rules and regulations

Title 17—Commodity and Securities Exchanges

CHAPTER I—COMMODITY FUTURES TRADING COMMISSION

PART 17—REPORTS BY FUTURES COMMISSION MERCHANTS AND FOREIGN BROKERS

PART 18—REPORTS BY TRADERS

Large-Trader Reporting Requirements for Foreign Brokers, Foreign Traders, and Futures Commission Merchants

The Commodity Futures Trading Commission ("Commission") has amended Parts 17 and 18 of the Regulations under the Commodity Exchange Act ("Act") to delay for a period of up to 60 days the application to foreign traders and foreign brokers of the large-trader reporting requirements for the commodities newly regulated under the Commodity Futures Trading Commission Act of 1974 ("CFTCA"),[1] and to require, for a similar period, futures commission merchants to report on a gross basis the positions in these commodities carried for omnibus accounts of foreign brokers. This action was taken after concern was expressed within the Commission about the effect of the new reporting requirements when applied to foreign-based traders and brokers.

These amendments do not affect reports required of foreign traders and foreign brokers for trades and positions in commodities regulated prior to the CFTCA, nor do they affect the July 7, 1975, effective date of the reporting requirements for futures commission merchants and domestic traders in the newly regulated commodities, including the requirement that futures commission merchants identify and report both foreign and domestic accounts in such commodities.

During this interim period of up to 60 days, the Commission intends to work with market users, exchange officials, and other interested persons to develop a better system of collecting market information relating to the activities of foreign-based traders and brokers in the newly regulated contract markets. The Commission recognizes that the reporting regulations which are being delayed for foreign traders and brokers may yet prove to be the best method of collecting the needed information. Those reporting requirements will become effective on September 4, 1975, or such earlier date as the Commission by ten days notice provides, unless an alternative method can be shown to provide a better solution to the problem of obtaining adequate information. The amendments require futures commission merchants, during this interim period, to report on a gross basis the positions in newly regulated commodities carried for omnibus accounts of foreign brokers, regardless of the requirements of the various exchanges. This reporting requirement will provide the Commission with useful information for daily market surveillance and provide an indication of the extent of foreign participation in the newly regulated contract markets. In those situations where the information reported by futures commission merchants indicates that positions carried for foreign brokers pose a threat to an orderly market, the regulations, as amended, permit the Commission by special call to require that reports be filed showing the identification of, and positions for, foreign-based individual traders in omnibus accounts of foreign brokers. The regulations further permit the Commission by special call to require reports directly from any foreign-based individual trader.

STATUTORY AUTHORITY

Because the reporting requirements respecting the newly regulated commodities, including their application to foreign traders and foreign brokers, became effective on July 7, 1975, the Commission finds that the notice and public procedure specified in 5 U.S.C. 553(b) and the publication 30 days before effective date specified in 5 U.S.C. 553(d) are impractical and unnecessary and would be contrary to the public interest. In consideration of the foregoing, Parts 17 and 18 in Chapter I of Title 17 of the Code of Federal Regulations have been amended, effective July 7, 1975, as follows:

1. Part 17 is amended by adding §§ 17.04 and 17.05 to read as follows:

§ 17.04 Reports by Foreign Brokers.

The requirements under Part 17 of these regulations concerning reports of foreign brokers shall be suspended until September 4, 1975, or such earlier date as the Commission upon 10 days notice provides, with respect to any commodity regulated under the Act but not specifically set forth in section 2(a) of the Act prior to the enactment of the Commodity Futures Trading Commission Act of 1974, except that a foreign broker shall file such reports within one business day after a special call upon such foreign broker by the Commission.

§ 17.05 Reports by Futures Commission Merchants.

When submitting reports required by § 17.00(a) of these regulations respecting omnibus accounts of foreign brokers, each futures commission merchant shall show gross positions (i.e., the total long open contracts and the total short open contracts for all individual accounts included in any such omnibus account) in any commodity regulated under the Act but not specifically set forth in Section 2(a) of the Act prior to the enactment of the Commodity Futures Trading Commission Act of 1974.

NOTE.—This § 17.05 shall expire on September 4, 1975, or such earlier date as the Commission upon 10 days notice provides.

2. Part 18 is amended by adding § 18.07 to read as follows:

§ 18.07 Reports by Foreign Traders.

Any trader located outside of the United States or its territories shall not be required, until September 4, 1975, or such earlier date as the Commission upon 10 days notice provides, to file the reports required by this Part 18 of these regulations for any commodity regulated under the Act but not specifically set forth in section 2(a) of the Act prior to the enactment of the Commodity Futures Trading Commission Act of 1974, except that any such trader is required to file such reports within one business day after a special call upon such trader by the Commission.

(7 U.S.C. 6i, 12a(5))

Issued in Washington, D.C. on July 10, 1975.

WILLIAM T. BAGLEY,
Chairman, Commodity Futures Trading Commission.

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[1] See 40 FR 23994-6 (June 4, 1975).

CHAPTER II—SECURITIES AND EXCHANGE COMMISSION

[Rel. No. 34-11497]

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

Adoption of Uniform Net Capital Rule and an Alternative Net Capital Requirement for Certain Brokers and Dealers

The Securities and Exchange Commission today announced the adoption of a uniform net capital rule, Rule 15c3-1 (17 CFR 240.15c3-1), effective September 1, 1975 subject to the transitional provisions of paragraph (g) of the rule which delay the effective date of certain provisions to January 1, 1976. The delayed effective date for certain of the rule's provisions has been provided in order to insure that the broker-dealer community and all those who will be required to work with the rule will be able to become thoroughly familiar with its provisions. The adoption of the uniform net capital rule follows the Commission's consideration of comments re-

ceived in response to Securities Exchange Act Release No. 11094 (November 11, 1974). The new rule discontinues the exemption heretofore embodied in the Commission's net capital rule for members of designated national securities exchanges (other than certain specialists) required to comply with net capital rules of such exchanges.

The rule, as adopted, continues the basic net capital concept under which the securities industry has operated for many years and, in addition, introduces an alternative concept to measure the capital adequacy of broker-dealers. The approaches to capital adequacy and financial responsibility embodied in the rule are designed to balance the need for adequate protection for customer assets and the need for flexibility in efficiently using and deploying the financial resources of the securities industry.

I. Uniform Rule 15c3-1

A. Introduction

On November 11, 1974, the Commission published for comment revisions to the proposed uniform net capital rule and announced its intention to adopt the uniform rule after the expiration of the comment period. The rule had previously been published for comment in Securities Exchange Act Release No. 9891 (December 5, 1972) and Securities Exchange Act Release No. 10525 (November 29, 1973). In order to ease the transition to a uniform rule for many brokers and dealers, the Commission has incorporated provisions in the uniform net capital rule which currently exist in superseded capital rules of national securities exchanges, including the concepts of secured demand note capital and a modified flow through of capital from subsidiaries. The Commission will monitor carefully those provisions and strengthen them where experience dictates that such action is necessary or appropriate. In addition, because of the comoprehensive nature of the uniform net capital rule, some of its provisions have been modified from the form proposed on November 11, 1974, to clarify application of the rule. Other suggestions to further refine the rule would be carefully considered by the Commission. The following is a summary of changes in the uniform rule as adopted from the rule as now in effect. The summary also highlights changes from the rule as proposed on November 11, 1974.

B. Minimum Net Capital Requirements

1. The rule as adopted reduces from 20:1 to 15:1 the maximum ratio of aggregate indebtedness to net capital which a broker or dealer may maintain.

2. The $5,000 minimum net capital requirement has been extended to brokers or dealers who engage in the sale of mutual funds on a direct wire order basis and certain floor brokers who effect but do not clear transactions for other brokers or dealers.

3. A $50,000 minimum net capital requirement has been established for writers and endorsers of options where such options are not listed on a registered national securities exchange.

4. Finally, for market makers the rule as adopted requires minimum net capital requirements equal to $25,000 or $2,500 per security in which such broker or dealer makes a market with a maximum requirement of $100,000 or a 15:1 ratio, whichever is greater. For securities which have a market value of less than $5 per share a minimum requirement of $500 for each such security has been retained.

C. Exemptions

The rule as adopted separately classifies stock exchange specialists who do not deal with other than members, brokers or dealers and certain specialists and market makers in options under specified circumstances and exempts such classes from the rule. The rules, settled practices and applicable regulatory procedures of the American Stock Exchange, Boston Stock Exchange, Midwest Stock Exchange, New York Stock Exchange, Pacific Stock Exchange, PBW Stock Exchange and the Chicago Board Options Exchange are satisfactory to the Commission to permit the separate classification of such market makers and specialists and their exemption from the provisions of the rule.

It should be noted, however, that section 15(c)(3) of the Securities Exchange Act of 1934 ("the Act") requires the establishment of minimum financial responsibility requirements for all brokers and dealers. The application of financial responsibility requirements to specialists presents unique questions which are still being explored by the Commission and, while the alternative approach adopted today appears to be a possible solution to this question, the Commission believes further study is warranted. The Commission expects to conclude its review as promptly as practicable.

The Commission also wishes to note that the recent amendments to the Act would make the net capital rule applicable to municipal securities brokers and municipal securities dealers but would not be applicable to banks as defined in the Act. The Commission welcomes any comments which municipal securities brokers and dealers may have respecting the application of these requirements, and any special problems which may be encountered by them.

D. Aggregate Indebtedness

1. *Indebtedness Collateralized by Exempted Securities.* The rule as adopted gives brokers or dealers the option of charging net capital by an amount equal to 4% of any indebtedness collaterialized by exempted securities in lieu of including the amount of such indebtedness in the computation of aggregate indebtedness under the rule.

2. *Deferred Income Taxes.* Deferred income tax liabilities, recognized by the broker or dealer pursuant to generally accepted accounting principles, may be excluded from aggregate indebtedness under the rule.

E. Net Capital

1. *Fixed Assets.* As revised from the November proposal, the rule permits the deduction of fixed assets and assets which cannot readily be converted to cash, net of any indebtedness adequately secured thereby, if the fixed assets have been acquired for use in the ordinary course of the trade or business of a broker or dealer; however, insofar as fixed assets are not acquired for use in the trade or business of the broker or dealer, they will be deducted net of any indebtedness secured thereby only if the lender's sole recourse in the event of a default in the payment of such indebtedness is solely to such assets.

2. *Deficits in Certain Accounts of Customers.* As adopted, the rule requires a broker or dealer who permits a customer's account to be carried on an unsecured or partly secured basis or who maintains a customer's cash account in deficit where more than one extension under Regulation T of the Board of Governors of the Federal Reserve System has been granted with respect to a specified securities transaction to treat such accounts as if they were proprietary accounts and the broker or dealer is required to apply the appropriate haircut on the securities contained in such account so that the collection risk and the resultant market risk in accounts which are unsecured or partly secured will be recognized as being borne by the broker or dealer.

3. *Good Faith Deposits.* The rule as adopted makes clear that good faith deposits must be deducted from net worth as an asset not readily convertible to cash if not returned to the broker or dealer within 11 business days subsequent to the settlement date of the underwriting with an issuer.

4. *Free Shipments of Securities.* The rule as adopted requires a deduction from net worth for receivables arising out of free shipments of securities (other than mutual fund redemptions) in excess of $5,000 per shipment and all free shipments (including mutual fund redemptions) outstanding more than 7 business days.

5. *Certain Municipal Bond Trusts and Liquid Asset Funds.* Since the maximum haircut for securities contained within the portfolio of a liquid asset fund or municipal bond unit investment trust is 5%, the rule as adopted provides for a haircut of 5% on the broker's or dealer's proprietary or other positions in such funds or trusts.

6. *Commercial Paper and Non-Convertible Debt Securities.* Under the rule as adopted commercial paper and nonconvertible debt securities will receive haircuts based on their remaining time to maturity, if rated in the appropriate categories by at least two nationally recognized statistical rating organizations rather than one such organization as proposed in Securities Exchange Act Release No. 11094.

7. *Undue Concentration.* The rule as adopted continues to require an undue

concentration haircut where any security position owned by the broker or dealer and in position for more than 11 business days exceeds 10% of the net capital of the broker or dealer before the application of haircuts. In addition, the rule as adopted permits the Examining Authority of the broker or dealer to reduce the undue concentration charge for a specialist who is subject to the rule with respect to his specialty stock where it is in the public interest to do so.

8. *Fails to Receive and Fails to Deliver.* The rule as adopted excludes from aggregate indebtedness fail to receive contracts where the broker or dealer does not carry a contra long position in such securities in a customer's account. However, in order to encourage the prompt elimination of failing contracts, the rule requires that until January 1, 1977, any fail to deliver contract outstanding more than 15 business days past settlement be treated as if it were a proprietary position of the broker or dealer by marking the contract to the market and applying a haircut. After January 1, 1977, fail to deliver contracts will be treated as proprietary positions of the broker or dealer if they are outstanding more than 11 business days. Any adverse movement of the market value of the security which is the subject of a fail to deliver is to be charged against capital and any favorable movement of the underlying security would serve to reduce the haircut.

9. *Options*—a. *Positions of Markets Makers and Specialists in Options.* The rule requires specialists, market makers, and registered traders in options who either transact business with other than members, brokers or dealers or who are clearing members of the Options Clearing Corporation ("OCC") to comply with the basic provisions of the net capital rule as they relate to options. However, the rule will continue to classify separately and exempt market makers and specialists who are not clearing members of the OCC and who do not transact a business in securities with other than members, brokers and dealers. In that connection, the rule incorporates specific net capital treatment for brokers and dealers carrying the accounts of such options specialists, market makers and registered traders. The Commission anticipates that market maker, specialist and registered trader capital requirements will be amended periodically to provide for modifications of those requirements as the option market may evolve.

b. *Determination of Net Worth and Unrealized Profits and Losses in Options.* These provisions of the rule have been substantially revised to clarify the determination of net worth and unrealized profits and losses in options and related securities positions which may be hedged by options.

