

17 CFR Parts 240 and 249

[(Release No. 34-30929; File No. S7-25-91)
(International Series Release No. 421)]

57 FR 32159 07/21/92

RIN: 3235-AF44

**Final Temporary Risk Assessment
Rules**

AGENCY: Securities and Exchange
Commission.

ACTION: Adoption of rules.

SUMMARY: The Securities and Exchange Commission is adopting Rules 17h-1T and 17h-2T (17 CFR 240.17h-1T and 17 CFR 240.17h-2T) under the Securities Exchange Act of 1934 (the "Exchange Act"). The rules are being adopted primarily pursuant to the authority conferred on the Commission by the Market Reform Act of 1990. Rule 17h-1T would require broker-dealers to maintain and preserve records and other information concerning certain of the broker-dealer's associated persons. The requirement to maintain and preserve information under Rule 17h-1T would extend to the financial and securities

activities of the holding companies, affiliates, or subsidiaries of a broker-dealer that are reasonably likely to have a material impact on the financial or operational condition of the broker-dealer. Rule 17h-2T would require broker-dealers to file with the Commission quarterly reports concerning the information required to be maintained and preserved under Rule 17h-1T.

DATES: The rules become effective September 30, 1992. See section IV. of the Supplementary Information section of this release for the temporary implementation schedule.

FOR FURTHER INFORMATION CONTACT: Michael A. Macchiaroli, (202) 272-2904 or Roger G. Coffin, (202) 272-7375, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street NW., Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

I. Introduction

A. Background

On August 30, 1991, the Commission proposed for comment temporary Rules 17h-1T and 17h-2T, which, together with proposed Form 17-H, would establish a risk assessment recordkeeping and reporting system for broker-dealers.¹ The Rules were proposed pursuant to the authority conferred on the Commission by the Market Reform Act of 1990 (the "Reform Act"), which added section 17(h) to the Exchange Act.² Section 17(h) provides the Commission with specific authority to obtain information regarding certain activities of broker-dealer affiliates and augments the Commission's authority with respect to matters relating to the financial responsibility of broker-dealers.

Section 17(h) requires broker-dealers to maintain and preserve such risk assessment information as the Commission by rule prescribes with respect to those associated persons of the broker-dealer whose "business activities are reasonably likely to have a material impact on the financial and operational condition" of the broker-dealer, including the broker-dealer's "net capital, its liquidity, or its ability to finance its operations".³ The statute provides that the records should concern the broker-dealer's "policies, procedures, or systems for monitoring and controlling financial and operational risks to it resulting from the

activities" of its material associated persons and should "describe, in the aggregate, each of the financial and securities activities conducted by, and the customary sources of capital and funding" of associated persons whose business activities are reasonably likely to have a material impact on the broker-dealer".⁴ In addition, the Reform Act authorizes the Commission to require broker-dealers to file summary reports of the information and records maintained pursuant to the recordkeeping provisions.⁵

The Commission's proposal contained two rules. Proposed Rule 17h-1T set forth the specific recordkeeping requirements applicable to broker-dealers and provided guidelines to be used in establishing which associated persons of the broker-dealer are subject to the recordkeeping and reporting requirements.

Included in the recordkeeping requirements were risk management policy information, financial data, including consolidating and consolidated financial statements, securities and commodities position data, and other categories of financial and securities related information. Proposed Rule 17h-2T would require broker-dealers to file quarterly reports on proposed Form 17-H.

Proposed Form 17-H contained general instructions for use in reporting information and included a separate section of line items to be used in reporting numerical data to the Commission. Recognizing that the proposal would establish new recordkeeping and reporting burdens on members of the securities industry, who in the past have been required to report on the financial and operational condition of the registered entity only, the Commission requested public comment on the scope of the proposal, the burdens of complying with the rules, as well as the specific recordkeeping and reporting requirements contained therein.

B. Brief Summary of Comment and Commission Action

In response to the request for comment, the Commission received 63 letters addressing the proposed risk assessment rules. Generally, the commentators criticized the breadth of the proposal and the level of detail in the information required to be maintained and reported. Many commentators urged the Commission to reduce the potential universe of broker-dealer affiliates as to which the broker-

dealer would be required to maintain records. Other commentators addressed the application of the proposed rules to foreign entities. Many of these writers suggested that foreign affiliates operating under a regulatory scheme should be exempt from the proposed rules. Finally, the commentators suggested numerous technical changes to the recordkeeping and reporting requirements, many of which the Commission believes are helpful and have been incorporated into the rules being adopted today. Specific aspects of the comments are discussed in greater detail in the applicable sections of this release.

In summary, today the Commission is adopting, with certain modifications, Rules 17h-1T and 17h-2T, together with Form 17-H. The general approach taken in the rules being adopted today remains as proposed. Broker-dealers will be required to designate, using the guidelines set forth in Rule 17h-1T and subject to Commission oversight, Material Associated Persons for the purposes of Rules 17h-1T and 17h-2T. Broker-dealers will then be required to maintain certain information concerning the financial and securities activities of each Material Associated Person and will be required to file quarterly reports with the Commission on Form 17-H.

The rules being adopted today differ from the proposal in several respects. The Commission has undertaken to address the primary objection to the proposal, which was the burden imposed by the detailed information required by the risk assessment rules. To address this issue, the amount of information required to be maintained has been reduced in those areas where the information would not significantly assist the Commission and especially where it could be costly for a broker-dealer to obtain. The Commission believes that the cumulative effect of the modifications to the proposal and to the amount and format of the data required will significantly reduce the burdens associated with complying with the new rules.

The revisions to the proposed rules also incorporate certain of the commentators' suggestions with respect to the reporting and recordkeeping requirements. Additionally, special provisions for certain domestic and foreign entities have been added. Finally, the rules incorporate certain of the commentators' suggestions concerning the exemptive provisions: as proposed, the rules would exempt broker-dealers that maintain less than \$5 million in capital and which do not

¹ Exchange Act Release No. 29635 (August 30, 1991); 56 FR 44014. (September 6, 1991).

² Pub. L. No. 101-432, 104 Stat. 963 (1990); 15 U.S.C. 78q(h).

³ See section 17(h)(1) of the Act.

⁴ *Id.*

⁵ *Id.*

carry customer accounts. The final rules raise this exemption to \$20 million.

The Commission is adopting temporary rules to commence the formal information gathering process envisioned by the Market Reform Act. The Commission believes it would be appropriate, after some experience is gained with the information obtained pursuant to the temporary rules, to evaluate the operation of the risk assessment rules. The Commission would require the Division of Market Regulation to prepare a study evaluating the effectiveness of the rules. The report will be issued within 90 days after the rules have been fully operative for two years, and will be issued for public comment. Once the industry has commented, and the Commission has made its own evaluation, the Commission will decide what, if any, further refinements or modifications are appropriate.

Because the Commission believes it is important to commence the risk assessment program as soon as possible, the rules will become effective pursuant to a temporary implementation schedule. Pursuant to this schedule, broker-dealers will be required to maintain the information required by paragraphs (a)(1)(i) (the organization chart), (a)(2)(ii) (risk management policy information) and (a)(1)(iii) (disclosure of litigation) of Rule 17h-1T commencing September 30, 1992. Rule 17h-2T will require broker-dealers to file this limited information with the Commission on or before October 31, 1992. The rules will become fully effective on December 31, 1992.

II. Analysis of Public Comments

The general areas of the Commission's proposal that drew the attention of the commentators may be described as follows: (1) Which broker-dealer affiliates should be covered by the rules and the amount of information required to be kept by a broker-dealer concerning each covered affiliate; (2) the application of the rules to foreign entities; (3) the treatment of affiliates which are regulated entities (including domestic and foreign banks, insurance companies and futures commission merchants); (4) the rules' general exemptive provisions; and (5) technical recordkeeping, reporting and filing issues.

A. Scope of Risk Assessment Rules

As noted above, section 17(h) requires broker-dealers to keep records with respect to the financial and securities activities of those associated persons of the broker-dealer whose "business activities are reasonably likely to have a

material impact" on the broker-dealer's financial and operational condition.⁶ Section 17(h) does not indicate which associated persons of a broker-dealer should fall under this statutory standard; however, the legislative history accompanying the Reform Act suggests a flexible facts and circumstances approach.⁷

To incorporate this approach, proposed Rule 17h-1T contained several factors to be used by broker-dealers in determining which affiliates are subject to the rules. For the purposes of the risk assessment rules, affiliates subject to the rules are known as "Material Associated Persons."

