



# Federal Register

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**Monday,  
June 14, 2004**

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**Part V**

## **Department of the Treasury**

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**17 CFR Part 403**

**Government Securities Act Regulations:  
Protection of Customer Securities and  
Balances; Order Regarding the Collateral  
Registered Government Securities Brokers  
and Dealers Must Pledge When  
Borrowing Customer Securities; Final Rule  
and Notice**

**DEPARTMENT OF THE TREASURY****17 CFR Part 403**

RIN 1505-AA94

**Government Securities Act Regulations: Protection of Customer Securities and Balances****AGENCY:** Office of the Under Secretary for Domestic Finance, Treasury.**ACTION:** Final rule.

**SUMMARY:** The Department of the Treasury (“Treasury,” or “We,” or “Us”) is issuing in final form an amendment to the customer protection rules in § 403.4 of the regulations issued under the Government Securities Act of 1986 (“GSA”), as amended.<sup>1</sup> This provision requires entities registered with the Securities and Exchange Commission (“SEC”) as specialized government securities brokers and dealers (“registered government securities brokers and dealers”) under § 15C(a)(2) of the Securities Exchange Act of 1934 (“the Exchange Act”)<sup>2</sup> to comply with the requirements of the SEC customer protection rule (“SEC Rule 15c3-3”) with certain modifications. We published a proposed rule on December 11, 2003, and received no comments. We are therefore adopting the changes as proposed. Specifically, this amendment makes certain conforming technical changes to the GSA regulations that allow for the expansion of collateral that registered government securities brokers and dealers may pledge when borrowing fully paid or excess-margin securities from customers. This final rule allows us to designate additional categories of collateral pursuant to an order issued by Treasury.

**EFFECTIVE DATE:** June 14, 2004.

**ADDRESSES:** This final rule is available for downloading from the Bureau of the Public Debt’s Web site at <https://treasurydirect.gov/laws-and-regulations/auction-regulations-uocl>. It is also available for public inspection and copying at the Treasury Department Library, Room 1428, Main Treasury Building, 1500 Pennsylvania Avenue, NW., Washington, DC 20220. To visit the library, call (202) 622-0990 for an appointment.

**FOR FURTHER INFORMATION CONTACT:** Lee Grandy (Associate Director), Deidere Brewer (Government Securities Specialist), or Kevin Hawkins (Government Securities Specialist), Bureau of the Public Debt, Government Securities Regulations Staff, (202) 691-

3632 or e-mail us at [govsecreg@bpd.treas.gov](mailto:govsecreg@bpd.treas.gov).

**SUPPLEMENTARY INFORMATION:** The implementing regulations Treasury issued in 1987<sup>3</sup> under the Government Securities Act of 1986<sup>4</sup> adopted the SEC’s customer protection rule at 17 CFR 240.15c3-3 with certain modifications. Currently, § 403.4 of the GSA regulations maintains for registered government securities brokers and dealers the customer protection standards set out in SEC Rule 15c3-3 for brokers and dealers when borrowing fully paid or excess-margin securities from customers.

On March 17, 2003, the SEC published a final amendment<sup>5</sup> 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. Since an SEC order cannot be incorporated by reference to apply to registered government securities brokers and dealers, on December 11, 2003,<sup>6</sup> we issued a proposed rule with conforming technical changes to § 403.1<sup>7</sup> and § 403.4<sup>8</sup> of the GSA regulations that will allow Treasury to expand the categories of permissible collateral by issuing an exemptive order. We received no comments on the proposed rule. As explained below, we are adopting the rule as proposed. We believe this final amendment will continue to protect customer securities and balances, while potentially adding liquidity to the securities lending markets and lowering borrowing costs for registered government securities brokers and dealers.

**I. Background****A. SEC Rule 15c3-3**

In 1972, the SEC adopted the customer protection rule, Rule 15c3-3, to protect customer securities and funds held by brokers and dealers.<sup>9</sup> 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

<sup>3</sup> The GSA regulations were published as a final rule on July 24, 1987 (52 FR 27910). The regulations, as amended, are codified at 17 CFR Chapter IV.

<sup>4</sup> Pub. L. 99-571, 100 Stat. 3208 (1986).

<sup>5</sup> Securities and Exchange Act Release No. 34-47480 (March 11, 2003), 68 FR 12780 (March 17, 2003).

<sup>6</sup> 68 FR 69059 (December 11, 2003).

<sup>7</sup> 17 CFR 403.1.

<sup>8</sup> 17 CFR 403.4.

<sup>9</sup> 17 CFR 240.15c3-3.

the categories of permissible collateral.<sup>10</sup>

On March 17, 2003, the SEC issued a final amendment to Rule 15c3-3 that allows for the expansion of collateral that brokers and dealers may pledge when borrowing fully paid or excess-margin securities from customers pursuant to orders issued by the SEC.<sup>11</sup> 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<sup>12</sup> the list of permissible categories of collateral under Rule 15c3-3.<sup>13</sup>

**B. Government Securities Act Regulations**

When Treasury first issued the implementing regulations<sup>14</sup> for the GSA<sup>15</sup> in 1987, we reviewed the existing regulations for brokers and dealers registered with the SEC under § 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 § 15C or the rules and regulations

<sup>10</sup> 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 § 3(a)(42)(A) and § 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.

<sup>11</sup> See *supra* note 5.

<sup>12</sup> Securities and Exchange Act Release No. 47683 (April 16, 2003), 68 FR 19864 (April 22, 2003).

<sup>13</sup> The SEC order expands permissible collateral for brokers and dealers 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.

<sup>14</sup> See *supra* note 3.

<sup>15</sup> See *supra* note 4.

<sup>1</sup> 15 U.S.C. 78o-5.

