SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34–46014; File No. S7–19–02]

RIN 3235–AI50

Confirmation Requirements for Transactions of Security Futures Products Effected in Futures Accounts

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: In accordance with the Commodity Futures Modernization Act of 2000 (''CFMA''), the Securities and Exchange Commission (''SEC'' or ''Commission'') is publishing for comment proposed rule amendments and a new rule under the Securities Exchange Act of 1934 (''Exchange Act''). The proposed rule amendments and new rule are designed to clarify the disclosures broker-dealers effecting transactions in security futures products in customer futures accounts must make in the confirmations sent to customers regarding those transactions. The amendments would exclude certain broker-dealers effecting transactions in security futures products in customer futures accounts from the SEC's confirmation disclosure rule, provided that the transaction confirmations for these accounts disclose specific information and notify customers that certain additional information would be available upon written request. The new rule would also provide that broker-dealers effecting transactions for customers in security futures products in a futures account are exempt from the disclosure requirements of Exchange Act Section 11(d)(2).

DATES: Comments should be received on or before July 10, 2002.

ADDRESSES: Comments should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. Comments also may be submitted electronically at the following e-mail address: *rule-comments@sec.gov.* All comment letters should refer to File No. S7–19–02; 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: Catherine McGuire, Chief Counsel, Patricia Albrecht, Special Counsel, or Norman Reed, Staff Attorney, at (202) 942–0073, Office of the Chief Counsel, Division of Market Regulation, Securities and Exchange Commission, 450 5th Street, NW., Washington, DC 20549–1001.

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I. Introduction

The CFMA permits the trading of security futures, *i.e.,* futures contracts on individual securities and on narrow-based security indexes.[1] The CFMA defines security futures both as ''securities'' under the federal securities laws,[2] and as futures contracts for purposes of the Commodity Exchange Act (''CEA'').[3] Accordingly, the SEC and the Commodity Futures Trading Commission (''CFTC'') have joint jurisdiction over the intermediaries and markets that trade security futures products (''SFPs'').

Because they are subject to regulation both as securities and as futures contracts, SFPs must be traded on trading facilities and through intermediaries that are registered with both the SEC and the CFTC. 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, a futures commission merchant (''FCM'') may register with the SEC pursuant to Section 15(b)(11) of the Exchange Act and the rules adopted by the SEC[4] (''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[5] (''Notice FCM'').

Notice BDs are exempt from certain provisions of the Exchange Act,[6] and Notice FCMs are exempt from certain provisions of the CEA.[7] 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. The CFMA does not exempt firms that are ''fully-registered'' with both the CFTC and the SEC (''Full FCM/Full BDs'') from any provisions of the Exchange Act or the CEA.

The CFMA requires the SEC, in consultation with the CFTC, to issue such rules, regulations, or orders as are necessary to avoid duplicative or conflicting regulations applicable to Full FCM/Full BDs with respect to the treatment of customer funds, securities, or property, maintenance of books and records, financial reporting, or other financial responsibility rules, involving SFPs.[8] In absence of this proposed rulemaking, every firm effecting transactions in SFPs would need to comply with all of the confirmation disclosure requirements of the Exchange Act and the CEA, which would create the kind of duplicate regulation for SFPs that the CFMA's direction attempts to avoid.

II. Proposed Amendments and New Rule

A. Rule 10b–10

Generally, Exchange Act Rule 10b–10 requires broker-dealers that effect transactions for customers in securities, other than U.S. savings bonds or

[1] Pub. L. 106–554, 114 Stat. 2763. Under Exchange Act Section 3(a)(55)(A), the term ''security future'' is defined as a contract of sale for future delivery of a single security or of a narrow-based security index. 15 U.S.C. 78c(a)(55)(A). Under Exchange Act Section 3(a)(56), the term ''security futures product'' is defined as a security future or an option on security future. 15 U.S.C. 78C(a)(56).

[2] *See, e.g.*, Exchange Act Section 3(a)(10) (15 U.S.C. 78c(a)(10)).

[3] The term ''security future'' is defined in CEA Section 1a(31) (7 U.S.C. 1a(31)) as a contract of sale for future delivery of a single security or of a narrow-based security index. Under CEA Section 1a(33) (7 U.S.C. 1a(33)), the term ''security futures product'' is defined as a security future or an option on a security future.

[4] 15 U.S.C. 78o(b)(11)(a)(i) and Exchange Act Release No. 44730 (August 21, 2001), 66 FR 45137 (August 27, 2001).

[5] 7 U.S.C. 6f(a)(2) and 66 FR 43080 (August 17, 2001).

[6] Exchange Act Section 15(b)(11)(B) (15 U.S.C. 78o(b)(11)(B)).

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

[8] Exchange Act Section 15(c)(3)(B) (15 U.S.C. 78o(c)(3)(B)). *Cf.* CEA Section 4d(c) (7 U.S.C. 6d(c)) (providing the same requirement for the CFTC).

municipal securities,[9] to provide a confirmation, at or before the completion of each transaction, disclosing certain basic terms of the transaction. The confirmation requires, among other things, the disclosure of: the date, identity, price, and number of shares bought or sold; [10] the capacity of the broker-dealer; [11] the net dollar price and yield of a debt security; [12] and, under specified circumstances, the amount of compensation paid to the broker-dealer and whether payment for order flow is received.[13] The customer confirmation requirement, portions of which have been in effect for over 50 years, provides basic investor protections by conveying information allowing investors to verify the terms of their transactions; alerting investors to potential conflicts of interest with their broker-dealers; acting as a safeguard against fraud; and providing investors a means to evaluate the costs of their transactions and the quality of their broker-dealer's execution.[14]

Although the CFMA exempted Notice BDs from certain Exchange Act provisions, including Exchange Act Section 11,[15] it did not exempt them from Exchange Act Section 10 and the rules promulgated thereunder, including Exchange Act Rule 10b–10.[16] In addition, as stated previously, the CFMA did not exempt Full FCM/Full BDs from any provisions of the Exchange Act or the rules promulgated thereunder. Accordingly, under the CFMA, entities effecting SFP transactions in futures accounts currently are required to meet the confirmation disclosure requirements of both the CEA and the Exchange Act and the rules thereunder.

CEA Rule 1.33(b)[17] provides the disclosure requirements FCMs effecting futures transactions must follow. However, although CEA Rule 1.33(b) requires an FCM to provide a customer with a ''written confirmation of each commodity futures transaction,'' [18] it does not specify what information must be included in the confirmation.[19] The rules of certain futures exchanges, such as the Chicago Mercantile Exchange (''CME'') and the Chicago Board of Trade (''CBOT''),[20] require an FCM to disclose in writing no later than the following business day after each transaction specific information regarding that transaction effected in a futures account. Information that must be disclosed includes the commodity bought or sold, the quantity, the price, and the delivery month.[21] The CBOT also requires disclosure of the name of the other party to the contract (in other words, the FCM on the opposite side of the contract) or a notice disclosing that such information is available upon request.[22]

In a joint release issued by the SEC and the CFTC (''the Commissions'') proposing customer protection, reccordkeeping, reporting, and bankruptcy rules for accounts holding SFPs,[23] the Commissions requested comment on the application to transactions in SFPs of their confirmation rules (Rule 10b–10 under the Exchange Act [24] and Rule 1.33(b) under the CEA [25]). Of the three comment letters the Commissions received, two specifically addressed the Commissions' requests for comments on the subject of confirmations for SFPs.[26]

As an initial matter, the Commissions asked whether the application of the confirmation rules to FCMs and broker-dealers should follow from the type of account in which the SFPs are effected. One commenter supported having confirmation statements follow the type of the account and recommended that the SEC adopt a rule that would exempt SFPs carried in futures accounts from Exchange Act Rule 10b–10.[27] The other commenter suggested that the SEC clarify that Exchange Act Rule 10b–10 would not apply to a Notice BD or a Full FCM/Full BD carrying SFPs in a futures account.[28]

The Commissions also asked whether the information that FCM customers currently receive on confirmations would fulfill the purposes of Rule 10b–10 or whether FCMs should provide the particular information required by Rule 10b–10 to customers in SFP transactions upon the customers' request, to the extent that information is not already provided on the confirmations that the FCM prepares. In addition, the Commissions asked what it would cost FCMs to provide the information required under Rule 10b–10 on SFP confirmations.