These provisions provide, in part, that options positions should, for net worth purposes, be carried at their market value and, in addition, describe the manner in which the proceeds received from writing options are to be recognized. As proposed in November, the rule would have treated the cost or proceeds of listed options as if they were long or short securities positions and would not have included the proceeds received from writing options in net worth; as revised, such cost or proceeds are treated as premium expense or income where such options are related to long or short securities positions or short positions in options.

c. *Options Haircuts.* The determination of the appropriate haircuts for positions in options have not changed from the prior public exposure of the rule and may be found in Appendix A (17 CFR 240.15c3–1a) to the rule. Those haircuts follow existing industry practice; the Commission believes, however, that it is appropriate to review on a continuing basis the level of haircuts to be applied to options positions and to make further adjustments as more experience is gained with the operation of option markets. In particular, the provisions with respect to haircuts on long options may be revised to establish an appropriate relationship between haircuts applied to the securities underlying options and the relatively higher price volatility of options compared to the underlying security.

10. *U.S. Government Securities.* Under the rule as adopted, government securities subject to repurchase agreements are to be treated as if owned by the broker or dealer with an appropriate haircut applied to the market value of the security. In the case of reverse repurchase agreements for U.S. Government securities, such transactions result in the broker having a secured receivable from the person who has, in effect, borrowed funds from the broker or dealer; therefore, any capital charge will be limited ot the deficiency, if any, in the securities collateralizing the receivable. Finally, matched repurchase agreements which result in fully secured matched contractual commitments to buy or sell the U.S. government securities subject to the agreements should not normally receive a capital charge.

11. *Satisfactory Subordination Agreements.* The rule as adopted sets forth in a separate Appendix D (17 CFR 240.15c3–1d) to the rule the requirements for satisfactory subordination agreements.

The rule makes clear that subordinated capital contributions may be made only in the form of contributions of cash or securities; however, all contributions of securities must be made pursuant to a secured demand note arrangement. The Appendix defines the minimum standards for the contribution and form of secured demand notes as well as subordinated contributions of cash. Appendix D should be carefully examined by broker-dealers and their counsel in preparing subordination agreements.

12. *Flow Through Capital from Subsidiaries and Affiliates.* Appendix C (17 CFR 240.15c3–1c) to the rule sets forth the requirements which must be met to consolidate in a single net capital computation the assets and liabilities of subsidiaries and affiliates in order to obtain flow through capital benefits for a parent broker or dealer.

The rule as adopted provides that flow through capital benefits can be available to the parent only if the subsidiary or affiliate is majority-owned or controlled and only if the assets of the subsidiary or affiliate or the broker's or dealer's interest therein may be distributed to the broker or dealer within a 30 day period. In addition, subordinated obligations of the subsidiary may not serve to increase the net worth of the parent unless the obligations are also subordinated to the claims of present and future creditors of the parent. The rule as adopted also requires that liabilities which are guaranteed by the broker or dealer be reflected in the firm's net capital computation.

The rule as adopted restricts flow through capital treatment currently provided under exchange net capital rules by requiring the computation of net capital and aggregate indebtedness to be made on a fully consolidated basis as well as placing limitations on the withdrawal of capital from such consolidated subsidiaries. The Commission will carefully monitor the effect of the flow through capital provisions and may modify them where appropriate.

F. DEBT-EQUITY REQUIREMENTS

The rule as adopted requires that a broker or dealer must maintain equity, as defined, equal to 30% of its debt-equity total, as defined. For this purpose, the rule provides that a subordination agreement with an initial term of three years and a remaining term of at least 1 year contributed by a partner or stockholder of the broker or dealer may be treated as equity with respect to the rule's debt-equity requirement. At such time as the remaining term of such subordination agreement is less than 1 year, it will cease to be equity under the rule unless the term is extended by the lender.

II. Alternative Net Capital Requirement

The Commission in adopting the alternative net capital requirement has determined to adopt a new concept to measure the capital adequacy of brokers or dealers. The Commission believes the new approach will insure the protection of investors as well as improve the ability of brokers or dealers to meet the future needs of the nation's corporate issuers to raise both equity and debt capital in the evolving central market.

The implementation of Rule 15c3–3 (17 CFR 240.15c3–3), with its objective of furnishing protection for the integrity of customers' funds and securities, has made it no longer necessary to rely solely on net capital requirements to insure the protection of investors. Ultimately, it may be possible for Rule 15c3–3 (17 CFR 240.15c3–3) in some form to replace the liquidity requirements of the net capital rule and become the primary source of protection to customer assets held by

the broker or dealer. The alternative approach adopted today moves in that direction.

The key factors which distinguish the securities industry from other industries are its custodial responsibility for customers' funds and securities and its role in facilitating capital raising for government and corporations. Accordingly, the scope and purpose of any rules and regulations concerning the fiscal responsibility of a broker or dealer should focus upon the construction of an environment in which financial miscalculations of a broker or dealer do not result in loss to its customers or the customers of another broker or dealer. The Commission believes the alternative approach will effectively create and maintain an environment of customer protection while enabling the securities industry to fulfill its function of capital raising and the maintenance of a liquid secondary market by:

1. Acting as an effective early warning device to provide reasonable assurance against loss of customer assets through a logical interface with other operation standards and existing surveillance, reporting and examination aspects of the securities industry regulatory framework;

2. Avoiding the inefficient and costly commitment of capital within the securities industry where such a commitment is not necessary for customer protection;

3. Eliminating, to the extent possible and consistent with the objective of customer protection, competitive restraints on the securities industry's ability to compete effectively with other diversified financial institutions;

4. Making the capital structures of brokers and dealers as well as their investment and operating policies more understandable to lending institutions and other suppliers of capital and to the public; and

5. Providing some reasonable and finite limitation on broker-dealer expansion to minimize the possibility of customer loss and the possibility that the SIPC Fund will have to be utilized to protect customers.

1. ALTERNATIVE NET CAPITAL REQUIREMENT

Rule 15c3–1(f) (17 CFR 240.15c3–1(f)) as adopted establishes a minimum net capital or liquidity standard which is designed to measure the general financial integrity and liquidity of a broker or dealer and the minimum net capital deemed necessary to meet the broker's or dealer's continuing commitments to its customers. The alternative also indicates to other creditors with whom the broker or dealer may deal what portion of its liquid assets in excess of that required to protect customers is available to meet other commitments of the broker or dealer. In addition, the amount of the firm's liquid assets in excess of the broker's or dealer's minimum requirement necessary to protect customers gives the Commission, self-regulators and SIPC sufficient early warning to take appropriate action to protect customers prior to the time when the broker's or dealer's assets would be insufficient to satisfy customers' claims in the event of liquidation.

While the alternative eliminates the traditional standard of limiting obligations of brokers or dealers (i.e., the ratio of aggregate indebtedness to net capital), its substitutes the aggregate dollar amount of firm assets which have as their source transactions with customers (i.e., items includable in the Formula for Determination of Reserve Requirements for Brokers and Dealers ("Reserve Formula") as the standard for determining the maximum permissible level of the broker's or dealer's customer-related activity. Rule 15c3–1(f) (17 CFR 240.15c3–1(f)), thus, requires a broker-dealer to maintain minimum net capital equal to the greater of $100,000 or 4% of aggregate debit balances includable in the Reserve Formula.

The alternative as adopted will be applicable only to brokers or dealers who have not elected to operate pursuant to an exemption from Rule 15c3–3 (17 CFR 240.15c3–3) through either subparagraphs (k)(1) or (k)(2)(i). Brokers or dealers who meet the requirements of subparagraph (k)(2)(ii) of Rule 15c3–3 (17 CFR 240.15c3–3) and introduce all customer transactions to another broker or dealer on a fully disclosed basis are eligible to operate pursuant to Rule 15c3–1(f) (17 CFR 240.15c3–1(f)), if they maintain minimum net capital of at least $100,000.

Since the alternative approach provides a carefully refined and structured measurement of customer obligations, it is appropriate to enhance the ability of brokers or dealers to engage in market making, block positioning and specializing in equity securities. To achieve this objective, the alternative approach reduces the haircut on long positions in equity securities to 15% of the market value of such securities. Generally, the rule exempts short positions in equity securities from any haircut to the extent such positions do not exceed 25% of the broker's or dealer's long positions in equity securities. However, the alternative approach requires a 30% haircut on security positions in excess of the 25% exclusion.

Because the alternative approach seeks to measure the general financial integrity of the broker or dealer, it is appropriate to adopt more stringent requirements to guard against brokers or dealers overextending themselves by unduly concentrating their assets in any one security position. Consequently, the alternative approach results in an additional 15% haircut on equity positions to the extent they exceed 10% of net capital before the application of haircuts, and such undue concentration charges would be imposed immediately rather than be delayed for 11 business days as provided in the basic rule. However, in the case of security positions which result from the broker's or dealer's underwriting activity, the additional charge would be imposed after 11 business days.

Under the alternative, specialists who deal with the public and who are, therefore, subject to the rule may be exempted from the undue concentration provisions of the rule with respect to their specialty securities upon appropriate application to the Examining Authority for such specialist if the Examining Authority finds it in the public interest to do so.

Under the alternative, the haircut on risk arbitrage transactions is the lesser of the haircut provided for equity securities generally under Rule 15c3–1 (f) (17 CFR 240.15c3–1(f)) or 30% of the greater of the long or short position in the arbitrage transaction.

In addition, the alternative approach precludes the withdrawal of equity capital if the broker's or dealer's minimum net capital is less than 7% of aggregate Reserve Formula debits, and subordinated capital may not be withdrawn if the broker's or dealer's minimum net capital would be less than 6% of aggregate Reserve Formula debits.

2. MODIFICATIONS TO RULE 15C3–3 (17 CFR 240.15C3–3

As mentioned earlier, the Commission believes that the objectives of the alternative approach can only be achieved by further strengthening the custodial requirements and Reserve Formula safeguards developed for the protection of customer assets established by Rule 15c 3–3 (17 CFR 240.15c3–3).

Thus, the alternative as adopted requires aggregate debit items in the Reserve Formula to be reduced by 3% rather than the 1% reduction of certain debit items which now exists. This reduction of debit items will thus provide, in the event of a liquidation, an additional cushion of secured debit items which will be available to satisfy customers with whom the broker or dealer effects transactions. In addition, the alternative would require that stock record differences and suspense account items be included in the Reserve Formula after 7 business days.

Finally, the alternative has been revised to provide that fails and any related receivables which arise as a result of the failure of issuers to make timely delivery of newly issued government securities or money market instruments to the broker or dealer may be excluded from the Reserve Formula for 3 business days.

3. DIVISION OF MARKET REGULATION INTERPRETATION OF ITEMS INCLUDABLE IN THE RESERVE FORMULA

The alternative requirement is founded upon the broker's or dealer's aggregate Reserve Formula debits as determined by Exhibit A to Rule 15c3–3 (17 CFR 240.-15c3–3a). Therefore, the allocation methods used to determine which fail contracts relate to proprietary accounts as opposed to customer accounts and which securities borrowed or loaned relate to proprietary or customer transactions are particularly important since they directly affect the level of aggregate debits of a broker or dealer and, consequently, determine the level of its

minimum net capital requirement. The Commission, therefore, has determined to publish the following interpretations of the Division of Market Regulation respecting the various allocation approaches to be followed under Rule 15c3–3 (17 CFR 240.15c3–3) regardless of whether the broker or dealer elects to operate under the alternative approach.

a. *Fails to Deliver vs. Fails to Receive.* Fails to receive which are not allocable to long positions in the proprietary or other accounts of the broker or dealer and fails to deliver which are not allocable to short positions in the proprietary or other accounts of the broker or dealer are customer related and should be included in the computation of the Reserve Formula.

b. *Stock Loaned vs. Stock Borrowed.* Amounts representing stock borrowed which are not allocable to short securities positions in customer accounts or other items includable in the Reserve Formula and amounts representing stock loans which are not allocable to long securities positions in customer accounts or other items includable in the Reserve Formula should be excluded from the Reserve Formula.

c. *Principal Transactions with Customers.* Where a dealer purchases securities as principal from his customer and where such securities have not been resold by the broker or dealer, the credit balance due to the customer arising from his sale of securities to the broker or dealer may be excluded from the Reserve Formula until the securities sold have been delivered by the customer.

d. *Fails to Deliver vs. Securities in Possession or Control in Excess of Segregation Requirements.* Where an amount representing securities failed to deliver is allocable to securities in the broker's or dealer's physical possession and such securities are in excess of the broker's or dealer's possession or control requirement, the fail to deliver amount should be excluded from the Reserve Formula.

Effective Date—Transitional Provisions

As noted earlier, the Commission has determined to delay the effective date of certain of the rule's provisions in order to enable broker-dealers and the various Examining Authorities to become thoroughly familiar with the rule's provisions. The Commission also recognizes that the transition to the new rule will require broker-dealers to make significant adjustments to their recordkeeping systems in order to insure their ability to effectively accumulate the data necessary to compute net capital, aggregate indebtedness, and the alternative net capital requirement. In addition, the various designated Examining Authorities will be required to revise their reporting and surveillance systems in order to properly monitor the financial conditions of their members and their compliance with the rule. Finally, a substantial educational effort will be required over the next several months to insure that broker-dealers and their operating personnel are thoroughly trained in the operation of the rule.

Accordingly, the Commission has determined that both the minimum net capital requirements and the maximum permissible net capital ratio at which a broker-dealer may operate as set forth in paragraph (a) of the rule shall become effective on September 1, 1975. In addition, Appendix D of the rule regarding satisfactory subordination agreements will also become effective on September 1, 1975.

The effect of implementing these provisions on September 1, 1975 will be to establish minimum financial responsibility requirements for all brokers and dealers. New minimum capital requirements for floor brokers, market makers and broker-dealers who write or endorse options otherwise than on a national securities exchange will be effective on September 1, 1975. In addition, all broker-dealers will be required to operate under a uniform maximum ratio of aggregate indebtedness to net capital of 15 to 1, thereby making uniform the requirements presently applicable to broker-dealers who are members of the NASD, SECO, and the PBW with the net capital ratio requirements applicable to all other broker-dealers.

Further, the implementation of Appendix D respecting satisfactory subordination agreements on September 1, 1975 will insure that all broker-dealers will be subject to a uniform provision respecting the permanency of subordinated capital and uniform subordinated debt retention requirements.

Paragraph (g) of the rule would delay until January 1, 1976 the requirement of all brokers and dealers to compute net capital, aggregate indebtedness and the alternative net capital computation pursuant to the new rule. In this connection, the Commission has required that all Examining Authorities submit to the Commission no later than July 31, 1975 a plan setting forth the steps the Examining Authority will be required to take (including but not limited to modifications of reporting and surveillance requirements and the education of both examiners and broker-dealers) in order to provide for an orderly transition to all provisions of the rule by January 1, 1976.

