NASD
National Association of Securities Dealers, Inc.
1735 K St., N.W. • Washington, D.C. 20006 • (202) 728-8000

notice to members 87-49

August 10, 1987

TO: All NASD Members and Other Interested Persons

ATTENTION: REGISTRATION AND TRAINING PERSONNEL

RE: New $10 NYSE Series 7 Development Fee to Begin in August

EXECUTIVE SUMMARY

Beginning with the August 15, 1987, administration of the Series 7 General Securities Registered Representative Examination, the NASD will collect a $10 test-development fee from its members for the New York Stock Exchange (NYSE) for each Series 7 grade posted to a candidate's registration record. These fees will be collected for and transferred to the NYSE to defray the expenses incurred by the NYSE for the development and maintenance of the Series 7 question bank.

BACKGROUND

Under a long-standing agreement with the NASD, the NYSE has borne most of the costs to develop and maintain the Series 7 General Securities Registered Representative Examination question bank. The NYSE maintains five geographically dispersed industry committees of question writers and reviewers. Each committee meets several times a year to add new or improved questions to the Series 7. The NYSE maintains this question bank at the exchange and delivers future test forms to the NASD, which, in turn, prints, administers, and grades the tests. Over the years, the NYSE has paid most of the expenses of the industry committees and the NYSE test-assembly programs.

To help defray these expenses, beginning August 15, 1987, the NASD will collect a $10 test-development fee for the NYSE from all candidates who take a

Series 7. The fees collected from NASD members will be transferred in their entirety to the NYSE.

The NASD is expecting SEC approval of an amendment to Schedule A to the NASD By-Laws that will incorporate this fee assessment. In this connection, the NASD will debit a member's registration account $10 for each Series 7 grade posted to a candidate's registration record.

Questions concerning this notice may be directed to David Uthe, Senior Qualifications Analyst, NASD Qualifications, at (301) 738-6695.

Sincerely,

John T. Wall
Executive Vice President
Member & Market Services

NASD
National Association of Securities Dealers, Inc.
1735 K St., N.W. • Washington, D.C. 20006 • (202) 728-8000

notice to members 87-50

August 10, 1987

TO: All NASD Members and Other Interested Persons

RE: Amendments to SEC Rules 15c3-1, 17a-3, and 17a-13 Regarding Treatment of Repurchase and Reverse Repurchase Agreements

The Securities and Exchange Commission (SEC) has amended its net capital, recordkeeping, and quarterly securities-count rules under the Securities Exchange Act of 1934 regarding the treatment of repurchase (repo) and reverse repurchase (reverse repo) agreements entered into by registered broker-dealers.

The amendments to SEC Rule 15c3-1 will become effective on September 10, 1987. The amendments to SEC Rules 17a-3 and 17a-13 became effective on July 25, 1987.

The text of the SEC's amendments, as reprinted in the Federal Register, is attached as Exhibit A.

The significant aspects of the amendments are discussed below.

- Rule 15c3-1--Uniform Net Capital Rule

1. Reverse Repurchase Agreement Deficits

Broker-dealers will be required to take a charge to net worth in arriving at net capital for the full amount by which the contract price of a reverse repo exceeds the value of the securities received under the agreement. The charge may be reduced for certain permissible same-party offsets and margin or other deposits held by the broker-dealer. The charge may also be reduced by calls for margin and marks to market or other required deposits that are outstanding one business day or less. Currently, the charge for deficits on reverse repos ranges from 0 percent to 100 percent depending on maturity of the agreement.

2. Repurchase Agreement Deficits

For repo deficits, broker-dealers will be required to deduct from net worth in arriving at net capital the greater amount computed under combined Tests

1 and 2, or Test 3, if greater. (Tests 1, 2, and 3 are described below.) The first test addresses the deficit in an individual repo contract while the second test deals with the aggregate repo deficits with any one party in excess of 25 percent of tentative net capital (TNC). The third test involves the aggregate deficits of all repo contracts with all parties in excess of 300 percent of TNC. When computing the deductions, broker-dealers may net repo and reverse repo agreements entered into with the same party and these deficits may also be reduced by margin calls outstanding one business day or less.

Test 1:

Deduct the amount by which the value of securities subject to a repo agreement exceeds the allowable percentage of funds received by the broker-dealer under those agreements as follows:

(1) 105 percent for U.S. Treasury Bills, Notes, and Bonds.

(2) 110 percent for securities issued or guaranteed as to principal or interest by an agency of the United States or mortgage-related securities.

(3) 120 percent for all other securities.

and

Test 2:

Deduct the excess of the difference between the market value of securities subject to repo agreements with a counterparty and the funds received (if less than market value of the securities) over 25 percent of the broker-dealer's TNC. However, as to the same counterparty, the charge will be the greater of the amount computed under either this test or Test 1 above.

or

Test 3:

Compare the aggregate market value of securities subject to repo agreements to the total amount of funds received under such agreements. If the aggregate market value of the securities exceeds the funds received by an amount greater than 300 percent of the broker-dealer's tentative net capital, the broker-dealer is required to deduct the amount equal to the excess over 300 percent of the broker-dealer's TNC. If the deficit computed under Test 3 is greater than the combined deficits under Tests 1 and 2, then the charge to net capital shall be the deficit computed under Test 3. If the deficit under Test 3 is less, the charge to net capital shall be the combined deficits from Tests 1 and 2.

(Exhibit B shows examples of calculation of charges under Tests 1, 2, and 3.)

3. Excess Margin on Reverse Repurchases

The amendments require a broker-dealer to increase its required net capital by 10 percent of the excess market value of U.S. Treasury securities subject to reverse repo agreements with one counterparty over 105 percent of the funds paid pursuant to such agreements. The percentage parameter for reverse repos using U.S. agency or mortgage-backed securities will be 110 percent and for all other securities, 120 percent. The SEC will entertain no-action requests from those broker-dealers that can show that specific securities received under a reverse repurchase agreement were not used to obtain funds.

4. Transactions With Affiliates

The amendments provide for a deduction in certain circumstances from net worth in arriving at net capital for intercompany receivables and liabilities to affiliates, where collateral given to the affiliate exceeds the liability, unless the books and records of the affiliate are made available for inspection.

- Rule 17a-3--Maintenance of Books and Records

Broker-dealers will, in addition to other provisions of the rule, be required to (1) maintain a separate ledger reflecting the assets and liabilities resulting from repo and reverse repo transactions, (2) record securities subject to repos on the securities position record, and (3) maintain copies of confirmations that it sends out with regard to repo transactions.

- Rule 17a-13--Quarterly Securities Count

Broker-dealers will be required to account for securities that are the subject of repo and reverse repo agreements as they do for other securities for which they are responsible.

* * * * *

Questions concerning this notice may be directed to I. William Fishkind, Associate Director, NASD Financial Responsibility, at (202) 728-8405.

Sincerely,

John E. Pinto, Jr.
Senior Vice President
Compliance

Attachments

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34-24553; File No. S7-21-86]

Financial Responsibility Rules

AGENCY: Securities and Exchange Commission.

ACTION: Final rule amendments.

SUMMARY: The Securities and Exchange Commission ("Commission") is amending its net capital, recordkeeping and quarterly securities count rules under the Securities Exchange Act of 1934 ("Act") in connection with the treatment of repurchase and reverse repurchase agreements entered into by registered broker-dealers. The recordkeeping rule is amended to specifically require broker-dealers to maintain certain books and records with respect to their repurchase and reverse repurchase transactions, including securities records and copies of all confirmations. The quarterly securities count rule is amended to clarify that broker-dealers are required to account for securities that are the subjects of repurchase and reverse repurchase agreements, as they do for other securities for which they are responsible. The net capital rule is amended to establish deductions from net worth in arriving at net capital for repurchase and reverse repurchase agreements under certain risk circumstances. The rule is further amended to require additional capital when the broker-dealer has attained a high degree of leverage as a result of those agreements. The rule as amended will also require deductions regarding transactions with affiliates when the affiliate's records are not made available for examination.

EFFECTIVE DATE: Ninety days from publication in the Federal Register, except for amendments to §§ 240.17a-3 and 240.17a-13 which will be effective on July 25, 1987.

FOR FURTHER INFORMATION CONTACT: Michael A. Macchiaroli, (202) 272-2904, Julio A. Mojica, (202) 272-2372, or Michael P. Jamroz, (202) 272-2398, Division of Market Regulation, 450 5th Street, NW., Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

I. Introduction

In September of 1986, the Commission proposed amendments to its financial responsibility rules relating to repurchase and reverse repurchase agreements ("repos" and "reverse repos").[1] Those proposed amendments were the result of the failures of several government securities dealers which caused substantial harm to public investors and broker-dealers through fraudulent practices or inadequate accountability.[2]

In response to those failures, the Congress has enacted the Government Securities Act ("GSA") which, among other things, granted the Department of Treasury ("Treasury") authority to adopt financial responsibility rules for all brokers and dealers in government securities, including those currently registered with the Commission.[3] Subsequently, the Treasury has proposed rules that, to a large extent, incorporate existing Commission financial responsibility regulations.[4] With some modification, the Treasury's proposed rules would require all government securities brokers and dealers to comply with Securities Exchange Act Rules 17a-3, 17a-4, 17a-5, 17a-7, 17a-8, 17a-11, 17a-13 and 15c3-3. The modifications to the Treasury's proposed version of Commission Rules 17a-3 and 17a-13[5] include those amendments proposed by the Commission in September.

The Treasury also proposed to apply Rule 15c3-3 to all government securities dealers, with certain modifications. The proposed modifications to Rule 15c3-3[6] relate to hold in custody repos[7] and would alter the requirements proposed by the Commission in September. In its release, the Commission proposed to require broker-dealers that enter into hold in custody repurchase agreements to: (i) Disclose the rights and liabilities of the parties, including the fact that the Securities Investor Protection Corporation ("SIPC") has taken the position that coverage under the Securities Investor Protection Act of 1970 may not be available; (ii) confirm the securities that are subject to such agreement; and (iii) maintain possession and control of those securities with certain exceptions. The Commission's proposed amendments would not require possession and control during the trading day for securities subject to hold in custody repurchase agreements of over $1 million. That exemption was provided to facilitate the settlement of government securities transactions during the trading day.

The comments rearding the proposed amendments to Rule 153-3 were favorable in most instances except with respect to the requirement to disclose the rights and liabilities of the parties to repurchase agreements. The Commission has determined, however, to repropose the amendments to Rule 15c3-3 in a manner that will substantially conform Rule 15c3-3 to the Treasury's rule. The Commission's proposal is the subject of a separate release.

Although not every comment is discussed in this release, the comments received with respect to Release No. 34-23602 have been reviewed extensively by the Commission and incorporated, as appropriate, in the amendments that the Commission is adopting today. In addition, a summary of comments has been prepared and placed in Public File No. S7-21-86. The comments received by the Commission regarding the proposed amendments to Rules 17a-3 and 17a-13 were generally favorable. With respect to Rule 15c3-1, the comments suggested that:

(i) The increased capital requirement for excess margin would inhibit the broker-dealer's ability to control credit risk;

(ii) The deduction for reverse repos should not be 100% of the deficit and should allow for margin calls; and

(iii) The examination of the affiliate should be limited to verification of which entity has possession and control over the collateral. The amendments to Rules 17a-3, 17a-13 and Rule 15c3-1 and the comments received with respect to those rules are discussed in greater detail below.

II. Accountability for Money and Securities

1. Rule 17a-3

Rule 17a-3 prescribes the books and records that a broker-dealer is required to maintain. The proposed amendments will specifically require a broker-dealer

[1] *See* Securities Exchange Act Release No. 23602 (September 4, 1986) 51 FR 32658 (September 15, 1986). A repurchase agreement involving a security is the sale of that security at a specified price with a simultaneous agreement to repurchase the security at a specified price on a specified future date. A reverse repurchase agreement involving a security is the purchase of that security at a specified price with a simultaneous agreement to resell the security at a specified price on a specified future date.

[2] *See* The Regulation of the Government Securities Market, Report by the Securities and Exchange Commission to the Subcommittee on Telecommunications, Consumer Protection and Finance of the Committee on Energy and Commerce of the U.S. House of Representatives (June 20, 1985).

[3] *See* section 15C(b) of the Securities Exchange Act as amended by the GSA.

[4] *See* 52 FR 5660 (February 25, 1987).

[5] *See* 17 CFR 240.17a-3 and 17 CFR 240.17a-13.

[6] *See* 17 CFR 240.15c3-3.

[7] A hold in custody repurchase agreement is a repurchase agreement where the broker.dealer retains custody of the counterparty's securities.

to: (i) Maintain a separate ledger reflecting the assets and liabilities resulting from repo and reverse repo transactions (commonly referred to as the "Repo Book"); (ii) record securities subject to repos and reverse repos on the securities record; and (iii) maintain copies of confirmations that it sends out with regard to repurchase transactions. The commentators generally supported the amendments to Rule 17a–3 and the Commission has determined to adopt the proposed amendments to ensure accountability for the funds and securities involved in repo transactions.