The first factor set forth in Rule 17h-1T is the nature and proximity of the relationship between the registered firm and an associated person. Second is the overall funding needs of the broker-dealer and the degree, if any, to which the broker-dealer is financially dependent upon the associated person. Where a broker-dealer relies on the commercial paper or other unsecured credit of the holding company for financing, the broker-dealer would be materially affected by an acceleration or call by holders of such obligations because of events at the holding company level. Third is the degree to which the broker-dealer or its customers rely on the associated person for operational services or support. Merely offering products or services to the customers of broker-dealers, such as insurance products to brokerage customers will not, in and of itself, rise to the level of materiality called for by the risk assessment rules. However, if a broker-dealer relies on the associated person for significant operational facilities or services, the activities or financial difficulties of the associated person may well have a material impact on the broker-dealer. Fourth is the level of risk present in the types of activities of the broker-dealer or its associated person. Associated persons engaged in activities such as transactions in derivative products, merchant banking or venture capital activities are more likely to have a material impact on the broker-dealer than associated persons that engage in less risky activities. The final factor is the extent to which the associated person has the ability or the authority to cause a withdrawal of capital from the broker-dealer. These factors were intended to amplify the

statutory standard and to suggest some, but not all, of the criteria that may be relevant to a determination of materiality.

Because of the complexity and diversity of the various holding companies which own broker-dealers, the Commission's proposal would leave the initial determination of which associated persons are Material Associated Persons up to the reporting broker-dealer, subject to Commission oversight. The Commission believes this method remains the most practical way to implement the recordkeeping and reporting provisions of the risk assessment rules and is incorporating this approach into the final rules. The commentators raised a number of issues with regard to the designation of Material Associated Persons under the proposed rules.

1. Financial Strength of the Affiliate

Several commentators urged the Commission to incorporate other factors, such as the associated person's rating by a rating agency, the financial strength of the broker-dealer, or the financial strength of the associated person into Rule 17h-1T. According to this argument, a parent or affiliate in sound fiscal health is less likely to have a material impact on the financial and operational condition of the associated broker-dealer than a parent experiencing financial difficulties.

While a well-capitalized parent or affiliate can be a source of strength to the registered entity, the Commission does not believe that the financial strength of the broker-dealer or an associated person should be relevant in designating Material Associated Persons under the risk assessment rules. The Commission's risk assessment program is designed to provide information regarding significant broker-dealer affiliates on a regular and continuing basis. It would be insufficient for the Commission to receive an incomplete picture of any single holding company structure, especially in light of the fact that the financial strength of the parent may rest behind the broker-dealer's credit rating or access to the commercial paper market. The Commission's risk assessment program is designed to enable the Commission to monitor the financial and securities activities of all associated persons whose business activities are, by themselves, reasonably likely to have a material impact on the broker-dealer. A broker-dealer could be impacted by a significant and sudden change in the fiscal position of a key affiliate or parent, despite the prior

⁶ The term "associated person of a broker or dealer" is defined in Section 3(a)(18) of the Exchange Act. For the purposes of the risk assessment rules, the term does not include natural persons.

⁷ See H. Rep. at 27.

apparent financial stability of that entity.

2. Factors in Designating Material Associated Persons

The commentators also urged the Commission to refine or restrict the factors set forth in proposed Rule 17h-1T concerning the designation of Material Associated Persons. Essentially, these commentators suggested that the rules explicitly state that holding companies not primarily engaged in financial or securities activities should not be considered Material Associated Persons. While there may be instances where the activities of an ultimate parent or affiliate are not material to the financial condition of the broker-dealer, particularly if the parent or affiliate's primary business does not involve financial or securities activities, the Commission does not believe it would be appropriate to draw a bright line test in this regard. Instead, a facts and circumstances analysis is required. The first factor set forth in Rule 17h-1T, the nature and proximity of the relationship between the broker-dealer and the associated person, is intended to encompass these types of issues.

To illustrate, certain broker-dealer holding companies consist of at least two layers. The first level usually includes the direct parent of the broker-dealer and a number of related financial services entities. As stated in the proposing release, the Commission believes, absent very unusual circumstances, that these entities should be designated Material Associated Persons. This is particularly true in light of the fact that many broker-dealers carry potentially risky or highly leveraged positions, including interest rate agreements and over-the-counter derivative products in these first-tier affiliates.

The next layer may consist of a corporate holding company which has a controlling interest in the broker-dealer holding company and often one or more other intermediate holding companies that engage in businesses independent of the broker-dealer. The scope of the final risk assessment rules may, in some instances, extend to certain of these entities, especially if the broker-dealer depends on any of these companies as a source of funding. Alternatively, intermediate holding companies or an ultimate parent company may meet the material impact test. The financial distress or a potential bankruptcy filing by such an entity could directly threaten the broker-dealer's ability to obtain credit or might interfere with the broker-dealer's access to the clearance and

settlement system. If the day-to-day operations of the broker-dealer are or could be affected by the activities of the affiliate or parent, then that affiliate is most likely a Material Associated Person. On the other hand, there may be situations where, after an evaluation of all the relevant facts and circumstances, it appears that associated persons in the upper levels of the holding company hierarchy are likely to have only a remote impact on the financial and operational condition of the broker-dealer, and should not be designated Material Associated Persons. If the ultimate parent in a multi-tiered holding company is primarily involved in non-financial and non-securities activities, such as retailing or manufacturing, the Commission believes the parent should not, absent unusual circumstances, be designated a Material Associated Person.

3. Use of Exchange Act Reports

Finally, several commentators suggested that the Commission create a separate category for Material Associated Persons that are subject to periodic Exchange Act reporting obligations. These public Material Associated Persons, argued the commentators, should be permitted to submit copies of reports on Forms 10-K and 10-Q for risk assessment purposes. While the Commission's goal is to incorporate as much readily available information as possible into the risk assessment program, it does not believe that Exchange Act reports, without additional disclosure, can be used by broker-dealers in reporting on a Material Associated Person. Exchange Act reports are public disclosure documents that do not contain the specialized data required to enable the Commission staff to adequately assess the overall financial condition of a holding company and the potential impact its key members can have on a registered broker-dealer. Moreover, the Commission needs to have uniformity in the reports filed under the rules. Even though some of the information required by Form 17-H is contained in Forms 10-K and 10-Q, the Commission does not believe it would be unduly burdensome to reformat it on Form 17-H.

B. Treatment of Regulated Entities

Proposed Rules 17h-1T and 17h-2T contained special provisions for associated persons or brokers or dealers subject to the regulatory supervision of certain federal and state regulatory authorities. These provisions were designed to diminish the need for broker-dealers to create an additional set of records where records

substantially similar to those required by the risk assessment rules are created for the use of other federal or state regulators. The Commission is adopting the special provisions, with some refinements, as they apply to banks and insurance companies, and is adding a section for Material Associated Persons subject to the regulation of the Commodity Futures Trading Commission.

1. Banks

Proposed Rule 17h-1T provided that a broker-dealer would be deemed to be in compliance with the rule's recordkeeping requirements with respect to a Material Associated Person subject to the supervision of a federal banking agency if the broker-dealer maintained copies of the reports filed by the associated bank with its federal banking regulator. Proposed Rule 17h-2T permitted the broker-dealer to furnish copies of such reports to the Commission. The Commission is adopting these provisions substantially as proposed. Several commentators requested clarification on the application of these provisions to domestic and foreign banks.

One commentator suggested that the rules should be clarified to specify which forms filed with bank regulators need to be maintained and filed by the broker-dealer. In addition, several commentators requested clarification with respect to the application of these provisions to foreign banks subject to federal banking regulation.⁸

Proposed Rules 17h-1T and 17h-2T would require the broker-dealer to maintain and file copies of all the reports filed with a federal banking regulator. After analyzing the comments and the various federal banking reports, the Commission has determined that not all banking reports need be filed with the Commission as part of the risk assessment program. Rather, the rules being adopted today specify that the broker-dealer must maintain copies of all reports filed by the bank Material Associated Person to comply with Rule 17h-1T. However, Rule 17h-2T specifies that domestic banks will only be

⁸ One commentator, noting the comprehensive scheme of federal banking regulation, suggested that Material Associated Persons that are banks should be exempt from the rules altogether. Despite this regulatory scheme, Congress provided the Commission with the authority to request information from banks for risk assessment purposes. The Commission believes that the risk assessment program would not be complete if such information is not obtained. As envisioned in the Reform Act, the Commission will obtain such information in the form presented to federal banking authorities.

required to file copies of Forms FY-9C and Form FR Y-6 with the Commission.⁹ The Commission believes these forms are the only bank reporting forms essential to risk assessment.