One commenter noted that confirmations of futures transactions generally provide much of the same information required by Rule 10b–10. Moreover, this commenter stated that futures customers understand that they have a right to request information in addition to that specifically disclosed on the confirmation. Some of this additional information includes the time of the transaction and the name of the person on the opposite side of the transaction.[29] The commenter noted this is the same information that Rule 10b–10 generally allows broker-dealers to choose whether to disclose in the confirmation or to make available upon written request of the customer.[30] This commenter also maintained that applying Rule 10b–10(a)(2)—which

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[9] Municipal securities are covered by a parallel rule MSRB Rule G–15, which applies to all municipal securities-dealers—both bank and non-bank dealers.

[10] 17 CFR 240.10b–10(a)(1).

[11] 17 CFR 240.10b–10(a)(2) and (8).

[12] 17 CFR 240.10b–10(a)(5) and (6).

[13] *See, e.g.,* 17 CFR 240.10b–10(a)(2)(i)(B), (C) and (D); 17 CFR 240.10b–10(a)(8)(i)(A).

[14] Exchange Act Release. No. 34962 (November 10, 1994), 59 FR 59612 (November 17, 1994).

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

[16] 17 CFR 240.10b–10.

[17] 17 CFR 1.33(b). Specifically, CEA Rule 1.33(b)(1) requires FCMs that effect futures transactions for customers to provide, no later than the next business day after the transaction, ''a written confirmation of each commodity futures transaction caused to be executed by it * * *.''

[18] 17 CFR 1.33(b)(1).

[19] CEA Rule 1.33b(2) (17 CFR 1.33(b)(2)) does specify the detail required in a confirmation of a commodity option transaction. In addition, CEA Rule 1.46(a) (17 CFR 1.46(a)) requires an FCM to furnish a futures or options customer a purchase-and-sale statement when an offsetting transaction is executed showing the financial result of the transactions in involved.

[20] *See, e.g.,* CME Rule 537; CBOT Rules 421.00 and 421.01.

[21] CME Rule 537; CBOT Rules 421.00.

[22] *See, e.g.,* CBOT Rules 421.00 and 421.01.

[23] Exchange Act Release. No. 44854 (September 26, 2001), 66 FR 50786 (October 4, 2001).

[24] 17 CFR 240.10b–10.

[25] 17 CFR 1.33(b). Specifically, CEA Rule 1.33(b)(1) requires FCMs that effect futures transactions for customers to provide, no later than the next business day after the transaction, ''a written confirmation of each commodity futures transaction caused to be executed by it * * *.''

[26] Letter dated December 5, 2001, from Thomas W. Sexton, Vice President and General Counsel, National Futures Association, to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission; Letter dated December 5, 2001, from John M. Damgard, President, Futures Industry Association, and Mark E. Lackritz, President, Securities Industry Association, to Jonathan G. Katz, Secretary, U.S. Securities & Exchange Commission. The other letter, dated December 4, 2001, from James J. McNulty, Chicago Mercantile Exchange, Inc. and David J. Vitale, Board of Trade of the City of Chicago, Inc, to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, did not address the application of the confirmation requirements of the Commission and the CFTC but did support account specific recordkeeping requirements.

[27] Letter dated December 5, 2001, from Thomas W. Sexton, Vice President and General Counsel, National Futures Association, to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission.

[28] Letter dated December 5, 2001, from John M. Damgard, President, Futures Industry Association, and Mark E. Lackritz, President, Securities Industry Association, to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission.

[29] Letter dated December 5, 2001, from Thomas W. Sexton, Vice President and General Counsel, National Futures Association, to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission.

[30] *See* Exchange Act Rule 10b–10(a)(1) and (a)(2)(i)(A) (17 CFR 240.10b–10(a)(1) and (a)(2)(i)(A)).

requires a broker-dealer to disclose whether it is acting as a principal or agent in a transaction—to confirmations of SFP transactions would create operational and programming burdens for FCMs without providing corresponding benefits.[31]

The Commissions also requested information on whether there would be any costs to broker-dealers to provide the information required under CEA Rule 1.33(b) on SFP confirmations and how long it would take firms to implement systems to provide this information. In addition, the Commissions asked whether any other considerations relating to customers should be taken into account. The Commissions did not receive any comments on these queries.

After carefully considering all of the comments received, the SEC has decided to avoid duplicate regulation by proposing a new paragraph (e) to Rule 10b–10. New paragraph (e) would clarify the type and nature of information a Notice BD and a Full FCM/Full BD must disclose under Rule 10b–10 in confirmations of SFP transactions effected in futures accounts. In doing so, we have taken into account the disclosure requirements of CEA Rule 1.33(b) and the disclosure rules of the CME and the CBOT.[32]

Amended Rule 10b–10(e) would require essentially the same type and nature of information required under CEA Rule 1.33(b) and the above-described futures exchange rules, as well as additional information concerning the capacity in which the Notice BD or Full FCM/Full BD is acting when effecting an SFP transaction and information regarding payment for order flow. It also would conform to the timing requirements that are customary for futures confirmations.

Specifically, Rule 10b–10(e)(1) would provide that, as long as certain conditions are met, the requirements of paragraphs (a) and (b) of Rule 10b–10 will not apply to a Notice BD or a Full FCM/Full BD that effects transactions for customers in SFPs in a futures account (as that term is defined in proposed Exchange Act Rule 15c3–3(a)(15)).[33] First, under subparagraph (i) of proposed paragraph (e)(1), the Notice BD or Full FCM/Full BD must give or send to the customer, no later than the next business day after execution of any SFP transaction, written notification disclosing: the date the transaction was executed, the identity of the single security or narrow-based security index underlying the contract for the SFP, the number of shares or units (or principal amount) of such SFP purchased or sold, the price, and the delivery month. Second, under subparagraph (ii) of proposed paragraph (e)(1), the Notice BD or Full FCM/Full BD must give or send to the customer no later than the next business day after execution of any SFP transaction, written notification disclosing the source and amount of any remuneration received or to be received in connection with the transaction. This includes, but is not limited to, any markup, commissions, costs, fees, and other charges incurred in connection with the transaction.

From discussions with industry participants, our staff understands that this information is routinely disclosed in confirmations on futures transactions.[34] The staff also understands from these discussions that customers in the futures markets may negotiate to pay commissions or fees on futures transactions based on the purchase and subsequent liquidating sale or based on the sale and subsequent covering purchase rather than paying the commissions or fees at both the initiating and closing trade.[35]

Regardless, confirmation statements are sent to customers after both the initiating and closing trades, and the remuneration information in these confirmation statements reflects how the customers have chosen to pay commissions and fees. This disclosure system is designed to ensure that the customer is consistently aware of the nature and amount of the commissions and fees he is paying for the transactions effected in his futures account.[36] Accordingly, we believe that this same disclosure system for fees and commissions for SFP transactions effected by Notice BDs and Full FCM/Full BDs in futures accounts is sufficient for purposes of Rule 10b–10(e)(1)(ii).

Subparagraph (iii) of Rule 10b–10(e)(1) would also require the Notice BD or Full FCM/Full BD to give or send to the customer no later than the next business day after execution of any SFP transaction, written notification disclosing the fact that certain information will be available upon written request of the customer. This includes information about the time of the execution of the transaction and the identity of the other party to the contract. We believe that, while this information does not necessarily need to appear on the confirmation statement itself, the customer should have notice that it is available and will be provided upon written request.

Subparagraph (iii) also would require the Notice BD or Full FCM/Full BD to disclose that it will provide upon written request of the customer information regarding whether the broker or dealer is acting as agent for such customer, as agent for some other person, as agent for both such customer and some other person, or as principal for its own account; and, if the broker or dealer is acting as principal, whether it is engaging in a block transaction or an exchange of SFPs for physical securities (''EFP''). Although Rule 10b–10(a)(2) requires this information to appear in a confirmation of a securities transaction, we note that confirmations of futures transactions do not generally include this information. A commenter has also noted that customers would be aware of block trades and exchanges for physicals because these transactions require customer consent and that it would be unduly burdensome to require futures confirmations systems to capture and transmit this information.[37]

The nature of the futures markets appears to provide the reasons for this disparity. First, the CEA and CFTC Regulations require most futures transactions to be agency transactions.[38] An FCM conducts futures transaction in a principal capacity only when conducting a block trade or an EFP.[39]

[31] Letter dated December 5, 2001, from Thomas W. Sexton, Vice President and General Counsel, National Futures Association, to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission.

[32] *See* CME Rule 537; CBOT Rules 421.00 and 421.01.

[33] Exchange Act Release No. 44854 (September 25, 2001), 66 FR 50785 (October 4, 2001).