2. Rule 17a–13

Rule 17a–13 requires that a broker-dealer physically count, verify and account for securities held in his physical possession or otherwise within his control or direction. Currently, the Rule does not contain a specific reference to securities that are the subjects of repurchase and reverse repurchase agreements. The purpose of the amendment is to make it clear that a broker-dealer is held accountable for repo securities as it is other securities subject to its possession or control. The commentators generally expressed support for the amendment and the Commission is adopting it in the form proposed.[8]

III. Leverage and Risk Control

1. Introduction

Securities Exchange Act Rule 15c3–1 requires that a broker-dealer's net capital must exceed the greater of $25,000 or 6⅔ percent of its aggregate indebtedness [9] if the broker-dealer does not elect the alternative method. If it elects the alternative method under paragraph (f), the broker-dealer's net capital must exceed the greater of $100,000 or 2 percent of its aggregate debit items as computed in accordance with the Securities Exchange Act Rule 15c3–3a Formula for Determination of Reserve Requirement for Brokers and Dealers ("Reserve Formula"). Net capital, defined in paragraph (c)(2) of Rule 15c3–1, is computed by deducting from net worth, among other things, illiquid assets, unsecured receivables, and certain percentage deductions of the market value of securities and commodities positions of the firm. Those percentages generally take into account market risk, liquidity and volatility of the broker-dealer's holdings.

2. Reverse Repurchase Agreements Deficits

When the uniform net capital rule was adopted in 1975, the Commission required broker-dealers to deduct from net worth in arriving at net capital the amount by which the contract price of a reverse repo exceeded the value of the securities received under the agreement ("reverse repo deficit").[10] The Commission's rule reflected that if a broker-dealer does not receive securities or other property of sufficient worth to cover the counterparty's obligation under a reverse repurchase agreement, the broker-dealer is exposed to risk for the amount of the deficiency.

In 1982, the Commission adopted the current treatment of reverse repo deficits [11] Instead of deducting the entire deficit, the Commission amended the rule such that only a percentage of the deficit, depending on the term of the agreement, would be required to be deducted. Those amendments were in response to the concerns of broker-dealers regarding the application of the rule to the practices of the time. The rule recognized that many repurchase agreements were term, as opposed to overnight agreements, and reverse repo deficits were likely to occur as time passed.

Some commentators suggested that the reverse repo deficit deduction should be similar to the proposed charges for repo deficits.[12] Under the proposal, the broker-dealer would not deduct the entire repo deficit as it would a reverse repo deficit. The proposal would only require a deduction when the repo deficit exceeded certain specified constraints. The Commission designed the repo deficit deductions in this manner to recognize that broker-dealers normally provide excess securities under a repo as a "cushion" or margin. Conversely, the Commission understands that when broker-dealers engage in reverse repos, they normally receive excess securities. Therefore, the deduction for reverse repo deficits not only more accurately reflects risk, but also the current industry practice. Accordingly, the Commission has adopted the proposed amendment.

3. Repurchase Agreement Deficits

For repo deficits, the proposed amendments required broker-dealers to deduct the largest amount computed under three separate tests. Under the first test, the broker-dealer deducts the amount by which the value of U.S. Treasury securities subject to repurchase agreements with a counterparty exceeds 105 percent of the funds received by the broker-dealer under those agreements. This charge takes into account the risk that the broker-dealer is exposed to when it delivers securities under a repurchase agreement that are valued in excess of the amount the broker-dealer receives from the counterparty.

Under the second test, the broker-dealer deducts the excess of the difference between the market value of securities subject to repurchase agreements with a counterparty and the funds received (if less than the market value of the securities) over 25 percent of the broker-dealer's tentative net capital. The second charge takes into account the exposure to risk incurred by the broker-dealer in delivering a concentration of excess securities under repurchase agreements to one counterparty.

Under the third test, the broker-dealer compares the aggregate market value of securities subject to repurchase agreements to the total amount of funds it has received under such agreements. If the aggregate market value of the securities exceeds the funds received by an amount greater than 300 percent of the broker-dealer's tentative net capital, the broker-dealer is required to deduct the amount equal to the excess over 300 percent of the broker-dealer's tentative net capital. The third computation compares the aggregate repurchase agreement exposure with all counterparties to the broker-dealer's tentative net capital.

The Commission continues to believe that the three alternative tests accurately measure the risks entailed in

[8] One commentator asked if substitution of securities subject to a repurchase agreement would cause the thirty day period under the rule to start again. Paragraph (b)(3) to Rule 17a–13 requires verification of securities "* * * subject to his control or direction but not in his physical possession, where such securities have been in said status for longer than thirty days". The Commission takes the position that the substitution of securities subject to a repurchase agreement changes the status of those securities for purposes of Rule 17a–13. Consequently, any substitution would cause the thirty day period to start again.

[9] The term aggregage indebtedness is defined in paragraph Rule 15c3–1(c)(1).

[10] *See* Securities Exchange Act Release No. 11497 (June 26, 1975), 40 FR 29729 (July 16, 1975).

[11] *See* Securities Exchange Act Release No. 18737 (Mar. 13, 1982), 47 FR 21759 (May 20, 1982). Subparagraph (c)(2)(iv)(F) of Rule 15c3–1 prescribes a schedule of deductions ranging from zero to 100 percent for deficits resulting from reverse repurchase agreements (*i.e.*, the difference between the contract price and the market value of the security). The amount of the charge depends on the maturity of the repo agreement.

[12] A repurchase agreement deficit occurs when the market value of securities subject to a repurchase agreement exceeds the contract price of the repurchase agreement.

repurchase transactions. Accordingly, the Commission has adopted the proposed amendments with two modifications. As in the case of reverse repo deficits, the commentators requested that margin calls be taken into account. In recognition of the industry practice of requesting margin when exposure exceeds certain limits, the Commission has modified the amendments to reduce the repo deficit for purposes of the rule by margin calls outstanding one business day or less. In computing the deductions, the broker-dealer is allowed to net repurchase and reverse repurchase agreements into with the same party.[13]

The commentators also pointed out that the 105% parameter under the first test should be increased where the securities subject to the repo are not United States Treasury securities. These commentators noted that it was common industry practice to require Government Agency Securities valued in excess of 105 percent of the funds received in the repo. For this reason, the factor has been increased to 110 percent for mortgage-backed securities and to 120 percent for other securities.

4. Excess Margin on Reverse Repos

While most broker-dealers properly protect themselves against credit risk related to reverse repos by receiving securities that are valued in excess of the funds they have extended under the agreement, some broker-dealers create leverage by obtaining the use of funds through matched repurchase agreements. Those broker-dealers enter into reverse repurchase agreements, receive securities that are valued substantially in excess of the amount advanced, then sell the securities pursuant to repurchase agreements for an amount of cash greater than the amount advanced under the reverse repurchase agreements. The net funds obtained are then used in the business of the broker-dealer.

Under the amendments, the broker-dealer is required to increase its required net capital by ten percent of the excess market value of U.S. Treasury securities subject to reverse repos agreements with one counterparty over 105 percent of the funds paid pursuant to such agreements. Commentators reported that this amendment would inhibit the credit function of the broker-dealer because it would require capital when the broker-dealer is protecting itself against credit risk.

The Commission does not wish to interfere in the normal credit policies of a broker-dealer. The Commission, however, believes that the leverage obtainable in repurchase transactions is of such magnitude that some restraint is necessary. Restraint in the use of "customer" property usually occurs through Rule 15c3–3, which prevents use of customer funds and securities to finance the broker-dealer's inventory. If Rule 15c3–3 were applicable to repurchase transactions, there would be no need for this amendment. However, the Commission, relying to some degree on the determination of the Securities Investor Protection Corporation that for purposes of the Securities Investor Protection Act [14] repo participants are not customers, has not taken the position that repo participants are "customers" for purposes of Rule 15c3–3. Such a determination would in effect result in a 100 percent capital charge as to the excess margin because the broker-dealer would likely fund the additional Reserve Account deposit with its own capital

In sum, the Commission believes that the use of excess repo margin does raise concerns. Indeed, the misappropriation of excess margin accounted for a large percentage of total losses in both the E.S.M. and Bevill, Bresler failures. Accordingly, the Commission believes that because the broker-dealer has obtained leverage through the use of third party funds, an additional capital requirement is appropriate. Therefore, the Commission adopts the proposed amendments, but with one modification as suggested by the commentators.[15] The 105% parameter will apply only to reverse repos using U.S. Treasury securities. As in the repo deficit area, the appropriate parameter for mortgage-backed securities will be 110%. The parameter for securities other than U.S. Treasury and mortgaged-backed securities will be 120 percent. With this modification, the Commission believes that the amendment provide assurance that firms will be able to meet customer obligations without unduly revising current industry practices.

5. Transactions with Affiliates

The amendments announced today also include a deduction from net worth in arriving at net capital for intercompany transactions with affiliates where the registered broker-dealer is potentially exposed to loss unless the books and records of the affiliate are available for examination. The amendment covers all intercompany receivables (not otherwise deducted) and liabilities to affiliates where collateral given to the affiliate exceeds the amount of the liability. The comment letters stated that the scope of the examination of the affiliate should be limited to verification of the location and control of the collateral. The Commission believes, however, that it is difficult, if not impossible, to determine which entity has control over collateral without the ability to conduct a broad examination. the Commission has clarified the language of the amendment, however, to indicate that the purpose of the examination is to demonstrate the validity of the receivable or payable.

The Commission emphasizes that a broad review of the books and records of the affiliate will be necessary in some cases because the assets pledged as collateral by the affiliate in the intercompany loan may be fungible, for example securities or commodities positions. If the assets are fungible, and examiner will need to determine, by review of the firm's use of all of the assets of that group, if the assets pledged by the affiliate are being used for another purpose.

The Commission's concerns extend

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[13] The Commission recognizes that when a broker-dealer enters into repurchase agreements using proprietary securities, the firm may incur a deduction because of a repo deficit and a deduction, or haircut, related to the securities. The Commission also understands that it is difficult for broker-dealers that engage in a significant amount of repurchase transactions to identify the specific securities that were used in a particular repurchase agreement. For those broker-dealers that believe they have a program which can specifically indentify those proprietary securities which are used in a particular repurchase agreement, the Commission will entertain requests for no-action positions that would allow any repurchase agreement deficit deduction to be reduced by the haircut already incurred with respect to the repurchase agreement securities.

[14] The status of repo participants for SIPA purposes has become more uncertain, however, as the United States District Court for the District of New Jersey has decided that repo participants are customers for purposes of the Securities Investor Protection Act of 1970 ("SIPA"). The United States District Court for the District of New Jersey decided in *Cohen v. Army Moral Support Fund (in re Bevill, Bresler and Schulman)*, Adv. Proc. No. 85–2103 (slip op.) (D.N.J. Oct. 23, 1986 that repo transactions were purchases and sales rather than secured loans. The practical effect of this decision was to extend coverage under the Securities Investor Protection Act to repo participants within that jurisdiction.

[15] The Commission understands that it is difficult for broker-dealers that engage in significant repurchase agreement activity to identify whether specific securities obtained under a reverse repurchase agreement were used by the firm to obtain the use of funds. The Commission is willing to entertain no-action requests from those broker-dealers that can show that specific securities received under a reverse repurchase agreement were not used to obtain funds.

beyond the question of control over collateral. In past examinations and investigations, the Commission has noted that some registered broker-dealers have used unregistered affiliates to embezzle customer funds or conduct fraudulent transactions. Those transactions have, in some cases, been initiated in the registered broker-dealer and transfered, via an intercompany account, to an unregistered affiliate upon regulatory investigation.

The Commission does, however, adopt this amendment with the understanding that examiners will use discretion in applying the rule. The Commission expects any examination to be limited to demonstrating the validity of the receivable or payable. Moreover, no examination would be necessary if the examiner believes that the capital of the registered broker-dealer is not at risk as a result of the transactions. For example, under most circumstances examiners should not find it necessary to question transactions with affiliated publicly held companies that are subject to the independent annual audit requirements under the Securities Exchange Act Rules.

Some commentators have suggested that futures commission merchants be exempt from this provision. The amendments announced today include that modification. The Commission has also decided to exempt registered government securities brokers or dealers from the provision.

IV. Summary of Final Regulatory Flexibility Analysis

The Commission has prepared a final Regulatory Flexibility Analysis in accordance with 5 U.S.C. 604 regarding the amendments to Rules 17a-3, 17a-13 and 15c3-1. The Analysis notes that the objective of the amendments is to further the purposes of the various financial responsibility rules which are to provide safeguards with respect to the financial responsibility and related practices of brokers and dealers and to require broker-dealers to maintain such records as necessary or appropriate in the public interest or for the protection of investors. The analysis states that the amendments would subject small broker-dealers to additional record-keeping, disclosure, capital and accountability requirements. The Analysis states that the Commission did not receive any comments concerning the Initial Regulatory Flexibility Analysis. A copy of the Final Regulatory Flexibility Analysis may be obtained by contacting Michael P. Jamroz, Division of Market Regulation, Securities and Exchange Commission, Washington, DC 20549 (202) 272-2398.