Statutory Authority and Competitive Considerations

These amendments to 17 CFR 240.15c3–1 and the adoption of 17 CFR 240.15c3–1a–d are adopted pursuant to the Securities Exchange Act of 1934 (the "Act") particularly sections 10(b), 15(c)(3), 17(a) and 23(a) thereof, effective September 1, 1975. As previously noted, adoption of a uniform net capital rule has been under consideration by the Commission since 1972; adoption of a uniform net capital rule was one of the recommendations of the Commission's *Study of Unsafe and Unsound Practices of Brokers and Dealers* (Report and Recommendations of the Securities and Exchange Commission, December 1972, House Document No. 92–231 at p. 5) prepared pursuant to section 11(h) of the Securities Investor Protection Act of 1970. The Securities Act Amendments of 1975 (Pub. L. 94–29) amended section 15(c)(3) of the Act to require promulgation of minimum financial responsibility requirements for all brokers and dealers by September 1, 1975.

The rule as adopted will have an impact on competition. In some instances the minimum amounts of net capital are the same as amounts heretofore required under Rule 15c3–1 (17 CFR 240.15c3–1) and under applicable exchange rules; however, the method of calculating net capital and aggregate indebtedness has been altered and, as noted, the permissible ratio of aggregate indebtedness to net capital has been lowered from 20:1 to 15:1 for brokers and dealers who do not (or cannot) elect the alternative capital requirement. The uniform net capital rule may, consequently, increase the amount of capital required for brokers or dealers or for prospective brokers or dealers, thereby raising entry levels for participation in the securities industry; in addition, the changes in the calculations of the net capital ratio may reduce the amount of business which some brokers or dealers will be permitted to engage in with a given amount of capital. Finally, in certain lines of business, brokers and dealers compete with other types of financial institutions which are separately regulated and may not be subject to equivalent financial requirements.

The Commission has determined, however, that any burden on competition imposed by the uniform net capital rule is necessary and appropriate in furtherance of the purposes of the Act and that the rule is necessary and appropriate to implement the provisions of the Act, and in particular section 15(c)(3) thereof, to provide safeguards with respect to the financial responsibility and related practices of brokers or dealers; to eliminate illiquid and impermanent capital; and to assure investors that their funds and securities are protected against financial instability and operational weaknesses of brokers or dealers.

In 17 CFR Chapter II, §§ 240.15c3–1, 240.15c3–1a, 240.15c3–1b, 240.15c3–1c, and 240.15c3–1d are revised to read as follows:

§ 240.15c3–1 Net capital requirements for brokers or dealers.

(a) No broker or dealer shall permit his aggregate indebtedness to all other persons to exceed 1500 percentum of his net capital, except as otherwise limited by the provisions of subparagraph (a)(1), or, in the case of a broker or dealer electing to operate pursuant to paragraph (f) of this section, no broker or dealer shall permit his net capital to be less than 4 percent of aggregate debit items as computed in accordance with § 240.15c3–3a of this Chapter, except as otherwise limited by paragraph (f) of this section, and every broker or dealer shall have the net capital necessary to comply with the following conditions, except as otherwise

provided for in paragraph (f) of this section.

(1) *Brokers or Dealers Engaging in a General Securities Business.* No broker or dealer, except one who operates under paragraph (f) of this section, shall permit his aggregate indebtedness to all other persons to exceed 800 percentum of his net capital for 12 months after commencing business as a broker or dealer and, except as otherwise provided for in paragraph (a) or paragraph (f) of this section, the broker or dealer shall at all times have and maintain net capital of not less than $25,000 or $25,000 plus the sum of each broker or dealer subsidiary's minimum net capital requirement which is consolidated pursuant to Appendix (C) (17 CFR 240.15c3-1c).

(2) *Brokers Who Do Not Generally Carry Customers' Accounts.* Notwithstanding the provisions of subparagraph (a)(1) hereof, a broker or dealer shall have and maintain net capital of not less than $5,000 if he does not hold funds or securities for, or owe money or securities to, customers and does not carry accounts of, or for, customers, except as provided for in subdivision (v) below, and he conducts his business in accordance with one or more of the following conditions and does not engage in any other securities activities;

(i) He introduces and forwards as a broker all transactions and accounts of customers to another broker or dealer who carries such accounts on a fully disclosed basis and (the introducing broker or dealer) promptly forwards all of the funds and securities of customers received in connection with his activities as a broker;

(ii) He participates, as broker or dealer, in underwritings on a "best efforts" or "all or none" basis in accordance with the provisions of 17 CFR 240.15c2-4(b)(2) and he promptly forwards to an independent escrow agent customers' checks, drafts, notes or other evidences of indebtedness received in connection therewith which shall be made payable to such escrow agent;

(iii) He promptly forwards, as broker or dealer, subscriptions for securities to the issuer, underwriter, sponsor or other distributor of such securities and receives checks, drafts, notes or other evidences of indebtedness payable solely to the issuer, underwriter, sponsor or other distributor who delivers the securities purchased directly to the subscriber;

(iv) He effects an occasional transaction in securities for his own investment account with or through another registered broker or dealer;

(v) He acts as broker or dealer with respect to the purchase, sale and redemption of redeemable shares of registered investment companies or of interests or participations in insurance company separate accounts, whether or not registered as an investment company, and he promptly transmits all funds and delivers all securities received in connection with such activities;

(vi) He introduces and forwards all customer and all principal transactions with customers to another broker or dealer who carries such accounts on a fully disclosed basis and promptly forwards all funds and securities received in connection with his activities as a broker or dealer and does not otherwise hold funds or securities for or owe money or securities to, customers and does not otherwise carry proprietary (except as provided in subdivision (a)(2)(iv) above) or customer accounts and his activities as dealer are limited to holding firm orders of customers and in connection therewith: (A) in the case of a buy order, prior to executing such customers' order, purchases as principal the same number of shares or purchases shares to accumulate the number of shares necessary to complete the order which shall be cleared through another broker or dealer or (B) in the case of a sell order, prior to executing such customers' order, sells as principal the same number of shares or a portion thereof which shall be cleared through another broker or dealer; or

(vii) He effects, but does not clear, transactions in securities as a broker on a registered national securities exchange for the account of another member of such exchange.

(3) *Brokers or Dealers Engaged Solely in the Sale of Redeemable Shares of Registered Investment Companies and Certain Other Share Accounts.* Net capital of not less than $2,500 shall be maintained by a broker or dealer who engages in no other securities activities except those prescribed in this subparagraph and who meets all of the following conditions:

(i) His dealer transactions are limited to the purchase, sale and redemption of redeemable shares of registered investment companies or of interests or participations in an insurance company separate account, except that he may also effect an occasional transaction in other securities for his own investment account with or through another registered broker or dealer;

(ii) His transactions as broker are limited to: (A) the sale and redemption of redeemable shares of registered investment companies or of interests or participations in an insurance company separate account whether or not registered as an investment company; (B) the solicitation of share accounts for savings and loan associations insured by an instrumentality of the United States; and, (C) the sale of securities for the account of a customer to obtain funds for immediate reinvestment in redeemable securities of registered investment companies; and

(iii) He promptly transmits all funds and delivers all securities received in connection with his activities as a broker or dealer, and does not otherwise hold funds or securities for, or owe money or securities to, customers.

(4) *Certain Additional Capital Requirements for Market Makers.* Notwithstanding the provisions of subparagraphs (a)(1), (2) and (3), a broker or dealer engaged in activities as a market maker as defined in subparagraph (c)(8) of this section shall maintain net capital in an amount not less than $2,500 for each security in which he makes a market (unless a security in which he makes a market has a market value of $5 or less in which event the amount of net capital shall be not less than $500 for each such security) based on the average number of such markets made by such broker or dealer during the 30 days immediately preceding the computation date, except that under no circumstances shall he have net capital less than that required by subparagraph (a)(1), or be required to maintain net capital of more than $100,000 unless otherwise required by the provisions of paragraphs (a) or (f) of this section.

(5) *Certain Additional Capital Requirements for Brokers or Dealers Engaged in the Sale of Options.* Notwithstanding the provisions of subparagraphs (a)(1)-(4), a broker or dealer who endorses or writes options, including but not limited to puts, calls, straddles, strips, or straps otherwise than on a registered national securities exchange or a facility of a registered national securities association shall have net capital of not less than $50,000.

(b) Exemptions:

(1) The provisions of this section shall not apply to any specialist who does not transact a business in securities with other than members, brokers or dealers and who is in good standing and subject to the capital requirements of the American Stock Exchange (if he is not also a clearing member of the Options Clearing Corporation), the Boston Stock Exchange, the Midwest Stock Exchange, the New York Stock Exchange, the Pacific Stock Exchange, the PBW Stock Exchange (if he is not also a clearing member of the Options Clearing Corporation), or the Chicago Board Options Exchange (if he is not also a clearing member of the Options Clearing Corporation) provided that this exclusion as to a particular specialist of any exchange or as to the exchange itself may be suspended or withdrawn by the Commission at any time, upon ten (10) days written notice to such exchange or specialist, if it appears to the Commission that such action is necessary or appropriate in the public interest or for the protection of investors.

(2) The Commission may, upon written application, exempt from the provisions of this section, either unconditionally or on specified terms and conditions, any broker or dealer who satisfies the Commission that, because of the special nature of its business, its financial position, and the safeguards it has established for the protection of customers' funds and securities, it is not necessary in the public interest or for the protection of investors to subject the particular broker or dealer to the provisions of this section.

(c) Definitions. For the purpose of this section:

AGGREGATE INDEBTEDNESS

(1) The term "aggregate indebtedness" shall be deemed to mean the total

money liabilities of a broker or dealer arising in connection with any transaction whatsoever and includes, among other things, money borrowed, money payable against securities loaned and securities "failed to receive," the market value of securities borrowed to the extent to which no equivalent value is paid or credited (other than the market value of margin securities borrowed from customers in accordance with the provisions of 17 CFR 240.15c3–3 and margin securities borrowed from non-customers), customers' and non-customers free credit balances, credit balances in customers' and non-customers' accounts having short positions in securities, equities in customers' and non-customers' future commodities accounts and credit balances in customers' and non-customers' commodities accounts, but excluding:

EXCLUSIONS FROM AGGREGATE INDEBTEDNESS

(i) Indebtedness adequately collateralized by securities which are carried long by the broker or dealer and which have not been sold or by securities which collateralize a secured demand note pursuant to Appendix (D) (17 CFR 240.15c 3–1d) to this section or indebtedness adequately collateralized by spot commodities which are carried long by the broker or dealer and which have not been sold;

(ii) Amounts payable against securities loaned, which securities are carried long by the broker or dealer and which have not been sold or which securities collateralize a secured demand note pursuant to Appendix (D) (17 CFR 240.15c

(iii) Amounts payable against securities failed to receive which securities are carried long by the broker or dealer and which have not been sold or which securities collateralize a secured demand note pursuant to Appendix (D) (17 CFR 240.-15c3–1d) or amounts payable against securities failed to receive for which the broker or dealer also has a receivable related to securities of the same issue and quantity thereof which are either fails to deliver or securities borrowed by the broker or dealer;

(iv) Credit balances in accounts representing amounts payable for securities or money market instruments not yet received from the issuer or its agent which securities are specified in subdivision (c)(2)(vi)(E) and which amounts are outstanding in such accounts not more than three (3) business days;

(v) Equities in customers' and non-customers' accounts segregated in accordance with the provisions of the Commodity Exchange Act and the rules and regulations thereunder;

(vi) Liability reserves established and maintained for refunds of charges required by Section 27(d) of the Investment Company Act of 1940, but only to the extent of amounts on deposit in a segregated trust account in accordance with 17 CFR 270.27d–1 under the Investment Company Act of 1940;

(vii) Amounts payable to the extent funds and qualified securities are required to be on deposit and are deposited in a "Special Reserve Bank Account for the Exclusive Benefit of Customers" pursuant to 17 CFR 240.15c3–3 under the Securities Exchange Act of 1934;

(viii) Fixed liabilities adequately secured by assets acquired for use in the ordinary course of the trade or business of a broker or dealer but no other fixed liabilities secured by assets of the broker or dealer shall be so excluded unless the sole recourse of the creditor for nonpayment of such liability is to such asset;

(ix) Liabilities on open contractual commitments;

(x) Indebtedness subordinated to the claims of creditors pursuant to a satisfactory subordination agreement, as defined in Appendix (D) (17 CFR 240.15c3–1d);

(xi) Liabilities which are effectively subordinated to the claims of creditors (but which are not subject to a satisfactory subordination agreement as defined in Appendix (D) (17 CFR 240.15c3–1d)) by non-customers of the broker or dealer prior to such subordination, except such subordinations by customers as may be approved by the Examining Authority for such broker or dealer;

(xii) Credit balances in accounts of general partners; and

(xiii) Deferred tax liabilities.

NET CAPITAL

(2) The term "net capital" shall be deemed to mean the net worth of a broker or dealer, adjusted by:

ADJUSTMENTS TO NET WORTH RELATED TO UNREALIZED PROFIT OR LOSS AND DEFERRED TAX PROVISIONS

(i)(A) Adding unrealized profits (or deducting unrealized losses) in the accounts of the broker or dealer;

(B)(*1*) In determining net worth, all long and all short positions in listed options shall be marked to their market value and all long and all short securities and commodities positions shall be marked to their market value.

(*2*) In determining net worth, the value attributed to any unlisted option shall be the difference between the option's exercise value and the market value of the underlying security. In the case of an unlisted call, if the market value of the underlying security is less than the exercise value of such call it shall be given no value and in the case of an unlisted put if the market value of the underlying security is more than the exercise value of the unlisted put it shall be given no value.

