7 U.S.C. 1a(31)) and Exchange Act section 3(a)(55) (15 U.S.C. 78c(a)(55)).

[4] CEA section 1a(32) (7 U.S.C. 1a(32)) and Exchange Act section 3(a)(56) (15 U.S.C. 78c(a)(56)).

[5] Pursuant to CEA section 4f(a)(1) (7 U.S.C. 6f(a)(1)).

[6] Pursuant to Exchange Act section 15(b)(1) (15 U.S.C. 78*o*(b)(1)).

[7] CEA section 4d(c) (7 U.S.C. 6d(c)) and Exchange Act section 15(c)(3)(B) (15 U.S.C. 78*o*(c)(3)(B)).

[8] Section 6(g)(5)(A) of the Exchange Act provides that it is unlawful for any person to execute or trade a security futures product until the later of: ''(i) 1 year after the date of enactment of the Commodity Futures Modernization Act of 2000; or (ii) such date that a futures association registered under Section 17 of the Commodity Exchange Act has met the requirements set forth in Section 15A(k)(2) of this title.'' 15 U.S.C. 78f(g)(5)(A). There is an exception to this provision, however, for principal-to-principal transactions between eligible contract participants. Exchange Act section 6(g)(5)(B) (15 U.S.C. 78f(g)(5)(B)). The term ''eligible contract participant'' is defined at CEA section 1a(12) (7 U.S.C. 1a(12)).

[9] 15 U.S.C. 78aaa *et seq*.

[10] Proposed new paragraphs (vv) of CFTC Rule 1.3 and (a)(15) of Rule 15c3–3.

[11] Proposed new paragraphs (ww) of CFTC Rule 1.3 and (a)(14) of Rule 15c3–3.

[12] 17 CFR 240.15c3–3(a)(1).

[13] 17 CFR 240.17a–3, 240.17a–4, 240.17a–5, 240.17a–7, 240.17a–11, and 240.17a–13 respectively.

[14] 15 U.S.C. 78*o*(b)(11)(A)(i) and Exchange Act Release No. 44730 (August 21, 2001), 66 FR 45137 (August 27, 2001).

[15] *See* note 3.

[16] CEA section 2(a)(1)(D)(i)(III) (7 U.S.C. 4(a)(1)(D)(i)(II)) and Exchange Act section 6(h)(3)(D)(i)(III) (15 U.S.C. 78f(h)(3)(D)).

[17] *See* note 4.

[18] Exchange Act sections 3(a)(10) and (11) respectively (15 U.S.C. 78c(a)(10) and 15 U.S.C. 78c(a)(11)).

[19] *See* note 3.

[20] *See* note 4 and accompanying text.

B. Regulation of Broker-Dealers and FCMs that Effect Transactions in Security Futures Products

As an SFP is both a security and a future, a person must be registered both as an FCM with the CFTC and as a broker-dealer with the SEC to effect SFP transactions. The CFMA amended the CEA and the Exchange Act to provide notice registration procedures for persons that may be required to register with the SEC or the CFTC solely because they are effecting SFP transactions. Under the notice registration procedures, an FCM may register with the SEC pursuant to Section 15(b)(11) of the Exchange Act and the rules adopted by the SEC [21] (''Notice BD'') and a broker-dealer may register with the CFTC pursuant to Section 4f(a)(2) of the CEA and rules adopted by the CFTC [22] (''Notice FCM''). Notice BDs are exempt from certain provisions of the Exchange Act,[23] and Notice FCMs are exempt from certain provisions of the CEA.[24] These statutory provisions were designed to allow persons that previously had engaged ''solely'' in either the securities or futures business to participate in SFP business without being subject to conflicting or duplicative regulation.

C. The Applicability of CFTC and SEC Customer Protection Rules and SIPA to Accounts Holding SFPs

The CEA requires that customer funds be segregated and separately accounted for by FCMs.[25] In addition, the Exchange Act and certain rules enacted thereunder require that a broker-dealer follow certain steps to assure that customer assets are not used to fund the broker-dealer's business.[26] These provisions provide similar protections for customers, but, when applied to SFPs, could cause a Full FCM/Full BD to maintain two separate reserves to satisfy both sets of requirements. However, pursuant to the CEA, Exchange Act, and SIPA, a broker-dealer that also is a Notice FCM is not subject to the segregation requirements of the CEA,[27] and an FCM that also is a Notice BD is not subject to Rule 15c3–3 [28] and may not be a member of the Securities Investor Protection Corporation (''SIPC'').[29]

1. Segregation Requirements

Section 4d of the CEA [30] sets forth the segregation requirements that apply to FCMs with respect to commodity interest transactions. By this provision, an FCM must treat and deal with money, securities and property received from customers, or accruing to such customers as a result of trades, as belonging to such customers.[31] The money, securities and property of customers also may not be commingled with the funds of the FCM nor used to margin or guarantee the trades or contracts, or to secure or extend the credit, of any customer or person other than the one for whom the same are held.[32] Such money, securities and property, however, may, for convenience, be commingled with the money, securities and property of other customers when deposited with a bank, trust company, clearing organization or another FCM.

These segregation requirements protect the money, securities and property of customers of an FCM that are deposited to engage in commodity interest transactions. They provide protection by requiring that the customer funds be segregated from the FCM's own funds and strictly limit the permitted uses of the funds to customer-related transactions (such as to post margin and pay the daily variation settlement for customers' positions at the various futures clearing organizations). An FCM must have sufficient funds in segregation at all times to meet its obligations to customers. A firm must complete a computation demonstrating compliance with its segregation requirement on a daily basis.[33] If customer funds held in segregated accounts are less than the FCM's segregation requirement, the FCM must immediately deposit its own funds into the segregated account to meet the requirements and report immediately that it was undersegregated.[34] There is no limit on the amount of customer funds that is protected.

In the event of bankruptcy, customer claims have priority with respect to customer funds over all claims except administrative expenses related to such funds. If there also is a shortfall in the amount of funds held in segregation for customers, the distribution of customer funds proceeds on a *pro rata* basis.

Although the segregation requirements apply to an FCM with respect to SFPs, they are specifically made inapplicable by the CFMA to Notice FCMs.[35] Thus, the segregation requirements apply only to a firm that is fully-registered as an FCM.

2. Rule 15c3–3 and SIPA

Pursuant to Rule 15c3–3, broker-dealers that carry customer accounts are required to maintain, at all times when deposits are required, a ''Special Reserve Bank Account for the Exclusive Benefit of Customers'' [36] (''Special Reserve Account''). A broker-dealer must maintain in this account cash and/or qualified securities in amounts computed under a specified formula (the ''Reserve Requirement'').[37] The funds so held must be segregated from any other bank account of the broker-dealer.[38] Generally, broker-dealers that must maintain $1 million or more in their Special Reserve Accounts will compute their Reserve Requirement on a weekly basis (*i.e.,* as of each Friday). If necessary, these broker-dealers must then make a deposit to the Special Reserve Account to bring the balance in that account up to the Reserve Requirement no later than one hour after the opening of banking business on the second following business day.[39] Although Rule 15c3–3 applies to a broker-dealer with respect to SFPs, changes made to the Exchange Act by the CFMA make the Rule inapplicable to a Notice BD.[40] Thus, Rule 15c3–3 applies only to a firm that is a fully-registered broker-dealer.

SIPA provides additional protection for customer funds and securities held by a broker-dealer. SIPA defines the term ''customer'' as ''any person * * * who has a claim on account of securities received, acquired, or held by the debtor in the ordinary course of its business as a broker or dealer from or for the securities accounts of such person [including] any person who has deposited cash with the debtor for the purpose of purchasing securities * * *.'' [41] The CFMA amended SIPA's definition of the term ''security'' to include a ''security futures product.'' [42] Accordingly, a customer's funds held by

[21] *See* note 14.

[22] 7 U.S.C. 6f(a)(2) and 66 FR 43080 (August 17, 2001).

[23] Exchange Act section 15(b)(11)(B) (15 U.S.C. 78*o*(b)(11)(B)).

[24] CEA section 4f(a)(4)(A) (7 U.S.C. 6f(a)(4)(A)).

[25] CEA section 4d (7 U.S.C. 6d).

[26] Exchange Act section 15(c)(3) (15 U.S.C. 78*o*(c)(3)), and 17 CFR 240.15c3–3.

[27] CEA section 4f(a)(4)(A)(ii) (7 U.S.C. 6f(a)(4)(A)(ii)).

[28] Exchange Act section 15(b)(11)(B)(iii) (15 U.S.C. 78*o*(b)(11)(B)(iii)).

[29] SIPA section 3(a)(2)(A) (15 U.S.C. 78ccc(a)(2)(A)).

[30] *See* note 25.

[31] CEA section 4d(a)(2) (7 U.S.C. 6d(a)(2)).

[32] *Id.*

[33] 17 CFR 1.32.

[34] 17 CFR 1.12(h).

[35] CEA section 4f(a)(4)(A)(ii) (7 U.S.C. 6f(a)(4)(A)(ii)).

[36] 17 CFR 240.15c3–3(e).

[37] *Id.*

[38] *Id.*

[39] 17 CFR 240.15c3–3(e)(3).

[40] Exchange Act section 15(b)(11)(B)(iii) (15 U.S.C. 78*o*(b)(11)(B)(iii)).

[41] SIPA section 16(2) (15 U.S.C. 78*lll*(2)).

[42] SIPA section 16(14) (15 U.S.C. 78*lll*(14)).

a fully-registered broker-dealer for the purposes of trading SFPs benefit from SIPA protection, provided that a customer's SFP positions are carried in a securities account.

With limited exceptions, every broker-dealer registered pursuant to Section 15(b)(1) of the Exchange Act must be a member of SIPC.[43] When a SIPC member is closed due to bankruptcy or other financial difficulties, SIPC works to return to customers the cash and securities held by the broker-dealer. SIPA also provides that, to the extent that the broker-dealer does not have sufficient resources to return the cash and securities to customers, SIPC will replace the missing assets, up to $500,000 per customer (including $100,000 for cash claims). The CFMA further amended SIPA to provide that any FCM that registers as a Notice BD may not become a member of SIPC.[44] Because these Notice BDs are not members of SIPC, the customer funds held by them would not benefit from SIPA protection.

3. The CFTC and SEC Customer Protection Rules and SIPA Apply to Firms That Are Full FCMs/Full BDs

As discussed above, an FCM that is a ''Notice BD'' is not subject to Rule 15c3–3 and is not a member of SIPC. Similarly, a broker-dealer that is a ''Notice FCM'' is not subject to the segregation requirements of the CEA. Thus, an account in which customer SFP positions are held that is carried by a notice registrant is protected either by Rule 15c3–3 and SIPA or by the CEA segregation scheme, but not by both. However, absent the proposed rules, a Full FCM/Full BD would need to comply with the segregation requirements of the CEA, Rule 15c3–3, and SIPA with relation to customer accounts in which SFPs are held because an SFP is both a security and a future.

As amended by the CFMA, Section 4d(c) of the CEA[45] and Section 15(c)(3)(B) of the Exchange Act[46] require that the Commissions, in consultation with each other, issue such rules as are necessary to avoid duplicative or conflicting regulations applicable to a Full FCM/Full BD. The proposed rules would alleviate duplicative regulation by permitting Full FCM/Full BDs to either choose, or allow their customers to choose, whether SFP positions will be held in a futures account subject to CEA segregation requirements or a securities account subject to Rule 15c3–3 and SIPA.

III. Proposed Rules and Amendments

A. Proposed Amendment to CFTC Rule 1.55

CFTC Rule 1.55, which sets forth the general disclosure obligations of FCMs and introducing brokers, would be amended by adding proposed paragraph (h) to require FCMs that are soliciting or accepting orders for or otherwise handling any transaction in SFPs to provide the disclosures that are proposed to be added by CFTC Rule 41.42 (''Rule 41.42''). These obligations would not apply to a firm if it does not engage in SFP transactions on behalf of customers. Nor would they apply to a firm with respect to customers that do not engage in such transactions. However, if the customer engages or intends to engage in SFP transactions, the disclosure must be made, regardless of whether the customer is a retail client or an eligible contract participant.[47]

B. Proposed New Rule 41.42 and Paragraph (o) of Rule 15c3–3

1. Where SFPs May Be Held

Paragraph (a) of proposed Rule 41.42 and corresponding paragraph (o)(1) of Rule 15c3–3 would confirm that a Full FCM/Full BD is permitted to hold customer SFPs in either a futures account or a securities account.[48] The Full FCM/Full BD may choose either to maintain all customer SFPs in futures accounts, to maintain all customer SFPs in securities accounts, or to maintain some customers' SFP positions in futures accounts and other customers' SFP positions in securities accounts. In addition, a Full FCM/Full BD may decide to provide some or all of its customers with the discretion to select where their SFP positions will be held. In any event, the Full FCM/Full BD would have the choice to decide whether customer SFPs will be held in a futures account or in a securities account, or to provide customers with the discretion to select the account type.