V. Statutory Authority

Pursuant to the Securities Exchange Act of 1934 and particularly sections 15(c)(3), 17 and 23 thereof, 15 U.S.C. 78*o*(c)(3), 78q, and 78w, the Commission is adopting amendments to §§ 240.15c3-1, 240.17a-3, and 240.17a-13 of Title 17 of the Code of Federal Regulations in the manner set forth below.

List of Subjects in 17 CFR Part 240

Brokers, Reporting and recordkeeping requirements, Securities.

VI. Text of Amendments

In accordance with the foregoing, 17 CFR Part 240 is amended as follows:

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

1. The authority citation for Part 240 continues to read in part as follows:

Authority: Sec. 23, 48 Stat. 901, as amended; 15 U.S.C. 78w * * *. § 240.15c3-1, § 240.17a-4 and § 240.17a-13 are also issued under Secs. 15(c)(3) and 17(a), 15 U.S.C. 78*o* (c)(3) and 78q(a).

2. By revising paragraphs (c)(2)(iv)(F)(*1*), (c)(2)(iv)(F)(*2*) and (c)(2)(iv)(F)(*3*) and by adding paragraphs (a)(9) and (c)(2)(iv)(H) of § 240.15c3-1 as follows:

§ 240.15c3-1 Net capital requirements for brokers and dealers.

(a) * * *

(9) *Certain Additional Capital Requirements for Brokers or Dealers Engaging in Reverse Repurchase Agreements.* Notwithstanding the provisions of paragraphs (a)(1)-(8) of this section, a broker or dealer shall maintain net capital in addition to the amounts required under paragraphs (a) or (f) of this section in an amount equal to 10 percent of:

(i) The excess of the market value of United States Treasury Bills, Bonds and Notes subject to reverse repurchase agreements with any one party over 105 percent of the contract prices (including accrued interest) for reverse repurchase agreements with that person; and

(ii) The excess of the market value of securities issued or guaranteed as to principal or interest by an agency of the United States or mortgage related securities as defined in section 3(a)(41) of the Act subject to reverse repurchase agreements with any one party over 110 percent of the contract prices (including accrued interest) for reverse repurchase agreements with that person; and

(iii) The excess of the market value of other securities subject to reverse repurchase agreements with any one party over 120 percent of the contract prices (including accrued interest) for reverse repurchase agreements with that person.

* * * * *

(c) * * *

(2) * * *

(iv) * * *

(F)(*1*) For purposes of this paragraph:

(*i*) The term "reverse repurchase agreement deficit" shall mean the difference between the contract price for resale of the securities under a reverse repurchase agreement and the market value of those securities (if less than the contract price).

(*ii*) The term "repurchase agreement deficit" shall mean the difference between the market value of securities subject to the repurchase agreement and the contract price for repurchase of the securities (if less than the market value of the securities).

(*iii*) As used in paragraph (c)(2)(iv)(F)(*1*) of this section, the term "contract price" shall include accrued interest.

(*iv*) Reverse repurchase agreement deficits and the repurchase agreement deficits where the counterparty is the Federal Reserve Bank of New York shall be disregarded.

(*2*) (*i*) In the case of a reverse repurchase agreement, the deduction shall be equal to the reverse repurchase agreement deficit.

(*ii*) In determining the required deductions under paragraph (c)(2)(iv)(F)(*2*)(*i*) of this section, the broker or dealer may reduce the reverse repurchase agreement deficit by:

(*A*) Any margin or other deposits held by the broker or dealer on account of the reverse repurchase agreement;

(*B*) Any excess market value of the securities over the contract price for resale of those securities under any other reverse repurchase agreement with the same party;

(*C*) The difference between the contract price for resale and the market value of securities subject to repurchase agreements with the same party (if the market value of those securities is less than the contract price); and

(*D*) Calls for margin, marks to the market, or other required deposits which are outstanding one business day or less.

(*3*) (*i*) In the case of repurchase agreements, the deduction shall be:

(*A*) The excess of the repurchase agreement deficit over 5 percent of the contract price for resale of United States Treasury Bills, Notes and Bonds, 10 percent of the contract price for the resale of securities issued or guaranteed as to principal or interest by an agency of the United States or mortgage related securities as defined in section 3(a)(41) of the Act and 20 percent of the contract price for the resale of other securities and;

(*B*) The excess of the aggregate repurchase agreement deficits with any one party over 25 percent of the broker or dealer's net capital before the application of paragraphs (c)(2)(vi) or (f)(3) of this section (less any deduction taken under paragraph (c)(2)(iv)(F)(*3*)(*i*)(A) of this section or, if greater;

(*C*) The excess of the aggregate repurchase agreement deficits over 300 percent of the broker or dealer's net capital before the application of paragraphs (c)(2)(vi) or (f)(3) of this section.

(*ii*) In determining the required deduction under paragraph (c)(2)(iv)(F)(*3*)(*i*) of this section, the broker or dealer may reduce a repurchase agreement deficit by:

(*A*) Any margin or other deposits held by the broker or dealer on account of a reverse repurchase agreement with the same party to the extent not otherwise used to reduce a reverse repurchase deficit;

(*B*) The difference between the contract price and the market value of securities subject to other repurchase agreements with the same party (if the market value of those securities is less than the contract price) not otherwise used to reduce a reverse repurchase agreement deficit; and

(*C*) Calls for margin, marks to the market, or other required deposits which are outstanding one business day or less to the extent not otherwise used to reduce a reverse repurchase agreement deficit.

* * * * *

(*H*) Any receivable from an affiliate of the broker or dealer (not otherwise deducted from net worth) and the market value of any collateral given to an affiliate (not otherwise deducted from net worth) to secure a liability over the amount of the liability of the broker or dealer unless the books and records of the affiliate are made available for examination when requested by the representatives of the Commission or the Examining Authority for the broker or dealer in order to demonstrate the validity of the receivable or payable. The provisions of this subsection shall not apply where the affiliate is a registered broker or dealer, registered government securities broker or dealer or bank as defined in section 3(a)(6) of the Act or insurance company as defined in section 3(a)(19) of the Act or investment company registered under the Investment Company Act of 1940 or federally insured savings and loan association or futures commission merchant registered pursuant to the Commodity Exchange Act.

* * * * *

3. By revising paragraphs (a)(4)(v), (a)(4)(vi), (a)(5) and (a)(8), and adding paragraph (a)(4)(vii) to § 240.17a-3.

§ 240.17a-3 Records to be made by certain exchange members, brokers and dealers.

(a) * * *

(4) * * *

(v) Securities failed to receive and failed to deliver;

(vi) All long and all short securities record differences arising from the examination, count, verification and comparison pursuant to Rule 17a-13 and Rule 17a-5 hereunder (by date of examination, count, verification and comparison showing for each security the number of long or short count differences);

(vii) Repurchase and reverse repurchase agreements;

(5) A securities record or ledger reflecting separately for each security as of the clearance dates all "long" or "short" positions (including securities in safekeeping and securities that are the subjects of repurchase or reverse repurchase agreements) carried by such member, broker or dealer for his account of for the account of his customers or partners or others and showing the location of all securities long and the offsetting position to all securities short, including long security count differences and short security count differences classified by the date of the physical count and verification in which they were discovered, and in all cases the name or designation of the account in which each position is carried.

* * * * *

(8) Copies of confirmations of all purchases and sales of securities, including all repurchase and reverse repurchase agreements, and copies of notices of all other debits and credits for securities, cash and other items for the account of customers and partners of such member, broker or dealer.

* * * * *

4. By revising paragraph (b)(1), (b)(2) and (b)(3) of § 240.17a-13 as follows:

§ 240.17a-13 Quarterly security counts to be made by certain exchange members, brokers and dealers.

(b) * * *

(1) Physically examine and count all securities held including securities that are the subjects of repurchase or reverse repurchase agreements;

(2) Account for all securities in transfer, in transit, pledged, loaned, borrowed, deposited, failed to receive, failed to deliver, subject to repurchase or reverse repurchase agreements or otherwise subject to his control or direction but not in his physical possession by examination and comparison of the supporting detail records with the appropriate ledger control accounts;

(3) Verify all securities in transfer, in transit, pledge, loaned, borrowed, deposited, failed to receive, failed to deliver, subject to repurchase or reverse repurchase agreements or otherwise subject to his control or direction but not in his physical possession, where such securities have been in said status for longer than thirty days;

* * * * *

By the Commission.

June 4, 1987.

Shirley E. Hollis,

Assistant Secretary.

[FR Doc. 87-13390 Filed 6-10-87; 8:45 am]

BILLING CODE 8010-01-M

Exhibit B

EXAMPLES OF CALCULATIONS OF CHARGES

Assumed Tentative Net Capital (TNC): $50 Million

Test 1

Individual Repo Funds Received	$10 million	
Collateral Market Value	12 million	
105%*	10.5 million	
Excess Collateral	1.5 million	
Tentative Capital Charge**		$1.5 million

Test 2

Total Repo Funds Received with Single Account not including individual in Test 1 above	$50 million	
Total Collateral Market Value for above account	65 million	
Deficit	15 million	
25% of TNC	12.5 million	
Tentative Capital Charge**		$2.5 million

Test 3

Total of all Repo Funds Received	$300 million	
Total Collateral Market Value for all Repos	452 million	
Deficit	152 million	
300% of TNC	150 million	
Tentative Capital Charge		$2 million

The charge shall be the greater of the amounts computed under Tests 1 and 2 combined, or Test 3.

Capital Charge Calculation:

Test 1	$1.5 million	
Test 2	2.5 million	
	4 million	
Test 3	2 million	
Actual Charge (Tests 1 & 2 combined)		$4 million

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* Collateral assumed to be U.S. Treasury Bills, Notes, and Bonds.

** As to the same counterparty, the charge will be the greater of the amount computed under either Test 1 or Test 2.

NASD National Association of Securities Dealers, Inc.
1735 K St., N.W. • Washington, D.C. 20006 • (202) 728-8000

notice to members 87-51

August 12, 1987

TO: All NASD Members and Other Interested Persons

RE: Treasury Department Adopts Changes to the Requirements Concerning Financial Recordkeeping and Reporting of Currency and Foreign Transactions

EXECUTIVE SUMMARY

The Department of the Treasury has finalized amendments to the implementing regulations of the Bank Secrecy Act. Also known as the "Currency and Foreign Transactions Reporting Act of 1970," these regulations govern the financial recordkeeping and reporting of currency and foreign transactions. The amendments, which were originally published for comment in August 1986, change the requirements concerning reporting multiple, same-day currency transactions; the time periods for filing reports; verifying customer identity when filing currency transaction reports; and recording taxpayer identification numbers. The amendments also include civil penalties for structuring transactions.

The text of the release containing all final changes (Federal Register, April 8, 1987) is attached.

BACKGROUND

The Bank Secrecy Act (the Act) was enacted as a means of requiring certain financial institutions, including broker-dealers, to keep records and file reports regarding various financial matters that may be useful in criminal, tax, or other regulatory investigations. The provisions of 31 CFR Part 103 of the Act, also known as the "Currency and Foreign Transactions Reporting Act," govern the payment, receipt, or transfer of currency exceeding $10,000, the export or import of currency or monetary instruments exceeding $10,000 out of or into the United States, and certain foreign financial transactions and accounts.

The Treasury Department is authorized to implement and administer the Act's reporting and recordkeeping requirements. With respect to broker-dealers, however, the Treasury Department delegated its responsibility to the Securities and Exchange Commission (SEC). To ensure compliance and effective oversight by self-regulatory organizations, the SEC adopted Rule 17a-8 under the Securities Exchange Act of 1934 (the Exchange Act).

SEC Rule 17a-8, which became effective on January 18, 1982, requires broker-dealers to file reports and make and preserve records pursuant to the Exchange Act and the regulations adopted thereunder. Moreover, in accordance with other SEC recordkeeping rules, such as SEC Rule 17a-3(a)(1), the SEC has taken the position that broker-dealers are required to make and retain their records in a manner that identifies the receipt and disbursement of currency in connection with securities transactions.

On August 25, 1986, the Department of the Treasury published in the Federal Register a series of proposed changes designed to strengthen enforcement of the Bank Secrecy Act's provisions by ensuring the collection of additional information regarding transactions in currency or monetary instruments and certain foreign transactions and accounts.

SUMMARY OF FINAL AMENDMENTS

The proposed amendments address a number of issues. After reviewing the comments received, the Treasury Department issued a final rule encompassing most of the original proposals, although a number of provisions were modified.