(C) Adding to net worth the lesser of any deferred income tax liability related to the items in (*1*), (*2*), and (*3*) below, or the sum of (*1*), (*2*) and (*3*) below;

(*1*) The aggregate amount resulting from applying to the amount of the deductions computed in accordance with subparagraph (c)(2)(vi) and Appendices (A) and (B) (17 CFR 240.15c3–1a) and (17 CFR 240.15c3–1b) or, where appropriate, paragraph (f) of this section, the appropriate Federal and state tax rate(s) applicable to any unrealized gain on the asset on which the deduction was computed;

(*2*) Any deferred tax liability related to income accrued which is directly related to an asset otherwise deducted pursuant to this section;

(*3*) Any deferred tax liability related to unrealized appreciation in value of any asset(s) which has been otherwise deducted from net worth in accordance with the provisions of this section; and,

(D) Adding, in the case of future income tax benefits arising as a result of unrealized losses, the amount of such benefits not to exceed the amount of income tax liabilities accrued on the books and records of the broker or dealer, but only to the extent such benefits could have been applied to reduce accrued tax liabilities on the date of the capital computation, had the related unrealized losses been realized on that date.

(ii) *Subordinated Liabilities.* Excluding liabilities of the broker or dealer which are subordinated to the claims of creditors pursuant to a satisfactory subordination agreement, as defined in Appendix (D) (17 CFR 240.15c3–1d).

(iii) *Sole Proprietors.* Deducting, in the case of a broker or dealer who is a sole proprietor, the excess of liabilities which have not been incurred in the course of business as a broker or dealer over assets not used in the business.

(iv) *Assets Not Readily Convertible Into Cash.* Deducting fixed assets and assets which cannot be readily converted into cash (less any indebtedness excluded in accordance with subdivision (c)(1)(viii) of this section) including, among other things:

(A) *Fixed Assets and Prepaid Items.* Real estate; furniture and fixtures; exchange memberships; prepaid rent, insurance and other expenses; goodwill, organization expenses;

(B) *Certain Unsecured and Partly Secured Receivables.* All unsecured advances and loans; deficits in customers' and non-customers' unsecured and partly secured notes; deficits in customers' and non-customers' unsecured and partly secured accounts after application of calls for margin, marks to the market or other required deposits which are outstanding 5 business days or less, except deficits in cash accounts as defined in 12 CFR 220.4(c) of Regulation T under the Securities Exchange Act of 1934 for which not more than one extension respecting a specified securities transaction has been requested and granted, and deducting for securities carried in any of such accounts the percentages specified in subparagraphs (c)(2)(vi) or (f) of this section or Appendix (A) (17 CFR 240.15c3–1a); receivables arising out of free shipments of securities (other than mutual fund redemptions) in excess of $5,000 per shipment and all free shipments (including mutual fund redemptions) outstanding more than 7 business days; any collateral deficiencies in secured demand notes as defined in Appendix (D) (17 CFR 240.15c3–1d);

(C) *Certain Receivables.* Interest receivable, floor brokerage receivable, commissions receivable from other brokers or dealers (other than syndicate profits

which shall be treated as required in subdivision (c)(2)(iv)(E) below), mutual fund concessions receivable and management fees receivable from registered investment companies, all of which receivables are outstanding longer than thirty (30) days from the date they arise; dividends receivable outstanding longer than thirty (30) days from the payable date; and good faith deposits arising in connection with an underwriting, outstanding longer than eleven (11) business days from the settlement of the underwriting with the issuer;

(D) *Insurance Claims.* Insurance claims which, after seven (7) business days from the date the loss giving rise to the claim is discovered, are not covered by an opinion of outside counsel that the claim is valid and is covered by insurance policies presently in effect; insurance claims which after twenty (20) business days from the date the loss giving rise to the claim is discovered and which are accompanied by an opinion of outside counsel described above, have not been acknowledged in writing by the insurance carrier as due and payable; and insurance claims acknowledged in writing by the carrier as due and payable outstanding longer than twenty (20) business days from the date they are so acknowledged by the carrier; and,

(E) *Other Deductions.* All other unsecured receivables; all assets doubtful of collection less any reserves established therefor; and, the funds on deposit in a "segregated trust account" in accordance with 17 CFR 270.27d–1 under the Investment Company Act of 1940, but only to the extent that the amounts on deposit in such segregated trust account exceeds the amount of liability reserves established and maintained for refunds of charges required by Sections 27(d) and 27(f) of the Investment Company Act of 1940; Provided, that any amount deposited in the "Special Reserve Bank Account for the Exclusive Benefit of Customers" established pursuant to 17 CFR 240.15c3–3 and clearing deposits shall not be so deducted.

(v) *Securities Differences.* Deducting the market value of all short securities differences (which shall include securities positions reflected on the securities record which are not susceptible to either count or confirmation) unresolved for seven (7) business days after discovery and the market value of any long security differences, where such securities have been sold by the broker or dealer before they are adequately resolved, less any reserves established therefor;

(vi) *Securities Haircuts.* Deducting the percentages specified in subdivisions (A)–(M) below (or the deductions prescribed for securities positions set forth in Appendix (A) (17 CFR 240.15c3–1a) or, where appropriate, paragraph (f) of this section) of the market value of all securities, money market instruments or options in the proprietary or other accounts of the broker or dealer.

(A) *Government Securities.* In the case of a security issued or guaranteed as to principal or interest by the United States or any agency thereof, the applicable percentages of the market value of the net long or short position in each of the categories specified below are:

(*1*) Less than 1 year to maturity—0 percent;

(*2*) 1 year but less than 3 years to maturity—1 percent;

(*3*) 3 years but less than 5 years to maturity—2 percent;

(*4*) 5 years or more to maturity—3 percent.

(B) *Municipals.* In the case of any municipal security, as defined in Section 3(a)(29) of the Securities Exchange Act of 1934, which is not traded flat or in default as to principal or interest, the applicable percentages of the market value on the greater of the long or short position in each of the categories specified below are:

(*1*) Less than 1 year to maturity—1 percent

(*2*) 1 year but less than 2 years to maturity—2 percent;

(*3*) 2 years but less than 5 years to maturity—3 percent;

(*4*) 5 years or more to maturity—5 percent.

(C) *Canadian Debt Obligations.* In the case of any security issued or unconditionally guaranteed as to principal and interest by the Government of Canada, the percentages of market value to be deducted shall be the same as in (A) above.

(D) *Certain Municipal Bond Trusts and Liquid Asset Funds.* In the case of securities of an investment company registered under the Investment Company Act of 1940, which assets are in the form of cash or securities or money market instruments which are described in subdivisions (A)–(C) above or (E) below, the deduction shall be 5 percent of the market value of the greater of the long or short position.

(E) *Commercial Paper, Bankers Acceptances and Certificates of Deposit.* In the case of any short-term promissory note or evidence of indebtedness which has a fixed rate of interest or is sold at a discount, and which has a maturity date at date of issuance not exceeding nine months exclusive of days of grace, or any renewal thereof, the maturity of which is likewise limited and is rated in one of the three highest categories by at least two of the nationally recognized statistical rating organizations, or in the case of any negotiable certificate of deposit or bankers acceptance or similar type of instrument issued or guaranteed by any bank as defined in section 3(a)(6) of the Securities Exchange Act of 1934, the applicable percentages of the market value of the greater of the long or short position in each of the categories specified below are:

(*1*) Less than 30 days to maturity—0 percent;

(*2*) 30 days but less than 91 days to maturity—⅛ of 1 percent;

(*3*) 91 days but less than 181 days to maturity—¼ of 1 percent;

(*4*) 181 days but less than 271 days to maturity—⅜ of 1 percent;

(*5*) 271 days but less than 1 year to maturity—½ of 1 percent; and

(*6*) With respect to any negotiable certificate of deposit or bankers acceptance or similar type of instrument issued or guaranteed by any bank, as defined above, having 1 year or more to maturity, the deduction shall be on the greater of the long or short position and shall be the same percentage as that prescribed in subdivision (c)(2)(vi)(A) above.

(F) *Nonconvertible Debt Securities.* In the case of nonconvertible debt securities having a fixed interest rate and fixed maturity date and which are not traded flat or in default as to principal or interest and which are rated in one of the four highest rating categories by at least two of the nationally recognized statistical rating organizations, the applicable percentages of the market value on the greater of the long or short position in each of the categories specified below are:

(*1*) Less than one year to maturity—1 percent;

(*2*) One year but less than two years to maturity—2 percent;

(*3*) Two years but less than three years to maturity—3 percent;

(*4*) Three years but less than four years to maturity—4 percent;

(*5*) Four years but less than five years to maturity—5 percent; and

(*6*) Five years or more to maturity—7 percent.

(G) *Convertible Debt Securities.* In the case of a debt security not in default which has a fixed rate of interest and a fixed maturity date and which is convertible into an equity security, the deductions shall be as follows: If the market value is 100 percent or more of the principal amount, the deduction shall be determined as specified in subdivision (J) below; if the market value is less than the principal amount, the deduction shall be determined as specified in subdivision (F) above if such securities are rated as required by subdivision (F) above.

(H) *Preferred Stock.* In the case of cumulative, nonconvertible preferred stock ranking prior to all other classes of stock of the same issuer, which are not in arrears as to dividends, the deduction shall be 20 percent of the market value of the greater of the long or short position;

(I) *Risk Arbitrage Positions.* In the case of each risk arbitrage transaction, the deduction shall be 30 percent (or such other percentage as required by this subdivision) on the long or equivalent short position, whichever has the greater market value. For the purposes of this subdivision (I), a "risk arbitrage transaction" shall mean the sale (either when issued, when distributed or short) of securities involved in a pending merger, consolidation, transfer of assets, exchange offer, recapitalization or other similar transaction which has been publicly announced and has not been terminated, in connection with a previous or approximately simultaneous offsetting purchase of other securities which upon consummation of the transaction will result in the equivalent of the securities sold.

(J) *All Other Securities.* In the case of all securities, except those described in Appendix (A) (17 CFR 240.15c3–1a) and, where appropriate, paragraph (f) of this section, which are not included in any of the percentage categories enumerated in subdivisions (A)–(I) above or (K)(ii) below, the deduction shall be 30 percent of the market value of the greater of the long or short position and to the extent the market value of the lesser of the long or short position exceeds 25 percent of the market value of the greater of the long or short position, there shall be a percentage deduction on such excess equal to 15 percent of the market value of such excess. Provided, that no deduction need be made in the case of (*1*) a security which is convertible into or exchangeable for other securities within a period of 90 days, subject to no conditions other than the payment of money, and the other securities into which such security is convertible or for which it is exchangeable, are short in the accounts of such broker or dealer or (2) a security which has been called for redemption and which is redeemable within 90 days.

(K) *Securities with a Limited Market.* In the case of securities (other than exempted securities, nonconvertible debt securities, and cumulative nonconvertible preferred stock) which are not: (*1*) traded on a national securities exchange; (2) designated as "OTC Margin Stock" pursuant to Regulation T under the Securities Exchange Act of 1934; (*3*) quoted on "NASDAQ"; or (*4*) redeemable shares of investment companies registered under the Investment Company Act of 1940, the deduction shall be as follows:

(*i*) in the case where there are regular quotations in an inter-dealer quotations system for the securities by three or more independent market-makers (exclusive of the computing broker or dealer) and where each such quotation represents a bona fide offer to brokers or dealers to both buy and sell in reasonable quantities at stated prices, or where a ready market as defined in subdivision (c)(11)(ii) is deemed to exist, the deduction shall be determined in accordance with subdivision (J) above;

(*ii*) in the case where there are regular quotations in an inter-dealer quotations system for the securities by only one or two independent market-makers (exclusive of the computing broker or dealer) and where each such quotation represents a bona fide offer to brokers or dealers both to buy and sell in reasonable quantities, at stated prices, the deduction on both the long and short position shall be 40 percent.

(L) Where a broker or dealer demonstrates that there is sufficient liquidity for any securities long or short in the proprietary or other accounts of the broker or dealer which are subject to a deduction required by subdivision (K) above, such deduction, upon a proper showing to the Examining Authority for the broker or dealer, may be appropriately decreased, but in no case shall such deduction be less than that prescribed in subdivision (J) above.

(M) *Undue Concentration.* In the case of money market instruments or securities of a single class or series of an issuer, including any option written, endorsed or held to purchase or sell securities of such a single class or series of an insurer (other than "exempted securities"), which are long or short in the proprietary or other accounts of a broker or dealer, including securities which are collateral to secured demand notes defined in Appendix (D) (17 CFR 240.15c3–1d), for more than 11 business days and which have a market value of more than 10 percent of the "net capital" of a broker or dealer before the application of subparagraph (c)(2)(vi) or Appendix (A) (17 CFR 240.15c3–1a), there shall be an additional deduction from net worth and/or the Collateral Value for securities collateralizing a secured demand note defined in Appendix (D) (17 CFR 240.15c3–1d), equal to 50 percent of the percentage deduction otherwise provided by this subparagraph (c)(2)(vi) or Appendix (A) (17 CFR 240.15c3–1a), on that portion of the securities position in excess of 10% of the "net capital" of the broker or dealer before the application of subparagraph (c)(2)(vi) and Appendix (A) (17 CFR 240.15c3–1a). This provision shall apply notwithstanding any long or short position exemption provided for in subdivision (I) or (J) of this subparagraph (except for long or short position exemptions arising out of the first proviso to subdivision (c)(2)(vi)(J)) and the deduction on any such exempted position shall be 15% of that portion of the securities position in excess of 10% of net capital before the application of subparagraph (c)(2)(vi) and Appendix (A) (17 CFR 240.15c3–1a). Provided, that such additional deduction shall be applied in the case of equity securities only on the market value in excess of $10,000 or the market value of 500 shares, whichever is greater, or $25,000 in the case of a debt security. Provided, further, that any specialist which is subject to a deduction required by this subdivison (M), respecting his specialty stock, who can demonstrate to the satisfaction of the Examining Authority for such broker or dealer that there is sufficient liquidity for such specialists' specialty stock and that such deduction need not be applied in the public interest for the protection of investors, may upon a proper showing to such Examining Authority have such undue concentration deduction appropriately decreased, but in no case shall the deduction prescribed in subdivision (J) above be reduced. Each such Examining Authority shall make and preserve for a period of not less than 3 years a record of each application granted pursuant to this subdivision, which shall contain a summary of the justification for the granting of the application.

(vii) *Non-Marketable Securities.* Deducting 100 percent of the carrying value in the case of securities in the proprietary or other accounts of the broker or dealer, for which there is no ready market, as defined in subparagraph (c)(11), and securities, in the proprietary or other accounts of the broker or dealer, which cannot be publicly offered or sold because of statutory, regulatory or contractual arrangements or other restrictions.