The Commissions request comment on whether any differences in regulatory structure between the CEA and Exchange Act customer protection rules would cause broker-dealers or FCMs, or the customers of either, to be placed at a disadvantage if one structure were used as compared to the other, either from a regulatory or operational perspective. Further, the Commissions request comment on proposed paragraphs (a) of Rule 41.42 and (o)(1) of Rule 15c3–3 that permit firms to choose the type of account in which customer SFPs will be held, including with respect to any operational or regulatory issues. In addition, the Commissions request comment as to whether either the ability to provide customers with a choice as to the type of account in which they would like SFP positions to be held or the act of providing customers with such choice would raise any issues, including any operational or regulatory issues.

Proposed paragraph (a)(2) of Rule 41.42 and corresponding paragraph (o)(1)(ii) of Rule 15c3–3 would require a firm to establish a written policy describing whether customer SFPs and any customer assets used to margin them will be held in a futures account or a securities account. The firm's policy could stipulate that the firm holds SFPs for customers solely in securities accounts or solely in futures accounts. Alternatively, the firm's policy could provide that the firm permits customers to make an election as to the type of account in which SFPs will be held. If the firm decided to permit customers to make such an election, the firm would have to detail in its written policy the process and the procedure to be followed by the firm where the customer failed to make an election. Further, if a firm allows certain customers to make an election as to account type, but does not allow other customers to make such an election, the written policy should clearly explain which customers may or may not make an election.

2. Requirements for Holding and Effecting Transactions in SFPs for the Benefit of Customers

Proposed paragraph (b) of Rule 41.42 and corresponding paragraph (o)(2) of Rule 15c3–3 set forth a number of requirements that a firm would have to meet before it could hold or effect transactions in SFPs on behalf of a customer. Firms that do not permit customers to hold SFPs or engage in SFP transactions would not be affected by the proposed requirements.

The proposed rules also would apply where an account is transferred from another FCM or broker-dealer. For instance, a Full FCM/Full BD would be required to have written procedures relating to when a disclosure document will be provided to and an

[43] *See* note 29.

[44] *Id.*

[45] 7 U.S.C. 6d(c).

[46] 15 U.S.C. 78*o*(c)(3)(B).

[47] *See* note 8.

[48] The proposed amendments also would add paragraphs (vv) and (ww) to CFTC Rule 1.3, and corresponding paragraphs (a)(15) and (a)(14) to Rule 15c3–3, which define the terms ''futures account'' and ''securities account.'' Proposed paragraph 41.42(f) clarifies that money, securities, or property held to margin, guarantee or secure SFPs held in a futures account are subject to the segregation requirements of Section 4d of the CEA (7 U.S.C. 6d).

acknowledgement obtained from a customer transferring in an account containing SFPs. As with new accounts, firms would need to send a disclosure document and obtain an acknowledgement before any order for an SFP could be accepted from the customer. If the customer's SFPs are held in a futures account at the delivering firm, but the receiving firm's procedure is to maintain customer SFP positions in a securities account, the receiving broker-dealer would be required to receive a written acknowledgement of this change in account type from the customer.

a. Disclosure Document Requirement

Proposed new paragraph (b)(1) of Rule 41.42 and corresponding paragraph (o)(2)(i) of Rule 15c3–3 set forth the disclosure document requirements that would apply to a firm that engages in SFPs transactions on behalf of customers. The Commissions view these disclosure requirements as essential to address potential customer confusion regarding the nature of SFPs and the protections afforded to customers trading such products pursuant to the regulations of the Commissions. Specifically, these paragraphs would require a firm that effects SFPs transactions on behalf of customers to provide its customers with a general description of the protections afforded futures accounts under Section 4d of the CEA and securities accounts under Rule 15c3–3 and SIPA. In addition, the firm would have to indicate whether the customer's SFPs will be held in a futures account or in a securities account. The disclosure required pursuant to proposed paragraphs (b)(1)(iii) of Rule 41.42 and corresponding paragraph (o)(2)(i)(C) of Rule 15c3–3 also requires that a firm indicate whether the firm permits its customers to make or change an election. The proposed paragraphs also would require the firm to include a statement in the disclosure document that the protections provided by the alternative regulatory scheme would not be available with respect to that account.

The firm would not be required to furnish a disclosure document to every customer. Disclosure would be required only with respect to customers that engage or intend to engage in SFP transactions or for whom the firm holds SFPs. The Commissions expect that this disclosure document will be provided to a customer either when an account is opened or at some later date were the customer to express an interest in engaging in SFP transactions (but before an order to buy or sell an SFP is accepted by the firm).

In order to provide firms with maximum flexibility, the proposed rules do not set forth specific prescribed language that a firm would have to include in a disclosure document. Industry representatives developing a model disclosure document concerning SFPs have consulted the staffs of the Commissions. The staffs have encouraged these industry representatives to include discussions of both the segregation requirements and Rule 15c3–3 and SIPA protections in one model disclosure document.

The Commissions request comment on the disclosure document requirements contained in proposed paragraphs (b)(1) of Rule 41.42 and (o)(2)(i) of Rule 15c3–3, including any operational or regulatory issues. The Commissions also invite comments as to whether the rules should mandate specific language and, if so, suggestions as to what language should be included in the rules.

b. Customer Acknowledgement Requirement

So that a customer trading SFPs understands which protections would apply to that customer's account, proposed paragraph (b)(2) of Rule 41.42 and corresponding paragraph (o)(2)(ii) of Rule 15c3–3 would require that a Full FCM/Full BD obtain a signed acknowledgement from such customer before the firm could accept an order for a SFP from that customer. The acknowledgement would have to specify which regulatory regime applies and that the customer understands that the account will not be protected under the alternative regulatory scheme. This acknowledgement will help to evidence that a customer understands that an SFP held in a futures account is not covered by SIPA and an SFP held in a securities account is not protected by segregation. Notice registrants are not required to obtain this acknowledgment from customers because they are only subject to one customer protection regulatory scheme.[49]

The Commissions request comment on the requirement to obtain a signed acknowledgement contained in proposed paragraphs (b)(2) of Rule 41.42 and (o)(2)(ii) of Rule 15c3–3, including any customer protection, operational or regulatory issues. The Commissions also invite comment as to whether a signed acknowledgement is necessary to demonstrate that a customer understands the protections applicable to an account in which SFPs are traded and held, or, if not, what other procedure may instead be used to demonstrate the customer's understanding.

3. Changes in Account Type

Proposed paragraph (c) of Rule 41.42 and corresponding paragraph (o)(3) of Rule 15c3–3 set forth the general rule that a firm may change the type of account in which customer SFPs are held. This change may be made pursuant to a customer's request, or the firm could make a unilateral decision to change a customer's account type based on an assessment that one regulatory scheme or another is preferable or cost-effective. If a firm changes a customer's account type, the firm would be required to create a detailed record concerning the change, obtain a signed acknowledgement from the customer indicating that the customer understood which regulatory scheme governs the account and that the account would not be protected under the alternative regulatory scheme, and notify the customer in writing of the date that the change became effective.

While the rules would permit a Full FCM/Full BD to choose the type of account in which customer SFP positions would be held, and to unilaterally change the type of account in which customer SFP positions would be held, the Commissions expect that each firm will make these choices without unfairly disadvantaging its customers. A Full FCM/Full BD should consider the effect of its choices on its customers and the criteria used to make these choices in light of its obligations under the CEA, Exchange Act, and SRO Rules. At the same time, firms may have many reasons to change account types (*e.g.,* operational purposes), and the Commissions do not intend to limit a firm's ability to initiate account type changes for legitimate business purposes.

The Commissions invite comment on the advisability of allowing firms to change the type of account in which customer SFPs are held, including any operational or regulatory issues.

4. Recordkeeping Requirements

Proposed paragraph (d) of Rule 41.42 and corresponding paragraph (f)(2) of Exchange Act Rule 17a–3 are intended to clarify what recordkeeping requirements would apply to a Full FCM/Full BD that effects transactions in and holds SFPs for the benefit of customers and to address the Commissions' obligations to avoid duplicative or conflicting regulations relating to the maintenance of books and

[49] *See* notes 21 through 24 and accompanying text.

records involving SFPs by Full FCMs/Full BDs.

Certain differences exist between the CFTC books and records rules and Exchange Act Rules 17a–3 and 17a–4. For instance, CFTC Rule 1.31 requires that all books and records required to be kept by an FCM must be kept for a period of five years from the date thereof, and further, that the required books and records may be stored on micrographic or electronic storage media unless the documents are trading cards or other documents on which trade information is originally recorded in writing.[50] Certain records required to be preserved pursuant to the Exchange Act Rule 17a–4, by contrast, must be held for either three or six years, depending upon the particular record.

The Commissions believe that application of the specific recordkeeping requirements under the CEA and the Exchange Act should follow from the type of account in which the SFPs are held. Thus, if SFPs are held in a futures account, the recordkeeping requirements under the CEA would apply to the firm with respect to that account. Conversely, if SFPs are held in a securities account, the recordkeeping rules under the securities laws would apply. Such recordkeeping requirements would be in addition to those that would be imposed by proposed Rule 41.42 and paragraph (o) of Rule 15c3–3.

The Commissions request comment as to whether any records required to be created or maintained pursuant to either regulatory scheme should also be required by the recordkeeping rules of the other regulator so that full and complete records are maintained regarding SFP transactions under both regulatory schemes. In addition, the Commissions request comment on whether the amendments to the Commissions' record creation and maintenance rules proposed in this release are sufficient to avoid conflicting or duplicative regulation.

C. Customer Account Statements

The Commissions similarly believe that application of the specific customer account statement delivery requirements under the CEA and the Exchange Act should follow from the type of account in which SFPs are held. Generally, FCMs must send account statements to customers monthly,[51] whereas broker-dealers must send account statements to customers on a quarterly basis.[52] Nevertheless, the Commissions propose that application of the requirements for sending account statements to customers should follow from the type of account in which the SFPs are held.[53]

D. Confirmations

The Commissions request comment on the application to transactions in SFPs of their confirmation rules (Rules 10b–10 under the Exchange Act[54] and Rule 1.33(b) under the CEA),[55] which have different requirements. Should the application of the confirmation rules to FCMs and broker-dealers follow from the type of account in which SFPs are held? Does the information that FCM customers receive on confirmations prepared pursuant to CEA Rule 1.33(b) serve the purposes of Exchange Act Rule 10b–10? Should FCMs provide the particular information required by Exchange Act Rule 10b–10 to customers in SFP transactions upon the customers' request, to the extent that the information is not already provided on the confirmation that the FCM prepares pursuant to CEA Rule 1.33(b)? What would be the cost(s) to FCMs to provide the information required under Exchange Act Rule 10b–10 on SFP confirmations? What would be the cost(s) to broker-dealers to provide the information required under Rule 1.33(b) on SFP confirmations? How long would it take firms to implement systems to provide this information? Are there any other considerations relating to customers that should be taken into account?

E. CFTC Bankruptcy Treatment: Proposed Amendments to Part 190

The proposed amendments to part 190 are intended to make clear that a customer that is trading SFPs that are held in a securities account at a broker-dealer would not be entitled to benefit from the priority treatment Part 190 affords to customers in the event of insolvency of the FCM. The amendments would exclude from the definition of ''specifically identifiable property,'' security futures products and any property received to margin, guarantee or secure such positions held in a securities account. SFP positions and associated margin held in such accounts would be excluded from the net equity calculation and the definition of ''customer property.'' Consistent with these changes, claimants would have to signify on their proof of claim form whether SFP positions are held in a securities or futures account.