[34] *See* Memorandum to file number S7–17–01 regarding February 12, 2002 Conference call between Commission staff members and representatives of Morgan Stanley Dean Witter (March 13, 2002).

[35] *See* Memorandum to file number S7–17–01 regarding February 27, 2002 and March 5, 2002 conversations between Securities and Exchange Commission staff member and representative of Morgan Stanley Dean Witter (March 12, 2002).

[36] *See* Memorandum to file number S7–17–01 regarding February 27, 2002 and March 5, 2002 conversations between Securities and Exchange Commission staff member and representative of Morgan Stanley Dean Witter (March 12, 2002).

[37] Letter dated December 5, 2001, from Thomas W. Sexton, Vice President and General Counsel, National Futures Association, to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission. *See, e.g.*, CRE Rules 526 and 538, BrokerTec Futures Exchange (''BTEX'') Rules 406 and 407; *see also* Chicago Board of Trade's Proposal to Adopt Block Trading Procedures, 65 FR 58051 (September 27, 2000).

[38] *See* CEA Section 4b(a)(iv) (7 U.S.C. 6b(a)(iv)) and CFTC Regulations 1.38 and 1.55.2(a)–(b) (17 CFR 1.38 and 155.2(a)–(b)).

[39] *See* Memorandum to file number S7–17–01 regarding March 11, 2002, and March 12, 2002, conversations between Securities and Exchange

Continued

Block trades and EFPs are privately-negotiated transactions that may be traded apart from the public auction market either on or off the exchange trading floor.[40] In addition, a block trade executed on an exchange generally cannot trigger the execution of conditional orders, such as stop orders, or otherwise affect orders in the regular market.[41] An FCM that effects block trades and EFPs must meet stringent exchange rules, including keeping and maintaining detailed records of the transactions, timely reporting the transactions to the relevant exchange and/or clearing organization, and obtaining customer consent for the transactions.[42]

Nevertheless, an SFP is not only a futures product but a security product, and, as reflected in Rule 10b–10(a)(2) and Exchange Act Section 11(d)(2),[43] we consider that a broker-dealer's capacity when effecting a securities transaction is important information that should be available to a customer. We recognize, however, that requiring a confirmation of an SFP transaction effected in futures accounts to disclose whether the Notice BD or Full FCM/Full BD effected the transaction as an agent (and who the entity was an agent for) or a principal could create operational and programming burdens. Therefore, Rule 10b–10(e)(1)(iii) would require only that the information be made available upon written request of the customer.

Because the futures industry has never previously been required to provide this type of information on a regular basis, it may need additional time to adjust its members' operational systems, not only to capture this information when necessary, but also to disclose on the confirmation itself that the information is available upon a customer's written request. Therefore, as explained further below, new Rule 10b–10(e)(2) would provide that the provisions of Rule 10b–10(e)(1)(iii) do not become effective for broker-dealers effecting SFP transactions in futures accounts until June 1, 2003, as long as the broker-dealers meet certain conditions. This transitional provision should provide the futures industry with sufficient time to make the necessary adjustments to their systems to comply with Rule 10b–10(e)(1)(iii).

Finally, subparagraph (iv) of Rule 10b–10(e)(1) would require a Notice BD or Full FCM/Full BD to give or send to the customer no later than the next business day after execution of any SFP transaction, written notification disclosing whether it receives payment for order flow for effecting SFP transactions. It must also disclose the fact that the source and nature of any compensation received in connection with the particular transaction will be furnished upon the customer's written request. Our staff understands from discussions with industry representatives that payment for order flow is not currently practiced in the futures industry.[44] There is no reliable method to predict whether the practice of payment for order flow will develop in relation to SFP transactions. Nevertheless, subparagraph (iv) provides a foundation to address the disclosure of payment for order flow in the event it arises in relation to SFP transactions. Because payment for order flow is not currently a practice in the futures industry, it is unlikely that the operational systems for futures accounts would currently capture such information for disclosure purposes. Therefore, as explained further below, Rule 10b–10(e)(2) would provide the futures industry additional time to modify their systems to capture payment for order flow information.

Because the futures industry may need additional time to make the necessary changes to comply with all of the requirements of Rule 10b–10(e)(1), the Commission proposes to provide a transitional provision to allow the futures industry the extra time to make those changes. Specifically, Rule 10b–10(e)(2)(i) would provide that subparagraph (iii) of Rule 10b–10(e)(1) does not become effective until June 1, 2003, *provided* that, if the broker-dealer receives a written request from a customer for the information Paragraph (e)(1)(iii) requires the broker-dealer to disclose upon a customer's written request, the broker-dealer makes the information available to the customer. Rule 10b–10(e)(2)(ii) would provide that Paragraph (e)(1)(iv) shall also become effective June 1, 2003.

In proposing these amendments to Rule 10b–10, we believe it is important to remind broker-dealers that they would continue to be subject to the antifraud provisions of the federal securities laws, including Exchange Act Rule 10b–5. We note in this regard that the preliminary note to Rule 10b–10 explains that the disclosure confirmation requirements of Rule 10b–10 are in addition to ''a broker-dealer's obligation under the general antifraud provisions of the federal securities laws to disclose additional information to a customer at the time of the customer's investment decision.'' In addition, broker-dealers are still subject to self-regulatory organization rules that, in their current form, require broker-dealers to disclose information that would not be required by our proposed amendments to Rule 10b–10.[45]

We invite comment on all aspects of this amendment to Rule 10b–10. We especially invite comment on the following subjects: (i) What, if any, burdens would result from requiring futures confirmation systems to capture and transmit information regarding capacity and payment for order flow for SFP transactions effected by Notice BDs or Full FCM/Full BDs in a futures accounts; (ii) what, if any, competitive burdens would affect Notice BDs effecting SFP transactions in futures accounts that similarly situated Full FCM/Full BDs would not be subject to; (iii) whether the amendments to Rule 10b–10 providing confirmation requirements for SFP transactions effected in futures accounts could result in competitive disadvantages for broker-dealers effecting SFP transactions in securities accounts that must follow all of the disclosure requirements of Rule 10b–10; (iv) if so, whether the requirements of paragraph (e) should be applied to all SFP transactions regardless of whether the transactions are effected in a securities account or in a futures account; (v) whether there are rules of other exchanges that provide different disclosure requirements that we should consider; (vi) whether there is any additional information that should be disclosed to customers; and (vii) whether the transitional period provides sufficient time to develop the necessary systems to capture the information required to be disclosed under proposed Rule 10b–10(e).

B. Rule 10b–10 SIPC Disclosure Requirement

Exchange Act Rule 10b–10(a)(9)[46] generally requires that a broker-dealer effecting securities transactions for a customer, or a broker-dealer clearing or carrying a customer's account, disclose in the confirmation if such broker-dealer is not a member of the Securities Investor Protection Corporation

Commission staff member and representative of Credit Suisse First Boston (March 12, 2002).

[40] *See* CME Rules 526, 538; CME Rulebook definitions of ''Exchange-For-Physical'' and ''Block Trade;'' *see also* (''BTEX'') Rules 406, 407.

[41] *See* CME Rule 526.E.

[42] *See* BTEX Rule 406(d) and (f); BTEX Rule 407(h) and (i); CME Rules 520, 526.A and H, 538.4.

[43] 15 U.S.C. 78k(d)(2).

[44] *See* Memorandum to file number S7–17–01 regarding March 11, 2002, and March 12, 2002, conversations between Securities and Exchange Commission staff member and representative of Credit Suisse First Boston (March 12, 2002).

[45] *See*, e.g., National Association of Securities Dealers Rule 2230.

[46] 17 CFR 240.10b–10(a)(9).

(''SIPC'').[47] This requirement is intended to make clear when customers are not protected by SIPC.