The proposed rules did not directly address the application of the rules to foreign banking organizations which are subject to regulation by U.S. banking regulators. The commentators, using an argument based on the language of the Reform Act and the legislative history, asserted that the intent of Congress was to include foreign banks that are subject to U.S. banking regulation under the special provisions for banks contained in the Reform Act and incorporated into the Commission's rules.¹⁰ After an examination of the content of these reports, and a comparison of their content to the reports filed by U.S. banks, the Commission has determined to permit foreign banking organizations that file reports under the banking statutes specified in the rules to file copies of their reports in the same fashion as domestic banks.

2. Insurance Companies

The Commission's proposal contained special provisions for insurance companies that are Material Associated Persons under the rules. A broker-dealer with an insurance company Material Associated Person would satisfy the recordkeeping requirements by maintaining copies of the annual and quarterly reports filed by the parent insurance company with the state insurance regulator of the parent's domiciliary state. A broker-dealer designating a stock insurance company as a Material Associated Person would be required to, in addition to maintaining state insurance reports, provide copies of the filings the insurance company makes under sections 13 or 15 of the Exchange Act, together with filings made under the Investment Company Act of 1940. For all other insurance companies, the broker-dealer will be required to file copies of the reports prepared for state regulatory use. Two commentators discussed the

provisions proposed for insurance companies.

One commentator suggested that brokers or dealers associated with a mutual insurance company Material Associated Person should be exempt from the rules except to the extent that they should be required to file the annual and quarterly reports filed by the insurance company with state regulators. The Commission believes that it is appropriate to have access through the broker or dealer to all those reports filed by insurance company Material Associated Persons. By requiring the broker-dealer to maintain all reports filed, the Commission is assured of prompt access to the information contained therein when necessary.

Another commentator noted that while all state insurance regulators require the insurance companies subject to their authority to file annual reports, only a limited number require quarterly statements while the risk assessment rules require quarterly disclosure. Although this commentator pointed out that states with quarterly filing requirements include the major markets for insurance companies, and that the major insurance companies therefore file quarterly reports, the Commission has a strong interest in receiving quarterly reports. Therefore, the rules provide that, in the event an insurance company does not prepare quarterly reports for a state, the associated broker-dealer must maintain the records required by Rule 17h-1T and file a Form 17-H on a quarterly basis. The commentator also indicated that reports are filed on forms adopted by the National Association of Insurance Commissioners, not on forms prescribed by the insurance company's domiciliary state. The text of the rules has been changed to reflect that distinction and to indicate that the reports are to be filed regardless of whom they are filed with at the state level. In conclusion, the Commission is adopting the provisions with respect to insurance companies as proposed with the clarification discussed above.

3. Futures Commission Merchants

The Commission has added a new provision to the rules adopted today with respect to Material Associated Persons subject to the supervision of the Commodity Futures Trading Commission (the "CFTC"). Pursuant to this section, a broker-dealer will be deemed in compliance with the recordkeeping and reporting requirements if it maintains and files copies of Forms 1 FR-FCM or 1 FR-IB

filed by the Material Associated Person. The Commission believes that it is appropriate to add these provisions because entities regulated by the CFTC are subject to recordkeeping, reporting, and supervisory requirements similar to those imposed by the Commission on broker-dealers.

C. Application of Rules to Non-Domestic Entities

Proposed Rules 17h-1T and 17h-2T would require registered broker-dealers to make and keep records with respect to all of their Material Associated Persons, regardless of the nationality or regulatory status of such Material Associated Person. In order to assess the impact of these requirements on multi-national conglomerates, the Commission's proposal specifically requested comment on the application of the risk assessment rules to foreign entities. In response, several U.S. subsidiaries of foreign firms, together with a number of foreign regulatory authorities, commented on the proposed rules.

The foreign commentators made the following suggestions. First, noting that many non-domestic Material Associated Persons are subject to the regulatory supervision of a foreign regulator, the commentators urged the Commission to exempt altogether any Material Associated Person subject to foreign regulation. As an alternative, the commentators requested that the Commission rely on the home country regulator of the Material Associated Person for assurances of the entities' financial soundness. In connection with this approach, the commentators urged the Commission to develop additional and more extensive information sharing agreements with international regulatory organizations in order to create a global risk management environment that primarily relies on the home country regulator of an international enterprise.

The Commission believes in the principle of cooperation and information sharing among financial and securities regulators. However, the Reform Act requires the Commission to promulgate rules requiring broker-dealers to report on the financial condition of all affiliates that could have a material impact on the U.S. registered entity. In today's global marketplace, that impact could just as easily be caused by a non-domestic entity as a domestic one. In light of the Congressional mandate in this area, the Commission does not believe it is appropriate to exempt foreign entities from the application of the risk assessment rules, even if a foreign firm

⁹ The Commission notes that the text of the Reform Act stated that broker-dealers would be permitted to file copies of reports filed by a bank pursuant to section 8 of the Bank Holding Company Act of 1956. Section 8 of that Act refers to penalties; the correct citation should refer to section 5 of the Bank Holding Company Act, which refers to reporting obligations. The rules have been modified to correct this error.

¹⁰ The proposed rules contained special provisions for banks "subject to examination by, and the reporting requirements of a Federal banking agency." The text of the Reform Act refers to the "examination by, or the reporting requirements of a Federal banking agency." The final rules have been revised to track the statutory language.

is regulated in its home country. Instead, the Commission has determined to adopt the approach suggested by certain commentators, which the Commission believes will enable the Commission to properly discharge its regulatory obligations while at the same time affording deference to the existence of foreign banking and securities regulators.

In a new section added to Rules 17h-1T and 17h-2T, a broker-dealer will be allowed to maintain and file reports prepared by a Material Associated Person for a Foreign Financial Regulatory Authority as that term is defined in section 3(a)(51) of the Act in lieu of having to prepare a Form 17-H.¹¹ The Commission believes this approach will not be unduly burdensome for foreign entities because the broker-dealer will be permitted to file copies of foreign regulatory reports directly with the Commission. The Commission notes that the treatment accorded to entities regulated by foreign authorities is similar to that accorded to regulated domestic entities. In effect, the Commission is not imposing any additional burdens on any regulated entity other than requiring an English translation of reports already produced.

Under the rules adopted today, where a Material Associated Person is subject to the regulatory supervision of a Foreign Financial Regulatory Authority, the broker-dealer may maintain and file copies of the reports produced for that regulator.

D. Exemptions

In order to create a risk assessment program that both deploys the Commission's resources in a cost-effective manner and focuses in on the segment of the securities industry most likely to have a significant impact on the operation of the markets or on investors, proposed Rules 17h-1T and 17h-2T contained three exemptive provisions. The first would permit individual broker-dealers to apply for an exemption. Section 17(h) of the Act directs the Commission to consider in the exemptive process a number of

factors that were contained in the proposed rules. Although the Commission believes it is appropriate for the Commission to consider exemptive applications from individual broker-dealers, because the factors for this general exemption are set forth in the text of the statute, it is unnecessary to repeat them in the text of the rules. Therefore, the language contained in the proposed rules duplicating the statutory language will not be repeated in the rules.

The second category of exemption contained in Rules 17h-1T and 17h-2T would exempt limited purpose mutual fund brokers who are exempt from the provisions of the customer protection rule, Rule 15c3-3 pursuant to paragraph (k)(1) thereof.¹² This category would include the firms associated with insurance companies that are registered with the Commission as broker-dealers in order to offer variable annuity and other related products. Because the Commission believes these limited purpose firms pose limited systemic or customer risk and are beyond the intended scope of the Reform Act, this aspect of the proposal is being adopted. This exemption will exempt these firms, regardless of the amount of capital they maintain.

The third category of exemption contained in the proposed rules would also have exempted broker-dealers that maintain capital of less than \$5 million and which do not carry customer accounts. The commentators who discussed this exemption generally agreed that the \$5 million capital threshold was too low. Alternatives ranged from \$25 to \$100 million in capital or a sliding scale approach correlating the amount of capital with the nature and scope of the risk associated with different activities. Several commentators suggested that the rules exempt all but the largest 50 to 75 broker-dealers. Virtually all the commentators opposed the condition that would cause all broker-dealers that hold customer funds or securities or carry customer accounts to be subject to the rules.