F. Rule 15c3–3 Definitions

The SEC is proposing to change the definition of ''customer'' and, as stated earlier, to add new definitions of ''securities account'' and ''futures account'' to establish which customer assets will be protected under the Exchange Act/SIPA scheme and which will be protected under the CEA/Part 190 scheme. To this end, a sentence has been added to the 15c3–3(a)(1) definition of ''customer'' that states, ''[i]n addition, the term [customer] shall not include a person to the extent that the person has a claim for security futures products held in a futures account.'' Further, new definitions of the terms ''securities account'' and ''futures account'' have been added to Rule 15c3–3 to clarify the customer definition by distinguishing the difference between a securities account and a futures account, as well as certain requirements set forth in proposed subsection (o) to Rule 15c3–3.

G. Exchange Act Recordkeeping Rules

The SEC is proposing to amend Rule 17a–3 by adding paragraph (f)(1) to clarify that an FCM that is a Notice BD is not subject to Rule 17a–3. This will also exempt such firms from compliance with much of Rule 17a–4. As stated previously, the SEC is also proposing to add paragraph (f)(2), which would clarify the recordkeeping requirements for Full FCM/Full BDs to avoid duplicative and conflicting regulation. The SEC is also proposing to amend Rule 17a–4 to clarify the length of time certain records must be maintained, and to incorporate a paragraph similar to CFTC Rule 1.35(a–2)(1) relating to documentation of cash transactions underlying exchanges of futures for cash commodities.

The SEC is of the view that, to alleviate potentially duplicative regulations, application of the recordkeeping requirements under the CEA and the Exchange Act should follow from the type of account in which the SFPs are held. As discussed above, proposed paragraph 17a–3(f) would codify this position. As a Notice BD must hold customer SFP positions in a futures account, it would not be subject to Exchange Act Rules 17a–3 and 17a–4. However, although a Notice BD is not subject to the record creation

[50] 17 CFR 1.31.

[51] 17 CFR 1.33(a). FCMs may send a quarterly statement if the account has neither open positions at the end of the statement period nor any changes to the account balance since the prior statement period.

[52] *E.g.,* NYSE Rule 409. However, in some cases broker-dealers must send account statements to customers more frequently (*see, e.g.,* NYSE Rule 730), and as a general business practice most broker-dealers send a monthly statement to each customer whose account has experienced activity during that month.

[53] Proposed paragraph (e) of Rule 41.42.

[54] 17 CFR 240.10b–10.

[55] 17 CFR 1.33(b).

requirements set forth in Rule 17a–3, it would be required to provide the SEC staff with documentation maintained pursuant to CFTC rules relating to SFP activities if such documents are requested.[56] The relief from Rule 17a–3 applicable to a Full FCM/Full BD is limited to circumstances where it holds or effects transactions in SFPs in a futures account.

The SEC is also proposing to amend Rule 17a–4(b)(9) to establish the length of time that those records broker-dealers must create pursuant to new paragraph 15c3–3(o) must be maintained. This paragraph will clarify that records created pursuant to new paragraph 15c3–3(o) must be kept for at least three years, the first two in an easily accessible place.

Lastly, the SEC is proposing new paragraph (k) to Exchange Act Rule 17a–4, which is meant to parallel the requirements of CFTC Rule 1.35(a–2)(1). This paragraph would require a broker-dealer that engages in an SFP business, upon request of the SEC, to request from its customers and provide to the SEC documentation of cash transactions underlying exchanges of SFPs for the underlying security(ies). This type of transaction is also called an exchange of futures for physicals (or an ''EFP''),[57] and is usually negotiated by the parties rather than being executed openly and competitively on an exchange or contract market. To fulfill its obligations under this rule, a broker-dealer may include the requirement that customers provide this information, if requested, in the account opening documents. The purpose of this proposed rule is to provide securities regulators with a method of obtaining information on each transaction underlying SFPs. Further, this information may be necessary to protect against market manipulation relating to physically-settled SFPs.

H. Exchange Act Reporting, Notification, and Quarterly Count Requirements

The SEC is also proposing new paragraphs 17a–5(a)(5), 17a–7(c), 17a–11(e), and 17a–13(e), which would exempt certain Notice BDs from the requirements to file FOCUS reports,[58] maintain records at a place within the United States,[59] send telegraphic notification to the SEC,[60] and perform quarterly securities counts to verify positions.[61] These exemptions would be limited to Notice BDs that are not members of a national securities exchange or national securities association fully-registered with the SEC pursuant to Sections 6(a) or 15A(a) of the Exchange Act respectively (''Fully-registered National Securities Exchange'' and ''Fully-registered National Securities Association'').[62] Notice BDs that are only members of one or more designated contract markets or derivatives transaction execution facilities, registered with the CFTC pursuant to CEA Sections 5 and 5a[63] and also registered as national securities exchanges or national securities associations solely for the purpose of trading SFPs by filing notice pursuant to either Section 6(g) or 15A(k) of the Exchange Act,[64] would not be required to file FOCUS reports.

IV. General Request for Comments

In addition to the specific requests for comments included in the release, the Commissions invite interested persons to submit written comments on all aspects of the proposed amendments. The Commissions also request comment as to whether there are other issues raised by the CFMA, including those related to any CEA, Exchange Act, and SIPA inconsistencies or areas of duplicative regulation regarding segregation, customer protection, creation and maintenance of records, customer statement and confirmation requirements, requirements to make or send reports or notifications to regulatory authorities, and requirements to periodically count or verify positions that have not been addressed in this release.

V. Paperwork Reduction Act

CFTC

This proposed rulemaking contains information collection requirements within the meaning of the Paperwork Reduction Act of 1995 (''PRA'').[65] The CFTC has submitted a copy of this part to the Office of Management and Budget (''OMB'') for its review.

Collection of Information

Part 41, Relating to security futures products, OMB Control Number 3038–0059.

The estimated burden associated with the proposed new rule would be 450 hours, which will result from new disclosure requirements applicable to FCMs. An estimated 225 firms will issue such disclosure statements and will obtain acknowledgements from customers.

The estimated burden of the proposed new rule was calculated as follows:

Estimated number of respondents: 225.

Reports annually by each respondent: 2.

Total annual Responses: 450.

Estimated average Number of Hours Per Response: 1.

Estimated Total Number of Hours of Annual Burden in Fiscal Year: 450.

This annual reporting burden of 450 hours represents an increase of 450 hours as a result of the proposed new rule.

Organizations and individuals desiring to submit comments on the information collection requirements should direct them to the Office of Information and Regulatory Affairs, OMB, Room 10235 New Executive Building, Washington, DC 20503, Attention: Desk Officer for the Commodity Futures Trading Commission.

The CFTC considers comments by the public on this proposed collection of information in—

- Evaluating whether the proposed collection of information is necessary for the proper performance of the functions of the CFTC, including whether the information will have a practical use;
- Evaluating the accuracy of the CFTC's estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used;
- Enhancing the quality, usefulness, and clarity of the information to be collected; and
- Minimizing the burden of collection of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology, *e.g.,* permitting electronic submission of responses.

[56] *See* Exchange Act section 17(b) (15 U.S.C. 78q(b)).

[57] An EFP involves simultaneous transactions in the futures and securities markets. Thus, one party buys the security and simultaneously sells (or gives up the long) SFPs while the other party sells the security and simultaneously buys (or receives long) SFPs.

[58] Broker-dealers are required to file monthly and/or quarterly reports on Form X–17A–5 pursuant to Rule 17a–5(a) (17 CFR 240.17a–5(a)), commonly referred to as FOCUS Reports.

[59] Non-resident brokers and dealers are required, pursuant to Rule 17a–7 (17 CFR 240.17a–7), to maintain certain records at a location, designated by the firm, within the United States, or provide the SEC with a signed undertaking stating that it will furnish such records to representatives of the SEC upon demand.

[60] Pursuant to Rule 17a–11 (17 CFR 240.17a–11).

[61] Pursuant to Rule 17a–13 (17 CFR 240.17a–13).

[62] 15 U.S.C. 78f(a) and 15 U.S.C. 78*o*–3(a). This does not include any national securities exchanges or national securities associations that are registered pursuant to Section 6(g) or 15A(k) of the Exchange Act (15 U.S.C. 78f(g) or 15 U.S.C. 78*o*–3(k)).

[63] 7 U.S.C. 7 and 7a.

[64] 15 U.S.C. 78f(g) or 15 U.S.C. 78*o*–3(k).

[65] 44 U.S.C. 3501 *et seq.*

OMB is required to make a decision concerning the collection of information contained in these proposed regulations between 30 and 60 days after publication of this document in the **Federal Register**. A comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. This does not affect the deadline for the public to comment to the CFTC on the proposed regulations. Copies of the information collection submission to OMB are available from the CFTC Clearance Officer, 1155 21st Street, NW, Washington, DC 20581, (202) 418–5160.

SEC

Certain provisions of the proposed amendments contain ''collection of information'' requirements within the meaning of the PRA. The SEC has submitted the proposed amendments to OMB for review in accordance with 44 U.S.C. 3507(d) and 5 CFR § 1320.11. The SEC is revising the collection of information under the title ''Amendments to Rules 15c3–3, 17a–3, 17a–4, 17a–5, 17a–7, 17a–11, and 17a–13 to Recognize Security Futures Products.'' The rules being amended contain currently approved collections of information under OMB control numbers 3235–0078, 3235–0033, 3235–0279, 3235–0123, 3235–0131, 3235–0085, and 3235–0035 respectively. The SEC projects that these amendments will change the burden for firms with respect to only two of these rules, specifically Rule 15c3–3 and 17a–4 (OMB control numbers 3235–0078 and 3235–0279 respectively), because the amendments to Rules 17a–3, 17a–5, 17a–7, 17a–11, and 17a–13 exempt certain Notice BDs from the requirements of those rules. The collections and maintenance of information, and the reports made to the SEC and others that are required pursuant to rules 15c3–3, 17a–3, 17a–4, 17a–5, 17a–7, 17a–11, and 17a–13 are mandatory. Reports made to the SEC pursuant to Rules 17a–5 and 17a–11 are considered by the SEC to be confidential financial information. 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.

A. Collection of Information under these Amendments

As mentioned previously in this release, the Amendments to Rules 15c3–3, 17a–3, 17a–4, 17a–5, 17a–7, 17a–11, and 17a–13 to Recognize Security Futures Products would require a broker-dealer that effects transactions in and hold SFPs for customers to establish a written policy, create a disclosure document and provide it to each customer that engages in SFP activities, obtain a signed acknowledgement from every such customer, and, if the broker-dealer also allows for changes of account type to be made, create a record of each change of account type, obtain a signed acknowledgement from every customer whose account type has been changed, and send notification of the effective date of the change to the customer. These records would need to be maintained by the broker-dealer for at least three years, the first two in an easily accessible place. The collection of information would be mandatory for each broker-dealer that wishes to effect transactions in and hold SFPs for customers.

B. Proposed Use of Information

The information collected pursuant to the proposed amendments to Rules 15c3–3, 17a–3, 17a–4, 17a–5, 17a–7, 17a–11, and 17a–13 would be used by the SEC, SROs, and other securities regulatory authorities, during examinations and investigations, to determine that a broker-dealer is in compliance with these rules and with other, related customer protection requirements. No governmental agency would regularly receive any of the information described above. Instead, the information would be stored by the broker-dealer and made available to the various securities regulatory authorities as required to facilitate examinations and investigations. Broker-dealers would also be required to provide each customer that wishes to engage in SFP activities a disclosure document, obtain an acknowledgement from every such customer, and send a notification to any customer whose account type has been changed.[66] The disclosure document would be used by customers to determine the protections provided by the various regulatory schemes to an account in which SFPs are held.

C. Respondents

These proposed amendments to Rules 15c3–3 and 17a–4 would only apply to firms that plan to effect transactions in and hold SFPs for the benefit of customers. In addition, these provision could only apply to broker-dealers that carry customer funds, securities or property and do not claim an exemption from Rule 15c3–3 (''clearing and carrying firms''). As of December 31, 2000, there were 425 registered broker-dealers doing a public business and not claiming an exemption from Rule 15c3–3 (''clearing and carrying firms''). In addition, only firms that plan to effect transactions in and hold SFPs for the benefit of customers will be required to comply with this rule. As of March 31, 2001, 90 broker-dealers were registered with the CFTC as FCMs, 63 of which are clearing and carrying firms. Based upon conversations between the SEC and industry representatives regarding the number of firms that may conduct a SFP business, the Staff estimates that the number of firms that will decide to engage in this business, in addition to the broker-dealers already registered with the CFTC as FCMs, is 10% of the clearing and carrying firms not presently registered with the CFTC. Thus, the Staff estimates that approximately 100 firms ($63 + ((425 - 63) \times 10\%)$) will be required to comply with these proposed amendments.