Changes that affect the activities of broker-dealers are highlighted below.

1. Multiple, same-day currency transactions. In its proposed amendments, the Treasury Department sought to codify an instruction on Form 4789, the Currency Transaction Report, that requires broker-dealers to report multiple, same-day transactions in currency by or on behalf of any person that total more than $10,000, if the broker-dealers are aware of them.

This requirement has been incorporated into the regulations with one modification -- the Treasury Department changed the term "is aware" to "has knowledge." It applies to any partner, director, officer, or employee of a broker-dealer, or any existing system at the broker-dealer that permits the firm to aggregate transactions.

The term "knowledge," as used in the final rule, includes the concept of "willful blindness" as well. For example, if a broker-dealer suspects someone may be structuring transactions to avoid filling out a record or report, but the broker-dealer deliberately refuses to ask questions because it wishes to remain ignorant, the broker-dealer will be deemed to have knowledge for purposes of assessing liability under the Bank Secrecy Act.

This regulation, however, does not require broker-dealers to adopt or purchase new systems to reveal the existence of multiple, same-day transactions.

2. Time periods for filing reports. The Treasury Department adopted without change its proposals to standardize the time periods for filing reports. All reports previously subject to filing within 30 calendar days must now be filed within 15 calendar days of the reportable event or upon request for the report from regulatory authorities.

3. Verification of customer identification. The Treasury Department noted that some financial institutions fail to show proper identification of customers on Form 4789, the Currency Transaction Report. To correct this, the Treasury Department proposed that verification of customer identity be made by examination of a document, other than an account signature card, that normally would be acceptable when cashing checks (e.g., a driver's license or credit card).

The Treasury Department altered its original proposal to permit financial institutions to refer to the customer's signature card when filling out Form 4789, but the specific identifying information, i.e., a driver's license or credit card number, must be recorded on the report form.

4. Recordkeeping requirements for extensions of credit. Previously, broker-dealers were required to keep records on extensions of credit exceeding $5,000. The Treasury Department changed this recordkeeping requirement to apply to extensions of credit exceeding $10,000.

5. Recordkeeping requirements for incoming transactions. In its proposal, the Treasury Department sought to extend broker-dealers' recordkeeping requirements to include incoming as well as outgoing transactions with persons, accounts, or places outside the United States that involve the transfer of currency, monetary instruments, funds, checks, investment securities, or credit in amounts exceeding $10,000. The proposal also included transactions that are later cancelled or not completed.

The Treasury Department received opposition to the requirement to retain records on transactions later cancelled. In the final amendment, recordkeeping requirements were extended to include all incoming transactions but a record of a cancelled transaction must be retained only in instances where such a record is normally made.

6. Taxpayer identification numbers. The Treasury Department received major opposition on its proposal to change the recordkeeping requirements and procedures for recording taxpayer identification numbers. The Treasury Department proposed that, when an account is in the name of two or more persons, broker-dealers would be required to secure the taxpayer identification number of each person having a financial interest in the account. Under existing regulations, broker-dealers are required to maintain only one taxpayer identification number for each such account.

In a comment letter to the Treasury Department, the NASD Capital and Margin Committee noted that, to date, broker-dealers have been successfully using one taxpayer identification number to identify a responsible party for each account and report the required information. The Committee questioned the usefulness of the proposed change, especially in light of the financial and operational burden it would place on broker-dealers.

After a review of the comments and similar concerns expressed by others, the Treasury Department decided to retain the requirement, consistent with Internal Revenue Service (IRS) rules, that only one taxpayer identification number be obtained when an account is maintained by one or more persons.

The proposal also eliminated the 45-day grace period for obtaining the taxpayer identification number. The Treasury Department decided to retain a grace period, but to reduce it to 30 days to be more consistent with IRS rules. In addition, the Treasury Department retained the proposed requirement that additional identifying information be acquired from non-resident aliens subject to the taxpayer identification rules.

7. Structured transactions. This amendment incorporates into the regulations the new statutory violation for structuring currency transactions to avoid the reporting requirements of the Bank Secrecy Act. The Treasury Department also added to the civil penalty section a reference to the penalties imposed for structuring transactions.

* * * * *

The amendments discussed above are the major changes affecting the activities of broker-dealers. The attached release, however, contains all changes finalized by the Treasury Department, including related information and commentary.

July 7, 1987, was the effective date for the amendments concerning the shortened time period for filing reports of the international transportation of currency and monetary instruments (paragraph 103.26(b)(2)), verification of customer identity for purposes of filling out Form 4789 (paragraph 103.27), and the recordkeeping requirements concerning incoming transactions (paragraph 103.33(b)). All other changes were effective May 8, 1987.

Questions concerning this notice may be directed to Susan Lang, NASD Surveillance Department, at (202) 728-6969.

Sincerely,

John E. Pinto, Jr.
Senior Vice President
Compliance

Attachment

DEPARTMENT OF THE TREASURY

Office of the Secretary

31 CFR Part 103

Amendments to Implementing Regulations Under the Bank Secrecy Act

AGENCY: Office of the Secretary, Treasury.

ACTION: Final rule.

SUMMARY: The Bank Secrecy Act, Public Law No. 91-508 (12 U.S.C. 1829b, 12 U.S.C. 1951 *et seq.*, 31 U.S.C. 5311 *et seq.*), empowers the Secretary of the Treasury to require financial institutions to keep records and file reports that the Secretary determines have a high degree of usefulness in criminal, tax and regulatory matters. On August 25, 1986, Treasury published in the **Federal Register** (51 FR 30233) a series of proposed changes to the Bank Secrecy Act regulations in 31 CFR Part 103 in order to ensure the collection of needed information, and to strengthen enforcement of the Act.

After review of the many comments received, Treasury is issuing a final rule encompassing all but three of the original proposals. One proposal, regarding exempt list customer certification statements, was enacted as part of the Anti-Drug Abuse Act of 1986 and was incorporated into Part 103 by final rule dated December 17, 1986 (51 FR 45108); two proposals, dealing with the purchase of more than $3,000 in monetary instruments, are still under consideration by Treasury and will be the subject of a separate notice to be issued within the next few months.

EFFECTIVE DATE: July 7, 1987 for those amendments to 31 CFR 103.11(e), 103.26(b)(2), 103.27, 103.33(b), 103.34(b)(13), and 103.37. All other changes to Part 103 made by this final rule are effective May 8, 1987.

FOR FURTHER INFORMATION CONTACT: Jonathan J. Rusch, Director, Office of Financial Enforcement, Office of the Assistant Secretary (Enforcement), Department of the Treasury, Room 4320, 1500 Pennsylvania Ave., NW., Washington, DC 20220, (202) 566-8022.

SUPPLEMENTARY INFORMATION:

Discussion of Comments

Over 300 comments, many quite detailed, were received from individuals and financial institutions. Many general comments concerned the burden on financial institutions and the costs of compliance posed by the proposed amendments. The proposals to which commenters objected most frequently concerned the reporting of cash purchases of more than $3,000 in monetary instruments, and for new recordkeeping requirements placed on the purchase of monetary instruments. Because an initial review of the comments on these proposals indicates that further review of the issue is needed prior to promulgation of any final rule, the proposals relating to the cash purchase of more than $3,000 in monetary instruments, the certification requirement relating to those purchases, and the new recordkeeping requirements on the purchase of monetary instruments are being held in abeyance at this time and are not included in this final rule. Treasury anticipates issuing a notice on this issue in the near future.

Several commenters also asserted that the proposed rule, if adopted, would be considered a "major rule" within the meaning of Executive Order 12291. In their view, the proposed rule would create significantly increased operational costs, high implementation costs, and an ultimate cost burden that would be imposed on consumers. Many of the comments on this issue failed to present any substantial evidence to support the assertion, and apparently misunderstood the extent of the burdens the proposed rule would place upon financial institutions. The only new major substantive requirements that this final rule imposes pertain to records maintained by currency dealers and exchangers, and the majority of those records are ordinary business records. Moreover, a number of provisions in the proposed rule have been modified after review of the comments received, and other provisions (such as the monetary instruments purchase provisions) will be treated separately in a future regulatory proposal. Finally, Treasury emphasizes that no provision in this final rule will obligate financial institutions to purchase computer hardware or software to comply with the revised regulations. In view of these considerations, it is the Department's position that any cost created by this final rule will be far below the 100 million dollar threshold for a Regulatory Impact Analysis under Executive Order 12291.

A general discussion of the comments and Treasury decisions on the various proposals is presented below.

(1) *Expand the definition of "bank" to include Edge Act corporations:* An "Edge" or "Agreement" corporation, as defined by 12 U.S.C. 611 *et seq.*, is a corporation organized in the United States for the purpose of engaging in international or foreign banking, or other foreign financial operations; such institutions are supervised by the Board of Governors of the Federal Reserve System. This amendment would clarify that the regulations include these entities. (Amendment #2.)

As this is merely a clarification that comports with Treasury's interpretation of the present regulations, there was no substantial discussion of this issue by the commenters; it will stay as drafted.

(2) *Add a new definition of "common carrier":* This new definition would clarify the reporting responsibilities for currency and monetary instruments that are transported into or out of the United States. (Amendment #2.)

Many commenters desired further clarification and expressed a desire to have armored car services, such as Brinks, and private messenger services covered within the definition. Several also suggested that the term "undertaken to do so [supply services] indiscriminately for all persons" be deleted so that companies that supply services only to banks could be covered. The definition will be clarified to include institutions such as Brinks and businesses that limit their clientele to banks. Private messenger services are not covered by the definition of "common carrier."

(3) *Revise the definition of "financial institution" in light of recent case law, and to include certain selling agents of traveler's checks, money orders and similar instruments:* This revision would modify the definition to comport with recent case law defining financial institutions for Bank Secrecy Act purposes, and expand the definition to include selling agents of certain monetary instruments and all transmitters of funds. (Amendment #2.)

Five major issues were raised: (a) Many commenters felt that the proposed definition of "check casher" was so broad that it would cover any business which cashed a check, even if only an incidental part of its business, thus putting the concept of exempt lists in jeopardy; (b) some commenters wanted to know what a person "subject to State or Federal banking supervision" meant and whether it covered nonbanking subsidiaries of banking institutions; (c) some commenters wanted a clarification of the term "transmitter of funds;" (d) some commenters wanted to know what were "similar instruments" to money orders not already listed; and (e) some commenters wanted to know the significance of including "agents" in the definition. In response to these comments, Treasury notes that (a) the term "check casher" has been defined further as someone engaged in the business of cashing checks; (b) coverage of those persons under "State or Federal banking supervision" was meant to cover all other banking institutions subject to examination by State or Federal banking supervisory authorities not already covered within the term "financial institution;" but the term does not include nonbanking subsidiaries, even if approval for the subsidiary initially must be given by the Federal or State banking authority; (c) "transmitter of funds, including telegraph companies" will be replaced by language that more closely tracks the relevant statute, 31 U.S.C. 5312; (d) the term "similar instruments" will be deleted; and (e) the term "agent" was added in order to make this definition consistent with the others in section 103.11.

(4) *Clarify and expand the definition of "monetary instruments" to include promissory notes, checks made out to fictitious payees, and certain other types of checks:* These substantive changes were proposed because enforcement experience indicated that certain cashier's checks and checks made out to fictitious payees were being used for money laundering, but arguably were not subject to current reporting requirements. Other amendments to the definition were intended to clarify the regulations. (Amendment #2.)

The major issues raised were (a) the use of the term "fictitious payee" and the near impossibility of a bank to determine when a check is made out to a "fictitious payee;" (b) the use of the term "promissory note" and concern as to its scope; (c) a request that the term "traveler's checks" be clarified to describe the different ways that a traveler's check could be considered to be in bearer form; and (d) clarification of the term "endorsed without restriction." Treasury has changed the definition in the final rule to clarify that the term "fictitious payee" is applicable only for the purposes of § 103.23. The issue would arise only in the rare case where a bank has to file a report under § 103.23, such as when the bank sends or receives funds from outside the United States by other than common carrier, and the bank knew at the time it filed the report that the payee was fictitious. The term "promissory note" refers to the UCC definition of that term. Treasury has not changed the definition of "traveler's check" because the definition of "monetary instrument" clearly states that the instrument in question, whether personal check, traveler's check, etc., must be in such a form that title would pass upon delivery; accordingly, that definition need not include separate descriptions of the circumstances in which these instruments could be considered to be in bearer form. The term "endorsed without restriction" is included as an example of how an instrument can be considered to be in bearer form; it does not need to be clarified further. The final rule also clarifies in the definition the difference between incomplete instruments and negotiable instruments, a distinction that previously was not as clear.

(5) *Add a new definition for "transition account" and insert it in place of the deleted term "demand deposit account" wherever it appears in the Part:* This new term would combine currently covered demand deposit accounts with recently developed money market and NOW accounts, which have many of the same characteristics as demand deposit accounts. (Amendments #2 & 3.)