Under the Securities Investor Protection Act of 1970 (''SIPA''), most broker-dealers registered under Exchange Act Section 15(b) must be members of SIPC.[48] When a SIPC member is liquidated in a SIPC proceeding, due to bankruptcy or other financial difficulties, SIPC will return to customers their cash and securities held by the broker-dealer. 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).[49]

We required that a broker-dealer disclose in its confirmations when it is not a SIPC member after we witnessed several incidents involving the financial failure of registered broker-dealers and their unregistered affiliates where customers became confused regarding the application of SIPC coverage to their accounts.[50] For example, in one of these cases, the failure of a registered broker-dealer and its government securities affiliate, which shared personnel and office facilities and did not distinguish between the two entities in certain written and oral communications, led to customer confusion concerning SIPC coverage. Because government securities brokers and dealers registered under Exchange Act 15C are not members of SIPC, the accounts of the customers of the government securities affiliates were not protected by SIPC.[51]

The SIPC disclosure requirement is in addition to a separate regulatory scheme pursuant to Exchange Act Section 15(c)(3) and Exchange Act Rule 15c3–3 to protect customers. That scheme protects the assets of broker-dealer customers by requiring a broker-dealer to follow certain steps to assure that customer assets are not used to fund the broker-dealer's business.[52]

The CEA has a different customer protection scheme for customers of FCMs. Under the CEA, customer funds must be segregated and separately accounted for by FCMs.[53]

The CFMA amended the Exchange Act and SIPA to provide that a Notice BD is not subject to Exchange Act Section 15(c)(3), or the rules promulgated thereunder, and that a Notice BD may not become a member of SIPC.[54] In addition, the CFMA amended the CEA to provide that a Notice FCM is not subject to the segregation requirements of the CEA.[55]

Full FCM/Full BDs do not have similar exemptions. Accordingly, the SEC and the CFTC have proposed rules that would permit Full FCM/Full BDs either to 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.[56] These rules would also require that, before a Full FCM/Full BD accepts an order from a customer for an SFP transaction, the Full FCM/Full BD must obtain a signed acknowledgement that the customer understands which protections would apply to the customer's particular account. The acknowledgment would have to specify which regulatory regime applies, and the customer would have to sign the acknowledgement stating that he understands that his particular account will not be protected under the alternative regulatory scheme. This acknowledgement is designed to help a customer understand 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 subject only to one customer protection regulatory scheme.

We are requesting comment on whether certain Notice BDs should be required, pursuant to Exchange Act Rule 10b–10(a)(9), to inform customers on a transaction-by-transaction basis that they are not members of SIPC. Should such a requirement be applicable to all notice registrants or to a subset that creates the greatest risk of confusion, such as those notice registrants that are associated persons[57] of fully-registered SIPC-member broker-dealers? In addition, we request comment on whether customers would benefit from being informed on a transaction-by-transaction basis that the protections provided by Exchange Act Rule 15c3–3 and SIPA do not apply to SFPs held in futures accounts by Full FCM/Full BDs. Further, we are interested in receiving comment on whether the absence of such disclosures in transaction confirmations could lead to the type of customer confusion the SIPC disclosure requirement in Exchange Act 10b–10(a)(9) was designed to address.

In addition, we note that self-regulatory organizations, such as the National Association of Dealers, Inc. and the National Futures Association, are working to develop model disclosure documents for SFPs. If these documents informed customers that the protections provided by Exchange Act Rule 15c3–3 and SIPA do not apply to SFPs held in futures accounts, would such disclosures provide them with sufficient information so that they would not need to be informed on a transaction-by-transaction basis?

C. Rule 11d2–1

Exchange Act Rule 10b–10(a)(2)[58] generally requires that a broker-dealer effecting a transaction for a customer must provide written notification at or before the completion of a transaction disclosing the capacity in which the broker-dealer acted when effecting a securities transaction. Similarly, Exchange Act Section 11(d)(2)[59] prohibits a broker-dealer from effecting any transaction for a customer with respect to any security (other than an exempted security) unless the broker-dealer ''discloses to such customer in writing at or before the completion of the transaction whether he is acting as a dealer for his own account, as a broker for such customer, or as a broker for some other person.''

As explained above, amended Rule 10b–10 would provide Full FCM/Full BDs and Notice BDs a conditional exception from the requirement in Exchange Act Rule 10b–10 to disclose the capacity in which they are acting when they effect SFP transactions for a customer in a futures account. Amended Rule 10b–10, however, would not provide an exception from the disclosure requirement of Exchange Act Section 11(d)(2). Under the CFMA, Notice BDs are exempt from the

[47] *See* Exchange Act Release No. 34962 (November 10, 1994), 59 FR 59612 (November 17, 1994).

[48] 15 U.S.C. 78ccc(a)(2) and 78ddd.

[49] 15 U.S.C. 78fff–3(a)(1).

[50] Exchange Act Release No. 33743 (March 9, 1994), 59 FR 12767 (March 17, 1994).

[51] *See id.; see generally, SEC* v. *Donald Sheldon Group, Inc. et al.*, Admin. Pro. File No. 3–6626 (Dec. 2, 1988.)

[52] Exchange Act Section 15(c)(3) (15 U.S.C. 78o(c)(3)) and 17 CFR 240.15c3–3.

[53] CEA Section 4f(a)(4)(A) (7 U.S.C. 6f(a)(4)(A)).

[54] Exchange Act Section 15(b)(11)(B)(iii) (15 U.S.C. 78o(b)(11)(B)(iii)); SIPA Section 3(a)(2)(A) (15 U.S.C. 78ccc(a)(2)(A)).

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

[56] Exchange Act Release No. 44854 (September 26, 2001), 66 FR 50786 (October 4, 2001).

[57] *See* Exchange Act Section 3(a)(18) (15 U.S.C. 78c(a)(18)) (''The term ''person associated with a broker or dealer'' or ''associated person of a broker or dealer'' means * * * any person directly or indirectly controlling, controlled by, or under common control with such broker or dealer * * *.''); *see also* Exchange Act Section 3(a)(9) (15 U.S.C. 78c(a)(9)) (''The term ''person'' means a natural person, company, government, or political subdivision, agency, or instrumentality of a government.'').

[58] 17 CFR 240.10b–10(a)(2).

[59] 15 U.S.C. 78k(d)(2).

provisions of Exchange Act Section 11.[60] This exemption, however, does not apply to Full FCM/Full BDs.

We believe that requiring Full FCM/Full BDs to comply with the disclosure requirement of Exchange Act Section 11(d)(2) would be inconsistent with the relief provided in the proposed amendments to Rule 10b–10. Therefore, to provide consistent relief, we are proposing an exemption from the disclosure requirement of Exchange Act Section 11(d)(2).[61] This exemption would be available only to Full FCM/Full BDs that effect SFP transactions in futures accounts and would allow them to effect SFP transactions in futures accounts without being required to disclose the capacity in which they are acting when they effect these transactions.

We invite comments on all aspects of proposed Rule 11d2–1. We especially invite comment on whether this exemption for Full FCM/Full BDs will have any anticompetitive impact on broker-dealers that are not eligible for this exemption.

III. General Request for Comments

We invite interested persons to submit written comments on all aspects of the proposed amendments and new rule, in addition to the specific requests for comments included in the release. Further, we invite comment on other matters that might have an effect on the proposals contained in the release, including any competitive impact.

Additionally, we request comment on whether broker-dealers executing trades in futures accounts for certain customers should be subject only to the confirmation requirements prescribed by the CFTC and the futures exchanges. Specifically, should broker-dealers effecting SFP transactions in customers' futures accounts be exempted from the disclosure requirements of Rule 10b–10 for their sophisticated institutional customers who are ''qualified investors,'' as that term is defined in the Exchange Act Section 3(a)(54),[62] if: (1) The institutional customers, after receiving full disclosure, knowingly agree not to receive information on the capacity in which a broker-dealer is acting when effecting SFP transactions in a customer's futures account and any information regarding payment for order flow; and (2) the disclosure rules of the CFTC and/or the futures exchanges, at a minimum, require disclosure of basic information, as specified in proposed paragraph (e)(1)(i) and (ii), the identity of the other party to the contract, and the time of the execution of the transaction (or the fact that information regarding the identity of the other party to the contract and the time of the execution of the transaction will be available upon request)? Should we use the statutory definition of ''qualified investors'' for purposes of this exemption, or should we define the category of customers differently?

More generally, in order to help us determine whether, and to what extent, direct regulation in this area is necessary, and to minimize the burdens associated with duplicative regulation while maintaining investor protection, we request detailed comments from futures exchanges that plan to trade security futures on their rules that will apply to the trading of security futures and whether there are any differences or similarities between those rules and the proposed amendments to Rule 10b–10 regarding the information required to be provided to customers effecting security futures transactions in futures accounts.

IV. Paperwork Reduction Act

Certain provisions of the proposed amendments to Exchange Act Rule 10b–10 contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995.[63] The Commission has submitted the proposed amendment to the Office of Management and Budget (''OMB'') for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The Commission is revising the collection of information entitled ''Proposed Confirmation of Transactions Amendment,'' OMB Control Number 3235–0444. 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. Rule 10b–10

1. Collection of Information Under the Proposed Confirmation of Transactions Amendment

As discussed previously in this release, the Proposed Confirmation of Transactions Amendment would permit alternative information disclosure requirements in confirmations provided to customers for transactions in SFPs in a futures account. This alternative information includes, the date the transaction was executed; the identity and number of shares or units bought or sold; the price and delivery month; the source and amount of broker remuneration; whether the broker received payment for order flow; and, the fact that other specified information about the execution of the transaction will be available upon written request. This information would be provided to a customer in the form of a confirmation.