The amendments to Rules 17a–3, 17a–5, 17a–7, 17a–11, and 17a–13 exempt certain parties from those rules, so they do not create any additional burdens.

D. Total Annual Reporting and Recordkeeping Burden

The hour burden of the proposed amendments to Rules 15c3–3, 17a–3, 17a–4, 17a–5, 17a–7, 17a–11, and 17a–13 is difficult to ascertain as any additional burdens would vary widely due to differences in broker-dealer SFP activity levels and current procedures and systems employed by the broker-dealers. The proposed amendments were drafted to permit flexible methods for the creation of records in order to reduce the burdens on broker-dealers.

The changes to Rules 17a–3, 17a–5, 17a–7, 17a–11 and 17a–13 will exempt certain broker-dealers that are registered by filing a notice with the SEC pursuant to Section 15(b)(11) of the Exchange Act from the requirements of these rules. Thus, they do not create or change any burdens or costs.

1. Rule 15c3–3

Pursuant to proposed new paragraph (o)(2)(iii) of Rule 15c3–3, a broker-dealer that effects transactions in SFPs for customers must obtain an acknowledgement from each customer indicating that a customer understands which regulatory structure will not apply to an account in which SFP transactions are effected or held. Broker-dealers will incur processing costs relating to receipt, tracking, and filing the signed acknowledgements. As stated previously, the SEC Staff estimates, based on conversations with industry groups, that 7,808,000 customers may want to effect transactions in SFPs and will therefore need to return the acknowledgement. The Staff estimates that it will take a person 5 minutes to

[66] Proposed paragraph (o) of Rule 15c3–3.

process each acknowledgement.[67] Thus, the total burden associated with processing these acknowledgements will be approximately 650,700 hours per year.[68]

Pursuant to proposed new paragraph (o)(3)(i) of Rule 15c3–3, a broker-dealer that changes the type of account in which a customer's SFPs are held must create a record of each change in account type. The Staff believes that not all broker-dealers that effect transactions in SFPs for customers will allow for changes in account type. To the extent that a broker-dealer does provide for changes of account type, the information required to be recorded is the type of information that could be easily accessed or created and maintained, therefore the Staff believes the costs of maintaining this information will be minimal. As discussed above, the Staff estimates that broker-dealers would be required to create this record for 1,561,600 accounts.[69] The Staff believes that it will take approximately 3 minutes to create each record.[70] Thus, the total annual burden associated with creating this record of change of account type will be 78,080 hours.[71]

Pursuant to proposed new paragraph (o)(3)(ii) of Rule 15c3–3, a broker-dealer that changes the type of account in which a customer's SFPs are held must obtain an acknowledgement from each customer whose account type was changed indicating that a customer understands which regulatory structure will not apply to that account. As discussed above, the Staff estimates that 1,561,600 accounts per year may change account type, thus broker-dealers would be required to obtain an acknowledgement from 1,561,600 customers. The Staff believes that it will take a broker-dealer approximately 5 minutes to process each acknowledgement. Thus, the total yearly burden of processing these acknowledgements will be approximately 130,133 hours.[72]

In total the SEC estimates that compliance with the proposed amendments to Rule 15c3–3 will require an additional 858,913 hours per year (650,700[73] + 78,080[74] + 130,133[75]).

2. Rule 17a–4

The changes to Rule 17a–4 clarify that the records required to be created pursuant to proposed paragraph 15c3–3(o) must be maintained for at least three years, two in an easily accessible place. Once these records are filed, the cost to maintain them is minimal. The SEC believes that the main cost would be the cost to assure that the broker-dealer is in compliance with the rule. The Staff estimates that it will take, on average, one compliance person approximately 1 hour per year to assure that the broker-dealer is in compliance with the record maintenance provisions of paragraph 17a–4(b)(9) as it relates to new paragraph 15c3–3(o). Thus, the total yearly burden of assuring compliance with the amendment to Rule 17a–4(b)(9) is approximately 100 hours (1 hour × 100 broker-dealers).

New paragraph 17a–4(k) would require that a broker-dealer that engages in a SFP business, upon request of the SEC, request from its customers and provide to the SEC documentation of cash transactions underlying exchanges of security futures products for the underlying security(ies). Broker-dealers can include an agreement that customers provide the broker-dealer with this documentation in many other account opening agreements or in the acknowledgement document, which must be created and the cost of which is provided for above. It has not yet been determined whether SFPs will be cash settled or physically settled. In addition, this is not a record which the broker-dealer would be required to create or maintain, but instead, a broker-dealer would only create this record when requested by the SEC.

The SEC Staff believes this requirement to be analogous to bluesheet requests made by the SEC to broker-dealers. Bluesheet requests are only sent to clearing firms, 661 of which were registered with the SEC as of December 31, 2000.[76] The SEC sent 32,278 bluesheet request letters to 294 broker-dealers from January 1, 2000 to December 31, 2000. Thus, 45% of the broker-dealers that could be affected received letters, and those broker-dealers that did receive letters received, on average, 110 letters each. Therefore, the SEC Staff estimates that 45 clearing and carrying firms that engage in SFP business will receive approximately 110 requests for the information required to be collected and provided pursuant to proposed paragraph (k) of Rule 17a–4, or a total of 4,950 requests. The SEC Staff estimates (based on its experience) that it will take approximately 2 hours for a broker-dealer to respond to a request to provide this information to a regulator. Therefore, the SEC Staff believes that it would take a total of approximately 9,900 hours each year for broker-dealers to comply with this requirement.[77]

In total the SEC estimates that compliance with the proposed amendments to Rule 17a–4 will require an additional 10,000 hours per year.

E. Request for Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), the SEC solicits comments to—(i) Evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility; (ii) Evaluate the accuracy of the agency's estimate of the burden of the proposed collections of information; (iii) Enhance the quality, utility, and clarity of the information to be collected; (iv) 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. The SEC strongly encourages commenters to identify and supply any relevant data, analysis and estimates concerning the burden of the proposed rules, especially where any commenter believes the SEC's estimates to be inaccurate.

Persons desiring to submit comments on the collection of information requirements proposed above should direct them to the following persons: (1) Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs,

[67] As the majority of clearing and carrying firms use automated account recordkeeping systems, the Staff believes that ''processing'' would consist of accessing the customer account record and noting receipt of the acknowledgement, then filing or scanning the acknowledgement. This estimate is based on representations made by industry representatives relating to other rule changes that included similar processing requirements.

[68] Or ((5min/60min) × 7,808,000 accounts). However, it should be noted that the Staff believes it to be unlikely that broker-dealers will experience 100% turnover in the number of SFP accounts, so these costs may decrease in subsequent years.

[69] As stated previously, the Staff estimates that 7,808,000 customers may want to engage in SFP transactions. Further, the Staff estimates that 20% per year may change account type. 20% of 7,808,000 is 1,561,600.

[70] In fact, the Staff believes that most firms will have this process automated. To the extent that no person need be involved in the generation of this record, the costs will be very minimal.

[71] (1,561,600 accounts x(3min/60min). However, it should be noted that the Staff believes it to be unlikely that broker-dealers will experience 100% turnover in the number of SFP accounts, so these cost may decrease in subsequent years.

[72] ((5min/60min) × 1,561,600 accounts). However, it should be noted that the Staff believes it to be unlikely that broker-dealers will experience 100% turnover in the number of SFP accounts, so these costs may decrease in subsequent years.

[73] Associated with proposed paragraph (o)(2)(iii) (17 CFR 240.15c3–3(o)(2)(iii)).

[74] Associated with proposed paragraph (o)(3)(i) (17 CFR 240.15c3–3(o)(3)(i)).

[75] Associated with proposed paragraph (o)(3)(ii) (17 CFR 240.15c3–3(o)(3)(ii)).

[76] *See* note 84.

[77] (4,950 requests × 2 hours per request) = 9,900 hours per year.

Office of Management and Budget, Room 10102, New Executive Office Building, Washington, DC 20503; and (2) Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609 with reference to File No. S7–17–01. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, so a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. The SEC has submitted the proposed collections of information to OMB for approval. Requests for the materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7–17–01, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, 450 Fifth Street, NW., Washington, DC 20549.

VI. Costs and Benefits of the Proposed Amendments

CFTC

Section 15 of the CEA, as amended by Section 119 of the CFMA, requires the CFTC to consider the costs and benefits of its actions before promulgating new regulations or issuing orders [78] under the CEA. By its terms, Section 15 does not require the CFTC to quantify the costs and benefits of a new regulation or to determine whether the benefits of the proposed regulation outweigh the costs. Rather, Section 15(a) simply requires the CFTC to ''consider the costs and benefits'' of its action.

Section 15(a) further specifies that the costs and benefits of the proposed CFTC action shall be evaluated in light of the following five considerations: (1) Protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The CFTC may, in its discretion, give greater weight to any one of the five enumerated areas of concern and may, in its discretion, determine that, notwithstanding its costs, a particular rule is necessary or appropriate to protect the public interest or to effectuate any of the provisions or to accomplish any of the purposes of the CEA.

There are three considerations relevant to this proposal. These are: (1) Protection of market participants and the public; (2) sound risk management practices; and (3) other public interest considerations. The CFTC has considered the costs and benefits of this proposal in light of these three areas of concern.

The proposal includes a disclosure requirement applicable to FCMs. Specifically, proposed rule 41.42 would require FCMs to make disclosure concerning the customer protections available under both the securities and futures regulatory systems. This requirement and the requirement that Full FCM/Full BDs obtain an acknowledgement from each customer stating that the customer is aware that the alternative regulatory protections are inapplicable to the customer's SFP account are specifically intended to ensure that SFP customers know what protections are, or are not, in place in the unlikely event of the insolvency of the firm.

In addition, Section 4d(c) of the CEA, as amended by the CFMA, requires the CFTC, in consultation with the SEC, to issue such rules, regulations, or orders as are necessary to avoid duplicative or conflicting regulations applicable to any firm that is fully-registered with both the CFTC and the SEC involving the application of relevant provisions of the CEA and the regulations relating to the treatment of customer funds. The proposed rule is intended to focus the dually-registered firms on the need to select which of the two regulatory regimes, the segregation requirements of the CEA or SIPA provisions, will provide coverage for SFP customer funds in the unlikely event that the firm becomes insolvent. This will be part of a firm's overall risk management structure to safeguard customer and firm assets.

As proposed, Rule 41.42 is intended to minimize the costs of compliance because it provides firms with maximum flexibility, consistent with legal requirements, in designing their own disclosure documents.[79] The CFTC notes that industry representatives, in consultation with staffs of the CFTC and SEC, are developing a model disclosure document concerning SFPs. The CFTC has expressed the view that the disclosure document should incorporate a discussion of the segregation requirements and SIPA, and that if it does, the CFTC will not require the discussion to be set forth in another separate document.

The CFTC invites public comment concerning its evaluation of the costs and benefits of the proposed rule. Commenters are invited to submit any data that they may have that will help in quantifying the costs and benefits of the proposed rules.

SEC

Passage of the CFMA in December of 2000 permitted the trading of single stock and narrow-based stock index futures and established a framework for joint regulation of SFPs by the CFTC and the SEC. This framework was necessary because the CFMA defined an SFP to be, at the same time, both a security and a contract for future delivery and therefore subject to both the CEA and the Exchange Act and the rules thereunder. In addition, the CFMA amended the CEA and the Exchange Act to require that any exchange or association listing SFPs and any intermediary effecting transactions in SFPs must register with both the CFTC and the SEC, subjecting these parties to both sets of regulations.

Although the CFMA amended the CEA and the Exchange Act such that fully-registered broker-dealers that are Notice FCMs are not subject to certain sections of the CEA and the rules thereunder, and that fully-registered FCMs that are Notice BDs are not subject to certain sections of the Exchange Act and the rules thereunder, Notice FCMs were not exempted from the entire CEA and Notice BDs were not exempted from the entire Exchange Act. In addition, firms that are fully-registered with both the CFTC and the SEC are fully subject to both the CEA and the Exchange Act and the rules thereunder.