The Commission believes that, especially in the initial phases of the risk assessment program, caution is warranted in the setting of the exemptive provisions in the risk assessment rules. The Commission does conclude, however, that a refinement can be made to this exemptive provision that will reduce the overall number of subject broker-dealers without a corresponding trade-off in risk. Therefore, the rules being adopted today raise the \$5 million to \$20 million except as to firms that hold customer assets (unless they maintain less than \$250,000 in net capital). Excluded also would be broker-dealers that clear customer trades but do not hold funds or securities for customers except to facilitate transactions and only for the time necessary to complete the transaction.

As noted, as proposed, all firms that carry customer accounts would be covered by the rules. The commentators objected to this aspect of the rules because it would subject certain firms with minimal capital to the recordkeeping and reporting requirements solely because they carry customer accounts. The Commission considers this to be a valid point which can be addressed by putting a "floor" on these firms. Accordingly, the rules have been revised to limit their application to those carrying firms that maintain in excess of \$250,000 in capital. Thus, all broker-dealers that carry customer accounts who maintain capital in excess of \$250,000 would be subject to the rules.

A review of the capitalization of the securities industry reveals that, of the approximately 5,600 broker-dealers that conduct a public business, approximately 600 firms clear and carry the accounts of customers. Of this number, approximately 435 firms have capital in excess of \$250,000. Together with firms that maintain in excess of \$20 million, today's action would subject approximately 630 firms to the risk assessment rules. However, Schedule I to the FOCUS Report requires broker-dealers to indicate whether or not the firm is a subsidiary of a parent which is not a registered broker-dealer. From this item an estimate of how many broker-dealers are part of a holding company structure (and could have Material Associated Persons) can be achieved. The most recent data from Schedule I shows that 280 broker-dealers indicated they were a subsidiary of a non-broker dealer. This data indicates that the actual number of broker-dealers that will be required to report on their Material Associated Persons will be considerably smaller than the

¹¹ Section 3(a)(51) of the Act defines a "foreign financial regulatory authority" to mean "any (A) Foreign securities authority, (B) other governmental body or foreign equivalent of a self-regulatory organization empowered by a foreign government to administer or enforce its laws relating to the regulation of fiduciaries, trusts, commercial lending, insurance, trading in contracts of sale of a commodity for future delivery, or other instruments traded on or subject to the rules of a contract market, board of trade, or foreign equivalent, or other financial activities, or (C) membership organization a function of which is to regulate participation of its members in activities listed above."

¹² These broker-dealers are exempt from the provisions of Rule 15c3-3 pursuant to paragraph (k)(1) thereof. They must limit their activities to the purchase, sale, and redemption of redeemable securities of registered investment companies or of interests or participation in an insurance company separate account, whether or not registered as an investment company; the solicitation of share accounts for savings and loan associations insured by an instrumentality of the United States; and the sale of securities for the account of a customer to obtain funds for immediate reinvestment in redeemable securities of registered investment companies.

approximately 630 firms potentially subject to the rules. Finally, while the staff plans to focus its efforts on the largest 50 to 75 broker-dealers, in the event of a problem with a firm that carries or holds customer accounts, the Commission and its staff will have access to this retained data and will be able to focus more promptly on customer exposure.

III. Final Risk Assessment Rules

A. Recordkeeping and Reporting Requirements

Proposed Rule 17h-1T would require broker-dealers to maintain and preserve two general categories of information concerning each Material Associated Person of the broker-dealer. The first category concerned the holding company's organization and risk management policies. The second involved the financial condition of the organization, including financial statements together with specialized categories of financial and securities activity related data, such as information concerning interest rate swaps, financial instruments and real estate ventures. Proposed Rule 17h-2T would require broker-dealers to file quarterly reports of the information required to be maintained by Rule 17h-1T.

The commentators to the Commission's proposal objected to the amount of information required to be maintained under proposed Rule 17h-1T. Moreover, the commentators argued that the level of detail required by proposed Form 17-H was excessive and beyond what the Commission requires for its regulatory purposes. The Commission is sensitive to the concerns articulated by the industry, and in adopting the risk assessment rules, is reducing, where possible, the recordkeeping and reporting burdens imposed by the rules. In addition, many of the commentators' suggestions with respect to the specifics of the proposal are being incorporated into the rules as adopted today.

1. Organization and Risk Management Policies

(a) *Organizational chart.* Paragraph (a)(1)(i) of Rule 17h-1T will require a broker-dealer to maintain an organizational chart of the holding company structure. The broker-dealer is required to indicate which associated persons of the broker-dealer are deemed to be Material Associated Persons. Associated persons that exist solely for tax reasons or that are shell companies that produce little or no revenue may either be omitted from the chart or

combined into a single entry to reduce the number of entries. As proposed, paragraph (a)(1)(i) would have required the maintenance of a flowchart compiled during the audit process. Several commentators pointed out that certain organizations either do not prepare flowcharts, or prepare them on a business segment rather than a legal entity basis, as the proposal would require. Based in part on the comments, the Commission has decided to eliminate the flowchart requirement.

Proposed Form 17-H specified that the organizational chart was to be filed in the broker-dealer's first risk assessment filing and at each year-end. Quarterly updates would be required only where a significant change has occurred in the information on file with the Commission. The Commission is adopting these filing requirements as proposed.¹³

Form 17-H has been revised to conform to paragraph (a)(1)(i) and no longer calls for a narrative discussion concerning the criteria used in selecting Material Associated Persons, the business lines conducted, and the names of the chief executive, operating financial officers of each Material Associated Person. These requirements were burdensome, and the Commission can obtain this information on an ad hoc basis as needed. Form 17-H will require the name and telephone number of a contact person at the broker-dealer who will be available to answer questions concerning the information reported therein, including the holding company structure and the criteria used in designating Material Associated Persons.

(b) *Risk management policies.* As proposed, paragraphs (a)(1)(ii) through (iv) would require a broker-dealer to maintain certain risk management policies for itself and each Material Associated Person. The Commission has reorganized these provisions into a single revised paragraph. As revised, the new paragraph no longer requires policies concerning credit controls and collateral procedures.¹⁴ As adopted,

¹³ Under the temporary implementation schedule set forth in this release, broker-dealers will be required to furnish an organizational chart 30 days after the initial effective date of the rules. Because the rules require broker-dealers to file the organizational chart in each year-end Form 17-H, broker-dealers operating on a calendar year end would technically be required to file another chart in the December filing. For the purposes of the phase-in of the rules, any broker-dealer filing an organizational chart under the temporary implementation schedule need not file the chart a second time in the first year-end filing unless a material change has occurred.

¹⁴ The Commission notes that the information regarding capital adequacy formerly contained in

Form 17-H will require a broker-dealer to file its policy information only in the first filing with the Commission; quarterly updates will be required only where a material change has occurred in the information on file with the Commission.

In addition, a number of commentators argued that the policies required by the rules should be the policies of the broker-dealer only, and not each Material Associated Person. The Commission agrees that this clarification is warranted. Therefore, the proposal has been amended to state that the policies required to be maintained under Rule 17h-1T and filed under Rule 17h-2T should be the broker-dealer's policies only. Additionally, the final rules require the broker-dealer to maintain policies for monitoring and controlling financial and operational risks to itself based on the activities of its Material Associated Persons.

Finally, some commentators were unsure whether the Commission's proposal instituted an affirmative burden to create policies and procedures in the risk management area if none previously existed. The Reform Act provided the Commission with authority to monitor existing procedures for controlling systemic risk in the securities industry. If a firm operates without the policies referred to in the rules, it will be sufficient for risk assessment purposes for the broker-dealer to document, in writing, the absence of such policies.