2. Proposed Use of Information

The purpose of the proposed amendments to Rule 10b-10 is to provide to investors the information necessary to evaluate their securities transactions and the broker-dealers effecting those transactions. In the absence of the Rule's requirements, investors may not be fully informed of important information relating to their securities transactions. In addition, the confirmations may be used by the Commission, self-regulatory organizations, and other securities regulatory authorities in the course of examinations, investigations, and enforcement proceedings. No governmental agency regularly would receive any of the information described above.

3. Respondents

The proposed amendments to Rule 10b–10 potentially apply to all of the approximately 8,000 fully registered broker-dealers and the projected 1,399 notice registered broker-dealers registered with the Securities and Exchange Commission provided they effect transactions for customers. It is important to note, however, that the provisions of the Proposed Confirmation of Transactions Amendments would apply only to the approximately 5,600 fully registered broker-dealers that conduct business with the general public and the approximately 1,399 of the projected notice registered broker-dealers that conduct business with the general public.

4. Total Annual Reporting and Recordkeeping Burden

We estimate that there will be 100 million confirmations during the first year of trading of security futures products. In our April 29, 2002 order adjusting the fee rates under Section 31 of the Exchange Act, we estimated that we would collect $450,000 in assessments on round turn transactions in security futures in fiscal 2003.[64] This estimate was based on the Congressional

[60] *See* Exchange Act Section 15(b)(11)(B)(ii) (15 U.S.C. 78o(b)(11)(B)(ii)).

[61] Exchange Act Section 36(a)(1) (15 U.S.C. 78mm(a)(1)); *see also* Exchange Act Section 23(a)(1) (15 U.S.C. 78w(a)(1)).

[62] 15 U.S.C. 78c(a)(54).

[63] 44 U.S.C. 3501 *et seq.*

[64] *See* Order Making 2003 Annual Adjustments to the Fee Rates Applicable Under Section 6(b) of the Securities Act of 1933 and Sections 13(e), 14(g), 31(b) and 31(c) of the Securities Exchange Act of 1934, Release Nos. 33–8095 and 34–45842 (April 29, 2002).

Budget Office's August 28, 2001 estimate of collections for that fiscal year, adjusted to reflect the reduction in the assessment rate included in the Investor and Capital Markets Fee Relief Act.[65] Dividing the estimated $450,000 in collections on round turn transactions in security futures by the assessment rate of $0.009 per round turn transaction yields 50 million round turn transactions. Because each of the estimated 50 million round turn transaction will involve at least two confirmations, we estimate that there will be approximately 100 million confirmations.

Because the process of generating a confirmation is automated, the Commission staff estimates from information provided by industry participants that it takes about one minute to generate and send a confirmation. The Commission staff also estimates from information provided by industry participants that broker-dealers effecting SFP transactions will spend 1.7 million hours complying with the proposed amendments to Rule 10b–10 (100 million confirmations at one minute per confirmation = 100 million minutes; 100 million minutes/60 minutes per hour = 1.7 million hours).

Broker-dealers routinely use confirmations for billing purposes. In addition, broker-dealers would send customers some type of statement regardless of the requirements of the proposed amendments to Rule 10b–10. The amount of confirmations sent and the cost of the confirmations vary from firm to firm. Smaller firms send fewer confirmations than larger firms because they effect fewer transactions.

As stated earlier, the Commission staff estimates that broker-dealers effecting SFP transactions will send approximately 100 million confirmations annually. According to the information provided by industry participants, the average cost per confirmation is estimated to be 89 cents, including postage. The annual cost to the industry for fiscal year 2003 is therefore estimated to be $89 million.

[65] *See* Pub. L. 107–123, 115 Stat. 2390 (2002). In August 2001, the Congressional Budget Office estimated that the Commission would collect $1,000,000 in assessments on round turn transactions in security futures in fiscal 2003. This estimate was based on an assessment rate of $0.02 per round turn transaction. The Investor and Capital Markets Fee Relief Act reduced the assessment rate to $0.009 per round turn transaction. In our fee adjustment order, we adjusted the Congressional Budget Office's estimate to reflect the assessment rate reduction. $1,000,000 × 0.009/0.02 = $450,000.

5. Collection of Information is Mandatory

This collection of information is mandatory.

6. Confidentiality

The collection of information pursuant to the proposed amendments to Rule 10b–10 would be provided by broker-dealers to customers, and also would be maintained by broker-dealers.

7. Record Retention Period

Exchange Act Rule 17a–4(b)(1)[66] requires broker-dealers to preserve confirmations for three years, the first two years in an accessible place.

8. Request for Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to:

(i) Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information would have practical utility;

(ii) Evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information;

(iii) Enhance the quality, utility, and clarity of the information to be collected; and

(iv) Minimize the burden of the collection of information on those required to respond, including through the use of automated collection techniques or other forms of information technology.

Persons desiring to submit comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549–0609, and refer to File No. S7–19–02. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this release in the **Federal Register**, therefore, comments to OMB are best assured of having full effect if OMB receives them within 30 days of this publication. The Commission 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. S7–19–02, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, 450 Fifth Street, NW., Washington, DC 20549.

[66] 17 CFR 240.17a–4(b)(1).

B. Rule 11d2–1

For the reasons discussed above, new Exchange Act Rule 11d2–1 provides an exemption from the capacity disclosure requirement in Exchange Act Section 11(d)(2) for Full FCM/Full BDs that are effecting transactions for customers in SFPs in futures accounts. This exemption from a statutory requirement does not impose recordkeeping or information collection requirements, or other collections of information that require approval of the Office of Management and Budget under 44 U.S.C. 3501, *et seq.* Accordingly, the Paperwork Reduction Act does not apply.

V. Costs and Benefits of Proposed Amendments

A. Introduction

Passage of the CFMA in December of 2000 permitted the trading of SFPs 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. Recognizing that some entities may be subject to duplicative or conflicting regulations, the CFMA amended the CEA and the Exchange Act to: (1) Exempt notice-registrants from certain (but not all) sections of the CEA, Exchange Act, and the rules thereunder, and (2) direct the CFTC and the SEC to issue rules, regulations, or orders, as necessary, to avoid certain duplicative or conflicting regulations relating to Full FCM/Full BDs.[67] Consistent with these provisions, the SEC is proposing to amend Exchange Act Rule 10b–10 by adding new paragraph (e) to Rule 10b–10, and proposing Exchange Act Rule 11d2–1.

B. Rule 10b–10

The proposed amendments to Rule 10b–10 strive to avoid duplicate regulation by requiring disclosure of essentially the same type and nature of information currently required to be disclosed in confirmations of futures transactions at essentially the same time. Specifically, proposed Rule 10b–10(e) provides that a Full FCM/Full BD

[67] 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.

and a Notice BD that effects transactions for customers in security futures products in a futures account (as that term is defined in Exchange Act Rule 15c3–3(a)(15)) does not have to comply with the disclosure requirements of paragraphs (a) and (b) of Rule 10b–10 if the Full FCM/Full BD or Notice BD discloses on the SFP transaction confirmations the date the transaction was executed; the identity and number of shares or units bought or sold; the price and delivery month; the source and amount of broker remuneration; and the fact that the time of the execution of the transaction, the identity of the other party to the contract, and the capacity in which the broker-dealer was acting in effecting the transaction will be available upon written request. The information to be made available upon written request is the same type of information that futures confirmations currently disclose is available to the customer upon written request. Proposed Rule 10b–10(e) also provides that Full FCM/Full BDs and Notice BDs must disclose whether they receive payment for order flow, and if so, must provide the source and nature of such remuneration upon request. In addition, proposed Rule 10b–10(e)(2) provides a phase-in period. Under that provision, broker-dealers are not required until June 1, 2003, to disclose in SFP confirmations information on payment for order flow and the fact that certain information will be provided upon request.

In considering the potential costs and benefits of the proposed amendments to Rule 10b–10, we have considered the transaction confirmation practices of both the futures industry and the securities industry and our duty to protect consumers by requiring adequate disclosure on securities transactions. In addition, we have considered how Full FCM/Full BDs and Notice BDs effecting SFP transactions in futures accounts will have to restructure their confirmation technology. Finally, we have identified specific costs and benefits, and requested comment on additional costs or benefits that may stem from proposed Rule 10b–10(e).