(viii) *Open Contractual Commitments.* Deducting, in the case of a broker or dealer who has open contractual commitments (other than those option positions subject to Appendix (A) (17 CFR 240.15c3–1a)) the respective deductions as specified in subdivision (c)(2)(vi) of this paragraph or Appendix (B) (17 CFR 240.15c3–1b) from the value (which shall be the market value whenever there is a market) of each net long and each net short position contemplated by any open contractual commitment in the proprietary or other accounts of the broker or dealer. In the case of a broker or dealer electing to operate pursuant to paragraph (f) of this section, the percentage deduction for contractual commitments in those securities which are treated in subdivision (f)(3)(ii) shall be 30%. Provided, that the deduction with respect to any single commitment shall be reduced by the unrealized profit, in an amount not greater than the deduction provided for by this section (or increased by the unrealized loss), in such commitment, and that in no event shall an unrealized profit on any closed transactions operate to increase net capital.

(ix) *Aged Fails to Deliver.* Deducting from the contract value of each failed to deliver contract which is outstanding 11 business days or longer the percentages of the market value of the underlying security which would be required by application of the deduction required by subparagraph (c)(2)(vi) or, where appropriate, paragraph (f) of this section. Provided, that such deduction shall be increased by any excess of the contract price of the fail to deliver over the market value of the underlying security or reduced by any excess of the market value of the underlying security over the contract value of the fail but not to exceed the amount of such deduction. Provided, however, that until January 1, 1977, the deduction provided for herein shall be applied only to those fail to deliver contracts which are outstanding 15 business days or longer.

(x) *Brokers or Dealers Carrying Accounts of Option Specialists.* With respect to any transactions in options listed on a registered national securities exchange or facility of a registered national securities association for which a broker or dealer acts as a guarantor, endorser, or carrying broker or dealer for options purchased or written by a specialist not subject to the provisions of this section, such broker or dealer shall adjust its net capital by deducting, for each class of option contracts in which such specialist is a market-maker, an amount equal to 130 percent of the market value of each option contract in a short position. Provided, however, in the case of long and short positions in option contracts for the same underlying security the deduction shall be the greater of (A) 30 percent of the market value of such long

positions or (B) 130 percent of the market value of the short positions less 70 percent of the market value of the long positions, less the amount of any equity as defined in paragraph (c)(13) in such specialist's account. Provided, that in no event shall this provision result in increasing the net capital of such guarantor, endorser, or carrying broker or dealer.

(xi) *Registered Traders in Options.* With respect to any broker or dealer who acts as a guarantor, endorser, or carrying broker or dealer for any registered trader who does not transact a business in securities with other than members, brokers, or dealers and who is subject to the provisions of this section, who has continuing market responsibilities for transactions in options listed on a registered national securities exchange or facility of a registered national securities association, deducting, for all options listed on the exchange or facility on which he has pursuant to the rules of that exchange or facility continuing market responsibilities, 130 percent of the market value of each option contract in a short position. Provided, however, in the case of long and short positions in option contracts for the same underlying security, the deduction shall be the greater of (A) 30 percent of the market value of such long positions or (B) 130 percent of the market value of short positions less 70 percent of the market value of long positions, less the amount of any equity as defined in subparagraph (c)(13) in such registered traders account. Provided, further, that in no event shall this provision result in increasing the net capital of such guarantor, endorser, or carrying broker or dealer.

(xii) *Deduction From Net Worth for Certain Undermargined Accounts.* Deducting the amount of cash required in each customer's or non-customer's account to meet the maintenance margin requirements of the Examining Authority for the broker or dealer, after application of calls for margin, marks to the market or other required deposits which are outstanding 5 business days or less.

(xiii) *Deduction From Net Worth for Indebtedness Collateralized by Exempted Securities.* Deducting, at the option of the broker or dealer, in lieu of including such amounts in aggregate indebtedness, 4 percent of the amount of any indebtedness secured by exempted securities not carried long in the proprietary or other accounts of the broker or dealer or representing exempted securities failed to deliver.

EXEMPTED SECURITIES

(3) The term "exempted securities" shall mean those securities deemed exempted securities by section 3(a)(12) of the Securities Exchange Act of 1934 and rules thereunder.

CONTRACTUAL COMMITMENTS

(4) The term "contractual commitments" shall include underwriting, when issued, when distributed and delayed delivery contracts, the writing or endorsement of puts and calls and combinations thereof, commitments in foreign currencies, and spot (cash) commodities contracts, but shall not include uncleared regular way purchases and sales of securities and contracts in commodities futures. A series of contracts of purchase or sale of the same security conditioned, if at all, only upon issuance may be treated as an individual commitment.

ADEQUATELY SECURED

(5) Indebtedness shall be deemed to be adequately secured within the meaning of this section when the excess of the market value of the collateral over the amount of the indebtedness is sufficient to make the loan acceptable as a fully secured loan to banks regularly making secured loans to brokers or dealers.

CUSTOMER

(6) The term "customer" shall mean any person from whom, or on whose behalf, a broker or dealer has received, acquired or holds funds or securities for the account of such person, but shall not include a broker or dealer, or a general, special or limited partner or director or officer of the broker or dealer, or any person to the extent that such person has a claim for property or funds which by contract, agreement or understanding, or by operation of law, is part of the capital of the broker or dealer or is subordinated to the claims of creditors of the broker or dealer. Provided, however, that the term "customer" shall also include a broker or dealer, but only insofar as such broker or dealer maintains a special omnibus account carried with another broker or dealer in compliance with 12 CFR 220.4(b) of Regulation T under the Securities Exchange Act of 1934.

NON-CUSTOMER

(7) The term "non-customer" means a broker or dealer, general partner, limited partner, officer, director and persons to the extent their claims are subordinated to the claims of creditors of the broker or dealer.

MARKET MAKER

(8) The term "market maker" shall mean a dealer who, with respect to a particular security, (i) regularly publishes bona fide, competitive bid and offer quotations in a recognized interdealer quotation system; or (ii) furnishes bona fide competitive bid and offer quotations on request; and, (iii) is ready, willing and able to effect transactions in reasonable quantities at his quoted prices with other brokers or dealers.

PROMPTLY TRANSMIT AND DELIVER

(9) A broker or dealer is deemed to "promptly transmit" all funds and to "promptly deliver" all securities within the meaning of subparagraphs (a)(2)(v) and (a)(3) of this section where such transmission or delivery is made no later than noon of the next business day after the receipt of such funds or securities. Provided, however, that such prompt transmission or delivery shall not be required to be effected prior to the settlement date for such transactions.

FORWARD AND PROMPTLY FORWARD

(10) A broker or dealer is deemed to "forward" or "promptly forward" funds or securities within the meaning of subdivisions (i) through (vi) of subparagraph (a)(2) only when such forwarding occurs no later than noon of the next business day following receipt of such funds or securities.

READY MARKET

(11) (i) The term "ready market" shall include a recognized established securities market in which there exists independent bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined for a particular security almost instantaneously and where payment will be received in settlement of a sale at such price within a relatively short time conforming to trade custom.

(ii) A "ready market" shall also be deemed to exist where securities have been accepted as collateral for a loan by a bank as defined in Section 3(a)(6) of the Securities Exchange Act of 1934 and where the broker or dealer demonstrates to its Examining Authority that such securities adequately secure such loans as that term is defined in subparagraph (c)(5) of this section.

EXAMINING AUTHORITY

(12) The term "Examining Authority" of a broker or dealer shall mean for the purposes of 17 CFR 240.15c3-1 and 240.-15c3-1a-d the national securities exchange or national securities association of which the broker or dealer is a member or, if the broker or dealer is a member of more than one such self-regulatory organization, the organization designated by the Commission as the Examining Authority for such broker or dealer, or if the broker or dealer is not a member of any such self-regulatory organization, the Regional Office of the Commission where such broker or dealer has its principal place of business.

EQUITY

(13) For purposes of subparagraphs (c)(2)(x) and (xi), equity shall be computed by adding the credit balance (if any) in the account to the current market value of all securities (including listed options) carried long in the accounts specified in subparagraphs (c)(2)(x) and (xi) and deducting the debit balance (if any) in the account and the current market value of all securities (including listed options) carried short in such accounts.

(d) *Debt-Equity Requirements.* No broker or dealer shall permit the total of outstanding principal amounts of its satisfactory subordination agreements (other than such agreements which qualify under this paragraph (d) as equity capital) to exceed 70 percent of its debt-equity total, as hereinafter defined, for a period in excess of 90 days or for such longer period which the Commission

may, upon application of the broker or dealer, grant in the public interest or for the protection of investors. In the case of a corporation, the debt-equity total shall be the sum of its outstanding principal amounts of satisfactory subordination agreements, par or stated value of capital stock, paid in capital in excess of par, retained earnings, unrealized profit and loss or other capital accounts. In the case of a partnership, the debt-equity total shall be the sum of its outstanding principal amounts of satisfactory subordination agreements, capital accounts of partners (exclusive of such partners' securities accounts) subject to the provisions of paragraph (e) of this section, and unrealized profit and loss. In the case of a sole proprietorship, the debt-equity total shall include the sum of its outstanding principal amounts of satisfactory subordination agreements, capital accounts of the sole proprietorship and unrealized profit and loss. *Provided, however,* That a satisfactory subordination agreement entered into by a partner or stockholder which has an initial term of at least three years and has a remaining term of not less than 12 months shall be considered equity for the purposes of this paragraph (d) if: (1) it does not have any of the provisions for accelerated maturity provided for by subparagraphs (b)(9)(i), (b)(10)(i) or (b)(10)(ii) of Appendix (D) (17 CFR 240.15c3-1d) and is maintained as capital subject to the provisions restricting the withdrawal thereof required by paragraph (e) of this section or (2) the partnership agreement provides that capital contributed pursuant to a satisfactory subordination agreement as defined in Appendix (D) (17 CFR 240.15c3-1d) shall in all respects be partnership capital subject to the provisions restricting the withdrawal thereof required by paragraph (e) of this section.

(e) *Limitation on Withdrawal of Equity Capital.* No equity capital of the broker or dealer or a subsidiary or affiliate consolidated pursuant to Appendix (C) (17 CFR 240.15c3-1c) whether in the form of capital contributions by partners (excluding securities in the securities accounts of partners and balances in limited partners' capital accounts in excess of their stated capital contributions), par or stated value of capital stock, paid-in capital in excess of par, retained earnings or other capital accounts, may be withdrawn by action of a stockholder or partner, or by redemption or repurchase of shares of stock by any of the consolidated entities or through the payment of dividends or any similar distribution, nor may any unsecured advance or loan be made to a stockholder, partner, sole proprietor or employee if, after giving effect thereto and to any other such withdrawals, advances or loans and any Payments of Payment Obligations (as defined in Appendix (D) (17 CFR 240.15c3-1d)) under satisfactory subordination agreements which are scheduled to occur within six months following such withdrawal, advance or loan, either aggregate indebtedness of any of the consolidated entities exceeds 1000 per centum of its net capital or its net capital would fail to equal 120 per centum of the minimum dollar amount required thereby or would be less than 7 percent of aggregate debit items computed in accordance with 17 CFR 240. 15c3-3a, or in the case of any broker or dealer included within such consolidation if the total outstanding principal amounts of satisfactory subordination agreements of the broker or dealer (other than such agreements which qualify as equity under paragraph (d) of this section) would exceed 70 percent of the debt-equity total as defined in paragraph (d). Provided, that this provision shall not preclude a broker or dealer from making required tax payments or preclude the payment to partners of reasonable compensation.

(f) *Alternative Net Capital Requirement.* (1) A broker or dealer who is not exempt from the provisions of 17 CFR 240.15c3-3 under the Securities Exchange Act of 1934 pursuant to subparagraph (k)(1) or (k)(2)(i) may elect not to be subject to the limitations of paragraph (a) of this section respecting aggregate indebtedness as defined in subparagraph (c)(1) of this section and certain deductions provided for in subparagraph (c)(2) of this section. Provided, that in order to qualify to operate under this paragraph (f), such broker or dealer shall at all times maintain net capital equal to the greater of $100,000 or 4 percent of aggregate debit items computed in accordance with the Formula for Determination of Reserve Requirements for Brokers and Dealers (Exhibit A to Rule 15c3-3 (17 CFR 240.15c3-3a) and shall notify the Examining Authority for such broker or dealer and the Regional Office of the Commission in which the broker or dealer has its principal place of business in writing of its election to operate under this provision. Once a broker or dealer has determined to operate pursuant to the provisions of this paragraph (f), he shall continue to do so unless a change in such election is approved upon application to the Commission.

(2) In the case of a broker or dealer who has consolidated a subsidiary pursuant to Appendix (C) [17 CFR 240.15c3-1c], such broker's or dealer's minimum net capital requirements shall be the sum of the greater of $100,000 or 4 percent of the parent broker's or dealer's aggregate debit items computed in accordance with 17 CFR 240.15c3-3a and the total of each consolidated broker or dealer subsidiary's minimum net capital requirements. The minimum net capital requirements of a subsidiary electing to operate pursuant to paragraph (f) of this section shall be the greater of $100,000 or 4 percent of its aggregate debit items computed in accordance with 17 CFR 240.15c3-3a. Where the subsidiary which has been consolidated has not elected to operate pursuant to paragraph (f), its minimum net capital requirement is the greater of its requirements under paragraph (a) of this section or 6⅔ percent of its aggregate indebtedness.

(3) A broker or dealer electing to operate pursuant to this paragraph (f) shall be subject to the deductions set forth in subparagraph (c)(2) of this section, except that he shall not be subject to the deductions required by subparagraphs (c)(2)(vi)(G), (c)(2)(vi)(J), (c)(2)(vi)(K)(i), and (c)(2)(vi)(M) and shall in lieu thereof deduct the following amounts under subparagraph (c)(2) in its computation of net capital:

(i) *Convertible Debt Securities.* In the case of a debt security not in default which has a fixed rate of interest and a fixed maturity date and which is convertible into an equity security, the deduction shall be as follows: If the market value is 100 percent or more of its principal amount, the deduction shall be determined as specified in (ii) below; if the market value is less than its principal amount the deduction shall be determined as in subdivision (c)(2)(vi)(F) of this section if such securities are rated as required by subdivision (c)(2)(vi)(F);

(ii) *Other Securities.* In the case of all securities, except as provided in Appendix (A) (17 CFR 240.15c3-1a) which are not included in any of the percentage categories specifically enumerated in subdivisions (A)-(H) or (K)(ii) of subparagraph (c)(2)(vi) of this section, the deduction shall be 15 percent of the market value of the long positions. To the extent the market value of short positions exceeds 25 percent of the market value of long positions, there shall be a percentage deduction equal to 30 percent of the market value of such excess. Provided, that no deduction need be made in the case of (A), a security which is convertible into or exchangeable for other securities within a period of 90 days, subject to no conditions other than the payment of money, and the other securities into which such security is convertible or for which it is exchangeable are short in the account of such broker or dealer or (B) a security which has been called for redemption and which is redeemable within 90 days. Provided, further, that at the option of the broker or dealer, securities described in subdivision (c)(2)(vi)(I) of this section may be included in the computation of the deductions under this subdivision (f)(3)(ii) if a lesser deduction would result.