(c) *Material legal proceedings.* Proposed Rule 17h-1T would require broker-dealers to keep records that describe all material pending legal proceedings to which the broker-dealer or any Material Associated Person is a party, or to which any of its property is subject and that would be required to be disclosed under GAAP. The commentators requested clarification on the application of this paragraph. As revised, new paragraph (a)(1)(ii) will require broker-dealers to maintain a record of material legal proceedings that would be required to be disclosed under GAAP on a consolidated basis looking at the organization as a whole. The references to the form and content of Item 103 of Regulation S-K have been deleted. Rule 17h-2T and Form 17-H will require this information to be filed in the first Form 17-H delivered to the

paragraph (a)(1)(vi) of proposed Rule 17h-1T has been incorporated into the revised paragraph (a)(1)(ii). Proposed Item 4 of Form 17-H, dealing with capital adequacy information, has been deleted as unnecessary.

adopted today. To ease the burdens associated with starting the risk assessment program, the Commission is adopting a temporary implementation schedule to phase-in the rules. During the comment process it was stated that certain of the items called for under the rules (such as the organization chart and risk management policy information) generally already exist. Therefore, it would not be difficult for broker-dealers to supply this information relatively shortly after the rules become effective. The remainder of the financial data will, it was argued, take sometime for the industry to compile.

The Commission believes it is important to commence the information gathering process as soon as possible and therefore the rules will require that broker-dealers maintain the information required by paragraphs (a)(1)(i) (the organization chart), (a)(2)(ii) (risk management policy information) and (a)(1)(iii) (disclosure of litigation) of Rule 17h-1T commencing September 30, 1992. Rules 17h-2T will require broker-dealers to file this limited information with the Commission on or before October 31, 1992. The rules will become fully effective on December 31, 1992.

V. Summary of Final Regulatory Flexibility Analysis

The Commission has prepared a Final Regulatory Flexibility Analysis ("FRFA") in accordance with 5 U.S.C. 630 concerning the final rules. The FRFA notes that the Commission did not receive any comments regarding the Initial Regulatory Flexibility Analysis. A copy of the FRFA may be obtained by contacting Roger G. Coffin, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, NW., Washington DC, 20549, (202) 272-7375.

VI. Statutory Analysis

Pursuant to the Securities Exchange Act of 1934 and particularly sections 17 and 23 thereof, 15 U.S.C. 78q and 78w, the Commission is adding a new 240.17h-1T and 240.17h-2T to title 17 of the Code of Federal Regulations in the manner set forth below.

VII. List of Subjects in 17 CFR Parts 240 and 249

Reporting and recordkeeping requirements; Securities.

VIII. Text of the Final Rules

In accordance with the foregoing, title 17, chapter II of the Code of Federal Regulations is 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 citation:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78i, 78j, 78l, 78m, 78n, 78o, 78p, 78s, 78w, 78x, 78ll(d), 79q, 79t, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, and 80b-11, unless otherwise noted.

Section 240.17h-1T also issued under 15 U.S.C. 78q.

2. By adding § 240.17h-1T to read as follows:

§ 240.17h-1T Risk assessment recordkeeping requirements for associated persons of brokers and dealers.

(a) Requirement to maintain and preserve information. (1) Every broker or dealer registered with the Commission pursuant to section 15 of the Act, and every municipal securities dealer registered pursuant to Section 15B of the Act for which the Commission is the appropriate regulatory agency, unless exempt pursuant to paragraph (c) of this section, shall maintain and preserve the following information:

(i) An organizational chart which includes the broker or dealer and all its associated persons. Included in the organizational chart shall be a designation of which associated persons are Material Associated Persons as that term is used in paragraph (a)(2) of this section;

(ii) Written policies, procedures, or systems concerning the broker or dealer's:

(A) Method(s) for monitoring and controlling financial and operational risks to it resulting from the activities of any of its associated persons, other than a natural person;

(B) Financing and capital adequacy, including information regarding sources of funding, together with a narrative discussion by management of the liquidity of the material assets, the structure of debt capital, and sources of alternative funding; and

(C) Trading positions and risks, such as records regarding reporting responsibilities for trading activities, policies relating to restrictions or limitations on trading securities and financial instruments or products, and a description of the types of reviews conducted to monitor existing positions, and limitations or restrictions on trading activities.

(iii) A description of all material pending legal or arbitration proceedings

involving a Material Associated Person or the broker or dealer that are required to be disclosed by the ultimate holding company under generally accepted accounting principles on a consolidated basis;

(iv) Consolidated and consolidating balance sheets, prepared in accordance with generally accepted accounting principles, which may be unaudited and which shall include the notes to the financial statements, as of quarter end for the broker or dealer and its ultimate holding company;

(v) Quarterly consolidated and consolidating income statements and consolidated cash flow statements, prepared in accordance with generally accepted accounting principles, which may be unaudited and which shall include the notes to the financial statements, for the broker or dealer and its ultimate holding company;

(vi) The amount as of quarter end, and at month end if greater than quarter end, of the aggregate long and short securities and commodities positions held by each Material Associated Person, including a separate listing of each single unhedged securities or commodities position, other than U.S. government or agency securities, that exceeds the Materiality Threshold at any month end;

(vii) The notional or contractual amounts, and in the case of options, the value of the underlying instruments, as of quarter end, of financial instruments with off-balance sheet risk and financial instruments with concentrations of credit risk (as those terms are used in Statement of Financial Accounting Standards No. 105) where the Material Associated Person operates a trading book, with a separate entry of each commitment where the credit risk (as that term is used in Statement of Financial Accounting Standards No. 105) with respect to a counterparty exceeds the Materiality Threshold at quarter end;

(viii) The aggregate amount as of quarter end, and the amount at month end if greater than quarter end, of all bridge loans and those other material unsecured extensions of credit (not including intra-group receivables) with an initial or remaining maturity of less than one year by each Material Associated Person, together with the allowance for losses for such transactions, including a specific description of any extensions of credit to a single borrower exceeding the Materiality Threshold at any month end;

(ix) The aggregate amount as of quarter end, and the amount at month end if greater than quarter end, of

commercial paper, secured and other unsecured borrowing, bank loans, lines of credit, or any other borrowings, and the principal installments of long-term or medium-term debt, scheduled to mature within twelve months from the most recent fiscal quarter for the broker or dealer and each Material Associated Person; and

(x) Data relating to real estate activities, including mortgage loans and investments in real estate, but not including trading positions in whole loans, conducted by each Material Associated Person, including:

(A) Real estate loans and investments by type of property, such as construction and development, residential, commercial and industrial or farmland;

(B) The geographic distribution, as of quarter end, by type of loan or investment where the amount exceeds the Materiality Threshold at quarter end;

(C) The aggregate carrying value of loans which each Material Associated Person deems to be not current as to interest or principal, together with the Material Associated Person's criteria for the determination of which loans are not current, or which are in the process of foreclosure or that have been restructured;

(D) The allowance for losses on loans and on investment real estate by type of loan or investment, and the activity in the allowance for losses account; and

(E) Information about risk concentration in the real estate investment and loan portfolio, including information about risk concentration to a single borrower or location of property if the risk concentration exceeds the Materiality Threshold at quarter end.

(2) The determination of whether an associated person of a broker or dealer is a Material Associated Person shall involve consideration of all aspects of the activities of, and the relationship between, both entities, including without limitation, the following factors:

(i) The legal relationship between the broker or dealer and the associated person;

(ii) The overall financing requirements of the broker or dealer and the associated person, and the degree, if any, to which the broker or dealer and the associated person are financially dependent on each other;

(iii) The degree, if any, to which the broker or dealer or its customers rely on the associated person for operational support or services in connection with the broker's or dealer's business;

(iv) The level of risk present in the activities of the broker's or dealer's associated persons; and

(v) The extent to which the associated person has the authority or the ability to cause a withdrawal of capital from the broker or dealer.

(3) The information, reports and records required by the provisions of this section shall be maintained and preserved in accordance with the provisions of section 240.17a-4 and shall be kept for a period of not less than three years in an easily accessible place.

(4) For the purposes of this section and section 240.17h-2T, the term "Materiality Threshold" shall mean the greater of:

(i) \$100 million; or

(ii) 10 percent of the broker or dealer's tentative net capital based on the most recently filed Form X-17A-5 or 10 percent of the Material Associated Person's tangible net worth, whichever is greater.