1. Benefits

a. Elimination of Conflicting and Duplicative Regulation

As stated previously, under the CFMA, Notice BDs and Full FCM/Full BDs effecting SFP transactions in futures accounts currently are required to meet the disclosure requirements of both the CEA and the Exchange Act and the rules thereunder. The proposed amendments to Rule 10b–10 are designed to benefit Notice BDs and Full FCM/Full BDs by avoiding conflicting and duplicative regulation of the disclosure requirements of SFP transactions effected in futures accounts. The proposed amendments accomplish this benefit by clarifying the type and nature of information these entities must disclose under Rule 10b–10 in confirmations of SFP transactions effected in futures accounts. Without the proposed amendments to Rule 10b–10, all Notice BDs and Full FCM/Full BDs would need to change their confirmation systems to comply with all of the disclosure requirements of Rule 10b–10.

The amendments would require delivery of a confirmation at the same point in time and containing essentially the same type and nature of information these registrants currently provide in confirmations of transactions in futures accounts. In addition, the amendments would provide a phase-in period that gives the affected entities until June 1, 2003, to disclose in SFP confirmations information on payment for order flow and the fact that certain information will be provided upon request. Because such information is not generally provided in confirmations of futures transactions, the transitional period will allow these broker-dealers time to make the necessary adjustments to their confirmation technology, not only to amend their confirmations to make the required additional disclosures, but also to ensure that their systems are capturing all of the information that customers are entitled to receive if they make a written request.

b. Customer Understanding

The confirmations for SFP transactions effected in futures accounts pursuant to the proposed amendments of Rule 10b–10 should benefit customers who choose to effect SFP transactions in a futures account but have not previously traded in a futures account by providing them with information similar to the type of information they would receive if they receive confirmations of trades effected in a securities account. In addition, the confirmations of the SFP transactions effected in the futures accounts will disclose specific additional information that the customer may receive if he makes a written request. The amendments should also benefit customers that already have experience in the futures markets and decide to effect SFPs in a futures account by providing them with a confirmation that is similar in type and information to the kind of confirmations they are used to receiving on transactions effected in futures accounts. In addition, customers should also benefit from the proposed Rule 10b–10 requirement that, if entities begin to receive payment for order flow for SFP transactions executed in futures accounts, they must disclose that fact and disclose upon written request the source and nature of the remuneration.

2. Costs

Pursuant to paragraph (e)(1)(i) of proposed Rule 10b–10, a Full FCM/Full BD and a Notice BD that effect transactions in SFPs in a customer's futures account will not be required to meet the disclosure requirements of Exchange Act Rule 10b–10(a) and (b), which broker-dealers effecting securities transactions must generally meet. Rather, the Full FCM/Full BD and Notice BD would be required to disclose certain information in the confirmation and also disclose in the confirmation the fact that certain additional information is available upon a customer's written request.

Subparagraphs (i) and (ii) of proposed Rule 10b–10(e)(1) require Full FCM/Full BDs and Notice BDs to give or send to the customer no later than the next business day after execution of any SFP transaction, written notification disclosing the date the transaction was executed, the identity of the single security or narrow-based security index underlying the contract for the security futures product, the number of shares or units (or principal amount) of such security futures product purchased or sold, the price, the delivery month, the source and amount of any remuneration received or to be received by the broker in connection with the transaction, including, but limited to, commissions, costs, fees, and other charges incurred in connection with the transaction. We understand that futures confirmations already provide this information.[68] Therefore, the SEC does not believe that requiring this information on confirmations of SFP transactions effected in futures accounts generates any additional costs to the futures industry.

Subparagraph (iii) of Rule 10b–10(e)(1) would require the Notice BD or Full FCM/Full BD to give or send to the customer no later than the next business day after execution of any futures securities product transaction, written notification disclosing the fact that certain information will be available upon written request of the customer.

[68] *See* CME Rule 537; CBOT Rules 421.00 and 421.01; see also Memorandum to file number S7–17–01 regarding February 12, 2002 conference call between Commission staff members and representatives of Morgan Stanley Dean Witter (March 13, 2002).

This includes information about the time of the execution of the transaction, and the identity of the other party to the contract. We understand from discussions with industry representatives that futures confirmations generally disclose that this information is available upon the customer's request.[69] Therefore, the SEC does not anticipate that this requirement will impose additional costs on the futures industry.

Subparagraph (iii) of Rule 10b–10(e)(1) would also require the Notice BD or Full FCM/Full BD to give or send to the customer no later than the next business day after execution of any futures securities product transaction, written notification disclosing that information regarding whether the broker or dealer is acting as agent for such customer, as agent for some other person, as agent for both such customer and some other person, or as principal for its own account; and if the broker or dealer is acting as principal, whether it is engaging in a block transaction or an exchange of securities futures products for physical securities, will be available upon written request of the customer. From discussions with industry representatives, the SEC staff understands that Full FCM/Full BDs and Notice BDs would not incur substantial expense by adding a disclosure that information regarding the capacity in which the Full FCM/Full BD or Notice BD acted in effecting the transaction is available upon a customer's request.[70] The SEC staff, however, understands from these discussions that there would be some expense involved in requiring the collection of information relating to the capacity in which the orders are executed in the trading systems, although industry representatives were unable to quantify the potential expenses.[71] Because the futures industry has never previously been required to provide this type of information on a regular basis, it may need additional time to adjust its members' operational systems, not only to capture this information when necessary, but also to disclose on the confirmation itself that the information is available upon a customer's written request. Thus, the proposed rule contains a transitional provision. Under proposed Exchange Act Rule 10b–10(e)(2), broker-dealers have until June 1, 2003 to disclose that certain information will be provided upon written request, as long as that information can be made available if a customer submits a written request. This transitional provision should provide the futures industry with sufficient time to make the necessary adjustments to their systems to comply with this provision of proposed Exchange Act Rule 10b–10(e)(1)(iv).

Subparagraph (iv) of proposed Rule 10b–10(e)(1) also requires that the Notice BD or Full FCM/Full BD give or send to the customer no later than the next business day after execution of any futures securities product transaction, written notification disclosing whether the entity receives payment for order flow for such transactions and, if it does, it must disclose the fact that the source and nature of the compensation will be furnished upon written request of the customer. The SEC staff understands from discussions with futures industry participants that payment for order flow is not currently a practice in the futures industry.[72] Accordingly, if the practice does not arise in connection with SFP transactions effected in futures accounts, there would be no costs associated with the proposed disclosure requirement of subparagraph (iii) because there would be nothing to report.

If, however, Full FCM/Full BDS or Notice BDs begin to receive payment for order flow for SFP transactions effected in futures accounts then those entities would need to adjust their operating systems to capture this information. Based on discussions with industry representatives, the SEC understands that systems development costs should be relatively low given the fact that the rule allows for the use of a generic disclaimer, as opposed to information that would require a trade-by-trade coding change. The SEC also understands from these discussions that more extensive costs would be associated with providing specific disclosures upon request about the nature and source of any payment for order flow received in connection with a transaction. Industry representatives, however, could not quantify the potential costs, in part, perhaps, because the representatives were uncertain whether payment for order flow will become a practice in connection with SFP transactions.[73]

In considering the costs Notice BDs and Full FCM/Full BDs would have to make to their confirmation systems in order to comply with the proposed amendments, we understand from discussions with industry representatives that these costs are less than the costs these entities would incur if they would have to adjust their confirmation systems to meet all of the Rule 10b–10 disclosure requirements.[74] Accordingly, the amendments to Rule 10b–10 actually reduce the costs to the affected entities.

We do not anticipate that the proposed amendments to Rule 10b–10 will provide any benefits or costs to broker-dealers effecting SFP transactions in securities accounts because they do not apply to SFP transactions effected in securities accounts. Accordingly, we believe that broker-dealers effecting SFP transactions in securities accounts would use existing systems that currently conform to all of the disclosure requirements of Rule 10b–10 for securities transactions. However, we have solicited comment on that issue and may apply the proposed amendments to Rule 10b–10 to such broker-dealers if it would result in a significant cost savings.

As we noted above, the proposed amendments to Rule 10b–10 would apply only to the approximately 5,600 fully registered broker-dealers that conduct business with the general public and the approximately 1,399 of the projected notice registered broker-dealers that conduct business with the general public. Also, as noted above, we estimate that there will be 100 million confirmations during the first year of trading of security futures products. According to the information provided by industry participants, the average cost per confirmation is estimated to be 89 cents, including postage. Therefore,

[69] *See* Memorandum to file number S7–17–01 regarding February 12, 2002 conference call between Commission staff members and representatives of Morgan Stanley Dean Witter (March 13, 2002).

