

DEPARTMENT OF THE TREASURY

Order Regarding the Collateral Registered Government Securities Brokers and Dealers Must Pledge When Borrowing Customer Securities

June 14, 2004.

Title I of the Government Securities Act of 1986¹ ("GSA") amended the Securities Exchange Act of 1934 ("Exchange Act") by adding § 15C, authorizing the Secretary of the Treasury ("Secretary") to promulgate regulations concerning the financial responsibility, protection of customer securities and balances, recordkeeping and reporting of government securities brokers and dealers. Section 15C(a)(5) of the Exchange Act² authorizes the Secretary, by rule or order, to conditionally or unconditionally exempt any government securities broker or dealer, or class of government securities brokers or dealers, from certain provisions under the GSA, or the rules thereunder, if the Secretary finds that such exemption is consistent with the public interest, the protection of investors, and the purposes of the Exchange Act.

By this order, the Secretary will allow 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 Exchange Act that borrow fully paid³ or excess-margin⁴ securities from customers to pledge a wider range of collateral than is permitted under paragraph (b)(3) of SEC Rule 15c3-3,⁵ as incorporated and modified by § 403.4 of the GSA regulations.⁶

As background, Title I of the GSA requires government securities brokers and dealers to comply with the rules prescribed by the Department of the Treasury ("Treasury," or "We," or "Us,") under the GSA. Treasury has

issued rules in 17 CFR, subchapter A, parts 400–449. Among those rules is a rule for the protection of customer securities and balances (part 403). As issued by Treasury in 1987,⁷ part 403 adopted the SEC's customer protection rule, SEC Rule 15c3-3,⁸ with certain modifications. At the same time we are issuing this order, we are also issuing a final rule amendment to § 403.4 of the GSA regulations to allow for the expansion of collateral that registered government securities brokers and dealers may pledge when borrowing fully paid or excess-margin government securities from customers.

Section 403.4(e) allows the Secretary to designate by order other collateral as permissible, 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."

Accordingly, after giving consideration to the liquidity, volatility, market depth and location and the issuer's creditworthiness in connection with the following described types of collateral, we find an exemption to be consistent with the public interest, the protection of investors, and the purposes of the Act. The exemption will potentially increase liquidity in the government securities market and lower borrowing costs for registered government securities brokers and dealers, while maintaining the customer protection objectives of § 403.4.

Therefore, it is ordered, pursuant to § 15C(a)(5) of the Exchange Act, that

⁷ The GSA regulations were published as a final rule on July 24, 1987 (52 FR 27910). Section 403.4 requires registered government securities brokers and dealers to comply with the requirements of SEC Rule 15c3-3 regarding reserves and custody of securities.

⁸ On March 17, 2003, the SEC issued a final amendment to SEC Rule 15c3-3 to allow for the expansion of the collateral general purpose brokers and dealers may pledge when borrowing securities from customers. Securities and Exchange Act Release No. 34-47480 (March 11, 2003), 68 FR 12780 (March 17, 2003). On April 22, 2003, the SEC issued by order the list of permissible categories of collateral that brokers and dealers may pledge under SEC Rule 15c3-3. Securities and Exchange Act Release No. 47683, 68 FR 19864 (April 22, 2003).

registered government securities brokers and dealers may pledge, in accordance with all applicable conditions set forth below and in § 403.4 of the GSA regulations, the following types of collateral (in addition to those permitted under paragraph (e) of § 403.4) when borrowing fully paid or excess-margin securities from customers:

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

2. "Government securities" as defined in § 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.

3. Securities issued by, or guaranteed as to principal and interest by, the following Multilateral Development Banks whose obligations are backed by the participating countries, including the U.S.: (i) The International Bank for Reconstruction and Development, (ii) the Inter-American Development Bank, (iii) the Asian Development Bank, (iv) the African Development Bank, (v) the European Bank for Reconstruction and Development, and (vi) the International Finance Corporation.

The categories of permissible collateral do not include securities that have no principal component (e.g., STRIPS).

Registered government securities brokers and dealers that pledge any of the government securities set forth above must, in addition to the notice requirements contained in paragraph (b)(3) of SEC Rule 15c3-3 as incorporated and modified by § 403.4, include in the written agreement with the customer a notice that some of the securities being provided by the borrower as collateral under the agreement may not be guaranteed by the United States.

Dated: May 24, 2004.

Brian C. Roseboro,

Under Secretary, Domestic Finance.

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¹ Pub. L. 99-571, 100 Stat. 3208 (1986).

² 15 U.S.C. 78o-5(a)(5).

³ 17 CFR 403.4(b).

⁴ 17 CFR 403.4(d).

⁵ 17 CFR 240.15c3-3.

⁶ 17 CFR 403.4.