Recognizing that some Full FCM/Full BDs may be subject to duplicative or conflicting regulations, the CFMA amended the CEA and the Exchange Act to direct the CFTC and the SEC to issue rules, regulations, or orders, as necessary, to avoid certain duplicative or conflicting regulations.[80] To this end, the SEC is proposing to amend Exchange Act Rules 15c3–3 and 17a–4 by adding new paragraphs (o) and (b)(9) respectively. The SEC is also proposing amendments that would exempt certain Notice BDs from Exchange Act Rules 17a–3, 17a–5, 17a–7, 17a–11, and 17a–13.

The amendments to Rule 15c3–3 would allow a Full FCM/Full BD to

[78] Section 15(a)(3) sets forth three exceptions to the requirement for conducting a cost benefit analysis, none of which would be applicable to the proposed rule changes.

[79] The Commissions have requested comment, however, on whether the proposed amendments should include standard mandatory language to be used by all firms.

[80] CEA section 4d(c) (7 U.S.C. 6d(c)) and Exchange Act section 15(c)(3)(B) (15 U.S.C. 78*o*(c)(3)(B)) respectively.

choose to carry a customer's SFP positions either in a securities account or a futures account. Whether a SFP is held by a Full FCM/Full BD in a securities or a futures account will determine whether the account will be subject to the CFTC's segregation requirements or the SEC's customer protection rule and SIPA. To both identify the manner in which a firm holds SFPs and to assure that each customer understands which regulatory structure will be applied to an account in which SFPs are held, proposed paragraph (o) of Rule 15c3–3 requires that a firm establish written policies, provide customers with specific disclosures, and obtain written acknowledgements from customers indicating that the customer understands which regulatory structure governs an account in which SFPs are held. In addition, if a firm provides a structure that permits the account type to be changed, the firm must also create a detailed record of any change, obtain an additional acknowledgement from the customer indicating that they understand a change has been made and that the account will be protected pursuant to a new regulatory structure, and notify the customer in writing of the effective date of the change.

The SEC has identified below certain costs and benefits relating to the proposed Amendments to Rules 15c3–3, 17a–3, 17a–4, 17a–5, 17a–7, 17a–11, and 17a–13 to Recognize Security Futures Products. The SEC requests comments on all aspects of this cost-benefit analysis, including identification of any additional costs and/or benefits of the proposed amendments. The SEC strongly encourages commenters to identify and supply any relevant data, analysis and estimates concerning the costs and/or benefits of the proposed amendments.

A. Benefits

1. Elimination of Conflicting and Duplicative Regulation

The proposed amendments to Rule 15c3–3 benefit broker-dealers by eliminating certain conflicting regulations for Full FCM/Full BDs. The amendments to Exchange Act Rules 17a–3 and 17a–4 also eliminate duplicative regulations for Notice BDs, which would have been subject to more than one set of recordkeeping rules.

The simplicity of these amendments benefits broker-dealers as well. The CFTC and the SEC, in amending these rules to eliminate duplicative and conflicting regulations, attempted to provide as much flexibility and create as few operational issues and additional costs as possible. Instead of creating a new structure to be used solely for SFPs, the Commissions made changes to the existing rules. Effectively, the proposed amendments allow broker-dealers and FCMs to maintain the same operational structure they use presently for securities and for futures, and simply choose the type of account in which SFPs will be held, therefore determining which regulatory structure will be applicable to SFPs.

2. Customer Understanding

The purpose of these two regulatory schemes is the protection of customer assets. The SEC believes it is important that customers are informed of what regulatory protections apply to the account in which their SFPs are held. If a firm does not allow customers to choose whether their SFP positions will be held in a securities account or a futures account, the disclosure document will help customers understand the regulatory protections applicable to their account. If a firm allows customers to choose whether their SFP positions will be held in a securities account or a futures account, the requirement that a disclosure document be sent to customers describing the protections afforded pursuant to Rule 15c3–3 and SIPA, as well as the protections afforded pursuant to CEA segregation rules will assist the customer in making an informed decision as to which regulatory scheme will protect their account. In addition, the requirement that a broker-dealer obtain a written acknowledgement from the customer indicating that the customer understands that an account will not be protected pursuant to the alternative regulatory scheme commemorates the customer's understanding of this issue, protecting both the customer and the broker-dealer. Without the disclosure document, it would be more difficult for the customer to obtain the information necessary to make an informed decision.

The requirement that the broker-dealer send a disclosure document to customers and obtain a written acknowledgement from them also benefits the broker-dealer. By sending this disclosure document and obtaining the customer's signed acknowledgement, the broker-dealer evidences that the customer has been notified and has agreed to the regulations applicable to an account. If a dispute with the customer were to arise, the broker-dealer may use the signed acknowledgement as evidence that the customer consented to the regulatory program that applied to the account.

3. Examination Efficiencies

Certain of the requirements included in the amendments are designed to assure that examinations of broker-dealers proceed in an efficient and effective manner. If the regulatory agency staff is unable to ascertain which regulatory structure is applicable to each customer account or what procedures the broker-dealer employs with relation to the administration of those accounts, it must spend more time at the firm to research and evidence these issues. This increases the time of examinations and similarly increases the costs both to the regulatory agency conducting the examination and to the broker-dealer, which must provide additional documentation and staff time to answer the regulatory agency staff's questions.

B. Costs

The amendments were drafted to permit flexibility in the creation of records in order to reduce the costs to broker-dealers. In addition, records created pursuant to the proposed amendments would be subject to the Exchange Act Rule 17a–4 maintenance requirements, which provide a number of options as to how a broker-dealer may maintain records. This gives each broker-dealer the flexibility to choose the least costly method to comply with the rules based upon its present processes and systems capabilities.

In addition, the cost of these proposed amendments is difficult to ascertain because they would vary widely due to differences both in the amount of SFP business in which a broker-dealer may engage and the current recordkeeping systems employed by the broker-dealer.

1. Addition of Paragraph 15c3–3(o)

a. Establishment of a Written Policy

Pursuant to proposed paragraph (o)(1)(ii) of Rule 15c3–3, a Full FCM/Full BD that effects transactions in SFPs for customers must establish a written policy describing how customer SFP positions will be treated, and, if applicable, the process by which a customer may elect the regulatory scheme that will apply to an account. Only broker-dealers that decide to effect transactions in SFPs for customers must draft these policies. SRO rules presently require that a broker-dealer establish written procedures to supervise the types of business in which it engages.[81] Thus, a Full FCM/Full BD would need to establish these procedures regardless of this amendment to Rule 15c3–3.

[81] *E.g.,* NASD Rule 3010.

Accordingly, the SEC estimates there is no cost associated with this amendment.

b. Furnishing a Disclosure Document to Customers

Pursuant to proposed new paragraph (o)(2)(i) of Rule 15c3–3, a broker-dealer that effects transactions in SFPs for customers must provide each of those customers with a disclosure document containing certain information. The SEC believes there would be two costs associated with furnishing this disclosure document; the initial, one-time cost to create the document, and the cost of printing and sending the disclosure document to customers.

The SEC understands that various industry groups are working to create template disclosure documents for use by the broker-dealer and FCM community. The creation of a template should decrease the cost to broker-dealers; however, each broker-dealer that creates such a disclosure document will still need to review the available template(s) to determine whether the template satisfies the requirements of the proposed rule as applied to the broker-dealer's own business, and whether it wants to tailor the document for its own purposes. Rule 15c3–3 applies to clearing firms that will carry accounts in which SFPs are held for the benefit of customers. As of December 31, 2000, there were 425 registered broker-dealers doing a public business and not claiming an exemption from Rule 15c3–3 (''clearing and carrying firms''). In addition, only firms that plan to effect transactions in and hold SFPs for the benefit of customers will be required to comply with this rule. As of March 31, 2001, 90 broker-dealers were registered with the CFTC as FCMs, 63 of which are clearing and carrying firms. Based upon conversations between the SEC and industry representatives regarding the number of firms that may conduct a SFP business, the SEC Staff estimates that the number of firms that will decide to engage in this business, in addition to the broker-dealers already registered with the CFTC as FCMs, is 10% of the clearing and carrying firms not presently registered with the CFTC. Therefore, the SEC Staff estimates that approximately 100 firms (63 + ((425 − 63) × 10%))) will be required to create a disclosure document. For each firm that does create a disclosure document, the SEC Staff estimates (based on its experience) that, on average, one attorney will spend approximately 20 hours to create the disclosure document, and one senior attorney will spend approximately 8 hours reviewing and editing the document. According to the Securities Industry Association (''SIA''), the hourly cost of an attorney is approximately $156.00[82] and the hourly cost of a deputy general counsel is $225.00.[83] Thus, the total, one-time cost of creating a disclosure document is approximately $492,000 (or (($156.00 × 20 hours) + ($225.00 × 8 hours)) × 100 broker-dealers).

The costs of printing the disclosure documents will be based on the number of customer accounts that will be opened to effect transactions in SFPs. At this time, it is not clear how many customers will want to engage in this type of business. As of December 31, 2000, broker-dealers reported that they maintained 97,600,000 customer accounts.[84] The SEC Staff estimates, based on conversations with industry groups, that 8% of these customers may engage in SFP transactions[85] (97,600,000 accounts × 8% = 7,808,000).

The costs of printing and sending the disclosure document to customers will be based on the number of customer accounts that will be opened by customers to effect transactions in SFPs. As discussed above, the SEC Staff estimates that 7,808,000 customers may engage in SFP transactions. In addition, the SEC Staff estimates that the cost of printing and sending each disclosure document will be approximately $.10 per document sent.[86] Thus, the cost of printing and sending the document required pursuant to proposed paragraph 15c3–3(o) will be approximately $780,800 (or (7,808,000 × $.10)).[87]

c. Obtaining an Acknowledgement From Customers

Pursuant to proposed new paragraph (o)(2)(ii) of Rule 15c3–3, a broker-dealer that effects transactions in SFPs for customers must obtain an acknowledgement from each such customer indicating that the customer understands which regulatory structure will apply and which will not apply to an account in which SFP transactions are effected or held. The SEC believes that broker-dealers will send the acknowledgement form to customers along with the disclosure document, thus substantially reducing the cost of sending the acknowledgement to customers. Aside from the postage costs, there are still costs that will be incurred relating to the development of the document and printing the documents to be sent. In addition, broker-dealers will incur processing costs relating to receipt, tracking, and filing the signed acknowledgements.

As an acknowledgement would be far more simple to create than a disclosure document, and in fact could be incorporated into the disclosure document, the SEC Staff estimates (based on its experience) that, on average, for each broker-dealer that creates these documents, one attorney will spend approximately 2 hours to create the acknowledgement or that portion of the disclosure document that must be returned by the customer as an acknowledgement, and one senior attorney will spend approximately 1 hour reviewing and editing the document. As stated above, the SEC Staff estimates that 100 broker-dealers will create an acknowledgement. According to the SIA, the hourly cost of an attorney is approximately $156.00[88] and the hourly cost of a deputy general counsel is $225.00.[89] Thus, the total, one-time cost of creating an acknowledgement or that portion of the disclosure document that must be returned by the customer as an acknowledgement is approximately $53,700 (or ($156.00 × 2) + ($225.00 × 1) × 100 broker-dealers).

The costs of printing the acknowledgement to be sent as part of or along with the disclosure document to customers will be based on the number of customer accounts that will be opened to effect transactions in SFPs. The SEC Staff estimates that the cost of printing each acknowledgement will be, on average, approximately $.045 per document sent.[90] As discussed above, the SEC Staff estimates that 7,808,000 customers may want to engage in SFP transactions. Thus, the total cost of printing the acknowledgement will be approximately $351,360 (or (7,808,000 × $.045)).[91]

When the customer returns these acknowledgements, the broker-dealer will need to process and file them. All

[82] Based on the SIA's *Report on Management and Professional Earnings in the Securities Industry 2000,* Tables 107 (Attorney) and 108 (Compliance Attorney) plus 35% overhead.

[83] Based on the SIA's *Report on Management and Professional Earnings in the Securities Industry 2000,* Table 110 (Deputy General Counsel) plus 35% overhead.