[70] *See* Memorandum to file number S7–17–01 regarding February 27, 2002 and March 5, 2002 conversations between Securities and Exchange Commission staff member and representative of Morgan Stanley Dean Witter (March 12, 2002).

[71] *See id.*

[72] *See* Memorandum to file number S7–17–01 regarding February 12, 2002 conference call between Commission staff members and representatives of Morgan Stanley Dean Witter (March 13, 2002); Memorandum to file number S7–17–01 regarding March 11, 2002, and March 12, 2002, conversations between Securities and Exchange Commission staff member and representative of Credit Suisse First Boston (March 12, 2002).

[73] *See* Memorandum to file number S7–17–01 regarding March 11, 2002, and March 12, 2002, conversations between Securities and Exchange Commission staff member and representative of Credit Suisse First Boston (March 12, 2002).

[74] See Memorandum to file number S7–17–01 regarding February 12, 2002 conference call between Commission staff members and representatives of Morgan Stanley Dean Witter (March 13, 2002); Memorandum to file number S7–17–01 regarding March 11, 2002, and March 12, 2002, conversations between Securities and Exchange Commission staff member and representative of Credit Suisse First Boston (March 12, 2002).

we estimate that the annual paperwork cost to the industry for fiscal year 2003 will be $89 million.

We request comments on the costs and benefits of the proposed amendments to Rule 10b–10. Commenters are strongly encouraged to identify and supply any relevant data, analysis, and estimates concerning the costs and/or benefits of the proposed amendments. Commenters should address in particular whether the proposed amendments to Rule 10b–10 will generate the anticipated benefits or impose the anticipated costs. As always, commenters are specifically invited to share additional quantifiable costs and benefits that they believe may be imposed or generated by the proposed amendments to Rule 10b–10.

C. Rule 11d2–1

Proposed Exchange Act Rule 11d2–1 would provide to Full FCM/Full BDs that are effecting SFP transactions for customers futures accounts an exemption from the requirement in Exchange Act Section 11(d)(2) that a broker-dealer effecting a transaction for a customer disclose in writing, at or before the completion of the transaction, the capacity in which the broker-dealer acted when effecting the transaction. As we have previously explained, we believe that requiring Full FCM/Full BDs to comply with the capacity disclosure requirement of Exchange Act 11(d)(2) would be inconsistent with the exemptive relief provided in proposed amendments to Rule 10b–10 that does not require automatic disclosure of capacity. Therefore, to provide consistent relief, we are proposing new Rule 11d2–1.

We do not anticipate that this exemption will generate large benefits or impose great costs. However, we have identified some potential benefits and costs that could result from Rule 11d2–1.

1. Benefits

This proposed exemption benefits Full FCM/Full BDs by avoiding any potential conflicting regulation regarding the disclosure of capacity when Full FCM/Full BDs effect SFP transactions for customers in futures accounts. This proposed exemption also is designed so that Notice BDs and Full FCM/Full BDs effecting SFP transactions in futures accounts will not have different disclosure requirements. Finally, if the Commission did not propose an exemption from Exchange Act Section 11(d)(2), certain of the anticipated benefits of the proposed amendments to Rule 10b–10 would be undermined.

2. Costs

Proposed Rule 11d2–1 would exempt Full FCM/Full BDS that effect SFP transactions in futures accounts from a statutory requirement to provide specific information to customers regarding the capacity those entities acted in when effecting such transactions. The exemption, therefore, prevents customers from learning this information from the confirmations they receive about these transactions. This cost, however, is ameliorated to a large extent by the fact that, pursuant to proposed amendments to Rule 10b–10, the confirmations of these transactions would inform the customers that information on capacity is available upon the customers' written request.

We request comments on the costs and benefits of proposed Rule 11d2–1 and ask commenters to provide supporting empirical data for any positions advanced. Commenters should address in particular whether proposed Rule 11d2–1 will generate the anticipated benefits or impose the anticipated costs. As always, commenters are specifically invited to share additionally quantifiable costs and benefits that they believe may be imposed or generated by proposed Rule 11d2–1.

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

Section 3(f) of the Exchange Act[75] requires the Commission, whenever it is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action will promote efficiency, competition, and capital formation. The proposed amendments to Rule 10b–10 and proposed Rule 11d2–1 are intended to clarify the disclosures broker-dealers effecting SFPs in customer futures accounts must make in the confirmations sent to customers regarding those transactions. We preliminarily believe that delineating the broker-dealers' disclosure obligations regarding SFP products effected in futures accounts should serve as an efficient and cost-effective means for those entities to reconcile their conflicting confirmation disclosure requirements with respect to SFPs. The proposed amendments to Rule 10b–10 and proposed Rule 11d2–1 should promote efficiency because firms may still use their present confirmation systems, after making the required adjustments, rather than having to build new confirmation systems.

In addition, the proposed amendments to Rule 10b–10 and proposed new Rule 11d2–1 are designed to give investors the information necessary to evaluate their securities transactions and the broker-dealers effecting those transactions. We preliminarily believe that our proposals would improve investor confidence and will therefore promote capital formation.

Section 23(a)(2) of the Exchange Act[76] requires the Commission, in making rules under the Exchange Act, to consider the impact that any such rule would have on competition. Exchange Act Section 23(a)(2) prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. As stated previously, the proposed amendments to Rule 10b–10 and new Rule 11d2–1 are designed to clarify the confirmation disclosure requirements only for broker-dealers effecting SFP transactions in customers' futures accounts and do not apply to broker-dealers effecting SFP transactions in customers' securities accounts. It is possible that the different disclosure requirements provided by the amendments to Rule 10b–10 and new Rule 11d2–1 may place a competitive burden on broker-dealers who must comply with all of the disclosure requirements of Rule 10b–10 because they effect SFP transactions in securities accounts. However, we preliminarily believe that any competitive burden imposed by these amendments and new rule are necessary and appropriate in furtherance of the purposes of the Exchange Act. In addition, we have solicited comment on whether the amendments and new rule impose any costs on broker-dealers effecting SFP transactions in securities accounts, and if so, whether they should also apply to broker-dealers effecting SFP transactions in securities accounts.

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

VII. Regulatory Flexibility Act Certification

Section 3(a) of the Regulatory Flexibility Act[77] requires the Commission to undertake an initial regulatory flexibility analysis of the effects of proposed rules and rule amendments on small entities, unless

[75] 15 U.S.C. 78c(f).

[76] 15 U.S.C. 78w(a)(2).

[77] 5 U.S.C. 603(a).

the Chairman certifies that the rules and rule amendments, if adopted, would not have a significant economic impact on a substantial number of small entities.[78]

The proposed amendments to Rule 10b–10 and proposed Rule 11d2–1 would apply only to broker-dealers that plan to effect security futures product transactions in futures accounts for the benefit of customers. The Commission's Office of Economic Analysis has determined that as of March 31, 2001, 90 broker-dealers were also registered with the CFTC as FCMs. None of those broker-dealers is a small entity.[79] There are also 1,399 entities (which includes FCMs and introducing brokers) that may be eligible to be registered as Notice BDs.[80] The CFTC has determined that FCMs are not small entities for the purposes of the RFA.[81] In addition, the CFTC has stated that it would evaluate within the context of a particular rule proposal whether some or all of affected introducing brokers would be considered to be small entities and, if so, what economic impact that rule would have on them.[82]

Under the CFMA, all Notice BDs and Full FCM/Full BDs, regardless of size, that effect SFP transactions in futures accounts must comply with Rule 10b–10, and all Full FCM/Full BDs effecting SFP transactions in futures accounts must comply with the disclosure requirements of Section 11. These disclosure requirements are in addition to the disclosures required under the CEA. The proposed amendments to Rule 10b–10 would conditionally exclude the affected firms from the general disclosure requirements of Rule 10b–10. Proposed Rule 11d2–1 would exempt affected Full FCM/Full BDs from the disclosure requirements of Section 11. Accordingly, all Notice BDs and Full FCM/Full BDs effecting SFP transactions in futures accounts would be able to send confirmations that are substantially similar to those confirmations they already provide to their customers for other futures transactions. Thus, the proposed amendments to Rule 10b–10 and proposed Rule 11d2–1, if adopted, would actually reduce the burden these entities face in meeting the disclosure requirements of both the Exchange Act and the CEA. Accordingly, we do not believe that the proposed amendments to Exchange Act Rule 10b–10 and proposed Rule 11d2–1 would have a significant economic impact on a substantial number of small entities.