<sup>2</sup> 15 U.S.C. 78o-5(a)(2).

thereunder,<sup>16</sup> on December 11, 2003, Treasury issued a proposed rule that was similar to the SEC's final rule. The amended rule would allow for the expansion of the categories of collateral designated as permissible through the issuance of a Treasury exemptive order. We identified in the preamble to the proposed amendment the categories of collateral we were considering for an order should the amendment to § 403.4 of the GSA regulations be issued in final form.<sup>17</sup> Since registered government securities brokers and dealers may conduct a business only in government and other exempted securities (except municipal securities), the list of securities we identified was more limited than the list the SEC provided in its order. Treasury did not receive any comment letters in response to the proposed rule.

## II. Analysis

We are now adopting, without change, the amendments to § 403.1 and § 403.4. The amendments add a new paragraph (e) to § 403.4 and make a conforming change to § 403.1. Paragraph (e) of § 403.4 modifies paragraph (b)(3)(iii)(A) of SEC Rule 15c3-3, and now provides that in addition to the categories of collateral currently acceptable (cash, U.S. Treasury bills and notes, and bank letters of credit), registered government securities brokers and dealers may pledge "such other collateral as the Secretary designates as permissible by order as consistent with the public interest, the protection of investors, and the purposes of the Act, after giving consideration to the collateral's liquidity, volatility, market depth and location, and the issuer's creditworthiness." Treasury is publishing at the same time as this rule an order designating the additional categories of collateral applicable to registered government securities brokers and dealers.

<sup>16</sup> 15 U.S.C. 78mm(b).

<sup>17</sup> The categories of collateral we identified in the proposed amendment were: "Government securities" as defined in § 3(a)(42)(A) and (B) of the Exchange Act; "Government securities" as defined in § 3(a)(42)(C) of the Exchange Act issued or guaranteed as to principal or interest by the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, the Student Loan Marketing Association, or the Financing Corporation; and securities issued by, or guaranteed as to principal and interest by certain Multilateral Development Banks.

We believe this amendment will provide us with the flexibility to expand the categories of collateral that may be pledged by registered government securities brokers and dealers, while maintaining the customer protection objectives of § 403.4. This amendment, and the accompanying order, will potentially increase liquidity in the securities lending markets and lower borrowing costs for registered government securities brokers and dealers.

## III. Special Analysis

This final rule makes only a technical change to the GSA regulations to provide for a broader list of collateral that registered government securities brokers and dealers may pledge. Therefore, this amendment does not meet the criteria for a "significant regulatory action" under Executive Order 12866. The purpose of the amendment is to relieve a restriction on registered government securities brokers and dealers; we are therefore making it effective immediately.

For the same reason, we certify under the Regulatory Flexibility Act<sup>18</sup> that the amendment, if adopted, would not have a significant economic impact on a substantial number of small entities. As a result, a regulatory flexibility analysis is not required.

Although the amendment is technical in nature, it does not impose any additional burdens on such firms. The amendment should increase liquidity in the government securities market and lower borrowing costs for registered government securities brokers and dealers. The collections of information under the Government Securities Act regulations have previously been reviewed and approved by the Office of Management and Budget under control number 1535-0089.

### List of Subjects in 17 CFR Part 403

Banks, Banking, Brokers, Government securities.

■ For the reasons set out in the preamble, 17 CFR part 403 is amended as follows:

### PART 403—PROTECTION OF CUSTOMER SECURITIES AND BALANCES

■ 1. The authority citation for part 403 is revised to read as follows:

<sup>18</sup> 5 U.S.C. 601.

**Authority:** Sec. 101, Pub. L. 99-571, 100 Stat. 3209; sec. 4(b), Pub. L. 101-432, 104 Stat. 963; sec. 102, sec. 106, Pub. L. 103-202, 107 Stat. 2344 (15 U.S.C. 78o-5(a)(5), (b)(1)(A), (b)(4)).

■ 2. Section 403.1 is revised to read as follows:

#### § 403.1 Application of part to registered brokers and dealers.

With respect to their activities in government securities, compliance by registered brokers or dealers with § 240.8c-1 of this title (SEC Rule 8c-1), as modified by §§ 403.2 (a), (b) and (c), with § 240.15c2-1 of this title (SEC Rule 15c2-1), with § 240.15c3-2 of this title (SEC Rule 15c3-2), as modified by § 403.3, and with § 240.15c3-3 of this title (SEC Rule 15c3-3), as modified by §§ 403.4 (a)-(d), (f)(2)-(3), (g)-(j), and (m), constitutes compliance with this part.

■ 3. Section 403.4 is amended by redesignating paragraphs (e) through (l) as paragraphs (f) through (m), respectively, and by adding new paragraph (e) to read as follows:

#### § 403.4 Customer Protection—reserves and custody of securities.

\* \* \* \* \*

(e) For purposes of this section, § 240.15c3-3(b)(3)(iii)(A) of this title is modified to read as follows:

(A) Must provide to the lender upon the execution of the agreement, or by the close of the business day of the loan if the loan occurs subsequent to the execution of the agreement, collateral that fully secures the loan of securities, consisting exclusively of cash or United States Treasury bills or Treasury notes or an irrevocable letter of credit issued by a bank as defined in § 3(a)(6)(A)-(C) of the Act (15 U.S.C. 78c(a)(6)(A)-(C)) or such other collateral as the Secretary designates as permissible by order as consistent with the public interest, the protection of investors, and the purposes of the Act, after giving consideration to the collateral's liquidity, volatility, market depth and location, and the issuer's creditworthiness; and

\* \* \* \* \*

Dated: May 24, 2004.

**Brian C. Roseboro,**

*Under Secretary, Domestic Finance.*

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