[84] December 31, 2000, FOCUS Schedule 1 filings.

[85] The SEC Staff derived its estimate from the number of active options accounts and conversations with industry representatives.

[86] This estimate is based on past conversations with industry representatives regarding other rule changes which required similar printing and postage costs. Postage may be minimized by including the disclosure document with other information mailed to customers.

[87] However, it should be noted that the SEC Staff believes it to be unlikely that broker-dealers will experience 100% turnover in the number of SFP accounts, so these costs may decrease in subsequent years.

[88] *See* note 82.

[89] *See* note 83.

[90] *See* note 86.

[91] *See* note 87.

customers that want to effect transactions in SFPs will need to return the acknowledgement. Therefore, based on the above estimates, broker-dealers will need to process 7,808,000 acknowledgements. The SEC Staff estimates that it will take 5 minutes to process each acknowledgement.[92] The SEC Staff believes that a broker-dealer would have a new accounts clerk process the acknowledgements as part of the required account documents. According to the SIA, the hourly cost of a new accounts clerk is approximately $23.40.[93] Thus, the total cost of processing these acknowledgements will be approximately $15.2 million (($23.40 per hour × (5min/60min)) × 7,808,000 accounts).[94]

d. Creation of a Record of Changes of Account Type

Pursuant to proposed new paragraph (o)(3)(i) of Rule 15c3–3, a broker-dealer that changes the type of account in which a customer's SFPs are held must create a record of each change in account type that includes the name of the customer, the account number, the date the broker-dealer received the customer's request to change the account type, and the date the change in account type took place. The SEC Staff believes that not all broker-dealers that effect transactions in SFPs for customers will allow for changes in account type. To the extent that a broker-dealer does provide for changes of account type, these data items are the type of information that would be easily accessed or created and maintained; therefore the SEC Staff believes the costs of maintaining this information will be minimal. As discussed above, the SEC Staff estimates that 7,808,000 customers may want to engage in SFP transactions. Further, the SEC Staff estimates that at most 20% per year may change account type.[95] Thus, broker-dealers would be required to create this record for, at most, 1,561,600 accounts (or 7,808,000 accounts × 20%). The SEC Staff believes that broker-dealers will have operations clerks create this record, and estimates that it will take an operations clerk approximately 3 minutes to create each record.[96] According to the SIA, the hourly cost of an operations specialist is approximately $42.00.[97] Thus, the total annual cost of creating this record of change of account type will be, at most, $3,279,360 (or ((1,561,600 accounts × (3min/60min)) × $42.00).

e. Obtaining an Acknowledgement from Customers

Pursuant to proposed new paragraph (o)(3)(ii) of Rule 15c3–3, a broker-dealer that changes the type of account in which a customer's SFPs are held must obtain an acknowledgement from each customer whose account type was changed indicating that the customer understands which regulatory structure will apply and which will not apply to that account. As discussed above, the SEC Staff estimates that, at most, 1,561,600 accounts per year may change account type; thus, broker-dealers would be required to obtain an acknowledgement from, at most, 1,561,600 customers per year. The SEC Staff believes that a broker-dealer would have a new accounts clerk process the acknowledgements as part of the required account documents, and that it would take the new accounts clerk approximately 5 minutes to process each acknowledgement. According to the SIA, the hourly cost of a new accounts clerk is approximately $23.40.[98] Thus, the total cost of processing these acknowledgements will be approximately $3 million (($23.40 × (5min/60min)) × 1,561,600 accounts).

f. Customer Notification of Effective Date of Change of Account Type

Pursuant to proposed new paragraph (o)(3)(iii) of Rule 15c3–3, a broker-dealer that changes the type of account in which a customer's SFPs are held must promptly notify the customer in writing of the date that change became effective. The SEC Staff believes that there are two costs associated with providing this notification to customers: The initial, one-time cost to draft the notification, and the cost of printing and sending the notification to customers.

The SEC Staff estimates (based on its experience) that, on average, one attorney will spend approximately 3 hours to create the notification, and one senior attorney will spend approximately 30 minutes reviewing and editing the document. According to the SIA, the hourly cost of an attorney is approximately $156.00[99] and the hourly cost of a deputy general counsel is $225.00.[100] Thus, the total, one-time cost of drafting the notification is approximately $58,050 (or ((156.00 × 3 hours) + ($225 × (30 min/60 min))) × 100 broker-dealers)).

As discussed above, the SEC estimates that 1,561,600 accounts per year may change account type; thus, broker-dealers would be required to send this notification to 1,561,600 customers. The SEC Staff believes that firms will use the least cost method to comply with these requirements, and will probably include this notification with other mailings sent to the customer. The SEC Staff estimates that the cost of printing and posting each notification will be approximately $.10 per document sent.[101] Therefore, the SEC Staff estimates that the cost of sending this notification to customers will be $156,160 (1,561,600 accounts × $.10).

2. Amendments to Rule 17a–4

The proposed amendments to Rule 17a–4 clarify that the records required to be created pursuant to new paragraph 15c3–3(o) must be maintained for at least three years, the first two in an easily accessible place. Once the broker-dealer files these records, the cost to maintain them is minimal. The SEC believes that the main cost would be the cost to assure that the broker-dealer is in compliance with the rule. The SEC Staff estimates that, on average, one compliance person will spend approximately 1 hour per year to assure that the broker-dealer is in compliance with the record maintenance provisions of paragraph 17a–4(b)(9) as it relates to new paragraph 15c3–3(o). According to the SIA, the hourly cost of a compliance manager is approximately $101.25.[102] Thus, the total yearly cost of assuring compliance with the proposed amendment to Rule 17a–4 is approximately $10,125 (or (101.25 × 1 hour) × 100 broker-dealers).

New paragraph 17a–4(k) would require a broker-dealer that engages in a SFP business, upon request of the SEC,

[92] As the majority of clearing and carrying firms use automated account recordkeeping systems, the SEC Staff believes that ''processing'' would consist of; accessing the customer account record and noting receipt of the acknowledgement, then filing or scanning the acknowledgement. This estimate is based on representations made by industry representatives relating to other rule changes that included similar processing requirements.

[93] Based on the SIA's *Report on Office Salaries In the Securities Industry 2000,* Table 062 (New Accounts Clerk) plus 35% overhead.

[94] *See* note 87.

[95] The SEC Staff does not believe that all broker-dealers that choose to engage in an SFP business will allow for changes of account type because it may be costly to do so. In addition, it is unlikely that many customers will change their account type once they have signed an acknowledgement. To the best of the SEC Staff's knowledge, there is no existing similar procedure to use as a basis for comparison.

[96] In fact, the SEC Staff believes that most firms will have this process automated. To the extent that no person need be involved in the generation of this record, the costs will be minimal.

[97] Based on the SIA's *Report on Office Salaries In the Securities Industry 2000,* Table 119 (Operations Specialist) plus 35% overhead.

[98] *See* note 93.

[99] *See* note 82.

[100] *See* note 83.

[101] *See* note 86.

[102] Based on the SIA's *Report on Management and Professional Earnings in the Securities Industry 2001,* Table 051 (Compliance Manager) plus 35% overhead.

to request from its customers and provide to the SEC documentation of cash transactions underlying exchanges of security futures products for the underlying security(ies). Broker-dealers can include an agreement that customers provide the broker-dealer with this documentation in many other account opening agreements or in the acknowledgement document, which must be created and the cost of which is discussed above. It has not yet been determined whether SFPs will be cash settled or physically settled. In addition, this is not a record which the broker-dealer would be required to create or maintain on a regular basis, but instead, a broker-dealer would create this record only when specifically requested by the SEC.

The SEC Staff believes this requirement to be analogous to bluesheet requests made by the SEC to broker-dealers. Bluesheet requests are only sent to clearing firms, 661 of which were registered with the SEC as of December 31, 2000.[103] The SEC sent 32,278 bluesheet request letters to 294 broker-dealers from January 1, 2000 to December 31, 2000. Thus, 45% of the broker-dealers that could be affected received letters, and those broker-dealers that did receive letters received, on average, 110 letters each. Therefore, the SEC Staff estimates that 45 clearing and carrying firms that engage in SFP business will receive approximately 110 requests for the information required to be collected and provided pursuant to proposed paragraph (k) of Rule 17a–4, or a total of 4,950 requests. The SEC Staff estimates (based on its experience) that it will take approximately 2 hours for a compliance manager to respond to a request to provide this information to a regulator. Therefore, the SEC Staff believes that it would take a total of approximately 9,900 hours, for a total cost of $1,002,375 per year for broker-dealers to comply with this requirement ((4,950 requests x 2 hours per request) = 9,900 hours per year; (9,900 hours per year × $101.25 per hour[104] = $1,002,375).

3. Systems Changes

The SEC Staff believes that broker-dealers may need to update their systems to provide for the printing and sending of disclosure documents and acknowledgements to SFP customers, and to create and maintain information as to changes of account type. The SEC Staff further believes, based on conversations with industry representatives, that many broker-dealers have not yet updated their systems to provide for the trading and processing of SFPs as certain specifications of these products have not been finalized. Due to this, the Staff believes that any systems coding changes needed to comply with the proposed amendments to Rules 15c3–3, 17a–3, 17a–4, 17a–5, 17a–7, 17a–11, and 17a–13 could be incorporated into the initial coding for these products, thus greatly decreasing the costs generally associated with systems changes. Therefore, the SEC Staff estimates that it may cost the broker-dealers engaging in this business approximately $2.4 million[105] to update their systems to comply with the proposed amendments to Rules 15c3–3, 17a–3, 17a–4, 17a–5, 17a–7, 17a–11, and 17a–13.

VII. Consideration of Burden on Competition, and Promotion of Efficiency, Competition, and Capital Formation

Section 3(f) of the Exchange Act[106] provides that whenever the SEC is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the SEC shall consider whether the action will promote efficiency, competition, and capital formation. The proposed amendments, which are intended to allow firms that plan to effect transactions in and hold SFPs for the benefit of customers a method to choose which type of regulatory structure will be applied to those customer positions, should serve as an efficient and cost-effective means for those entities to reconcile their conflicting customer protection and segregation requirements with respect to SFPs. These amendments should promote efficiency because they allow firms the flexibility to utilize their present systems for processing SFPs, allow firms and/or customers to choose the regulatory scheme that will be applied to accounts in which customer SFP positions are held, and educate customers regarding the different regulatory schemes, which may be applicable to their accounts, that serve to protect their assets.

Section 23(a)(2) of the Exchange Act[107] requires the SEC, in adopting Exchange Act rules, to consider the impact any such rule would have on competition and to not adopt a rule that would impose a burden on competition not necessary or appropriate in furthering the purposes of the Exchange Act. The SEC preliminarily believes the proposed amendments are necessary to eliminate conflicting or duplicative rules regarding customer protection and recordkeeping applicable to SFPs. The proposed amendments would allow Full FCM/Full BDs the flexibility to choose whether SFPs will be held in a futures account (subject to the CEA segregation requirements) or a securities account (subject to the Exchange Act and SIPA requirements), and consequently whether certain CEA or Exchange Act recordkeeping and reporting requirements, as well as requirements to reconcile all positions at least quarterly, will apply. This allows these Full FCM/Full to apply whatever regulatory scheme would be less burdensome. The proposed amendments would also exempt certain Notice BDs from Exchange Act Rules 17a–3, 17a–5, 17a–7, 17a–11, and 17a–13 because the CFTC has similar rules that would apply to these firms. Because the purpose of the proposed amendments is to eliminate conflicting and duplicative regulation with relation to Exchange Act section 15c(3) and 17(a)[108] in light of the CFMA, the SEC preliminarily believes that our proposals will not create any anti-competitive effects and in fact should promote competition by decreasing the costs associated with engaging in an SFP business.

The SEC requests comment on whether the proposed amendments are expected to promote efficiency, competition, and capital formation.

VIII. Summary of Regulatory Flexibility Act Certification

CFTC

The Regulatory Flexibility Act (''RFA'')[109] requires that agencies, in proposing rules, consider the impact of those rules on small businesses.[110] The proposed rules would apply to firms that are registered with the CFTC as FCMs. The CFTC has previously established certain definitions of ''small entities'' to be used by the CFTC in evaluating the impact of its rules on such entities in accordance with the RFA.[111] The CFTC has previously determined that FCMs are not small entities for the purpose of the RFA.[112] In defining ''small entities'' for the purpose of the RFA, the CFTC excluded FCMs based on the fiduciary nature of FCM-customer relationships and the minimum financial requirements that

[103] *See* note 84.