(b) *Special provisions with respect to material associated persons subject to the supervision of certain domestic regulators.* A broker or dealer shall be deemed to be in compliance with the recordkeeping requirements of paragraph (a) of this section with respect to a Material Associated Person if:

(1) Such Material Associated Person is subject to examination by, or the reporting requirements of, a Federal banking agency and the broker or dealer maintains in accordance with the provisions of this section copies of all reports submitted by such Material Associated Person with the Federal banking agency pursuant to section 5211 of the Revised Statutes, section 9 of the Federal Reserve Act, section 7(a) of the Federal Deposit Insurance Act, section 10(b) of the Home Owners' Loan Act, or section 5 of the Bank Holding Company Act of 1956 other than the Form FR 2068; or

(2) If such Material Associated Person is subject to the supervision of an insurance commissioner or other similar official or agency of a state, and the broker or dealer maintains in accordance with the provisions of this section copies of the Annual and Quarterly Statements with Schedules and Exhibits prepared by the insurance company on forms prescribed by the National Association of Insurance Commissioners; or

(3) In the event an insurance company is not required to prepare Quarterly Statements on forms prescribed by the National Association of Insurance Commissioners, the broker or dealer must maintain and preserve the records required by paragraph (a) of this section on a quarterly basis; or

(4) In the case of a Material Associated Person that is subject to the

supervision of the Commodity Futures Trading Commission, the broker or dealer maintains in accordance with the provisions of this section copies of the reports filed on Forms 1 FR-FCM or 1 FR-IB by such Material Associated Person with the Commodity Futures Trading Commission.

(c) *Special provisions with respect to material associated persons subject to the supervision of a foreign financial regulatory authority.* A broker or dealer shall be deemed to be in compliance with the recordkeeping requirements of paragraph (a) of this section with respect to a Material Associated Person if such broker or dealer maintains in accordance with the provisions of this section copies of the reports filed by such Material Associated Persons with a Foreign Financial Regulatory Authority. The broker or dealer shall maintain a copy of the original report and a copy translated into the English language. For the purposes of this section, the term Foreign Financial Regulatory Authority shall have the meaning set forth in section 3(a)(51) of the Act.

(d) *Exemptions.* (1) The provisions of this section shall not apply to any broker or dealer which is exempt from the provisions of section 240.15c3-3:

(i) Pursuant to paragraph (k)(1) of § 240.15c3-3; or

(ii) Pursuant to paragraph (k)(2) of § 240.15c3-3; or

(iii) If the broker or dealer does not qualify for an exemption from the provisions of § 240.15c3-3 and such broker or dealer does not hold funds or securities for, or owe money or securities to, customers and does not carry the accounts of or for customers; unless

(iv) In the case of paragraphs (d)(1)(ii) or (d)(1)(iii) of this section, the broker or dealer maintains capital including debt subordinated in accordance with appendix D of § 240.15c3-1 equal to or greater than \$20,000,000.

(2) The provisions of this section shall not apply to any broker or dealer which maintains capital including debt subordinated in accordance with appendix D of section 240.15c3-1 of less than \$250,000, even if the broker or dealer hold funds or securities for, or owes money or securities to, customers or carries the accounts of or for customers.

(3) In calculating capital for the purposes of this paragraph, a broker or dealer shall include the equity capital and subordinated debt of any other registered brokers or dealers that are associated with the broker or dealer and are not otherwise exempt from the

provisions pursuant to paragraph (d)(1)(i) of this section.

(4) The Commission may, upon written application by a Reporting Broker or Dealer, exempt from the provisions of this section, either unconditionally or on specified terms and conditions, any brokers or dealers associated with such Reporting Broker or Dealer. The term "Reporting Broker or Dealer" shall mean, in the case of a broker or dealer that is associated with other registered brokers or dealers, the broker or dealer which maintains the greatest amount of net capital as reported on its most recently fixed Form X-17A-5. In granting exemptions under this section, the Commission shall consider, among other factors, whether the records and other information required to be maintained pursuant to this section concerning the Material Associated Persons of the broker or dealer associated with the Reporting Broker or Dealer will be available to the Commission pursuant to § 240.17h-2T.

(e) *Location of records.* A broker or dealer required to maintain records concerning a Material Associated Person pursuant to this section may maintain those records either at the Material Associated Person or at a records storage facility provided that the records are located within the boundaries of the United States and the records are kept in an easily accessible place, as that term is used in § 240.17a-4. In order to operate pursuant to the provisions of this paragraph, the Material Associated Person or other entity maintaining the records shall file with the Commission a written undertaking in form acceptable to the Commission, signed by a duly authorized person, to the effect that the records will be treated as if the broker or dealer was maintaining the records pursuant to this section and that the entity maintaining the records undertakes to permit examination of such records at any time or from time to time during business hours by representatives or designees of the Commission and to promptly furnish the Commission or its designee true, correct, complete and current hard copy of any or all or any part of such records. The election to operate pursuant to the provisions of this paragraph shall not relieve the broker or dealer required to maintain and preserve such records from any of its responsibilities under this section or section 240.17h-2T.

(f) *Confidentiality.* All information obtained by the Commission pursuant to the provisions of this section from a broker or dealer concerning a Material Associated Person shall be deemed

confidential information for the purposes of section 24(b) of the Act.

(g) *Temporary implementation schedule.* Every broker or dealer subject to the requirements of this section shall maintain and preserve the information required by paragraphs (a)(1)(i), (ii), and (iii) of this section commencing September 30, 1992. Commencing December 31, 1992, the provisions of this section shall apply in their entirety.

3. By adding § 240.17h-2T to read as follows:

§ 240.17h-2T Risk assessment reporting requirements for brokers and dealers.

(a) *Reporting requirements of risk assessment information required to be maintained by section 240.17h-1T.* (1) Every broker or dealer registered with the Commission pursuant to section 15 of the Act, and every municipal securities dealer registered pursuant to section 15B of the Act for which the Commission is the appropriate regulatory agency, unless exempt pursuant to paragraph (b) of this section, shall file a Form 17-H within 60 calendar days after the end of each fiscal quarter. The Form 17-H for the fourth fiscal quarter shall be filed within 60 calendar days of the end of the fiscal year. The cumulative year-end financial statements required by section 240.17h-1T may be filed separately within 105 calendar days of the end of the fiscal year.

(2) The reports required to be filed pursuant to paragraph (a)(1) of this section shall be considered filed when received at the Commission's principal office in Washington, DC.

(3) For the purposes of this section, the term Material Associated Person shall have the meaning used in § 240.17h-1T.

(b) *Exemptions.* (1) The provisions of this section shall not apply to any broker or dealer which is exempt from the provisions of section 240.15c3-3:

(i) Pursuant to paragraph (k)(1) of § 240.15c3-3; or

(ii) Pursuant to paragraph (k)(2) of § 240.15c3-3; or

(iii) If the broker or dealer does not qualify for an exemption from the provisions of § 240.15c3-3 and such broker or dealer does not hold funds or securities for, or owe money or securities to, customers and does not carry the accounts of or for customers; unless

(iv) In the case of paragraphs (b)(1)(ii) or (b)(1)(iii) of this section, the broker or dealer maintains capital including debt subordinated in accordance with appendix D of § 240.15c3-1 equal to or greater than \$20,000,000.

(2) The provisions of this section shall not apply to any broker or dealer which maintains capital including debt subordinated in accordance with appendix D of § 240.15c3-1 of less than \$250,000, even if the broker or dealer hold funds or securities for, or owes money or securities to, customers or carries the accounts of or for customers.

(3) In calculating capital and subordinated debt for the purposes of this section, a broker or dealer shall include the equity capital and subordinated debt of any other registered brokers or dealers that are associated with the broker or dealer and are not otherwise exempt from the provisions pursuant to paragraph (b)(1)(i) of this section.

(4) The Commission may, upon written application by a Reporting Broker or Dealer, exempt from the provisions of this section, either unconditionally or on specified terms and conditions, any brokers or dealers associated with the Reporting Broker or Dealer. The term "Reporting Broker or Dealer" shall mean, in the case of a broker or dealer that is associated with other registered brokers or dealers, the broker or dealer which maintains the greatest amount of net capital as reported on its most recently filed Form X-17A-5. In granting exemptions under this section, the Commission shall consider, among other factors, whether the records and other information required to be maintained pursuant to § 240.17h-1T concerning the Material Associated Persons of the broker or dealer associated with the Reporting Broker or Dealer will be available to the Commission pursuant to the provisions of this section.