(iii) *Undue Concentrations.* In the case of money market instruments, or securities of a single class or series of an issuer, including any option written, endorsed or held to purchase or sell securities of such a single class or series of an issuer (other than "exempted securities"), and securities underwritten (in which case the deduction provided for herein shall be applied after 11 business days) which are long or short in the proprietary or other accounts of a broker or dealer and which have a market value of more than 10 percent of the "net capital" of a broker or dealer before the application of subparagraphs (c)(2)(vi), (f)(3) or Appendix (A) (17 CFR 240.-15c3-1a) there shall be an additional deduction from net worth equal to 50 percent of the percentage deduction otherwise provided by this section or Appendix (A) (17 CFR 240.15c3-1a) (in the case of securities described in subparagraph

(f)(3)(i) which receive a 30% deduction or securities described in subparagraph (f)(3)(ii) the deduction required by this subdivision (f)(3)(iii) shall be 15%) on that portion of the securities position in excess of 10 percent of the "net capital" of the broker or dealer before the application of subparagraphs (c)(2)(vi), (f)(3)(i) and (ii) and Appendix (A) (17 CFR 240.15c3-1a). This provision shall apply notwithstanding any long or short position exemption provided for in subparagraphs (c)(2)(vi)(I) or (f)(3)(ii) (except for a long or short position exemption arising out of the first proviso to subparagraph (f)(3)(ii)) and the deduction on any such exempted position shall be 15% of that portion of the position in excess of 10% of net capital before the application of subparagraph (c)(2)(vi), subparagraphs (f)(3)(i) and (ii) and Appendix (A) (17 CFR 240.15c3-1a). Provided, however, that any specialist who is subject to a deduction required by this subdivision (f)(3)(iii) respecting his specialty stock, who can demonstrate to the satisfaction of the Examining Authority for such broker or dealer that there is sufficient liquidity for such specialist's specialty stock and that such deduction need not be applied in the public interest for the protection of investors may on a proper showing to such Examining Authority have such undue concentration deduction appropriately decreased but in no case shall the deduction prescribed in subdivision (f)(3)(ii) above be reduced. Each such Examining Authority shall make and preserve for a period of not less than 3 years a record of each application granted pursuant to this subdivision, which shall contain a summary of the justification for the granting of the application.

(4) In the case of any deductions for open contractual commitments provided for in subparagraph (c)(2)(viii) of this section, the deduction for securities which are described in subparagraph (f)(2)(ii) shall be 30 percent.

(5) In addition to the foregoing, brokers or dealers electing this alternative shall:

(i) make the computation required by 17 CFR 240.15.3-3(e) and set forth in Exhibit A (17 CFR 240.15c3-3a) on a weekly basis and, in lieu of the 1 percent reduction of certain debit items required by Note B(2) in the computation of their Exhibit A requirement, reduce aggregate debit items in such computation by 3 percent;

(ii) include in Items 7 and 8 of Exhibit A (17 CFR 240.15c3-3a) the market value of items specified therein over 7 business days old;

(iii) exclude credit balances in accounts representing amounts payable for securities not yet received from the issuer or its agent which securities are specified in subdivision (c)(2)(vi) (A) and (E) of this section and any related debit items from the Exhibit A requirement for three business days.

(g) *Transitional Provisions.* (1) On September 1, 1975 the provisions of paragraph (a) of this section and Appendix D (17 CFR 240.15c3-1d) shall be applicable to all brokers or dealers subject to the provisions of this section; provided, however, that until no later than January 1, 1976 the computation of aggregate indebtedness and net capital may continue to be computed pursuant to the respective capital rules to which the broker or dealer was subject prior to September 1, 1975.

(2) Each Examining Authority shall file with the Commission no later than July 31, 1975 a plan providing for the transition to the provisions of subparagraphs (c)(1) and (c)(2), paragraphs (d), (e) and (f) of this section and Appendices A, B and C (17 CFR 240.15c3-1a, 240.15c3-1b, and 240.15c3-1c) for those brokers or dealers for which it is the Examining Authority. Such plan shall set forth the steps such Examining Authority will be required to take (including but not limited to modifications of reporting and surveillance requirements and the education of both examiners and broker-dealers) in order to provide for the orderly transition to all provisions of this section and Appendices A-D (17 CFR 240.15c3-1a, 240.15c3-1b, 240.15c3-1c and 240.15c3-1d) no later than January 1, 1976 and such Examining Authority's program for accomplishing those steps.

§ 240.15c3-1a Options (Appendix A to 17 CFR 240.15c3-1).

(a) *Certain Definitions.* (1) The term "listed option" shall mean any option traded on a registered national securities exchange or facility of a registered national securities association.

(2) The term "unlisted option" shall mean any option not traded on a registered national securities exchange or facility of a registered national securities association.

(b) *Certain Adjustments to Net Worth For Listed Options Before Computing the Deductions Specified in (c) Below.* (1) The market value of short positions in listed options shall be added to net worth and the market value of any long positions in listed options, which relate to long or short securities positions or short positions in listed options, shall be deducted from net worth, and;

(2) the amount by which the market value of a short security position, which is related to a long listed call, exceeds the exercise value of such long call, or the amount by which the exercise value of a long listed put, which is related to a long security position, exceeds the market value of the long security, shall be added to net worth, and;

(3) the amount by which the market value of the underlying security would exceed the exercise value of the short listed call, or the amount by which the exercise value of a short listed put exceeds the market value of the underlying security, shall be deducted from net worth.

(c) *Deductions From Net Worth for Uncovered Options and Securities Positions in Which the Broker or Dealer Has Offsetting Option Positions.* Every broker or dealer shall in computing net capital pursuant to 17 CFR 240.15c3-1 deduct from net worth the percentages of all securities positions or options in the proprietary or other accounts of the broker or dealer specified below. However, where computing the deduction required for a security position as if the security position had no related option position and positions in options as if uncovered would result in a lesser deduction from net worth, the broker or dealer may compute such deductions separately.

(1) *Uncovered Calls.* Where a broker or dealer is short a call, deducting, after the adjustment provided for in paragraph (b) of this Appendix (A), 30 percent (or such other percentage required by subdivisions (A)-(K) of subparagraph (c)(2)(vi) of 17 CFR 240.15c3-1) of the current market value of the security underlying such option reduced by any excess of the exercise value of the call over the current market value of the underlying security. Provided, that in no event shall the deduction provided by this subparagraph be less than $250 for each option contract for 100 shares.

(2) *Uncovered Puts.* Where a broker or dealer is short a put, deducting, after the adjustment provided for in paragraph (b) of this Appendix (A), 30 percent (or such other percentage required by subdivisions (A)-(K) of subparagraph (c)(2)(vi) of 17 CFR 240.15c3-1) of the current market value of the security underlying the option reduced by any excess of the market value of the underlying security over the exercise value of the put. Provided, that in no event shall the deduction provided by this subparagraph be less than $250 for each option contract for 100 shares.

(3) *Covered Calls.* Where a broker or dealer is short a call and long equivalent units of the underlying security, deducting, after the adjustments provided for in paragraph (b) of this Appendix (A), 30 percent (or such other percentage required by subdivisions (A)-(K) of subparagraph (c)(2)(vi) of 17 CFR 240.15c3-1 or 15 percent where a broker or dealer operates pursuant to paragraph (f) of 17 CFR 240.15c3-1) of the current market value of the underlying security reduced by any excess of the current market value of the underlying security over the exercise value of the call. Provided, that no such reduction shall have the effect of increasing net capital.

(4) *Covered Puts.* Where a broker or dealer is short a put and short equivalent units of the underlying security, deducting, after the adjustment provided for in paragraph (b) of this Appendix (A), 30 percent (or such other percentage required by subdivisions (A)-(K) of subparagraph (c)(2)(vi) of 17 CFR 240.15c3-1) of the current market value of the underlying security reduced by any excess of the exercise value of the put over the market value of the underlying security. Provided that no such reduction shall have the effect of increasing net capital.

(5) *Conversion Accounts.* Where a broker or dealer is long equivalent units

of the underlying security, long an unlisted put written or endorsed by a broker or dealer and short an unlisted call in his proprietary or other accounts, deducting 10 percent (or 50 percent of such other percentage required by subdivisions (A)–(K) of subparagraph (c)(2)(vi) of 17 CFR 240.15c3–1 or 5 percent where a broker or dealer operates pursuant to paragraph (f) of 17 CFR 240.15c3–1) of the market value of the underlying security.

(6) Where a broker or dealer is short equivalent units of the underlying security, long an unlisted call written or endorsed by a broker or dealer and short an unlisted put in his proprietary or other accounts, deducting 10 percent (or 50 percent of such other percentage required by subdivisions (A)–(K) of subparagraph (c)(2)(vi) of 17 CFR 240.15c3–1) of the market value of the underlying security.

(7) *Long Over-the-Counter Options.* Where a broker or dealer is long an unlisted put or call endorsed or written by a broker or dealer, deducting 30 percent (or such other percentage required by subdivisions (A)–(K) of subparagraph (c)(2)(vi) of 17 CFR 240.15c3–1 or 15 percent where a broker or dealer operates pursuant to paragraph (f) of 17 CFR 240.15c3–1) of the market value of the underlying security, not to exceed any value attributed to such option in paragraph (c)(2)(i) of 17 CFR 240.15c3–1.

(8) *Listed Options.* Where a broker or dealer is long listed options and there is no offsetting security position, deducting 30 percent of the market value of any net long positions in options in the same underlying security, with the same exercise price and the same expiration date. Where a broker or dealer has a net short position in an option in the same underlying security, with the same exercise price and the same expiration date and for which the broker or dealer does not have a related position in the underlying security or an option position otherwise provided for in this Appendix (A), the deduction shall be determined as provided in subparagraph (c) (1) or (2) of this Appendix (A).

(9) *Certain Security Positions with Offsetting Options.* Where a broker or dealer is long a security for which he is also long a listed put (such broker or dealer may in addition be short a call), deducting, after the adjustments provided in paragraph (b) of this Appendix (A), 30 percent (15 percent in the case of a broker or dealer operating pursuant to paragraph (f) of 17 CFR 240.15c3–1) of the market value of the long security position not to exceed the amount by which the market value of equivalent units of the long security position exceeds the exercise value of the put. Provided, that if the exercise value of the put is equal to or exceeds the market value of equivalent units of the long security position, no percentage deduction shall be applied.

(10) Where a broker or dealer is short a security for which he is also long a listed call (such broker or dealer may in addition be short a put), deducting, after the adjustments provided in paragraph (b) of this Appendix (A), 30 percent of the market value of the short security position not to exceed the amount by which the exercise value of the long call exceeds the market value of equivalent units of the short security position. Provided, that if the exercise value of the call is less than or equal to the market value of equivalent units of the short security position no percentage deduction shall be applied.

(11) *Certain Spread Positions.* Where a broker or dealer is short a listed call and is also long a listed call in the same class of option contracts and the long option expires on the same date as or subsequent to the short option, the deduction, after the adjustments required in paragraph (b) of this Appendix (A), shall be the amount by which the exercise value of the long call exceeds the exercise value of the short call. Provided, that if the exercise value of the long call is less than or equal to the exercise value of the short call, no deduction is required.

(12) Where a broker or dealer is short a listed put and is also long a listed put in the same class of option contracts and the long option expires on the same date as or subsequent to the short option, the deduction, after the adjustments required in paragraph (b) of this Appendix (A), shall be the amount by which the exercise value of the short put exceeds the exercise value of the long put. Provided, that if the exercise value of the long put is equal to or greater than the exercise value of the short put, no deduction is required.

§ 240.15c3–1b Deductions from net worth for certain commodities transactions (Appendix B to 17 CFR 240.15c3–1).

(a) Every broker or dealer in computing net capital pursuant to 17 CFR 240.15c3–1 shall:

(1) Deduct 30 percent of the market value of all "long" and all "short" future commodity contracts (other than those contracts representing spreads and straddles in the same commodity and those offsetting or hedging any "spot" commodity positions) carried in the proprietary or other accounts of the broker or dealer.

(2) Deduct 30 percent of the market value of spot commodities long or short in the proprietary or other accounts of the broker or dealer and in customers' and non-customers' accounts liquidating to a deficit. Provided, that the deduction shall be 10 percent of the market value of the spot commodities to the extent they are hedged by future commodity contracts or forward spot commodity contracts in the same commodity.

(3) Deduct, after application of calls for margin, marks to market or other required deposits outstanding 5 business days or less, the total of credit lines granted by the broker or dealer in "trade" accounts with net long positions or in "trade" accounts with net short positions, whichever is greater, plus any credit lines granted on open commodity contracts in "trade" accounts with no net long or net short position. In computing the credit line granted in the case of each account, deduct the amount of the equity or deficit therein. Provided, that any deficit is deducted under other provisions of 17 CFR 240.15c3–1. For purposes of this subdivision "trade" accounts shall mean an account for a business entity which regularly is engaged in the importing or processing of the commodity or the by-products thereof for which the credit line is granted.

(4) Deduct the total amount by which the daily limit fluctuation of all future commodity contracts carried for a customer's and non-customer's account or accounts controlled by such persons exceeds 15 percent of the debt-equity total of the broker or dealer as defined in paragraph (d) of 17 CFR 240.15c3–1. Contracts in each customer's or non-customer's account representing purchases and sales of a like amount of the same commodity in the same market may be eliminated. The daily limit fluctuations for future contracts effected in foreign markets are to be considered the same as if such contracts had been effected in a domestic market.