There were few comments. One commenter requested clarification of the status of accounts that are not subject to withdrawal by check. As long as withdrawals are by some form of negotiable order, the accounts are covered under this definition. The proposal is adopted as drafted without change.

(6) *Add a new definition for "business day":* This amendment would provide that the term "business day" for banks means banking day. (Amendment #2.)

Many commenters wanted further clarification of the proposed definition, pointing out that the hours the bank is open to the public are not necessarily the same as the hours the bank might be open for other purposes. Several commenters suggested that the definition refer to the day that the transaction is posted to the customer's account. Treasury has adopted that suggestion, and has revised the definition of "business day" to mean that day, as normally communicated to depository customers (such as by teller window sign), on which the bank routinely posts a particular transaction to its customer's account.

(7) *Clarify that financial institutions must report multiple, same-day currency transactions of which they are aware that total more than $10,000:* This amendment would codify the CTR Form 4789 instruction that currently requires financial institutions to report multiple, same-day transactions of which they are aware that are by or on behalf of any person and total more than $10,000. As indicated above, this would not impose any new burden on financial institutions to adopt or purchase systems to reveal the existence of multiple, same-day transactions. (Amendment #4.)

A majority of the comments expressed concern about this proposal. These comments were devoted largely to two issues: the meaning of the term "aware" in discussing the scienter element in reporting transactions; and the extent to which banks would have to adopt or purchase new systems to capture currency transaction data if their present systems cannot do so. In order to clarify the requirement, Treasury has changed the term "is aware" to "has knowledge." This term means knowledge on the part of a partner, director, officer or employee of a financial institution, or on the part of any existing system at the institution that permits it to aggregate transactions.

"Knowledge," as used in the final rule, clearly includes the concept of "willful blindness" as well. *See United States* v. *Jewell,* 532 F. 2d 697 (9th Cir.), *cert. denied,* 426 U.S. 951 (1976). This concept applies to a person who has deliberately avoided positive knowledge; that is, "if a person has his suspicion aroused but then deliberately omits to make further inquiries, because he wishes to remain in ignorance, he is deemed to have knowledge." *Jewell* at 700. If a financial institution suspects someone may be structuring transactions in order to avoid the filling out of a record or report, but deliberately refuses to ask questions because it wishes to remain ignorant and therefore, "innocent," the financial institution will be deemed to have knowledge for purposes of assessing liability under the Bank Secrecy Act.

Treasury emphasizes that this regulation does not require institutions to adopt or purchase new systems; however if and when financial institutions are considering the purchase of new computer systems, software or recordkeeping methods, Treasury urges that they consider the systems' ability to aggregate. Therefore, if a bank's existing system provides its officers or employees with information on transactions that may require reporting as aggregated transactions, that bank must make use of that system to comply with the reporting requirements of the Bank Secrecy Act, but need not adopt or purchase enhancements to increase that system's capability to identify multiple related transactions.

The commenters also raised the question of deposits and withdrawals accomplished through the use of night depository slots or automatic teller machines (ATM's). Treasury realizes that there is not a teller physically present when these transactions take place; however, when these transactions are later processed by a teller, if the teller (or the system) has knowledge that an aggregated deposit or withdrawal has taken place, then there is a duty to file a Form 4789 under this section. Commenters also wished to know whether the term "by or on behalf of any person" in the aggregation requirement required institutions to track multiple transactions to one specific account, even if made by more than one person, or to track transactions by one person making deposits/withdrawals in reportable amounts to or from several accounts. As long as "a transaction in currency of more than $10,000" has occurred, it does not matter if it was done by one person with one account, several persons with the same account, or one person with several accounts. Examples of reportable transactions would be two people depositing more than $10,000 in one account, though neither deposited a reportable amount, or one person making a deposit of more than $10,000, but depositing the money in more than one account. Obviously, the regulations cover more than activity tied to a particular account. Reportable transactions need not, and often do not, involve an account at all. Finally, Treasury also wishes to reiterate that "cash in or cash out totalling more than $10,000" means the total of all deposits *or* the total of all withdrawals. Deposits *and* withdrawals are not to be aggregated together for purposes of the Bank Secrecy Act. However, the total of all deposits or the total of all withdrawals during a particular business day should be aggregated in order to determine if a reportable deposit or withdrawal limit has been reached.

(3) *Require banks to obtain signed statements from their customers attesting to the basis for their exemption from the currency transaction reporting requirements:* (Amendment #4.)

Subtitle H of Title I of the Anti-Drug Abuse Act of 1986 (Pub. L. No. 99-570), the "Money Laundering Control Act of 1986," contained an amendment substantially similar to this proposal. By final rule dated December 17, 1986 (51 FR 45108), the Treasury Department issued a final rule incorporating this statutory requirement into Part 103 for all exemptions granted after October 27, 1986, the effective date of the legislation.

(9) *Permit banks to exempt from the currency transaction reporting requirement deposits by certain public utilities and commercial passenger carriers:* This proposed amendment to the exemption procedure would permit banks to exempt cash deposits by certain public utilities and commercial passenger carriers. (Amendment #4.)

Most commenters approved of the proposal, and requested that the restrictions be lifted which limited the public utilities to governmentally supervised utilities, and the passenger carriers to those whose stock is publicly traded. After consideration, Treasury is dropping the restrictions and expanding the exemption to include all passenger carriers and public utilities.

(10) *Clarify the prohibition on exempting automobile, boat and airplane dealerships:* This proposed amendment would clarify that no motor vehicle dealership (including, but not limited to, motorcycle, recreational vehicle, and farm equipment dealers), may be exempted from the currency reporting requirements. (Amendment #4.)

There was considerable confusion about use of the term "conveyance." After consideration of the comments, it is being dropped from the final rule, since it seemed to confuse the issue more than clarify it. Several comments were received concerning other exempt issues. Several commenters wanted the exemption privilege extended to other entities such as retail sellers of services or foreign businesses. Others wished the governmental entity exemption to be clarified, and some wished deletion of the requirement to report transactions with foreign correspondent banks. The question of expansion of the exemption privilege was not a matter at issue in this proposal. Also, Treasury feels that the governmental entity exemption is sufficiently clear as written. However, Treasury is clarifying the exemption privilege as it applies to check cashing services in order to resolve an internal inconsistency in § 103.22. Finally, some commenters raised operational difficulties with the requirement that a centralized exempt list be maintained. These commenters should be aware that the requirement to maintain a centralized list is not a new requirement, as it is presently required under 31 CFR 103.22(f).

(11) *Revise the procedures for filing all reports and for recording foreign financial accounts:* This amendment would update and clarify the procedures for filing all reports, and for keeping records of interests in foreign financial accounts. All reports previously subject to filing within 30 days would be filed within 15 days of the reportable event or the request for the report, whichever is applicable. (Amendments #5, 6 & 8.)

Many commenters wanted a universal 30 day filing date; a few commenters were under the mistaken impression that the CTR filing deadline was presently 30 days instead of 15. Many complained about the retention of original records, not copies, of the Form 4789. Some commenters also wanted the forms published for comments. The only changes proposed for 31 CFR 103.26 were to change the date for filing the Form 4790 (CMIR) to 15 days after receipt of the currency or monetary instruments, and to require that any exempt list information requested by Treasury under 31 CFR 103.22(g) be submitted within 15 days. After review of the comments, Treasury is retaining the proposal as originally drafted. As for publishing forms for public comment, information contained on the forms originally is specified in regulations which have been published for notice and comment. There is no need to publish proposed forms and request comments on an issue for which comment had already been solicited. Treasury, however, always is open to any written comments from institutions that may have difficulty dealing with a specific Treasury form.

A few questions were raised about the foreign financial report itself; one bank wanted an assurance that employees authorized to sign *ex officio* on accounts were not required to file the reports. Another commenter wanted to assure that its international interbank transfer accounts ("nostro accounts") also were not included. Employees authorized to sign on accounts are not required to file a report unless they have a personal financial interest in the account. Additionally, nostro accounts are not subject to the foreign financial account report, but are subject to the Forms 4789 and 4790 requirements.

(12) *Require that customer identification be verified by document examination:* This amendment would address a compliance problem Treasury identified with financial institutions that reported insufficient information on Forms 4789 to show proper identification of customers. This amendment would require financial institutions to exercise no less care in identifying the individuals conducting reportable transactions than they do when identifying nondepositors cashing checks. Signature cards alone would not satisfy the identification requirement. (Amendment #7.)

This was a major target for commenters, centering mainly on the proposal's impact on customer services and customer relations problems. Many banks said that they verify the identity of a customer when opening an account, and that they therefore should be permitted to rely on a signature card when filling out a Form 4789. Other commenters raised the issue of whether they must refuse a transaction if the customer refuses to supply the identification, while others wanted to know to what extent the bank could rely on the identification actually produced. Finally, some commenters wanted clarification of when a report "may be required" for purposes of obtaining the required information. After review of the comments, Treasury has altered the original proposal to permit banks that have obtained sufficient identifying information from the customer when opening the account, and that have noted that specific informaton on the signature card, to refer to the customer's signature card in filling out the Form 4789. Only specific identifying information, *i.e.*, a driver's license or credit card number, may be used on the Form 4789; the notation "known customer" or "signature card on file" still is not permitted. A conforming amendment provides that the signature card need not be consulted prior to conducting the transaction. Other foreign identity requirements are being clarified by specifying a foreign driver's license with a listed residence as an example of an acceptable document proving identity. The term "may be required" has been deleted. While Treasury has not taken the position that a financial institution must refuse a transaction if a customer refuses to supply sufficient identifying information, it reminds financial institutions that § 103.26(a) of the regulations already obligates a financial institution to file complete and accurate Forms 4789 on all reportable transactions. Financial institutions should treat the identification of persons conducting reportable transactions, whether or not account holders, with as much care as they would treat the identification of nondepositors who cash checks.

(13) *Limit financial institution recordkeeping requirements to extensions of credit exceeding $10,000 instead of $5,000:* This amendment would eliminate this recordkeeping requirement since it is no longer justified by the usefulness of the information retained. (Amendment #9.)

There was no dissent on this point. The proposal will stay as originally drafted.

(14) *Expand financial institution recordkeeping requirements to include incoming as well as outgoing transactions with persons, accounts or places outside the United States:* This amendment was proposed to respond to increasingly sophisticated international financial schemes, and would require that recordkeeping cover incoming as well as outgoing transactions, including transactions that are later cancelled or not completed for any reason. (Amendment #9.)

There was major opposition on the requirement to retain records on transactions later cancelled, mostly focusing on the fact that few banks recorded nonevents, and that therefore their systems would not capture this information. The regulation will be clarified in order to require that only where a record ordinarily was made of an order later cancelled should that record be retained.

(15) *Revise additional recordkeeping requirements for banks, casinos and brokers or dealers in securities to simplify the procedures for recording taxpayer identification numbers, and require those financial institutions to keep lists of all persons from whom taxpayer identification numbers have not been obtained:* This amendment would replace the current exemption provisions in §§ 103.34, 103.35 and 103.36 regarding taxpayer identification numbers (TINs) with a simpler requirement in section 103.38(c) that a list be maintained of all persons from whom a taxpayer identification number is not obtained. Similar procedures would be incorporated in the new additional recordkeeping requirements for foreign currency exchanges. (Amendments #10, 12, 13, 14 & 15.)

There was major opposition to this requirement, centering on: (a) What is considered a "financial interest" in the account for the purposes of obtaining the TIN of every person who has a financial interest in an account; (b) a conflict with the regulation in proposed § 103.38 (and present § 103.34(a)(4)) that directs adherences to IRS rules, which require the retention of one TIN; (c) the possible retroactivity of the requirement; (d) possible costly recordkeeping and computer system changes; (e) the ambiguity as to which accounts are included in the new requirement; and (f) the problem of obtaining all of the TINs when not all the parties are present at the time of the transaction. After review of the comments, Treasury has decided to retain the requirement, consistent with IRS rules, that only one TIN be obtained, instead of creating two different sets of requirements for obtaining TINs. The proposal also had eliminated the 45-day grace period to obtain the TIN. Treasury has decided to retain a grace period, but to reduce it to 30 days to be more consistent with IRS TIN rules. In addition, Treasury will retain the requirement contained in the proposal that additional identifying information be acquired from those non-resident aliens subject to the TIN rules, and to use the TIN rules for securities and brokers as a guide to formulating TIN rules for currency dealers and exchangers.

(16) *Clarify that additional recordkeeping requirements for banks include deposit slips and credit tickets:* This amendment would clarify that deposit slips and credit tickets should be retained as part of the paper trail already required by § 103.34 to be recorded, and that such records must stipulate whether transactions involve currency. (Amendment #11.). There was a great deal of opposition, centering primarily on: a) banks that do not have a currency line on their deposit slips; b) businesses that merely submit a register tape with the deposit and do not individually list all items; c) retention of the original as opposed to copies or microfilm; d) the $100 minimum for retention of the deposit slips, which many banks felt was too small; and e) various storage problems.