(c) *Special provisions with respect to material associated persons subject to the supervision of certain domestic regulators.* A broker or dealer shall be deemed to be in compliance with the reporting requirements of paragraph (a) of this section with respect to a Material Associated Person if:

(1) Such Material Associated Person is subject to examination by or the reporting requirements of a Federal banking agency and the broker or dealer or such Material Associated Person furnishes in accordance with paragraph (a) of this section copies of reports filed on Form FR Y-9C, Form FR Y-6, Form FR Y-7, and Form FR 2068 by the Material Associated Person with the Federal banking agency pursuant to section 5211 of the Revised Statutes, section 9 of the Federal Reserve Act, section 7(a) of the Federal Deposit Insurance Act, section 10(b) of the Home

Owners' Loan Act, or section 5 of the Bank Holding Company Act of 1956; or

(2) If the Material Associated Person is subject to the supervision of an insurance commissioner or other similar official agency of a state; and

(i) In the case of a Material Associated Person organized as a public stock company, the broker or dealer furnishes in accordance with the provisions of this section copies of the filings made by the insurance company pursuant to sections 13 or 15 of the Act and the Investment Company Act of 1940; or

(ii) In the case of Material Associated Person organized as a mutual insurance company or a non-public stock company, the broker or dealer furnishes in accordance with the provisions of this section copies of the Annual and Quarterly Statements prepared by the insurance company on forms prescribed by the National Association of Insurance Commissioners. The Annual Statement furnished to the Commission pursuant to this section shall include: The classification (distribution by state) section from the schedule of real estate; distribution by state, the interest overdue (more than three months), in process of foreclosure, and foreclosed properties transferred to real estate during the year sections from the schedule of mortgages; and the quality and maturity distribution of all bonds at statement values and by major types of issues section from the schedule of bonds and stocks. All other Schedules and Exhibits to such Annual and Quarterly Statements shall be maintained at the broker-dealer pursuant to the provisions of § 240.17h-1T but not furnished to the Commission.

(iii) In the event an insurance company organized as a stock or mutual company is not required to prepare Quarterly Statements, the broker or dealer must file with the Commission a Form 17-H in accordance with the provisions of this section on a quarterly basis.

(3) In the case of a Material Associated Person that is subject to the supervision of the Commodity Futures Trading Commission, the broker or dealer furnishes in accordance with the provisions of this section copies of the reports filed by the Material Associated Person with the Commodity Futures Trading Commission on Forms 1 FR-FCM or 1 FR-IB.

(4) No broker or dealer shall be required to furnish to the Commission any examination report of any Federal banking agency or any supervisory recommendations or analyses contained therein with respect to a Material Associated Person that is subject to the

regulation of a Federal banking agency. All information received by the Commission pursuant to this section concerning a Material Associated Person that is subject to examination by or the reporting requirements of a Federal banking agency shall be deemed confidential for the purposes of section 24(b) of the Act.

(5) The furnishing of any information or documents by a broker or dealer pursuant to this section shall not constitute an admission for any purpose that a Material Associated Person is otherwise subject to the Act. Any documents or information furnished to the Commission by a broker or dealer pursuant to this rule shall not be deemed to be "filed" for the purposes of the liabilities set forth in section 18 of the Act.

(d) *Special provisions with respect to material associated persons subject to the supervision of a foreign financial regulatory authority.* A broker or dealer shall be deemed to be in compliance with the reporting requirements of this section with respect to a Material Associated Person if such broker or dealer furnishes in accordance with the provisions of this section copies of the reports filed by such Material Associated Person with a Foreign Financial Regulatory Authority. The broker or dealer shall file a copy of the original report and a copy translated into the English language. For the purposes of this section, the term Foreign Financial Regulatory Authority shall have the meaning set forth in section 3(a)(51) of the Act.

(e) *Confidentiality.* All information obtained by the Commission pursuant to the provisions of this section from a broker or dealer concerning a Material Associated Person shall be deemed confidential information for the purposes of section 24(b) of the Act.

(f) *Temporary implementation schedule.* Every broker or dealer subject to the requirements of this section shall file the information required by Items 1, 2 and 3 of Form 17-H by October 31, 1992. Commencing December 31, 1992, the provisions of this section shall apply in their entirety.

PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934

4. The authority citation for part 249 continues to read as follows:

Authority: 15 U.S.C. 78a, *et seq.*, unless otherwise noted.

5. By adding § 249.328T to read as follows:

§ 249.328T Form 17-H, Risk assessment report for brokers and dealers pursuant to section 17(h) of the Securities Exchange Act of 1934 and rules thereunder.

This form shall be used by brokers and dealers in reporting information to the Commission concerning certain of their associated persons pursuant to section 17(h) of the Securities Exchange Act of 1934 [15 U.S.C. 78q(h)] and Rules 17h-1T and 17h-2T thereunder [§§ 240.17h-1T and 240.17h-2T of this chapter].

Note: This form will not appear in the Code of Federal Regulations.

**Securities and Exchange Commission,
Washington, DC 20549**

Form 17-H

Risk Assessment Report for Brokers and Dealers

Part I—Risk Assessment Reporting Requirements for Brokers and Dealers

SEC File No. _____
Crd No. _____
Name of Reporting Broker-Dealer _____
Address of Principal Place of Business _____
Firm I.D. No. _____
For Period Beginning (MM/DD/YY) _____
And Ending (MM/DD/YY) _____
Name and Telephone Number of Person To Contact in Regard to This Report _____
Name(s) of Material Associated Persons Contained in This Report: _____
Name of Associated Broker-Dealer(s) Not Filing (if applicable) _____

Attention

Intentional misstatements or omissions of facts constitute Federal Criminal Violations. See 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

Intentional misstatements or omissions of facts may also result in civil fines and other sanctions pursuant to Section 20 of the Securities Exchange Act of 1934.

The person signing this report represents hereby that all information contained in this Form is true, correct and complete. It is understood that all information in this Form is considered an integral part of this Form and that the submission of any amendment represents that all unamended information remains true, correct and complete as previously filed.

Pursuant to the Securities Exchange Act of 1934, the undersigned has caused this report to be signed on its behalf in the City of _____ and State of _____ on the _____ day of _____, 19____.

(Name of Broker-Dealer)

(Signature and Title of Person Duly Authorized to Submit This Report)

General Instructions

1. This Form consists of two parts. Part I consists of the organizational, policy and legal information required by paragraphs (a)(1)(i) through (iii) of section 240.17h-1T, together with the financial statements required by paragraphs (a)(1)(iv) and (v) of § 240.17h-1T. Part II contains line items for reporting the numerical and other data required by paragraphs (a)(1)(vi) through (x) of § 240.17h-1T

2. Report as of the last day of the fiscal quarter. This Form is to be filed within 60 calendar days of the end of each fiscal quarter by brokers and dealers concerning each Material Associated Person (as defined in Temporary Rules 17h-1T and 17h-2T). The Form for the fourth fiscal quarter shall be filed within 60 calendar days of the end of the fiscal year. The cumulative year end financial statements required by paragraphs (a)(1)(iv) and (v) of § 140.17h-1T may be filed separately within 105 calendar days of the end of the fiscal year.

3. In the event a broker or dealer is associated with one or more other registered brokers or dealers, each broker or dealer is required to file a separate Form 17-H. The Commission may exempt from the filing requirements all brokers or dealers associated with a broker or dealer that has been designated a "Reporting Broker or Dealer." The term "Reporting Broker or Dealer" shall have the meaning set forth in Rules 17h-1T and 17h-2T. A broker or dealer seeking designation as a Reporting Broker or Dealer must apply to the Commission for an exemption pursuant to Rule 17h-2T. Pending such designation, each broker or dealer associated with the broker or dealer requesting such designation as a Reporting Broker or Dealer is required to file a separate Form 17-H.

4. The information requested in Part II of this Form shall be completed separately for each Material Associated Person, even if the financial data contained in the broker or dealer's Form X-17A-5 contains information concerning a Material Associated Person. The broker-dealer should not include information concerning its activities in the information required by Part II of this Form if such information is filed with the Commission as part of the broker-dealer's Form X-17A-5 or Form G-405.

Item 1.—Organizational Chart Reflecting the Associated Persons and the Broker-Dealer

1. Provide a copy of the organizational chart maintained by the broker or dealer

pursuant to paragraph (a)(1)(i) of § 240.17h-1T.

2. The information provided pursuant to this Item should be included in the first Form 17-H filed by the broker or dealer and in the year end filing. Quarterly updates should be provided only where a material change in the information provided to the Commission has occurred.

Item 2.—Risk Management and Other Policies

1. Provide copies of the financing, capital adequacy, and risk management and other policies, procedures or systems maintained by the broker-dealer pursuant to paragraph (a)(1)(ii) of section 240.17h-1T.