[104] *See* note 102.

[105] This estimate is based on representations made by industry representatives relating to other rule changes that included similar systems modifications.

[106] 15 U.S.C. 78c(f).

[107] 15 U.S.C. 78w(a)(2).

[108] 5 U.S.C. 78*o*(c)(3) and 15 U.S.C. 78q(a).

[109] 5 U.S.C. 601 *et seq.*

[110] 5 U.S.C. 603(a).

[111] 47 FR 18618 (April 30, 1982)

[112] *Id.* at 18619.

apply to FCMs.[113] Accordingly, the Acting Chairman, on behalf of the CFTC, certifies pursuant to Section 5(b) of the RFA [114] that the proposed rules will not have a significant economic impact on a substantial number of small entities.

SEC

Section 3(a) of the RFA [115] requires the SEC to undertake an initial regulatory flexibility analysis of the effects of proposed rules and rule amendments on small entities, unless the SEC Chairman certifies that the rules and rule amendments, if adopted, would not have a significant economic impact on a substantial number of small entities.[116]

These proposed amendments to Rules 15c3–3 and 17a–4 would only apply to firms that plan to effect transactions in and hold SFPs for the benefit of customers. In addition, these provisions would apply only to broker-dealers that carry customer funds, securities or property and do not claim an exemption from Rule 15c3–3 (''clearing and carrying firms''). As of December 31, 2000, there were 425 registered clearing and carrying firms. As of March 31, 2001, 90 broker-dealers were registered with the CFTC as FCMs, 63 of which are clearing and carrying firms. Of these clearing and carrying firms registered with the SEC, 16 would be considered to be small entities,[117] none of which is registered with the CFTC as a FCM. In conversations with the SEC Staff, broker-dealers have expressed the view that they are uncertain as to how many firms, aside from those that are already registered with the CFTC to engage in a commodity and futures business, will conduct a SFP business. Based upon these conversations, the Staff estimates that the number of firms that will decide to engage in this business, in addition to the broker-dealers already registered with the CFTC as FCMs, is 10% of the clearing and carrying firms not presently registered with the CFTC. Thus, the Staff estimates that approximately 100 firms $(63 + ((425 - 63) \times 10\%))$ will be required to comply with these proposed amendments. Using the 10% estimate, the Staff believes that up to two small business entities may decide to engage in this type of business and therefore could be affected by the proposed amendments, but that the proposed amendments would not have a significant economic impact on a substantial number of small business entities.

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

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

IX. Text of Proposed Rules

List of Subjects

17 CFR Part 1

Consumer protection, Definitions, Reporting and recordkeeping requirements.

17 CFR Part 41

Security futures products, Customer protection.

17 CFR Part 190

Consumer protection, Definitions, Reporting and recordkeeping requirements.

17 CFR Part 240

Brokers, Customer protection, Dealers, Securities.

17 CFR Chapter I

Commodity Futures Trading Commission.

In accordance with the foregoing, the Commodity Futures Trading Commission hereby proposes to amend Chapter I of Title 17 of the Code of Federal Regulations as follows:

PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

1. The authority citation for Part 1 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6j, 6k, 6l, 6m, 6n, 6o, 6p, 7, 7a, 7b, 8, 9, 12, 12a, 12c, 13a, 13a–1, 16, 16a, 19, 21, 23, 24, as amended by the Commodity Futures Modernization Act of 2000, Appendix E of Pub. L. No. 106–554, 114 Stat. 2763 (2000).

2. Section 1.3 is amended by adding paragraphs (gg)(4), (vv) and (ww) to read as follows:

§ 1.3 Definitions.

* * * * *

(gg) * * *

(4) Notwithstanding paragraphs (gg)(1), (2) and (3) of this section, the term customer funds shall exclude money, securities or property held to margin, guarantee or secure security futures products held in a securities account, and all money accruing as the result of such security futures products.

* * * * *

(vv) *Futures account.* This term means an account governed by the segregation requirements of Section 4d of the Commodity Exchange Act and the rules thereunder.

(ww) *Securities account.* This term means an account governed by the reserve requirements of Section 15 of the Securities Exchange Act of 1934 and the rules thereunder.

3. Section 1.55 is amended by adding paragraph (h) to read as follows:

§ 1.55 Distribution of ''Risk Disclosure Statement'' by futures commission merchants and introducing brokers.

* * * * *

(h) Notwithstanding any other provision of this section or § 1.65, a person registered or required to be registered with the Commission as a futures commission merchant pursuant to Sections 4f(a)(1) or 4f(a)(2) of the Commodity Exchange Act and registered or required to be registered with the Securities and Exchange Commission as a broker or dealer pursuant to Sections 15(b)(1) or 15(b)(11) of the Securities Exchange Act of 1934 and rules thereunder must provide to a customer or prospective customer, prior to the acceptance of any order for, or otherwise handling any transaction in or in connection with, a security futures product for a customer, the disclosures set forth in § 41.42(b)(1) of this chapter.

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[113] *Id.*

[114] 5 U.S.C. 605(b).

[115] *See* note 110.

[116] *See* note 114.

[117] Pursuant to 17 CFR § 240.0–10, ''the term *small business* or *small organization* shall: [* * *] (c) [w]hen used with reference to a broker or dealer, mean a broker or dealer that: (1) [h]ad total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which is audited financial statements were prepared pursuant to § 240.17–5(d) or, if not required to file such statements, a broker or dealer that 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) [i]s not affiliated with any person (other than a natural person) that is not a small business or small organization as defined in this section * * *'' (17 CFR § 240.0–10(c)). Further, pursuant to § 240.0–10(i), ''[f]or purposes of paragraph (c) of this section, a broker or dealer is affiliated with another person if [* * *] [s]uch broker or dealer introduces transactions in securities, other than registered investment company securities or interests or participations in insurance company separate accounts, to such other person or introduces accounts of customers or other brokers or dealers, other than accounts that hold only registered investment company securities or interests or participations in insurance company separate accounts, to such other person that carries such accounts on a fully disclosed basis.'' (17 CFR § 240.0–10(i)).

PART 41—SECURITY FUTURES PRODUCTS

4. The authority citation for Part 41 continues to read as follows:

Authority: Section 252, Pub. L. 106–554, 114 Stat. 2763, 7 U.S.C. 1a, 2, 6f, 6j, 7a-2, 12a.

5. Section 41.42 is added to read as follows:

§ 41.42 Security futures products accounts.

(a) *Where security futures products may be held.* (1) A person registered with the Commission as a futures commission merchant pursuant to Section 4f(a)(1) of the Commodity Exchange Act (''CEA'') and registered with the Securities and Exchange Commission (''SEC'') as a broker or dealer pursuant to Section 15(b)(1) of the Securities Exchange Act of 1934 (''Securities Exchange Act'') (''Full FCM/Full BD'') may hold a customer's security futures products in a futures account or a securities account. A person registered with the Commission as a futures commission merchant pursuant to Section 4f(a)(2) of the CEA (a notice-registered FCM) may hold a customer's security futures products only in a securities account. A person registered with the SEC as a broker or dealer pursuant to Section 15(b)(11) of the Securities Exchange Act (a notice-registered broker-dealer) may hold a customer's security futures products only in a futures account.

(2) If the futures commission merchant is also a broker or dealer registered pursuant to Section 15(b)(1) of the Securities Exchange Act, the futures commission merchant shall establish a written policy describing whether customer security futures products will be placed in a futures account or a securities account and, if applicable, the process by which a customer may elect the type of account in which security futures products will be held (including the procedure to be followed if a customer fails to make an election of account type).

(b) *Disclosure requirements.* Before a futures commission merchant accepts an order for a security futures product from a customer, the firm shall:

(1) Furnish the customer with a disclosure document containing the following information:

(i) A description of the protections provided by the requirements set forth under Section 4d of the CEA applicable to a futures account;

(ii) A description of the protections provided by the requirements set forth under Securities Exchange Act Rule 15c3–3 and the Securities Investor Protection Act of 1970 applicable to a securities account;

(iii) A statement indicating whether the customer's security futures products will be held in a futures account or a securities account, or whether the firm permits customers to make or change an election of account type; and

(iv) A statement that, with respect to holding the customer's security futures products in a securities account or a futures account, the alternative regulatory scheme is not available to the customer in connection with that account.

(2) Obtain an acknowledgement that includes the dated signature of each owner of the account stating that the customer understands that the account will not be protected under the alternative regulatory scheme, if the futures commission merchant is also a broker or dealer registered pursuant to Section 15(b)(1) of the Securities Exchange Act.

(c) *Changes in account type.* A Full FCM/Full BD may change the type of account in which a customer's security futures products will be held, *Provided,* That:

(1) The firm shall create a record of each change in account type, including the name of the customer, the account number, the date the firm received the customer's request to change the account type, if applicable, and the date the change in account type became effective;

(2) Before the date the change in account types becomes effective, the firm must obtain an acknowledgement that includes the dated signature of each owner of the account stating that the customer understands that the account in which the security futures products will be held will not be protected pursuant to the alternative regulatory scheme; and

(3) The firm shall promptly notify the customer in writing of the date that the change became effective.

(d) *Recordkeeping requirements.* The Commission's recordkeeping rules shall apply to security futures products held in a futures account. The SEC's recordkeeping rules shall apply to security futures products held in a securities account and compliance therewith is required under this section.

(e) *Reports to customers.* The Commission's reporting requirements set forth in §§ 1.33 and 1.46 of this chapter shall apply to futures commission merchants holding security futures products in a futures account.

(f) *Segregation of customer funds.* All money, securities, or property held to margin, guarantee or secure security futures products held in a futures account, or accruing to customers as a result of such products, are subject to the segregation requirements of Section 4d of the CEA and the rules thereunder.

PART 190—BANKRUPTCY

6. The authority citation for Part 190 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 6c, 6d, 6g, 7a, 12, 19 and 24, and 11 U.S.C. 362, 546, 548, 556 and 761–766, unless otherwise noted.

7. Section 190.01 is amended by revising paragraph (f) and by adding paragraph (kk)(9) to read as follows:

§ 190.01 Definitions.

* * * * *

(f) *Commodity broker* means any person who is registered or required to register as a futures commission merchant under the Commodity Exchange Act including a person registered or required to be registered as such under parts 32 and 33 of this chapter, and a ''commodity options dealer,'' ''foreign futures commission merchant,'' ''clearing organization,'' and ''leverage transaction merchant'' with respect to which there is a ''customer'' as those terms are defined in this section, but excluding a person registered as a futures commission merchant under section 4f(a)(2) of the Commodity Exchange Act.

* * * * *

(kk) * * *

(9) Notwithstanding any other provision of this paragraph (kk), security futures products, and any money, securities or property held to margin, guarantee or secure such products, or accruing as a result of such products, shall not be considered specifically identifiable property for the purposes of Subchapter IV of the Bankruptcy Code or this part 190, if held in a securities account.

* * * * *

8. Section 190.02 is amended by:

a. Removing the period and in its place adding a '';'' at the end of paragraph (d)(8);

b. Redesignating paragraphs (d)(11) and (d)(12) as paragraphs (d)(12) and (d)(13), respectively; and

c. Adding a new paragraph (d)(11).

The revisions and additions read as follows:

§ 190.02 Operation of the debtor's estate subsequent to the filing date and prior to the primary liquidation date.

* * * * *

(d) * * *

(11) Whether the claimant's positions in security futures products are held in a futures account or a securities account, as these terms are defined in

§§ 1.3(vv) and (ww) of this chapter, respectively;

* * * * *

9. Section 190.07 is amended by revising paragraph (b)(1)(iii)(B)(*3*) and removing the undesignated paragraph following (b)(1)(iii)(B)(*3*) to read as follows:

§ 190.07 Calculation of allowed net equity.