The regulation presently in effect provides that copies may be kept of any required documents; the proposed change does not alter this. This minimum amount will stay at $100, in order to maintain the consistency and uniformity of the recordkeeping requirements for banks. Treasury again notes that the originals of these slips need not be kept; copies will suffice. The proposal that the individual deposited items be listed on the slip will be deleted. The deletion was made so that businesses that merely attach a register tape to a deposit slip to indicate the total amount deposited would not have to fill out a large number of deposit slips. The requirement that a bank be able to reconstruct a deposit has not been altered.

(17) *Require foreign currency dealers to keep certain additional records:* Treasury's enforcement experience indicates that foreign currency dealers are an increasingly important component of sophisticated money laundering and tax evasion schemes and currently are subject to little or no oversight other than under the Bank Secrecy Act. (Amendment #14.)

The comments received in response to this proposal centered on the low reporting threshold of $500, and the request for a definition of a "foreign currency dealer," with a specific exemption for banks. After review of the comments, it was decided to amend the regulation to change its heading to "currency dealer or exchanger" in order to be consistent with the statute, and to define "currency dealer or exchanger" in the definition section (31 CFR 103.11) as one engaged in business as such. Banks will be specifically exempted, as they already are subject to detailed recordkeeping requirements under Part 103. Additionally, the threshold reporting amount will be raised to $1,000, and the term "air express" will be changed to "common carrier" in order to make the terminology consistent with the rest of the Part.

(18) *Establish a uniform minimum retention period for transaction account records:* Under present regulations, bank records required to reconstruct deposits to demand deposit accounts can be destroyed two years after the transaction. However, the constraints placed on the Department by the two-year retention period have made it extremely difficult to document violations for more than one year with deposit records. The amendment to the record retention period was proposed to alleviate this problem and make the deposit record retention period consistent with the five-year retention requirement for the other records required by Part 103. (Amendment #15.)

There was major opposition to this proposal, mainly as to the increased costs associated with compliance and storage problems. Many also questioned the law enforcement utility of an increased retention period for these deposit records. As Treasury still feels that the constraints imposed on the Department by the two-year retention period make it difficult to document Bank Secrecy Act violations and tax and related financial crimes, the regulation will remain as drafted. Additionally, some commenters also wrote of the difficulty of retention of proof tapes. The regulation does not specifically require retention of proof tapes, the preamble in the Notice of Proposed Rulemaking merely mentioned proof tapes as the type of record which might be maintained by the bank to be able to reconstruct transactions at a later date.

(19) *Clarify the overall Bank Secrecy Act enforcement and compliance authority of the Assistant Secretary (Enforcement); replace references to "Administrator" of the NCUA with "Chairman of the Board;" delegate certain examination authority to the Commissioner, Internal Revenue Service; specify the criminal investigatory responsibilities of the Commissioners of Customs and Internal Revenue; and specify the requirement for periodic reports to the Assistant Secretary (Enforcement):* These amendments would: (1) Restate the overall responsibility of the Assistant Secretary for implementation and administration of Bank Secrecy Act reporting and recordkeeping requirements; (2) update regulatory language to reflect the recent change in the Assistant Secretary's title from "(Enforcement & Operations)" to "(Enforcement);" (3) correct a technical error in the delegations of Bank Secrecy Act compliance responsibility; (4) delegate to the Commissioner of Internal Revenue responsibility for the criminal investigation of all violations of Part 103 other than section 103.23; (5) restate existing delegations of investigatory responsibility; and (6) restate the requirement of periodic reports to the Assistant Secretary by agencies to which BSA compliance responsibility has been delegated. (Amendment #16.)

No real substantive issues were raised, although one commenter questioned changing the term "responsibility for assuring compliance" to "authority for assuring compliance." Further clarification is being accomplished in the final rule by changing the introductory wording in § 103.46(b) to "Authority to examine institutions to determine their compliance with the provisions of this part is delegated as follows:". New language also is being added to the section to incorporate the clarification in the Anti-Drug Abuse Act concerning what documents may be reviewed in a Bank Secrecy Act investigation. Finally, the Department's exclusive authority to impose civil penalties under the Bank Secrecy Act will be specifically stated, as will an assurance that a bank supervisory agency may report specific violations of the Act to the Department at any time.

(20) *Correct the civil penalty amount that can be assessed for willful violations of the recordkeeping requirements of this Part:* This amendment corrects a technical error in the regulations that implemented the increase in civil penalty amount made by the Comprehensive Crime Control Act of 1984. (Amendment #17.)

In order to keep the regulations as current as possible, the amendments to the civil penalty amounts now reflect civil penalties applicable to pre-1984 violations, civil penalties applicable to violations between October 1984 and October 1986 under the Comprehensive Crime Control Act, and civil penalties for violations after October 1986 under the Anti-Drug Abuse Act of 1986. A few commenters wished to have Treasury announce a "safe harbor" of allowable civil violations of the regulations prior to assessing penalties. Treasury has been given the authority and responsibility to enforce the Bank Secrecy Act, and intends to do so to the fullest extent possible. There will be no "safe harbor" of allowable violations.

(21) *A new section is being added to reference the new violation relating to the structuring of transactions:* This amendment merely incorporates into the regulations the new statutory violation of structuring currency transactions in order to avoid the reporting requirements of the Bank Secrecy Act. An addition also is being made to the civil penalty section to reference civil penalties for structuring transactions. (Amendments #17 & 18.)

In addition, readers should note that due to the passage of the Government Securities Act, Pub. L. 99-571, October 28, 1986, the Securities Exchange Act of 1934 has been amended to require government securities brokers and dealers to register with the Securities and Exchange Commission beginning July 25, 1987. Those government securities brokers and dealers presently not reqistered with the SEC will be required to do so, and therefore also will be subject to Part 103 Bank Secrecy Act regulations by virtue of the definition of "broker or dealer in securities" in 31 CFR 103.11(b).

Finally, because of the changes in the Bank Secrecy Act regulations that this final rule will effect, financial institutions may recognize some inconsistencies between the provisions of the regulations, as revised, and the instructions on the current version of Form 4789. Although Treasury will need to revise the Form 4789 instructions to take the regulatory changes into account, financial institutions are advised in the interim that in the event of conflict or inconsistency between a provision of the regulations and the Form 4789 instructions, the regulatory provisions shall control.

Executive Order 12291

This final rule is not a major rule for purposes of Executive Order 12291. It is not anticipated to have an annual effect on the economy of $100 million or more. It will not result in a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions. It will not have any significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States based enterprises to compete with foreign-based enterprises in domestic or foreign markets.

Regulatory Flexibility Act

Pursuant to section 605(b) of the Regulatory Flexibility Act, 5 U.S.C. 601, *et seq.*, it is hereby certified that this final rule will not have a significant economic impact on a substantial number of small entities. Most of the recordkeeping and reporting requirements imposed by this final rule concern information already found in routine business records. To the extent an affected financial institution has prudent record retention practices, it will already be retaining a substantial portion of the information identified in this proposed regulation.

Paperwork Reduction Act

The collection of information requirements mandated by this final rule have been reviewed and approved by the Office of Management and Budget under section 3504(h) of the Paperwork Reduction Act. (OMB Control No. 1505-0063.)

Drafting Information

The principal authors of this document are the Office of the Assistant General Counsel (Enforcement), and the Office of Financial Enforcement, Department of the Treasury.

List of Subjects in 31 CFR Part 103

Authority delegations (Government agencies), Banks and banking, Currency, Foreign banking, Investigations, Law enforcement, Reporting and recordkeeping requirements, Taxes.

PART 103—[AMENDED]

Amendment

31 CFR Part 103 is amended as set forth below:

1. The authority citation for Part 103 is revised to read as follows:

Authority: Sec. 21 of the Federal Deposit Insurance Act, Pub. L. 91-508, Title I, 84 Stat. 1114, 1116 (12 U.S.C. 1829b, 1951-9); and the Currency and Foreign Transactions Reporting Act, Pub. L. 91-508, Title II, 84 Stat. 1118, as amended (31 U.S.C. 5311-24).

2. Section 103.11 is revised to read as follows:

§ 103.11 Meaning of terms.

When used in this part and in forms prescribed under this part, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof, terms shall have the meanings ascribed in this section.

(a) *Bank.* Each agent, agency, branch or office within the United States of any person doing business in one or more of the capacities listed below:

(1) A commerical bank or trust company organized under the laws of any State or of the United States;

(2) A private bank;

(3) A savings and loan association or a building and loan association organized under the laws of any State or of the United States;

(4) An insured institution as defined in section 401 of the National Housing Act;

(5) A savings bank, industrial bank or other thrift institution;

(6) A credit union organized under the law of any State or of the United States;

(7) Any other organization chartered under the banking laws of any State and subject to the supervision of the bank supervisory authorities of a State;

(8) a bank organized under foreign law;

(9) Any national banking association or corporation acting under the provisions of section 25(a) of the Act of Dec. 23, 1913, as added by the Act of Dec. 24, 1919, ch. 18, 41 Stat. 378, as amended (12 U.S.C. 611-32).

(b) *Broker or dealer in securities.* A broker or dealer in securities, registered or required to be registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934.

(c) *Common carrier.* Any person engaged in the business of transporting individuals or good for a fee holds himself out as ready to engage in such transportation for hire and who undertakes to do so indiscriminately for all persons who are prepared to pay the fee for the particular service offered.

(d) *Currency.* The coin and paper money of the United States or of any other country that is designated as legal tender and that circulates and is customarily used and accepted as a medium of exchange in the country of issuance. Currency includes U.S. silver certificates, U.S. notes and Federal Reserve notes. Currency also includes official foreign bank notes that are customarily used and accepted as a medium of exchange in a foreign country.

(e) *Currency dealer or exchanger.* A person who engages as a business in dealing in or exchanging currency, except for banks which offer such services as an adjunct to their regular services.

(f) *Domestic.* When used herein, refers to the doing of business within the United States, and limits the applicability of the provision where it appears to the performance by such institutions or agencies of functions within the United States.

(g) *Financial Institution.* Each agent, agency, branch, or office within the United States of any person doing business, whether or not on a regular basis or as an organized business concern, in one or more of the capacities listed below:

(1) A bank (except bank credit card systems);

(2) A broker or dealer in securities;

(3) A currrency dealer or exchanger, including a person engaged in the business of a check casher;

(4) An issuer, seller, or redeemer of traveler's checks or money orders, except as a selling agent exclusively who does not sell more than $150,000 of such instruments within any given 30-day period;

(5) A licensed transmitter of funds, or other person engaged in the business of transmitting funds;

(6) A telegraph company;

(7) (i) A casino or gambling casino licensed as a casino or gambling casino by a State or local government and having gross annual gaming revenue in excess of $1,000,000.

(ii) A casino or gambling casino includes the principal headquarters and any branch or place of business of the casino or gambling casino.

(8) A person subject to supervision by any state or federal bank supervisory authority.

(h) *Foreign bank.* A bank organized under foreign law, or an agency, branch or office located outside the United States of a bank. The term does not include an agent, agency, branch or office within the United States of a bank organized under foreign law.

(i) *Foreign financial agency.* A person acting outside the United States for a person (except for a country, a monetary or financial authority acting as a monetary or financial authority, or an international financial institution of which the United States Government is a member) as a financial institution, bailee, depository trustee, or agent, or acting in a similar way related to money, credit, securities, gold, or a transaction in money, credit, securities, or gold.

(j) *Investment security.* An instrument which:

(1) Is issued in bearer or registered form;

(2) Is of a type commonly dealt in upon securities exchanges or markets or commonly recognized in any area in which it is issued or dealt in as a medium for investment;

(3) Is either one of a class or series or by its terms is divisible into a class or series of instruments; and

(4) Evidences a share, participation or other interest in property or in enterprise or evidences an obligation of the issuer.

(k) *Monetary instruments.* (1) Monetary instruments include:

(i) Currency;

(ii) All negotiable instruments (including personal checks, business checks, official bank checks, cashier's checks, third-party checks, promissory notes (as that term is defined in the Uniform Commercial Code), traveler's checks, and money orders) that are either in bearer form, endorsed without restriction, made out to a fictitious payee (for the purposes of section 103.23), or otherwise in such form that title thereto passes upon delivery;

(iii) Incomplete instruments (including personal checks, business checks, official bank checks, cashier's checks, third-party checks, promissory notes (as that term is defined in the Uniform Commercial Code), traveler's checks, and money orders) signed but with the payee's name omitted; and

(iv) Securities or stock in bearer form or otherwise in such form that title thereto passes upon delivery.

(2) Monetary instruments do not include warehouse receipts or bills of lading.