The 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 Commission is also requesting information regarding the potential impact of the proposed rules and rule amendments on the economy on an annual basis. Commenters should provide empirical data to support their views.

VIII. Statutory Authority

The Commission is proposing amendments to Rule 10b–10 and proposing new Rule 11d2–1 under the Exchange Act pursuant to the authority conferred by the Exchange Act, including Sections 10, 11, 17, 23(a), and 36(a)(1).[83]

Text of Proposed Rule Amendments and Rule

List of Subjects in 17 CFR Part 240

Brokers, Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, the Securities and Exchange Commission hereby proposes that Title 17, Chapter II, of the Code of Federal Regulation be amended as follows:

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

1. The authority citation for Part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78k, 78k–1, 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.

* * * * *

2. Section 240.10b–10 is amended by removing the authority citation following § 240.10b–10, redesignating paragraph (e) as paragraph (f), and adding new paragraph (e) to read as follows:

§ 240.10b–10 Confirmation of transactions.

* * * * *

(e) *Security futures products.* The provisions of paragraphs (a) and (b) 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)) to the extent that it effects transactions for customers in security futures products in a futures account (as that term is defined in § 240.15c3–3(a)(15)) and 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 effects transactions for customers in security futures products in a futures account (as that term is defined in § 240.15c3–3(a)(15)), *Provided* that:

(1) The broker or dealer that effects any transaction for a customer in security futures products in a futures account gives or sends to the customer no later than the next business day after execution of any futures securities product transaction, written notification disclosing:

(i) The date the transaction was executed, the identity of the single security or narrow-based security index underlying the contract for the security futures product, the number of shares or units (or principal amount) of such security futures product purchased or sold, the price, and the delivery month;

(ii) The source and amount of any remuneration received or to be received by the broker or dealer in connection with the transaction, including, but not limited to, markups, commissions, costs, fees, and other charges incurred in connection with the transaction;

(iii) The fact that information about the time of the execution of the transaction, the identity of the other party to the contract, and whether the broker or dealer is acting as agent for such customer, as agent for some other person, as agent for both such customer and some other person, or as principal for its own account, and if the broker or dealer is acting as principal, whether it is engaging in a block transaction or an exchange of security futures products for physical securities, will be available upon written request of the customer; and

(iv) Whether payment for order flow is received by the broker or dealer for such transactions and the fact that the source and nature of the compensation received in connection with the particular transaction will be furnished upon written request of the customer.

(2) *Transitional provision.* (i) Broker-dealers are not required to comply with paragraph (e)(1)(iii) of this section until June 1, 2003, *Provided* that, if the broker-dealer receives a written request from a customer for the information paragraph (e)(1)(iii) of this section

[78] 5 U.S.C. 605(b).

[79] *See* 17 CFR § 240.0–10.

[80] *See* Exchange Act Release No. 44730 (August 21, 2001), 66 FR 45137 (August 27, 2001).

[81] *Policy Statement and Establishment of Definitions of ''Small Entities'' for Purposes of the Regulatory Flexibility Act,* 47 FR 18618 (April 30, 1982).

[82] *Id.*

[83] 15 U.S.C. 78j, 78k, 78q, 78w(a), and 78mm(a)(1).

requires the broker-dealer to disclose upon a customer's written request, the broker-dealer makes the information available to the customer; and

(ii) Broker-dealers are not required to comply with paragraph (e)(1)(iv) of this section until June 1, 2003.

* * * * *

3. Section 240.11d2–1 is added to read as follows:

§ 240.11d2–1 Exemption from Section 11(d)(2) for certain broker-dealers effecting transactions for customers security futures products in futures accounts.

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 effects transactions for customers in security futures products in a futures account (as that term is defined in § 240.15c3–3(a)(15)), is exempt from section 11(d)(2) of the Act (15 U.S.C. 78k(d)(2)).

By the Commission.

Dated: May 31, 2002.

Jill M. Peterson,

Assistant Secretary.

Appendix A

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

Regulatory Flexibility Act Certification

I, Harvey L. Pitt, Chairman of the Securities and Exchange Commission (the ''Commission''), based on the representations of the Division of Market Regulation provided to me, and the analysis of the Office of Economic Analysis and the Office of the General Counsel provided to me, hereby certify, pursuant to 5 U.S.C. 605(b), that the proposed amendments to Rule 10b–10 and proposed new Rule 11d2–1 would not, if adopted, have a significant economic impact on a substantial number of small entities.

Dated: May 31, 2002.

Harvey L. Pitt,

Chairman.

[FR Doc. 02–14294 Filed 6–7–02; 8:45 am]

BILLING CODE 8010–01–P

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 52

[CA 207–0336b; FRL–7224–2]

Revisions to the California State Implementation Plan, Great Basin Unified Air Pollution Control District and South Coast Air Quality Management District

AGENCY: Environmental Protection Agency (EPA).

ACTION: Proposed rule.

SUMMARY: EPA is proposing to approve revisions to the Great Basin Unified Air Pollution Control District (GBUAPCD) portion and the South Coast Air Quality Management District (SCAQMD) portion of the California State Implementation Plan (SIP). These revisions concern the emission of particulate matter (PM–10) from GBAPCD open burning/open detonation (OB/OD) of propellants, explosives, and pyrotechnics (PEP); from SCAQMD storage, handling, and transport of coke, coal, and sulfur; and from SCAQMD paved and unpaved roads and livestock operations. We are proposing to approve local rules that regulate these emission sources under the Clean Air Act as amended in 1990 (CAA or the Act).

DATES: Any comments on this proposal must arrive by July 10, 2002.

ADDRESSES: Mail comments to Andy Steckel, Rulemaking Office Chief (AIR–4), U.S. Environmental Protection Agency, Region IX, 75 Hawthorne Street, San Francisco, CA 94105.

You can inspect copies of the submitted rule revisions and EPA's technical support documents (TSDs) at our Region IX office during normal business hours. You may also see copies of the submitted rule revisions and TSDs at the following locations:

Environmental Protection Agency, Air Docket (6102), Ariel Rios Building, 1200 Pennsylvania Avenue, NW, Washington DC 20460.

California Air Resources Board, Stationary Source Division, Rule Evaluation Section, 1001 ''I'' Street, Sacramento, CA 95814.

Great Basin Unified Air Pollution Control District, 157 Short Street, Bishop, CA 93514.

South Coast Air Quality Management District, 21865 East Copley Drive, Diamond Bar, CA 91765.

FOR FURTHER INFORMATION CONTACT: Al Petersen, Rulemaking Office (AIR–4), U.S. Environmental Protection Agency, Region IX; (415) 947–4118.

SUPPLEMENTARY INFORMATION: This proposal addresses the approval of local GBUAPCD Rule 432 and SCAQMD Rules 1158 and 1186. In the Rules and Regulations section of this **Federal Register**, we are approving these local rules in a direct final action without prior proposal because we believe this SIP revision is not controversial. If we receive adverse comments, however, we will publish a timely withdrawal of the direct final rule and address the comments in subsequent action based on this proposed rule. We do not plan to open a second comment period, so anyone interested in commenting should do so at this time. If we do not receive adverse comments, no further activity is planned. For further information, please see the direct final action.

Dated: May 9, 2002.

Alexis Strauss,

Acting Regional Administrator, Region IX.

[FR Doc. 02–14208 Filed 6–7–02; 8:45 am]

BILLING CODE 6560–50–P

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 52

[SIP NO. SD–001–0012b; FRL–7216–2]

Approval of an Air Quality Implementation Plan Revision; South Dakota; Rapid City Street Sanding Regulations To Protect the National Ambient Air Quality Standards for PM–10

AGENCY: Environmental Protection Agency (EPA).

ACTION: Proposed rule.

SUMMARY: EPA is taking direct final action to approve a State Implementation Plan (SIP) revision submitted by the State of South Dakota for the purpose of establishing street sanding, deicing and maintenance rules for Rapid City, South Dakota. In the ''Rules and Regulations'' section of this **Federal Register**, EPA is approving the State's SIP revision as a direct final rule without prior proposal because the Agency views this as a noncontroversial SIP revision and anticipates no adverse comments. A detailed rationale for the approval is set forth in the preamble to the direct final rule. If EPA receives no adverse comments, EPA will not take further action on this proposed rule. If EPA receives adverse comments, EPA will withdraw the direct final rule and it will not take effect. EPA will address all public comments in a subsequent final rule based on this proposed rule. EPA will not institute a second comment period on this action. Any