

that lends its clients' securities to broker-dealers,<sup>13</sup> and a joint letter from two trade associations, which collectively represent broker-dealers, mutual fund companies and banks.<sup>14</sup> All three expressed support for the proposed amendment.<sup>15</sup>

In the proposing release, the Commission requested comment on whether authority to issue orders should be delegated to the Division. Two commenters provided comments on this proposal. Both expressed support for such a delegation of authority.<sup>16</sup>

The Commission identified in the proposing release categories of collateral being considered for an order should the amendment to rule 15c3-3 become effective.<sup>17</sup> It also set forth certain conditions for the use of these collateral types. The Commission sought comment on whether the collateral and conditions were appropriate. All commenters supported the issuance of such an order.<sup>18</sup> The Commission intends to issue an order exempting these collateral types after the amendment becomes effective.

The Commission also sought comment on whether institutional

lenders of securities should be allowed to negotiate collateral agreements other than those required by rule 15c3-3. Two of the commenters responded that the Commission should consider whether the minimum requirements are necessary for certain narrowly defined institutional customers. However, they also urged the Commission to act quickly on the amendment as proposed and not let such consideration delay its adoption.<sup>19</sup> They suggested that any changes to address institutional lenders be accomplished through separate orders or rulemakings. Due to the complexities of the issue and in order to act expeditiously on the proposed amendment, further consideration of any change to the collateral requirements for institutional lenders will be addressed by subsequent Commission action.

#### D. Final Rule

The Commission is adopting a final rule amendment substantially in the form proposed in the proposing release.<sup>20</sup> The amendment adds language to paragraph (b)(3) of rule 15c3-3 providing that broker-dealers may pledge "such other collateral as the Commission designates as permissible by order as necessary or appropriate in the public interest and consistent with the protection of investors after giving consideration to the collateral's liquidity, volatility, market depth and location, and the issuer's creditworthiness." This is in addition to the categories of collateral (cash, U.S. treasury bills and notes, and bank letters of credit) currently permitted.

## II. Paperwork Reduction Act

The Commission stated in the proposing release that the amendment will not require a new collection of information. The amendment does not alter the range of collateral that a broker-dealer can pledge when borrowing customer securities, but instead amends the rule to establish criteria that the Commission will consider when issuing an order allowing additional collateral. The comment letters did not disagree with this assessment. In connection with rule 15c3-3, the Commission previously submitted to the Office of Management and Budget, pursuant to the Paperwork Reduction Act, a request for approval and received an OMB control number for the rule, OMB control number 3235-0078.

<sup>19</sup> See State Street letter; Associations letter.

<sup>20</sup> After the rule becomes effective, the Commission will consider whether to issue an order similar to the draft order included in the proposing release. See footnote 18 and accompanying text.

## III. Costs and Benefits of the Rule Amendments

In the proposing release, the Commission requested comment on the costs and benefits of the amendment to rule 15c3-3. The Commission estimated that the primary benefits of the amendment would be lowered borrowing costs and increased liquidity in the securities lending markets. All three commenters concurred with this estimate.<sup>21</sup> Two commenters also pointed out that the amendment will increase their ability to compete in foreign securities markets.<sup>22</sup>

The Commission estimated that there would not be any direct costs associated with the amendment because of its deregulatory nature. The Commission did not receive any comments on this estimate.

#### A. Benefits

The primary benefits of the amendment should be lowered borrowing costs and increased liquidity in the securities lending markets, and greater opportunity for U.S. firms to compete abroad. The current collateral requirements in rule 15c3-3 make it more economical for broker-dealers to borrow securities from other broker-dealers (which are not customers) since customers must be provided with a limited range of collateral. In such a case, the broker-dealer would be limited to borrowing the securities from broker-dealers agreeable to accepting another type of collateral. Expanding the categories of collateral will increase the supply of eligible lenders, which should decrease costs as a consequence of greater competition.

On the other side, customers will have the opportunity to enter into more lending transactions with broker-dealers. This will allow them to earn the fees associated with such transactions and thereby realize greater returns on their securities portfolios. The increased opportunities to borrow and lend securities should add liquidity to the securities lending markets.

<sup>21</sup> See Morgan Stanley letter ("[T]he ability to use these new types of collateral will provide substantially greater flexibility and reduced borrowing costs for U.S. broker-dealers, as well as increased liquidity in the securities markets."); State Street letter ("[T]he prompt issuance of the Final Rule and Collateral Orders will facilitate and promote efficient securities markets, decrease costs, increase competition and enhance the liquidity of securities markets."); Associations letter ("The Associations believe that these collateral types would materially increase liquidity and decrease borrowing costs \* \* \*").

<sup>22</sup> See Morgan Stanley letter; Associations letter.

<sup>13</sup> Letter from State Street Bank and Trust Company, dated July 31, 2002 ("State Street letter").

<sup>14</sup> Letter from The Bond Market Association, and Securities Industry Association, dated July 25, 2002 ("Associations letter").

<sup>15</sup> See Morgan Stanley letter ("We strongly support the proposed amendments to rule 15c3-3 and urge the Commission to adopt them without delay."); State Street letter ("State Street strongly supports and welcomes the Proposed Amendment."); Associations letter ("The Associations fully support the Commission's proposed amendment.").

<sup>16</sup> See Morgan Stanley letter ("[Delegation] will enable the Commission to be more responsive to short-term market conditions—including liquidity crises and settlement failures—as well as longer-term developments, such as evolving approaches to risk management and tightening settlement periods."); State Street letter ("State Street also supports and welcomes the delegation of the Commission's authority to the Division of Market Regulation.").

<sup>17</sup> The categories of collateral identified in the proposing release were: "Government securities" as defined in sections 3(a)(42)(A) and (B) of the Exchange Act; certain "government securities" meeting the definition in section 3(a)(42)(C) of the Exchange Act; securities issued or guaranteed by certain Multilateral Development banks; "mortgage related securities" as defined in section 3(a)(41) of the Exchange Act; certain negotiable certificates of deposit and bankers acceptances; foreign sovereign debt securities; foreign currency; and certain corporate debt securities.

<sup>18</sup> See Morgan Stanley letter ("Morgan Stanley also supports prompt issuance of the Commission's proposed order. Permitting the assets described in the order to be used as collateral for securities borrowing transactions would not, in our view, undermine in any way the Commission's customer protection objectives."). State Street letter; Associations letter ("[T]he conditions specified for each of the collateral types are appropriate to meet the goal of ensuring that borrowings of customer securities remain fully collateralized.").