(l) *Person.* An individual, a corporation, a partnership, a trust or estate, a joint stock company, an association, a syndicate, joint venture, or other unincorporated organization or group, and all entities cognizable as legal personalities.

(m) *Secretary.* The Secretary of the Treasury or any person duly authorized by the Secretary to perform the function mentioned.

(n) *Transaction account.* Transaction accounts include those accounts described in 12 U.S.C. § 461(b)(1)(C), money market accounts and similar accounts that take deposits and are subject to withdrawal by check or other negotiable order.

(o) *Transaction in currency.* A transaction involving the physical transfer of currency from one person to another. A transaction which is a transfer of funds by means of bank check, bank draft, wire transfer, or other written order, and which does not include the physical transfer of currency is not a transaction in currency within the meaning of this part.

(p) *United States.* The various States, the District of Columbia, the Commonwealth of Puerto Rico, and the territories and possessions of the United States.

(q) *Business day.* Business day, as used in this part with respect to banks, means that day, as normally communicated to its depository customers, on which a bank routinely posts a particular transaction to its customer's account.

3. Part 103 is amended by removing the phrase "demand deposit account" wherever it appears and inserting in its place the phrase "transaction account".

4. Section 103.22 is revised to read as follows:

§ 103.22 Reports of currency transactions.

(a)(1) Each financial institution other than a casino shall file a report of each deposit, withdrawal, exchange of currency or other payment or transfer, by, through, or to such financial institution which involves a transaction in currency of more than $10,000. Multiple currency transactions shall be treated as a single transaction if the financial institution has knowledge that they are by or on behalf of any person and result in either cash in or cash out totalling more than $10,000 during any one business day. Deposits made at night or over a weekend or holiday shall be treated as if received on the next business day following the deposit.

(2) Each casino shall file a report of each deposit, withdrawal, exchange of currency, gambling tokens or chips, or other payment or transfer, by, through, or to such casino which involves a transaction in currency of more than $10,000. Multiple currency transactions shall be treated as a single transaction if the casino has knowledge that they are by or on behalf of any person and result in either cash in or cash out totalling more than $10,000 during any twenty-four hour period.

(3) A financial institution includes all of its domestic branch offices for the purpose of this paragraph's reporting requirements.

(b) Except as otherwise directed in writing by the Assistant Secretary (Enforcement) or the Commissioner of Internal Revenue:

(1) This section shall not require reports:

(i) Of transactions with Federal Reserve Banks or Federal Home Loan banks;

(ii) Of transactions between domestic banks; or

(iii) By nonbank financial institutions of transactions with commercial banks (however, commercial banks must report such transactions with nonbank financial institutions).

(2) A bank may exempt from the reporting requirement of paragraph (a) of this section the following:

(i) Deposits or withdrawals of currency from an existing account by an established depositor who is a United States resident and operates a retail type of business in the United States. For the purpose of this subsection, a retail type of business is a business primarily engaged in providing goods to ultimate consumers and for which the business is paid in substantial portions by currency, except that dealerships which buy or sell motor vehicles, vessels, or aircraft are not included and their transactions may not be exempted from the reporting requirements of this section.

(ii) Deposits or withdrawals of currency from an existing account by an established depositor who is a United States resident and operates a sports arena, race track, amusement park, bar, restaurant, hotel, check cashing service licensed by state or local governments, vending machine company, theater, regularly scheduled passenger carrier or any public utility.

(iii) Deposits or withdrawals, exchanges of currency or other payments and transfers by local or state governments, or the United States or any of its agencies or instrumentalities.

(iv) Withdrawals for payroll purposes from an existing account by an established depositor who is a United States resident and operates a firm that regularly withdraws more than $10,000 in order to pay its employees in currency.

(c) In each instance the transactions exempted under paragraph (b) of this section must be in amounts which the bank may reasonably conclude do not exceed amounts commensurate with the customary conduct of the lawful, domestic business of that customer, or in the case of transactions with a local or state govenment or the United States or any of its agencies or instrumentalities, in amounts which are customary and commensurate with the authorized activities of the agency or instrumentality. This section does not permit a bank to exempt its transactions with nonbank financial institutions (except for check cashing services licensed by state or local governments), nor will additional exemption authority be granted for such transactions (except transactions by other check cashers).

(d) After October 27, 1986, a bank may not place any customer on its exempt list without first obtaining a written statement, signed by the customer, describing the customary conduct of the lawful domestic business of that customer and a detailed statement of reasons why such person is qualified for an exemption. The statement shall include the name, address, nature of business, taxpayer identification number, and account number of the customer being exempted. The signature, including the title and position of the person signing, will attest to the accuracy of the information concerning the name, address, nature of business, and tax identification number of the customer. Immediately above the signature line, the following statement shall appear: "The information contained above is true and correct to the best of my knowledge and belief. I understand that this information will be read and relied upon by the Government." The bank shall indicate in this statement whether the exemption covers withdrawals, deposits, or both, as well as the dollar limit of the exemption for both deposits and withdrawals. The bank also shall indicate whether the exemption is limited to certain types of deposits and withdrawals (*e.g.*, withdrawals for payroll purposes). In each instance, the exempted transactions must be in amounts that the bank may reasonably conclude do not exceed amounts commensurate with the customary conduct of the lawful domestic business of that customer. The bank is responsible for independently verifying the activity of the account and determining applicable dollar limits for exempted deposits or withdrawals. The bank must retain each statement that it obtains pursuant to this subparagraph as long as the customer is on the exempt list, and for a period of five years following removal of the customer from the bank's exempt list.

(e) A bank may apply to the Commissioner of Internal Revenue for additional authority to grant an exemption to the reporting requirement, not otherwise permitted under paragraph (b) of this section, if the bank believes that circumstances warrent such an exemption. Such requests shall be addressed to: Chief, Currency and Banking Reports Branch, Exemption Review Staff, IRS Data Center, Post Office Box 32063, Detroit, Michigan 48232, and must be accompanied by a statement of the circumstances that warrant special exemption treatment and a copy of the statement signed by the customer required by paragraph (d) of this section.

(f) A record of each exemption granted under this section and the reason therefor must be kept in a centralized list. The record shall include the names and addresses of all banks referred to in paragraph (b)(1)(ii) of this section, as well as the name, address, business, taxpayer identification number and account number of each depositor that has engaged in currency transactions which have not been reported because of the exemption provided in paragraph (b)(2) of this section. The record concerning the group of depositors exempted under the provisions of paragraph (b)(2) of this section shall also indicate whether the exemption covers withdrawals, deposits, or both, as well as the dollar limit of the exemption.

(g) Upon the request of the Assistant Secretary (Enforcement) or the Commissioner of Internal Revenue, a bank shall provide a report containing the list of the bank's customers whose transactions have been exempted under this section and such related information as the Assistant Secretary or Commissioner shall require, including copies of the statements required in paragraph (d) of this section. The report must be provided within 15 days of the request. Any exemption may be rescinded at the discretion of the requesting official, who may require the bank to file reports required by paragraph (a) of this section with respect to future transactions of any customer whose transactions previously were exempted.

(Approved by the Office of Management and Budget under control number 1505-0063)

5. The first sentence of § 103.24 is revised to read as follows:

§ 103.23 Reports of foreign financial accounts.

Each person subject to the jurisdiction of the United States (except a foreign subsidiary of a U.S. person) having a financial interest in, or signature or other authority over, a bank, securities or other financial account in a foreign country shall report such relationship to the Commissioner of the Internal Revenue for each year in which such relationship exists, and shall provide such information as shall be specified in a reporting form prescribed by the Secretary to be filed by such persons. * * *

6. Section 103.26 is revised to read as follows:

§ 103.26 Filing of reports.

(a)(1) A report required by § 103.22(a) shall be filed by the financial institution within 15 days following the day on which the responsible transaction occurred.

(2) A report required by § 103.22(g) shall be filed by the bank within 15 days after receiving a request for the report.

(3) A copy of each report filed pursuant to §103.22 shall be retained by the financial institution for a period of five years from the date of the report.

(4) All reports required to be filed by § 103.22 shall be filed with the Commissioner of Internal Revenue, unless otherwise specified.

(b)(1) A report required by § 103.23(a) shall be filed at the time of entry into the United States or at the time of depature, mailing or shipping from the United States, unless otherwise specified by the Commissioner of Customs.

(2) A report required by § 103.23(b) shall be filed within 15 days after receipt of the currency or other monetary instruments.

(3) All reports required by § 103.23 shall be filed with the Customs officer in charge at any port of entry or departure, or as otherwise specified by the Commissioner of Customs. Reports required by § 103.23(a) for currency or other monetary instruments not physically accompanying a person entering or departing from the United States, may be filed by mail on or before the date of entry, departure, mailing or shipping. All reports required by § 103.23(b) may also be filed by mail. Reports filed by mail shall be addressed to the Commissioner of Customs, Attention: Currency Transportation Reports, Washington, DC 20226.

(c) Reports required to be filed by § 103.24 shall be filed with the Commissioner of Internal Revenue on or before June 30 of each calendar year with respect to foreign financial acccounts exceeding $10,000 maintained during the previous calendar year.

(d) Reports required by §§ 103.22, 103.23 or 103.24 shall be filed on forms prescribed by the Secretary. All information called for in such forms shall be furnished.

(e) Forms to be used in making the reports required by §§ 103.22 and 103.24 may be obtained from the Internal Revenue Service. Forms to be used in making the reports required by § 103.23 may be obtained from the U.S. Customs Service.

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7. Section 103.27 is revised to read as follows:

§ 103.27 Identification required.

Before concluding any transaction with respect to which a report is required under § 103.22, a financial institution shall verify and record the name and address of the individual presenting a transaction, as well as record the identity, account number, and the social security or taxpayer identification number, if any, of any person or entity for whose or which account such transaction is to be effected. Verification of the identity of an individual who indicates that he or she is an alien or is not a resident of the United States must be made by passport, alien identification card, or other official document evidencing nationality or residence (*e.g.*, a Provincial driver's license with indication of home address). Verification of identity in any other case shall be made by examination of a document, other than a bank signature card, that is normally acceptable within the banking community as a means of identification when cashing checks for nondepositors (*e.g.*, a drivers license or credit card). A bank signature card may be relied upon only if it was issued after documents establishing the identity of the individual were examined and notation of the specific information was made on the signature card. In each instance, the specific identifying information (*i.e.*, the account number of the credit card, the driver's license number, etc.) used in verifying the identity of the customer shall be recorded on the report, and the mere notation of "known customer" or "bank signature care on file" on the report is prohibited.

(Approved by the Office of Management and Budget under control number 1505-0063)

8. The first sentence of § 103.32 is revised to read as follows:

§ 103.32 Records to be made and retained by persons having financial interests in foreign financial accounts.

Records of accounts required by § 103.24 to be reported to the Commissioner of Internal Revenue shall be retained by each person having a financial interest in or signature or other authority over any such account.* * *

9. Section 103.33 introductory text, (a), and (b) are revised and the OMB control number is added to read as follows:

§ 103.33 Records to be made and retained by financial institutions.

Each financial institution shall retain either the original or a microfilm or other copy or reproduction of each of the following:

(a) A record of each extension of credit in an amount in excess of $10,000, except an extension of credit secured by an interest in real property, which record shall contain the name and address of the person to whom the extension of credit is made, the amount thereof, the nature or purpose thereof, and the date thereof;

(b) A record of each advice, request, or instruction received or given regarding any transaction resulting (or intended to result and later cancelled if such a record is normally made) in the transfer of currency or other monetary instruments, funds, checks, investment securities, or credit, of more than $10,000 to or from any person, account, or place outside the United States.

* * * * *

(Approved by the Office of Management and Budget under control number 1505-0063)

10. Section 103.34(a) (1) introductory text and (2) are amended by removing the number "45" wherever it appears and inserting in its place the number "30", and by adding a new sentence at the end of paragraph (a)(1) to read as follows:

§ 103.34 Additional records to be made and retained by banks.

(a)(1) * * * Where a person is a non-resident alien, the bank shall also record the person's passport number or a description of some other government document used to verify his identity.

* * * * *

11. Section 103.34 is further amended by revising paragraph (b)(1) and adding a new paragraph (b)(13) and the OMB control number to read as follows:

§ 103.34 Additional records to be made and retained by banks.

* * * * *

(b) * * *

(1) Each document granting signature authority over each deposit or share account, including any notations, if such are normally made, of specific identifying information verifying the identity of the signer (such as a driver's license number or credit card number);

* * * * *

(13) Each deposit slip or credit ticket reflecting a transaction in excess of $100 or the equivalent record for direct deposit or other wire transfer deposit transactions. The slip or ticket shall record the amount of any currency involved.

(Approved by the Office of Management and Budget under control number 1505-0063)

12. Paragraphs (a) (1) introductory and (2) § 103.35 are amended by removing the number "45" wherever it appears and inserting in its place the number "30," and by adding a sentence at the end of paragraph (a)(1) and adding the OMB control number to read as follows:

§ 103.35 Additional records to be made and retained by brokers or dealers in securities.