* * * * *

(b) * * *

(1) * * *

(iii) * * *

(B) * * *

(3) The normal costs attributable to the payment of commissions, brokerage, interest, taxes, storage, transaction fees, insurance and other costs and charges lawfully incurred in connection with the purchase, sale, exercise, or liquidation of any commodity contract in such account. For purposes of this paragraph (b)(1), the open trade balance of a customer's account shall be computed by subtracting the unrealized loss in value of the open commodity contracts held by or for such account from the unrealized gain in value of the open commodity contracts held by or for such account. In calculating the ledger balance or open trade balance of any customer, exclude any security futures products, any gains or losses realized on trades in such products, any property received to margin, guarantee or secure such products (including interest thereon or the proceeds thereof), to the extent any of the foregoing are held in a securities account, and any disbursements to or on behalf of such customer in connection with such products or such property held in a securities account.

* * * * *

10. Section 190.08 is amended by revising paragraphs (a)(2)(v) and (a)(2)(vi) and by adding paragraph (a)(2)(vii) to read as follows:

§ 190.08 Allocation of property and allowance of claims.

* * * * *

(a) * * *

(2) * * *

(v) Property deposited by a customer with a commodity broker after the entry of an order for relief which is not necessary to meet the maintenance margin requirements applicable to the accounts of such customer;

(vi) Property hypothecated pursuant to § 1.30 of this chapter to the extent of the loan of margin with respect thereto; and

(vii) Money, securities or property held to margin, guarantee or secure security futures products, or accruing as a result of such products, if held in a securities account.

* * * * *

11. Section 190.10 is amended by adding paragraph (h) to read as follows:

§ 190.10 General.

* * * * *

(h) *Rule of construction.* Contracts in security futures products held in a securities account shall not be considered to be ''from or for the commodity futures account'' or ''from or for the commodity options account'' of such customers, as such terms are used in section 761(9) of the Bankruptcy Code.

12. Appendix A to Part 190 is amended by adding Item III g. to BANKRUPTCY APPENDIX FORM 4—PROOF OF CLAIM to read as follows:

APPENDIX A TO PART 190—BANKRUPTCY FORMS

* * * * *

BANKRUPTCY APPENDIX FORM 4—PROOF OF CLAIM

* * * * *

* * * * *

III. * * *

g. Whether the claimant's positions in security futures products are held in a futures account or a securities account, as these terms are defined in §§ 1.3(vv) and (ww) of this chapter, respectively.

* * * * *

By the Commodity Futures Trading Commission.

Dated: September 26, 2001.

Jean A. Webb,

Secretary of the Commission.

Securities and Exchange Commission

17 CFR Chapter II

The amendments are proposed pursuant to the authority conferred on the Securities and Exchange Commission by the Exchange Act, including Sections 3(b), 15(c)(3), 17(a), and 23(a).

In accordance with the foregoing, the Securities and Exchange Commission hereby proposes that Title 17 Chapter II of the Code of Federal Regulations 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 the following citations to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78k, 78k–1, 78*l,* 78m, 78n, 78o, 78p, 78q, 78s, 78u–5, 78w, 78x, 78*ll,* 78mm, 79q, 79t, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4 and 80b–11, unless otherwise noted.

* * * * *

Section 240.15c3–3 is also issued under Secs. 15(c)(2), 15(c)(3), 17(a), 23(a), 48 Stat. 895, 897, 901, secs. 3, 4, 8, 49 Stat. 1377, 1379, secs. 2, 5, 52, Stat. 1075, 1076, sec. 7(d), 84 Stat. 1653; 15 U.S.C. 78*o*(c), 78q(a), 78w(a); sec. 6(c), 84 Stat. 1652; 15 U.S.C. 78fff.

Section 240.15c3–3(o) is also issued under Pub. L. 106–554, 114 Stat. 2763, section 203.

* * * * *

2. The authority citation following § 240.15c3–3, is removed.

3. Section 240.15c3–3 is amended by:

a. Amending paragraph (a)(1) by adding a new sentence following the fourth sentence;

b. Adding paragraphs (a)(l4) and (a)(15); and

c. Adding paragraph (o).

The revisions and additions read as follows:

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

(a) * * *

(1) * * * In addition, the term shall not include a person to the extent that the person has a claim for security futures products held in a futures account. * * *

* * * * *

(14) The term *securities account* shall mean the account of a customer.

(15) The term *futures account* (also referred to as ''commodity account'') shall mean an account in which security futures products are held but which is not otherwise a securities account.

* * * * *

(o) *Security futures products*—(1) *Where security futures products shall be held.* A broker or dealer registered with the Commission pursuant to 15(b)(1) of the Act (15 U.S.C. 78*o*(b)(1)) that is also a futures commission merchant registered pursuant to Section 4f(a)(1) of the Commodity Exchange Act (7 U.S.C. 6f(a)(1)):

(i) May hold a customer's security futures products in a securities account or a futures account; and

(ii) Shall establish a written policy describing whether customer security futures products will be placed in a securities account or a futures account and, if applicable, the process by which a customer may elect the type of account in which security futures products will be held (including the procedure to be followed if a customer fails to make an election of account type).

(2) *Disclosure and record requirements.* Before a broker or dealer accepts an order for a security futures product from a customer, the broker or dealer shall:

(i) Furnish the customer with a disclosure document containing the following information:

(A) A description of the protections provided by the requirements set forth under this section and the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa *et seq.*) applicable to a securities account;

(B) A description of the protections provided by the requirements set forth under Section 4d of the Commodities Exchange Act (7 U.S.C. 6d) applicable to a futures account;

(C) A statement indicating whether the customer's security futures products will be held in a securities account or futures account, or whether the firm permits customers to make or change an election of account type; and

(D) A statement that, with respect to holding the customer's security futures products in a securities account or a futures account, the alternative regulatory scheme is not available to the customer with relation to that account.

(ii) Obtain, if the broker or dealer is also a futures commission merchant registered pursuant to Section 4f(a)(1) of the Commodity Exchange Act (7 U.S.C. 6f(a)(1)), an acknowledgement, that includes the dated signature of each owner of the account, stating that the customer understands that the account will not be protected under the alternative regulatory scheme.

(3) *Changes in account type.* A broker or dealer registered with the Commission pursuant to section 15(b)(1) of the Act (15 U.S.C. 78*o*(b)(1)) that is also a futures commission merchant registered pursuant to Section 4f(a)(1) of the Commodity Exchange Act (7 U.S.C. 6f(a)(1)) may change the type of account in which a customer's security futures products will be held, *Provided* that:

(i) The broker or dealer shall create a record of each change in account type, including the name of the customer, the account number, the date the broker or dealer received the customer's request to change the account type, if applicable, and the date the change in account type became effective.

(ii) Before the date the change in account types becomes effective, the broker-dealer must obtain an acknowledgement that includes the dated signature of each owner of the account, stating that the customer understands that the account in which the security futures products will be held will not be protected under the alternative regulatory scheme.

(iii) The broker or dealer shall promptly notify the customer in writing of the date that the change became effective.

4. Section 240.17a–3 is amended by adding paragraph (f) to read as follows:

§ 240.17a–3 Records to be made by certain exchange members, brokers and dealers.

* * * * *

(f) *Security futures products.* The provisions of this section shall not apply to:

(1) A broker or dealer registered pursuant to section 15(b)(11)(A) of the Act (15 U.S.C. 78*o*(b)(11)(A)) to the extent that it holds or effects transactions in security futures products in a futures account (as that term is defined in § 240.15c3–3(a)(15)); and

(2) A broker or dealer registered pursuant to section 15(b)(1) of the Act (15 U.S.C. 78*o*(b)(1)) that is also a futures commission merchant registered pursuant to section 4f(a)(1) of the Commodity Exchange Act (7 U.S.C. 6f(a)(1)), to the extent that it holds or effects transactions in security futures products in a futures account (as that term is defined in § 240.15c3–3(a)(15)).

5. Section 240.17a–4 is amended by revising paragraph (b)(9) and adding paragraph (k) to read as follows:

§ 240.17a–4 Records to be preserved by certain exchange members, brokers and dealers.

* * * * *

(b) * * *

(9) The records required to be made pursuant to § 240.15c3–3(d)(4) and (o).

* * * * *

(k) Every member, broker or dealer subject to this section that engages in the business of effecting transactions in or holding security future products shall, upon request of representatives of the Commission, request from its customers and, upon receipt thereof, provide to those representatives documentation of cash transactions underlying exchanges of security futures products for securities or exchanges of security futures products in connection with securities transactions.

6. Section 240.17a–5 is amended by redesignating paragraph (a)(5) as paragraph (a)(6) and adding new paragraph (a)(5) to read as follows:

§ 240.17a–5 Reports to be made by certain brokers and dealers.

(a) * * *

(5) The provisions of this paragraph (a) shall not apply to a broker or dealer registered pursuant to section 15(b)(11)(A) of the Act (15 U.S.C. 78*o*(b)(11)(A)) that is not a member of either a national securities exchange pursuant to section 6(a) of the Act (15 U.S.C. 78f(a)) or a national securities association registered pursuant to section 15A(a) of the Act (15 U.S.C. 78*o*–3(a)).

* * * * *

7. Section 240.17a–7 is amended by:

a. Removing from paragraphs (a)(1) and (a)(2) the words ''paragraph (b)'' and in their place adding ''paragraphs (b) and (c)''; and

b. Redesignating paragraph (c) as paragraph (d) and adding new paragraph (c) read as follows:

§ 240.17a–7 Records of non-resident brokers and dealers.

* * * * *

(c) The provisions of this section shall not apply to a broker or dealer registered pursuant to section 15(b)(11)(A) of the Act (15 U.S.C. 78*o*(b)(11)(A)) that is not a member of either a national securities exchange pursuant to section 6(a) of the Act (15 U.S.C. 78f(a)) or a national securities association registered pursuant to section 15A(a) of the Act (15 U.S.C. 78*o*–3(a)).

* * * * *

8. Section 240.17a–11 is amended by adding new paragraph (i) to read as follows:

§ 240.17a–11 Notification provisions for brokers and dealers.

* * * * *

(i) The provisions of this section shall not apply to a broker or dealer registered pursuant to section 15(b)(11)(A) of the Act (15 U.S.C. 78*o*(b)(11)(A)) that is not a member of either a national securities exchange pursuant to section 6(a) of the Act (15 U.S.C. 78f(a)) or a national securities association registered pursuant to section 15A(a) of the Act (15 U.S.C. 78*o*–3(a)).

9. Section 240.17a–13 is amended by redesignating paragraph (e) as paragraph (f) and adding new paragraph (e) to read as follows:

§ 240.17a–13 Quarterly security counts to be made by certain exchange members, brokers, and dealers.

* * * * *

(e) The provisions of this section shall not apply to a broker or dealer registered pursuant to section 15(b)(11)(A) of the Act (15 U.S.C. 78*o*(b)(11)(A)) that is not a member of either a national securities exchange pursuant to section 6(a) of the Act (15 U.S.C. 78f(a)) or a national securities association registered pursuant to section 15A(a) of the Act (15 U.S.C. 78*o*–3(a)).

* * * * *

By the Securities and Exchange Commission.

Dated: September 26, 2001.

Margaret H. McFarland,

Deputy Secretary.

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

APPENDIX A

Regulatory Flexibility Act Certification

I, Harvey L. Pitt, Chairman of the Securities and Exchange Commission (the ''Commission''), hereby certify, pursuant to 5 U.S.C. 605(b), that the proposed amendments to Rules 15c3–3, 17a–3, 17a–4, 17a–5, 17a–7, 17a–11 and 17a–13 under the Securities Exchange Act of 1934 (17 CFR §§ 240.15c3–3, 240.17a–3, 240.17a–4, 240.17a–5, 240.17a–7, 240.17a–11, and 240.17a–13 respectively), would not, if adopted, have a significant economic impact on a substantial number of small entities. These proposed amendments would eliminate conflicting and duplicative regulation relating to the manner in which certain Commission and Commodity Futures Trading Commission customer protection, recordkeeping, reporting, telegraphic notice, and quarterly securities count requirements apply to security futures products.

The proposed amendments would apply only to firms that plan to effect transactions in and hold security futures products for the benefit of customers. In addition, these provisions would apply only to broker-dealers that carry customer funds, securities, or property and do not claim an exemption from Rule 15c3–3.

Accordingly, the proposed amendments, if adopted, would not have a significant economic impact on a substantial number of small entities.

Dated: September 25, 2001.

Harvey L. Pitt,

Chairman.

[FR Doc. 01–24573 Filed 10–3–01; 8:45 am]

BILLING CODE 6351–01–P; 8001–01–P