

securities brokers and dealers to comply with the requirements of SEC Rule 15c3-3 regarding reserves and custody of customer securities.

On March 17, 2003, the SEC published a final amendment to Rule 15c3-3 to allow, through the issuance of an SEC order, the expansion of collateral that brokers and dealers may pledge when borrowing fully paid or excess-margin securities from customers.⁵ Since an SEC order cannot be incorporated by reference to apply to registered government securities brokers and dealers, we are proposing a conforming technical change to § 403.1⁶ and § 403.4⁷ of the GSA regulations. The change would allow Treasury to expand the categories of permissible collateral by issuing an exemptive order. We believe the proposed amendment would continue to protect customer securities and balances while adding liquidity to the securities lending markets and lowering borrowing costs for registered government securities brokers and dealers. In this notice we first provide background on the rule and then describe the proposed changes.

I. Background

A. SEC Rule 15c3-3

In 1972, the SEC adopted the customer protection rule, Rule 15c3-3, to protect customer funds held by brokers and dealers.⁸ At that time, securities brokers and dealers were required to pledge cash, U.S. Treasury bills and notes, or letters of credit as collateral when borrowing customer securities. In 1989, the SEC issued a no-action letter that expanded the categories of permissible collateral.⁹

On June 10, 2002, the SEC issued a proposed amendment to Rule 15c3-3 to allow for expanding the categories of collateral brokers and dealers may pledge when borrowing fully paid or excess-margin securities from customers.¹⁰ Under the proposed amendment, the SEC could expand the

collateral categories by issuing an SEC order. Prior to amending the customer protection rule, brokers and dealers that pledged fully paid or excess-margin customer securities were required to provide the lenders with collateral covering at a minimum the full amount of the securities loaned, and consisting exclusively of cash, U.S. Treasury bills and notes, or an irrevocable letter of credit issued by a bank. In the proposed amendment the SEC identified categories of collateral being considered for the SEC order. It also discussed certain conditions for the use of the identified types of collateral. The SEC received three favorable comment letters in response to its proposal.¹¹

On March 17, 2003, the SEC issued a final amendment to Rule 15c3-3 that was substantially the same as the proposed amendment.¹² The amendment permits brokers and dealers to pledge additional categories of collateral pursuant to orders issued by the SEC. The preamble to the SEC's final amendment stated that the amended rule provides flexibility to ensure receipt of full collateral by customers while allowing for a wider range of permissible collateral, thereby adding liquidity to the securities lending markets and lowering borrowing costs for brokers and dealers.

On April 22, 2003, the SEC issued by order the list of permissible categories of collateral under Rule 15c3-3.¹³ The order expands permissible collateral when borrowing a customer's securities to: "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.

B. Government Securities Act Regulations

When Treasury first issued the implementing regulations¹⁴ for the GSA¹⁵ in 1987, we considered the existing regulation of brokers and dealers registered with the SEC under section 15(b) of the Exchange Act in order to avoid overly burdensome or

duplicative regulations. In that regard, the GSA regulations at 17 CFR Chapter IV incorporate, by reference, many of the SEC's rules regulating brokers and dealers including, with modifications, SEC Rule 15c3-3.

Since the SEC does not have the authority to grant exemptions from section 15C or the rules and regulations thereunder,¹⁶ Treasury is issuing a proposed rule that is similar to the SEC's final rule.

The amended rule would allow for expanding the categories of collateral designated as permissible through the issuance of a Treasury exemptive order. We believe the proposed amendment and order would increase liquidity in the securities lending markets and lower borrowing costs for registered government securities brokers and dealers.

II. Analysis

Treasury is considering a more limited list of acceptable collateral for registered government securities brokers and dealers than the list the SEC provided in its order. Registered government securities brokers and dealers,¹⁷ as defined in the GSA regulations, may hold certain non-exempted securities for proprietary purposes. For example, registered government securities brokers and dealers can hold limited positions in foreign sovereign debt as investments; however, they cannot "deal" in such securities. We understand, from discussions with SEC staff, that if a registered government securities broker or dealer were to pledge such securities in a transaction with a customer, it could be viewed as "dealing" in such securities, which consequently could cause it to have to change its registration.

Therefore, after Treasury issues a final rule amendment, the categories of collateral we are considering designating as permissible by order include only exempted securities such as:

1. "Government securities" as defined in Section 3(a)(42)(A) and (B) of the Exchange Act.

2. "Government securities" as defined in Section 3(a)(42)(C) of the Exchange Act issued or guaranteed as to principal or interest by the following corporations: (i) The Federal Home Loan Mortgage Corporation, (ii) the Federal National Mortgage Association, (iii) the Student Loan Marketing Association, or (iv) the Financing Corporation.

¹⁶ 15 U.S.C. 78mm(b).

¹⁷ See 52 FR 5660 (February 25, 1987) and 17 CFR 400.3(o).

⁵ 68 FR 12780 (March 17, 2003).

⁶ 17 CFR 403.1.

⁷ 17 CFR 403.4.

⁸ 17 CFR 240.15c3-3.

⁹ See Letter from Michael A. Macchiaroli, Assistant Director, Division of Market Regulation, SEC, to Frances R. Bermanzohn, Esq., Senior Vice President of the Public Securities Association (March 2, 1989). The SEC no-action letter provided that under certain facts and circumstances, a broker or dealer could provide to a customer lender as the collateral in a government securities borrowing transaction any of the following: "government securities" as defined in section 3(a)(42)(A) and section 3(a)(42)(B) of the Exchange Act, and securities issued or guaranteed by the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, the Student Loan Marketing Association, or the Financing Corporation.

¹⁰ 67 FR 39642 (June 10, 2002).

¹¹ See *supra* note 10.

¹² See *supra* note 5.

¹³ 68 FR 19864 (April 22, 2003).

¹⁴ See *supra* note 4.

¹⁵ See *supra* note 3.