2. The information provided pursuant to this Item should be included in the first Form 17-H filed by the broker or dealer. Quarterly updates should be provided only where a material change in the information provided to the Commission has occurred.

Item 3.—Legal Proceedings

1. Provide the description of any material pending legal or arbitration proceedings maintained by the broker or dealer pursuant to paragraph (a)(1)(iii) of § 240.17h-1T.

2. The information provided pursuant to this Item should be included in the first Form 17-H filed with the Commission. Quarterly updates should be provided only where a material change in the information provided to the Commission has occurred.

Item 4.—Financial Statements

1. Provide the information required to be maintained by the broker or dealer pursuant to paragraphs (a)(1)(iv) and (a)(1)(v) of § 240.17h-1T. The financial statements may be presented on an unaudited basis. The statement of cash flows and the notes to financial statements may be omitted for the consolidating financial statements. Entities using accounting principles other than U.S. GAAP should indicate in a note the accounting principles used.

2. The consolidating financial statements must be presented on a subsidiary basis and shall indicate which subsidiaries are Material Associated Persons.

Part II—General Instructions for Part II of This Form

1. Provide the following information for each Material Associated Person as of the end of the quarter. Indicate the name of each Material Associated Person in a separate column. In the event a separate listing of a position, financial instrument or otherwise is

required pursuant to any of the provisions of § 240.17h-1T the broker or dealer should indicate as such in the appropriate section of this Part II. Indicate a separate listing for long and short positions.

I. Aggregate Securities and Commodities Positions Indicate long and short positions separately)

- 1. U.S. Treasury securities.....
- 2. U.S. Government agency.....
- 3. Securities issued by states and political subdivisions in the U.S..
- 4. Foreign securities:
 - (a) Debt securities.....
 - (b) Equity securities.....
- 5. Banker's acceptance.....
- 6. Certificates of deposit.....
- 7. Commercial paper.....
- 8. Corporate obligations.....
- 9. Stocks and warrants (other than arbitrage positions).
- 10. Arbitrage:
 - (a) Index arbitrage and program trading.....
 - (b) Risk arbitrage.....
 - (c) Other arbitrage.....
- 11. Options:
 - (a) Market value of put options:
 - (i) Listed.....
 - (ii) Unlisted.....
 - (b) Market value of call options:
 - (i) Listed.....
 - (ii) Unlisted.....
- 12. Spot commodities.....
- 13. Investments with no ready market:
 - (a) Equity.....
 - (b) Debt.....
 - (c) Other (include limited partnership interests).
- 14. Other securities of commodities...
- 15. Summary of delta or similar analysis (if available).

II. Financial Instruments With Off-Balance Sheet Risk and With Concentration of Credit Risk (Provide notional or contractual amounts where appropriate, or in the case of options, the values of the underlying instrument. In the event a separate listing of a position or instrument is required pursuant to the provisions of section 17h-1T separately state such position separately.)

- A. Securities
 - 1. When-issued securities:
 - (a) Gross commitments to purchase.....
 - (b) Gross commitments to sell.....
 - 2. Written stock option contracts:
 - (a) Market value, and the value of the underlying securities, of call contracts:
 - (i) Listed.....
 - (ii) Unlisted.....
 - (b) Market value, and the value of the underlying securities, of put contracts:
 - (i) Listed.....
 - (ii) Unlisted.....

- (c) Market value, and the value of the underlying securities, of naked call contracts:
 - (i) Listed.....
 - (ii) Unlisted.....
- (d) Market value, and the value of the underlying securities, of naked put contracts:
 - (i) Listed.....
 - (ii) Unlisted.....

- 3. Futures:
 - (a) U.S. Treasury and mortgage-backed securities futures.
 - (b) Other futures (specify)
- 4. Forwards:
 - (a) U.S. Treasury and mortgage-backed securities.
 - (i) Aggregate current cost of replacing contracts by counterparty in which the Material Associated Person has a gain.
 - (ii) Per counterparty breakdown where credit risk exceeds the Materiality Threshold.
 - (b) Other forwards (specify).....
 - (i) Aggregate current cost of replacing contracts by counterparty in which the Material Associated Person has a gain.
 - (ii) Per counterparty breakdown where credit risk exceeds the Materiality Threshold.

B. Interest Rate Swaps

- 1. U.S. dollar denominated swaps:
 - (a) Total notional or contractual amount.
 - (b) Aggregate current cost of replacing contracts by counterparty in which the Material Associated Person has a gain.
 - (c) Per counterparty breakdown where credit risk exceeds the Materiality Threshold.
- 2. Cross currency swaps:
 - (a) Total notional or contractual amount.
 - (b) Aggregate current cost of replacing contracts by counterparty in which the Material Associated Person has a gain.
 - (c) Per counterparty breakdown where credit risk exceeds the Materiality Threshold.

C. Foreign exchange

- 1. Swaps:
 - (a) Total notional or contractual amount.
 - (b) Aggregate current cost of replacing contracts by counterparty in which the Material Associated Person has a gain.
 - (c) Per counterparty breakdown where credit risk exceeds the Materiality Threshold.
- 2. Notional or contractual amounts of commitments to purchase foreign currencies and U.S. dollar exchange:
 - (a) Future
 - (b) Forwards.....
 - (i) Aggregate current cost of replacing contracts by

counterparty in which the Material Associated Person has a gain.

- (ii) Per counterparty breakdown where credit risk exceeds the Materiality Threshold.

3. Contractual value together with value of the underlying instruments of naked written option contracts.

D. All other swap agreements (specify type)

- 1. Total notional or contractual amount.
- 2. Aggregate current cost of replacing contracts by counterparty in which the Material Associated Person has a gain.
- 3. Per counterparty breakdown where credit risk exceeds the Materiality Threshold.

E. Commodities

- 1. Futures.....
- 2. Forwards.....

(a) Aggregate current cost of replacing contracts by counterparty in which the Material Associated Person has a gain.

(b) Per counterparty breakdown where credit risk exceeds the Materiality Threshold.

3. Sold option contracts (e.g., options on individual commodities and commodities indexes)

(a) Market value, and the value of the underlying securities, of call contracts:

- (i) Listed.....
- (ii) Unlisted.....

(b) Market value, and the value of the underlying securities, of put contracts:

- (i) Listed.....
- (ii) Unlisted.....

(c) Market value, and the value of the underlying securities, of naked call contracts:

- (i) Listed.....
- (ii) Unlisted.....

(d) Market value, and the value of the underlying securities, of naked put contracts:

- (i) Listed.....
- (ii) Unlisted.....

F. Loan commitments

- 1. Total amount.....
- 2. Unused portion.....

G. Total standby, commercial and similar letters of credit or guarantees.

H. Assets sold with recourse

I. Other off-balance sheet items (specify).

J. Summary of delta or similar analysis (if available).

K. Provide a separate listing, by amount, of significant concentrations of credit risk as defined in Statement of Financial Accounting Standards 105.

III. Bridge Loans and Other Extensions of Credit

- 1. Bridge loans
- 2. Other material credit extensions (specify).

3. Allowance for losses for credit extensions.

IV. Funding Sources

1. Short-term borrowings:

- (a) Commercial paper
- (b) Bank loans-secured
- (c) Bank loans-unsecured
- (d) Other.....
- (e) Total.....

2. Long and medium-term debt

3. Committed lines of credit

4. Amounts borrowed under credit lines.

5. Credit ratings for commercial paper

- (a) Standard & Poor's Corporation.
- (b) Moody's Investor Service
- (c) Other Nationally Recognized Statistical Rating Organization.

V. Real Estate

1. Real estate loans:

(a) Construction and land development.

(b) Secured by farmland.....

(c) Secured by residential properties.

(d) Commercial and industrial.....

(e) Other.....

2. Real estate investments:

(a) Construction and land development.

(b) Farmland.....

(c) Residential properties.....

(d) Commercial and industrial.....

(e) Other.....

3. Provide a separate listing of the above information by geographic region where the amount exceeds the Materiality Threshold.

4. Provide information about risk concentration to a single borrower, location or property in the investment or loan portfolio where the amount exceeds the Materiality Threshold

Dated: July 16, 1992.

By the Commission.

Jonathan G. Katz,

Secretary.

[FR Doc. 92-17151 Filed 7-20-92; 12:01 am]

BILLING CODE 8010-01-M