(5) Deduct exclusive of liquidating deficits deducted under other provisions of 17 CFR 240.15c3–1, the amount of cash required to provide margin on all future commodity contracts in customer's and non-customer's accounts equal to the amount necessary, after application of calls for margin, marks to market or other required deposits which are outstanding 5 business days or less, to restore the original margin required by the relevant commodity exchange, or the clearing house requirement, per contract, if the commodity exchange has no original margin requirement, when the original margin has been depleted by 50 percent.

(6) Deduct the amount of cash required to provide margin equal to 20 percent of the market value in each customer's and non-customer's account with equity, after application of calls for margin, marks to market or other required deposits outstanding 5 business days or less, when such account contains spot commodity positions, evidenced by warehouse receipts issued by a warehouse licensed by a commodity exchange, which are the result of a future contract tendered through an exchange within the last 90 days, and are not hedged by future contracts in the same commodity.

(7) Deduct the amount of cash required to provide margin equal to 10 percent of the market value in each customer's or non-customer's combined account with equity, after application of calls for margin, marks to the market or other required deposits outstanding 5 business days or less, when such account contains spot commodity positions evidenced by warehouse receipts issued by a warehouse licensed by a commodity exchange, which are the result of a future contract tendered through an exchange within the last 90 days and are hedged by future contracts in the same commodity.

(8) Deduct an amount equal to ½ percent of the market value of the total long or total short futures contracts (other than those contracts representing spreads or straddles in the same commodity and those contracts offsetting or hedging any "spot" commodity positions) in each commodity, whichever is greater, carried for all customers and non-customers.

(9) Deduct the debit balance in each customer's spot (cash) commodity account (i) other than the result of a tender made on a futures contract within the past 90 days and (ii) not evidenced by warehouse receipts issued by a warehouse licensed by a commodity exchange.

§ 240.15c3–1c Consolidated Computations of Net Capital and Aggregate Indebtedness for Certain Subsidiaries and Affiliates (Appendix C to 17 CFR 240.15c3–1).

(a) *Flow Through Capital Benefits.* Every broker or dealer in computing its net capital and aggregate indebtedness pursuant to 17 CFR 240.15c3–1 shall, subject to the provisions of paragraphs (b) and (d) of this Appendix, consolidate in a single computation assets and liabilities of any subsidiary or affiliate for which it guarantees, endorses or assumes directly or indirectly the obligations or liabilities. The assets and liabilities of a subsidiary or affiliate whose liabilities and obligations have not been guaranteed, endorsed, or assumed directly or indirectly by the broker or dealer may also be so consolidated if an opinion of counsel is obtained as provided for in paragraph (b) below.

(b) *Required Counsel Opinions.* (1) If the consolidation, provided for in (a) above, of any such subsidiary or affiliate results in the increase of the broker's or dealer's net capital and/or decrease in the broker's or dealer's ratio of aggregate indebtedness to net capital or increases the broker's or dealer's net capital and/or decreases the minimum net capital requirement called for by subparagraph (f)(1) of 17 CFR 240.15c3–1 and an opinion of counsel called for in subparagraph (b)(2) has not been obtained, such benefits shall not be recognized in the broker's or dealer's computation required by this section.

(2) Except as provided for in paragraph (b)(1) above, consolidation shall be permitted with respect to any subsidiaries or affiliates which are majority owned and controlled by the broker or dealer for which the broker or dealer can demonstrate to the satisfaction of the Commission, through the Examining Authority, by an opinion of counsel that the net asset values, or the portion thereof related to the parent's ownership interest in the subsidiary or affiliate may be caused by the broker or dealer or a trustee appointed pursuant to the Securities Investor Protection Act of 1970 or otherwise, to be distributed to the broker or dealer within 30 calendar days. Such opinion shall also set forth the actions necessary to cause such a distribution to be made, identify the parties having the authority to take such actions, identify and describe the rights of other parties or classes of parties, including but not limited to customers, general creditors, subordinated lenders, minority shareholders, employees, litigants and governmental or regulatory authorities, who may delay or prevent such a distribution and such other assurances as the Commission or the Examining Authority by rule or interpretation may require. Such opinion shall be current and periodically renewed in connection with the broker's or dealer's annual audit pursuant to 17 CFR 240.17a–5 under the Securities Exchange Act of 1934 or upon any material change in circumstances.

(c) *Principles of Consolidation.* In preparing a consolidated computation of net capital and/or aggregate indebtedness pursuant to this section, the following minimum and non-exclusive requirements shall be observed:

(1) Consolidated net worth shall be reduced by the estimated amount of any tax reasonably anticipated to be incurred upon distribution of the assets of the subsidiary or affiliate.

(2) Liabilities of a consolidated subsidiary or affiliate which are subordinated to the claims of present and future creditors pursuant to a satisfactory subordination agreement shall not be added to consolidated net worth unless such subordination extends also to the claims of present or future creditors of the parent broker or dealer and all consolidated subsidiaries.

(3) Subordinated liabilities of a consolidated subsidiary or affiliate which are consolidated in accordance with subparagraph (c)(2) above may not be prepaid, repaid or accelerated if any of the entities included in such consolidation would otherwise be unable to comply with the provisions of Appendix (D), 17 CFR 240.15c3–1d.

(4) Each broker or dealer included within the consolidation shall at all times be in compliance with the net capital requirement to which it is subject.

(d) *Certain Precluded Acts.* No broker or dealer shall guarantee, endorse or assume directly or indirectly any obligation or liability of a subsidiary or affiliate unless the obligation or liability is reflected in the computation of net capital and/or aggregate indebtedness pursuant to 17 CFR 240.15c3–1 or this Appendix (C), except as provided in paragraph (b)(1) above.

§ 240.15c3–1d Satisfactory Subordination Agreements (Appendix D to 17 CFR 240.15c3–1).

(a) *Introduction.* (1) This Appendix sets forth minimum and non-exclusive requirements for satisfactory subordination agreements (hereinafter "subordination agreement"). The Examining Authority may require or the broker or dealer may include such other provisions as deemed necessary or appropriate to the extent such provisions do not cause the subordination agreement to fail to meet the minimum requirements of this Appendix (D).

(2) *Certain Definitions.* For purposes of 17 CFR 240.15c3–1 and this Appendix (D):

(i) A subordination agreement may be either a subordinated loan agreement or a secured demand note agreement.

(ii) The term "subordinated loan agreement" shall mean the agreement or agreements evidencing or governing a subordinated borrowing of cash.

(iii) The term "Collateral Value" of any securities pledged to secure a secured demand note shall mean the market value of such securities after giving effect to the percentage deductions specified in subparagraph (c)(2)(vi) of 17 CFR 240.15c3–1.

(iv) The term "Payment Obligation" shall mean the obligation of a broker or dealer in respect to any subordination agreement (A) to repay cash loaned to the broker or dealer pursuant to a subordinated loan agreement or (B) to return a secured demand note contributed to the broker or dealer or reduce the unpaid principal amount thereof and to return cash or securities pledged as collateral to secure the secured demand note and (C) "Payment" shall mean the performance by a broker or dealer of a Payment Obligation.

(v) (A) The term "secured demand note agreement" shall mean an agreement (including the related secured demand note) evidencing or governing the contribution of a secured demand note to a broker or dealer and the pledge of securities and/or cash with the broker or dealer as collateral to secure payment of such secured demand note. The secured demand note agreement may provide that neither the lender, his heirs, executors, administrators or assigns shall be personally liable on such note and that in the event of default the broker or dealer shall look for payment of such note solely to the collateral then pledged to secure the same.

(B) The secured demand note shall be a promissory note executed by the lender and shall be payable on the demand of the broker or dealer to which it is contributed; provided, however, that the making of such demand may be conditioned upon the occurrence of any of certain events which are acceptable to the Commission and to the Examining Authority for such broker or dealer.

(C) If such note is not paid upon presentment and demand as provided for therein, the broker or dealer shall have the right to liquidate all or any part of the securities then pledged as collateral to secure payment of the same and to apply the net proceeds of such liquidation, together with any cash then included in the collateral, in payment of such note. Subject to the prior rights of the broker or dealer as pledgee, the lender, as defined herein, may retain ownership of the collateral and have the benefit of any increases and bear the risks of any decreases in the value of the collateral and may retain the right to vote securities contained within the collateral and any right to income therefrom or distributions thereon, except the broker or

dealer shall have the right to receive and hold as pledgee all dividends payable in securities and all partial and complete liquidating dividends.

(D) Subject to the prior rights of the broker or dealer as pledgee, the lender may have the right to direct the sale of any securities included in the collateral, to direct the purchase of securities with any cash included therein, to withdraw excess collateral or to substitute cash or other securities as collateral, provided that the net proceeds of any such sale and the cash so substituted and the securities so purchased or substituted are held by the broker or dealer, as pledgee, and are included within the collateral to secure payment of the secured demand note, and provided further that no such transaction shall be permitted if, after giving effect thereto, the sum of the amount of any cash, plus the Collateral Value of the securities, then pledged as collateral to secure the secured demand note would be less than the unpaid principal amount of the secured demand note.

(E) Upon payment by the lender, as distinguished from a reduction by the lender which is provided for in subdivision (b)(6)(iii) or reduction by the broker or dealer as provided for in subparagraph (b)(7) of this Appendix (D), of all or any part of the unpaid principal amount of the secured demand note, a broker or dealer shall issue to the lender a subordinated loan agreement in the amount of such payment (or in the case of a broker or dealer that is a partnership credit a capital account of the lender) or issue preferred or common stock of the broker or dealer in the amount of such payment, or any combination of the foregoing, as provided for in the secured demand note agreement.

(F) The term "lender" shall mean the person who lends cash to a broker or dealer pursuant to a subordinated loan agreement and the person who contributes a secured demand note to a broker or dealer pursuant to a secured demand note agreement.

(b) *Minimum Requirements for Subordination Agreements.* (1) Subject to paragraph (a) above, a subordination agreement shall mean a written agreement between the broker or dealer and the lender, which (i) has a minimum term of one year, except for temporary subordination agreements provided for in subparagraph (c)(5) of this Appendix (D), and (ii) is a valid and binding obligation enforceable in accordance with its terms (subject as to enforcement to applicable bankruptcy, insolvency, reorganization, moratorium and other similar laws) against the broker or dealer and the lender and their respective heirs, executors, administrators, successors and assigns.

(2) *Specific Amount.* All subordination agreements shall be for a specific dollar amount which shall not be reduced for the duration of the agreement except by installments as specifically provided for therein and except as otherwise provided in this Appendix (D).

(3) *Effective Subordination.* The subordination agreement shall effectively subordinate any right of the lender to receive any Payment with respect thereto, together with accrued interest or compensation, to the prior payment or provision for payment in full of all claims of all present and future creditors of the broker or dealer arising out of any matter occurring prior to the date on which the related Payment Obligation matures consistent with the provisions of 17 CFR 240.15c3-1 and 240.-15c3-1d, except for claims which are the subject of subordination agreements which rank on the same priority as or junior to the claim of the lender under such subordination agreements.

(4) *Proceeds of Subordinated Loan Agreements.* The subordinated loan agreement shall provide that the cash proceeds thereof shall be used and dealt with by the broker or dealer as part of its capital and shall be subject to the risks of the business.

(5) *Certain Rights of the Broker or Dealer.* The subordination agreement shall provide that the broker or dealer shall have the right to:

(i) Deposit any cash proceeds of a subordinated loan agreement and any cash pledged as collateral to secure a secured demand note in an account or accounts in its own name in any bank or trust company;

(ii) Pledge, repledge, hypothecate and rehypothecate, any or all of the securities pledged as collateral to secure a secured demand note, without notice, separately or in common with other securities or property for the purpose of securing any indebtedness of the broker or dealer; and

(iii) Lend to itself or others any or all of the securities and cash pledged as collateral to secure a secured demand note.

(6) *Collateral for Secured Demand Notes.* Only cash and securities which are fully paid for and which may be publicly offered or sold without registration under the Securities Act of 1933, and the offer, sale and transfer of which are not otherwise restricted, may be pledged as collateral to secure a secured demand note. The secured demand note agreement shall provide that if at any time the sum of the amount of any cash, plus the Collateral Value of any securities, then pledged as collateral to secure the secured demand note is less than the unpaid principal amount of the secured demand note, the broker or dealer must immediately transmit written notice to that effect to the lender and the Examining Authority for such broker or dealer. The secured demand note agreement shall also require that following such transmittal:

(i) The lender, prior to noon of the business day next succeeding the transmittal of such notice, may pledge as collateral additional cash or securities sufficient, after giving effect to such pledge, to bring the sum of the amount of any cash plus the Collateral Value of any securities, then pledged as collateral to secure the secured demand note, up to an amount not less than the unpaid principal amount of the secured demand note; and

(ii) Unless additional cash or securities are pledged by the lender as provided in (i) above, the broker or dealer at noon on the business day next succeeding the transmittal of notice to the lender must commence sale, for the account of the lender, of such of the securities then pledged as collateral to secure the secured demand note and apply so much of the net proceeds thereof, together with such of the cash then pledged as collateral to secure the secured demand note as may be necessary to eliminate the unpaid principal amount of the secured demand note; provided, however, that the unpaid principal amount of the secured demand note need not be reduced below the sum of the amount of any remaining cash, plus the Collateral Value of the remaining securities, then pledged as collateral to secure the secured demand note. The broker or dealer may not purchase for its own account any securities subject to such a sale.

(iii) The secured demand note agreement may also provide that, in lieu of the procedures specified in the provisions required by (ii) above, the lender with the prior written consent of the broker or dealer and the Examining Authority for the broker or dealer may reduce the unpaid principal amount of the secured demand note. Provided, that after giving effect to such reduction the aggregate indebtedness of the broker or dealer would not exceed 1000 per centum of its net capital or, in the case of a broker or dealer operating pursuant to paragraph (f) of 17 CFR 240.15c3-1, net capital would not be less than 7% of aggregate debit items computed in accordance with 17 CFR 240.15c3-3a. Provided, further, that no single secured demand note shall be permitted to be reduced by more than 15 percent of its original principal amount and after such reduction no excess collateral may be withdrawn. No Examining Authority shall consent to a reduction of the principal amount of a secured demand note if, after giving effect to such reduction, net capital would be less than 120 percent of the minimum dollar amount required by 17 CFR 240.15c3-1.

(7) *Permissive Prepayments.* A broker or dealer at its option but not at the option of the lender, may, if the subordination agreement so provides, make a Payment of all or any portion of the Payment Obligation thereunder prior to the scheduled maturity date of such Payment Obligation (hereinafter referred to as a "Prepayment"), but in no event may any Prepayment be made before the expiration of one year from the date such subordination agreement became effective; provided, however, that the foregoing restriction shall not apply to temporary subordination agreements which comply with the provisions of subparagraph (c)(5) of this Appendix (D). No Prepayment shall be made, if, after giving effect thereto (and to all Payments of Payment Obligations under any other

subordinated agreements then outstanding the maturity or accelerated maturities of which are scheduled to fall due within six months after the date such Prepayment is to occur pursuant to this provision or on or prior to the date on which the Payment Obligation in respect of such Prepayment is scheduled to mature disregarding this provision, whichever date is earlier) without reference to any projected profit or loss of the broker or dealer, either aggregate indebtedness of the broker or dealer would exceed 1000 per centum of its net capital or its net capital would be less than 120 per centum of the minimum dollar amount required by 17 CFR 240.15c3–1 or, in the case of a broker or dealer operating pursuant to paragraph (f) of 17 CFR 240.15c3–1, its net capital would be less than 7% of its aggregate debit items computed in accordance with 17 CFR 240.15c3–3a or its net capital would be less than 120% of the minimum dollar amount required by paragraph (f) of 17 CFR 240.15c3–1. Notwithstanding the above, no Prepayment shall occur without the prior written approval of the Examining Authority for such broker or dealer.

(8) *Suspended Repayment.* (i) The Payment Obligation of the broker or dealer in respect of any subordination agreement shall be suspended and shall not mature if, after giving effect to Payment of such Payment Obligation (and to all Payments of Payment Obligations of such broker or dealer under any other subordination agreement(s) then outstanding which are scheduled to mature on or before such Payment Obligation) either (A) the aggregate indebtedness of the broker or dealer would exceed 1200 per centum of its net capital or, in the case of a broker or dealer operating pursuant to paragraph (f) of 17 CFR 240.15c3–1, its net capital would be less than 6 percent of aggregate debit items computed in accordance with 17 CFR 240.15c3–3a, or (B) its net capital would be less than 120 percent of the minimum dollar amount required by 17 CFR 240.15c3–1 including paragraph (f), if applicable. Provided, that the subordination agreement may provide that if the Payment Obligation of the broker or dealer thereunder does not mature and is suspended as a result of the requirement of this subparagraph (b)(8) for a period of not less than six months, the broker or dealer shall thereupon commence the rapid and orderly liquidation of its business but the right of the lender to receive Payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of 17 CFR 240.15c3–1 and 240.15c3–1d.

(ii) Whenever a subordination agreement provides that a broker or dealer shall commence a rapid and orderly liquidation, as permitted in (i) above, the date on which the liquidation commences shall be the maturity date for each subordination agreement of the broker or dealer then outstanding, but the rights of the respective lenders to receive Payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of 17 CFR 240.15c3–1 and 240.15c3–1d.

(9) *Accelerated Maturity-Obligation to Repay to Remain Subordinate.* (i) Subject to the provisions of subparagraph (b)(8) of this Appendix, a subordination agreement may provide that the lender may, upon prior written notice to the broker or dealer and the Examining Authority given not earlier than six months after the effective date of such subordination agreement, accelerate the date on which the Payment Obligation of the broker or dealer, together with accrued interest or compensation, is scheduled to mature to a date not earlier than six months after the giving of such notice, but the right of the lender to receive Payment, together with accured interest or compensation, shall remain subordinate as required by the provisions of 17 CFR 240.15c3–1 and 240.15c3–1d.

(ii) Notwithstanding the provisions of subparagraph (b)(8) of this Appendix, the Payment Obligation of the broker or dealer with respect to a subordination agreement, together with accured interest and compensation, shall mature in the event of any receivership, insolvency, liquidation pursuant to the Securities Investor Protection Act of 1970 or otherwise, bankruptcy, assignment for the benefit of creditors, reorganization whether or not pursuant to the bankruptcy laws, or any other marshalling of the assets and liabilities of the broker or dealer but the right of the lender to receive Payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of 17 CFR 240.15c3–1 and 240.15c3–1d.

(10)(i) *Accelerated Maturity of Subordination Agreements on Event of Default and Event of Acceleration—Obligation to Repay to Remain Subordinate.* A subordination agreement may provide that the lender may, upon prior written notice to the broker or dealer and the Examining Authority of the broker or dealer of the occurrence of any Event of Acceleration (as hereinafter defined) given no sooner than six months after the effective date of such subordination agreement, accelerate the date on which the Payment Obligation of the broker or dealer, together with accrued interest or compensation, is scheduled to mature, to the last business day of a calendar month which is not less than six months after notice of acceleration is received by the broker or dealer and the Examining Authority for the broker or dealer. Any subordination agreement containing such Events of Acceleration may also provide, that if upon such accelerated maturity date the Payment Obligation of the broker or dealer is suspended as required by subparagraph (b)(8) of this Appendix (D) and liquidation of the broker or dealer has not commenced on or prior to such accelerated maturity date, then notwithstanding subparagraph (b)(8) of this Appendix the Payment Obligation of the broker or dealer with respect to such subordination agreement shall mature on the day immediately following such accelerated maturity date and in any such event the Payment Obligations of the broker or dealer with respect to all other subordination agreements then outstanding shall also mature at the same time but the rights of the respective lenders to receive Payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of this Appendix (D). Events of Acceleration which may be included in a subordination agreement complying with this subparagraph (b)(10) shall be limited to:

(A) Failure to pay interest or any installment of principal on a subordination agreement as scheduled;

(B) Failure to pay when due other money obligations of a specified material amount;

(C) Discovery that any material, specified representation or warranty of the broker or dealer which is included in the subordination agreement and on which the subordination agreement was based or continued was inaccurate in a material respect at the time made;

(D) Any specified and clearly measurable event which is included in the subordination agreement and which the lender and the broker or dealer agree (1) is a significant indication that the financial position of the broker or dealer has changed materially and adversely from agreed upon specified norms or (2) could materially and adversely affect the ability of the broker or dealer to conduct its business as conducted on the date the subordination agreement was made; or (3) is a significant change in the senior management of the broker or dealer or in the general business conducted by the broker or dealer from that which obtained on the date the subordination agreement became effective;

(E) Any continued failure to perform agreed covenants included in the subordination agreement relating to the conduct of the business of the broker or dealer or relating to the maintenance and reporting of its financial position; and

(ii) Notwithstanding the provisions of subparagraph (b)(8) of this Appendix, a subordination agreement may provide that, if liquidation of the business of the broker or dealer has not already commenced, the Payment Obligation of the broker or dealer shall mature, together with accrued interest or compensation, upon the occurrence of an Event of Default (as hereinafter defined). Such agreement may also provide that, if liquidation of the business of the broker or dealer has not already commenced, the rapid and orderly liquidation of the business of the broker or dealer shall then commence upon the happening of an Event of Default. Any subordination agreement which so provides for maturity of the Payment Obligation upon the occurrence of an Event of Default shall also provide that the date on which such Event of Default occurs shall, if liquidation of the broker or dealer has not already commenced, be the date on which the Payment Obligations of the broker or dealer with respect to all other subordination agreements then out-

standing shall mature but the rights of the respective lenders to receive Payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of this Appendix (D). Events of Default which may be included in a subordination agreement shall be limited to:

(A) the making of an application by the Securities Investor Protection Corporation for a decree adjudicating that customers of the broker or dealer are in need of protection under the Securities Investor Protection Act of 1970 and the failure of the broker or dealer to obtain the dismissal of such application within 30 days;

(B) The aggregate indebtedness of the broker or dealer exceeding 1500 per centum of its net capital or, in the case of a broker or dealer which has elected to operate under paragraph (f) of 17 CFR 240.15c3–1, its net capital computed in accordance therewith is less than 4% of its aggregate debit items computed in accordance with 17 CFR 240.15c3–3a, throughout a period of 15 consecutive business days, commencing on the day the broker or dealer first determines and notifies the Examining Authority for the broker or dealer, or the Examining Authority or the Commission first determines and notifies the broker or dealer of such fact;

(C) The Commission shall revoke the registration of the broker or dealer;

(D) The Examining Authority shall suspend (and not reinstate within 10 days) or revoke the broker's or dealer's status as a member thereof;

(E) Any receivership, insolvency, liquidation pursuant to the Securities Investor Protection Act of 1970 or otherwise, bankruptcy, assignment for the benefit of creditors, reorganization whether or not pursuant to bankruptcy laws, or any other marshalling of the assets and liabilities of the broker or dealer.

A subordination agreement which contains any of the provisions permitted by this subparagraph (b)(10) shall not contain the provision otherwise permitted by clause (i) of subparagraph (b)(9).

(c) *Miscellaneous Provisions*—(1) *Prohibited Cancellation.* The subordination agreement shall not be subject to cancellation by either party; no Payment shall be made with respect thereto and the agreement shall not be terminated, rescinded or modified by mutual consent or otherwise if the effect thereof would be inconsistent with the requirements of 17 CFR 240.15c3–1 and 240.15c3–1d.

(2) *Notice of Maturity or Accelerated Maturity.* Every broker or dealer shall immediately notify the Examining Authority for such broker or dealer if, after giving effect to all Payments of Payment Obligations under subordination agreements then outstanding which are then due or mature within the following six months without reference to any projected profit or loss of the broker or dealer, either the aggregate indebtedness of the broker or dealer would exceed 1200 percentum of its net capital or its net capital would be less than 120 percent of the minimum dollar amount required by 17 CFR 240.15c3–1, or, in the case of a broker or dealer who is operating pursuant to paragraph (f) of 17 CFR 240.15c3–1, its net capital would be less than 6 percent of aggregate debit items computed in accordance with 17 CFR 240.15c3–3a or less than 120% of the minimum dollar amount required by paragraph (f) of 17 CFR 240.15c3–1.

(3) *Certain Legends.* If all the provisions of a satisfactory subordination agreement do not appear in a single instrument, then the debenture or other evidence of indebtedness shall bear on its face an appropriate legend stating that it is issued subject to the provisions of a satisfactory subordination agreement which shall be adequately referred to and incorporated by reference.

(4) *Legal Title to Securities.* All securities pledged as collateral to secure a secured demand note must be in bearer form, or registered in the name of the broker or dealer or the name of its nominee or custodian.

(5) *Temporary Subordinations.* For the purpose of enabling a broker or dealer to participate as an underwriter of securities or other extraordinary activities in compliance with the net capital requirements of 17 CFR 240.15c3–1, a broker or dealer shall be permitted, on no more than three occasions in any 12 month period, to enter into a subordination agreement on a temporary basis which has a stated term of no more than 45 days from the date such subordination agreement became effective. Provided, that this temporary relief shall not apply to a broker or dealer if, at such time, it is subject to any of the reporting provisions of 17 CFR 240.17a–11 under the Securities Exchange Act of 1934, irrespective of its compliance with such provisions or if immediately prior to entering into such subordination agreement either (i) the aggregate indebtedness of the broker or dealer exceeds 1000 per centum of its net capital or its net capital is less than 120% of the minimum dollar amount required by 17 CFR 240.15c3–1, or (ii) in the case of a broker or dealer operating pursuant to paragraph (f) of 17 CFR 240.15c3–1, its net capital is less than 7 percent of aggregate debits computed in accordance with 17 CFR 240.15c3–3a or less than 120% of the minimum dollar amount required by paragraph (f), or (iii) the amount of its then outstanding subordination agreements exceeds the limits specified in paragraph (d) of 17 CFR 240.15c3–1. Such temporary subordination agreement shall be subject to all the other provisions of this Appendix.

(6) *Filing.* Two copies of any proposed subordination agreement (including nonconforming subordination agreements) shall be filed at least 10 days prior to the proposed execution date of the agreement with the Commission's Regional Office for the region in which the broker or dealer maintains its principal place of business or at such other time as the Regional Office for good cause shall accept such filing. Copies of the proposed agreement shall also be filed with the Examining Authority in such quantities and at such time as the Examining Authority may require. The broker or dealer shall also file with said parties a statement setting forth the name and address of the lender, the business relationship of the lender to the broker or dealer, and whether the broker or dealer carried funds or securities for the lender at or about the time the proposed agreement was so filed. All agreements shall be examined by the Commission's Regional Office or the Examining Authority with whom such agreement is required to be filed prior to their becoming effective. No proposed agreement shall be a satisfactory subordination agreement for the purposes of this section unless and until the Examining Authority has found the agreement acceptable and such agreement has become effective in the form found acceptable.

(7) *Subordination Agreements in Effect Prior to Adoption.* Any subordination agreement which has been entered into prior to September 1, 1975 and which has been deemed to be satisfactorily subordinated pursuant to 17 CFR 240.15c3–1 as in effect prior to September 1, 1975 or net capital rules of a registered national securities exchange, the members of which previously had been exempted from 17 CFR 240.15c3–1, shall continue to be deemed a satisfactory subordination agreement until the maturity of such agreement. Provided, that no renewal of an agreement which provides for automatic or optional renewal by the broker or dealer or lender shall be deemed to be a satisfactory subordination agreement unless such renewed agreement meets the requirements of this Appendix within 6 months from September 1, 1975. Provided, further, that all subordination agreements must meet the requirements of this Appendix within 5 years of September 1, 1975.

(Sec. 15, 48 Stat. 895; 15 USC 780)

By the Commission.

[SEAL] GEORGE A. FITZSIMMONS, *Secretary.*

[FR Doc.75-18325 Filed 7-15-75;8:45 am]

Title 5—Administrative Personnel

CHAPTER I—CIVIL SERVICE COMMISSION

PART 213—EXCEPTED SERVICE

Department of Commerce

Section 213.3314 is amended to show that one position of Confidential Assistant to the Administrator National Fire Prevention and Control Administration, is excepted under Schedule C.

Effective on July 16, 1975, § 213.3314 (u) is added as set out below.

* * * * *

§ 213.3314 Department of Commerce.

(u) *National Fire Prevention and Control Administration.* (1) One Confidential Assistant to the Administrator.