(a) * * * Where a person is a non-resident alien, the broker or dealer in securities shall also record the person's passport number or a description of some other government document used to verify his identity.

* * * * *

(Approved by the Office of Management and Budget under control number 1505-0063)

13. Section 103.36 is amended by adding a sentence to the end of paragraph (a) and adding the OMB control number to read as follows:

§ 103.36 Additional records to be made and retained by casinos.

(a) * * * Where a person is a nonresident alien, the casino shall also record the person's passport number or a description of some other government document used to verify his identity.

* * * * *

(Approved by the Office of Management and Budget under control number 1505-0063)

§§ 103.37 and 103.38 [Redesignated as §§ 103.38 and 103.39]

14. Sections 103.37 and 103.38 are redesignated as §§ 103.38 and 103.39, and a new § 103.37 is added to read as follows:

§ 103.37 Additional records to be made and retained by currency dealers or exchangers.

(a)(1) After July 7, 1987, each currency dealer or exchanger shall secure and maintain a record of the taxpayer identification number of each person for whom a transaction account is opened or a line of credit is extended within 30 days after such account is opened or credit line extended. Where a person is a non-resident alien, the currency dealer or exchanger shall also record the person's passport number or a description of some other government document used to verify his identity. Where the account or credit line is in the names of two or more persons, the currency dealer or exchanger shall secure the taxpayer identification number of a person having a financial interest in the account or credit line. In the event that a currency dealer or exchanger has been unable to secure the identification required within the 30-day period specified, it shall nevertheless not be deemed to be in violation of this section if:

(i) It has made a reasonable effort to secure such identification, and

(ii) It maintains a list containing the names, addresses, and account or credit line numbers of those persons from whom it has been unable to secure such identification, and makes the names, addresses, and account or credit line numbers of those persons available to the Secretary as directed by him.

(2) The 30-day period provided for in paragraph (a)(1) of this section shall be extended where the person opening the account or credit line has applied for a taxpayer identification or social security number on Form SS-4 or SS-5, until such time as the person maintaining the account or credit line has had a reasonable opportunity to secure such number and furnish it to the currency dealer or exchanger.

(3) A taxpayer identification number for an account or credit line required under paragraph (a)(1) of this section need not be secured in the following instances:

(i) Accounts for public funds opened by agencies and instrumentalities of Federal, State, local or foreign governments,

(ii) Accounts for aliens who are—

(A) Ambassadors, ministers, career diplomatic or consular officers, or

(B) Naval, military or other attaches of foreign embassies, and legations, and for members of their immediate families,

(iii) Accounts for aliens who are accredited representatives to international organizations which are entitled to enjoy privileges, exemptions, and immunities as an international organization under the International Organizations Immunities Act of December 29, 1945 (22 U.S.C. 288), and for the members of their immediate families,

(iv) Aliens temporarily residing in the United States for a period not to exceed 180 days,

(v) Aliens not engaged in a trade or business in the United States who are attending a recognized college or any training program, supervised or conducted by any agency of the Federal Government, and

(vi) Unincorporated subordinate units of a tax exempt central organization which are covered by a group exemption letter.

(b) Each currency dealer or exchanger shall retain either the original or a microfilm or other copy or reproduction of each of the following:

(1) Statements of accounts from banks, including paid checks, charges or other debit entry memoranda, deposit slips and other credit memoranda representing the entries reflected on such statements;

(2) Daily work records, including purchase and sales slips or other memoranda needed to identify and reconstruct currency transactions with customers and foreign banks;

(3) A record of each exchange of currency involving transactions in excess of $1000, including the name and address of the customer (and passport number or taxpayer identification number unless received by mail or common carrier) date and amount of the transaction and currency name, country, and total amount of each foreign currency;

(4) Signature cards or other documents evidencing signature authority over each deposit or security account, containing the name of the depositor, street address, taxpayer identification number (TIN) or employer identification number (EIN) and the signature of the depositor or of a person authorized to sign on the account (if customer accounts are maintained in a code name, a record of the actual owner of the account);

(5) Each item, including checks, drafts, or transfers of credit, of more than $10,000 remitted or transferred to a person, account or place outside the United States;

(6) A record of each receipt of currency, other monetary instruments, investment securities and checks, and of each transfer of funds or credit, or more than $10,000 received on any one occasion directly and not through a domestic financial institution, from any person, account or place outside the United States;

(7) Records prepared or received by a dealer in the ordinary course of business, that would be needed to reconstruct an account and trace a check in excess of $100 deposited in such account through its internal recordkeeping system to its depositary institution, or to supply a description of a deposited check in excess of $100;

(8) A record maintaining the name, address and taxpayer identification number, if available, of any person presenting a certificate of deposit for payment, as well as a description of the instrument and date of transaction;

(9) A system of books and records that will enable the currency dealer or exchanger to prepare an accurate balance sheet and income statement.

(Approved by the Office of Management and Budget under control number 1505–0063)

15. Paragraph (c) of newly redesignated § 103.38 is redesignated as (d), a new paragraph (c) is added, and newly redesignated paragraph (d) is revised and the OMB control number is added to read as follows:

§ 103.38 Nature of records and retention period.

* * * * *

(c) the rules and regulations issued by the Internal Revenue Service under 26 U.S.C. § 6109 determine what constitutes a taxpayer identification number and whose number shall be obtained in the case of an account maintained by one or more persons.

(d) All records that are required to be retained by this Part shall be retained for a period of five years. All such records shall be filed or stored in such a way as to be accessible within a reasonable period of time, taking into consideration the nature of the record, and the amount of time expired since the record was made.

(Approved by the Office of Management and Budget under control number 1505–0063)

16. Section 103.46 is amended by removing paragraph (b), by redesignating paragraph (a) as paragraph (b), by revising the introductory test of newly redesignated (b) and by revising (b)(5) and (b)(8), and by adding new paragraphs (a), (c), (d), (e) and (f) to read as follows:

§ 103.46 Enforcement.

(a) Overall authority for enforcement and compliance, including coordination and direction of procedures and activities of all other agencies exercising delegated authority under this Part, is delegated to the Assistant Secretary (Enforcement).

(b) Authority to examine institutions to determine compliance with the requirements of this Part is delegated as follows:

* * * * *

(5) To the Chairman of the Board of the National Credit Union Administration with respect to those financial institutions regularly examined for safety and soundness by NCUA examiners.

* * * * *

(8) To the Commissioner of Internal Revenue with respect to all financial institutions, except brokers or dealers in securities, not currently examined by Federal bank supervisory agencies for soundness and safety.

(c) Authority for investigating criminal violations of this Part is delegated as follows:

(1) To the Commissioner of Customs with respect to § 103.23;

(2) To the Commissioner of Internal Revenue except with respect to § 103.23.

(d) Authority for the imposition of civil penalties for violations of this part lies with the Assistant Secretary, and in the Assistant Secretary's absence, the Deputy Assistant Secretary (Law Enforcement).

(e) Periodic reports shall be made to the Assistant Secretary by each agency to which compliance authority has been delegated under paragraph (b) of this section. These reports shall be in such a form and submitted at such intervals as the Assistant Secretary may direct. Evidence of specific violations of any of the requirements of this Part may be submitted to the Assistant Secretary at any time.

(f) The Assistant Secretary or his delegate, and any agency to which compliance has been delegated under paragraph (b) of this section, may examine any books, papers, records, or other data of domestic financial institutions relevant to the recordkeeping or reporting requirements of this Part.

17. Paragraph (a) of § 103.47 is revised and redesignated as (b), paragraph (b) is redesignated as (d), and new paragraphs

(a), (c), (e), (f), (g) and (h) are added to read as follows:

§ 103.47 Civil penalty.

(a) For any willful violation, committed on or before October 12, 1984, of any reporting requirement for financial institutions under this Part or of any recordkeeping requirements of § 103.22, the Secretary may assess upon any domestic financial institution, and upon any partner, director, officer, or employee thereof who willfully participates in the violation, a civil penalty not to exceed $1,000.

(b) For any willful violation committed after October 12, 1984 and before October 28, 1986, of any reporting requirement for financial institutions under this part or of the recordkeeping requirements of § 103.32, the Secretary may assess upon any domestic financial institution, and upon any partner, director, officer, or employee thereof who willfully participates in the violation, a civil penalty not to exceed $10,000.

(c) For any willful violation of any recordkeeping requirement for financial institutions, except violations of § 103.32, under this part, the Secretary may assess upon any domestic financial institution, and upon any partner, director, officer, or employee thereof who willfully participates in the violation, a civil penalty not to exceed $1,000.

* * * * *

(e) For any willful of violation § 103.53 committed after January 26, 1987, the Secretary may assess upon any person a civil penalty not to exceed the amount of coins and currency involved in the transaction with respect to which such penalty is imposed. The amount of any civil penalty assessed under this paragraph shall be reduced by the amount of any forfeiture to the United States in connection with the transaction for which the penalty was imposed.

(f) For any willful violation committed after October 27, 1986, of any reporting requirement for financial institutions under this part (except §§ 103.24, 103.25 or 103.32), the Secretary may assess upon any domestic financial institution, and upon any partner, director, officer, or employee thereof who willfully participates in the violation, a civil penalty not to exceed the greater of the amount (not to exceed $100,000) involved in the transaction or $25,000.

(g) For any willful violation committed after October 27, 1986, of any requirement of §§ 103.24, 103.25, or 103.32, the Secretary may assess upon any person, a civil penalty:

(1) In the case of a violation of § 103.25 involving a transaction, a civil penalty not to exceed the greater of the amount (not to exceed $100,000) of the transaction, or $25,000; and

(2) In the case of a violation of §§ 103.24 or 103.32 involving a failure to report the existence of an account or any identifying information required to be provided with respect to such account, a civil penalty not to exceed the greater of the amount (not to exceed $100,000) equal to the balance in the account at the time of the violation, or $25,000.

(h) For each negligent violation of any requirement of this Part, committed after October 27, 1986, the Secretary may assess upon any financial institution a civil penalty not to exceed $500.

18. Part 103 is amended by adding at the end a new § 103.53 to read as follows:

§ 103.53 Structured transactions.

No person shall for the purpose of evading the reporting requirements of § 103.22 with respect to such transaction—

(a) Cause or attempt to cause a domestic financial institution to fail to file a report required under § 103.22;

(b) Cause or attempt to cause a domestic financial institution to file a report required under § 103.22 that contains a material omission or misstatement of fact; or

(c) Structure or assist in structuring, or attempt to structure or assist in structuring, any transaction with one or more domestic financial institutions.

Dated: March 30, 1987.

Francis A. Keating, II,

Assistant Secretary (Enforcement).

[FR Doc. 87-7797 Filed 4-6-87; 10:17 am]

BILLING CODE 4810-25-M

NASD
National Association of Securities Dealers, Inc.
1735 K St., N.W. • Washington, D.C. 20006 • (202) 728-8000

notice to members 87-52

August 12, 1987

TO: All NASD Members and Other Interested Persons

RE: Request for Comments on Proposed Amendment to the NASD Board of Governors' Corporate Financing Interpretation Concerning Public Offerings When Proceeds Are Directed to NASD Members

LAST DATE FOR COMMENT: SEPTEMBER 12, 1987.

EXECUTIVE SUMMARY

The NASD requests comments on a proposed amendment to the Interpretation of the Board of Governors---Review of Corporate Financing, under Article III, Section 1 of the NASD Rules of Fair Practice. The amendment would require a qualified independent underwriter to provide a pricing opinion and conduct due diligence when 10 percent or more of the net proceeds of a public offering are directed to NASD members participating in the distribution of the offering.

The NASD Board of Governors believes this amendment is necessary to address potential conflicts of interest that arise when a portion of the proceeds of the offering are directed to a member responsible for pricing and due diligence.

The text of the proposed amendment is attached.

BACKGROUND

Recently NASD members have become more involved in corporate takeovers by providing their clients, directly from their own funds, large sums of money to facilitate leveraged buyouts. The takeover, or leveraged buyout, is accomplished primarily with borrowed funds from a lending group that includes NASD members. The capital committed by members is not intended as a long-term investment but rather, as bridge financing to allow clients to quickly complete the transaction. The bridge loan is intended to be repaid with the proceeds of a public offering, usually of high-yield, high-risk bonds underwritten by the member.

The SEC and the NASD Corporate Financing Committee have expressed concern regarding potential conflicts of interest by members that provide bridge loans to finance corporate acquisitions by their clients. The concern is that a member-lender might be compromised in fulfilling its due diligence and other responsibilities when underwriting subsequent offerings by its issuer-client, the proceeds of which will be used to repay the member's loan. In such situations, the member has a potential conflict of interest in evaluating the issuer objectively as part of its due-diligence responsibilities and when establishing an appropriate offering price, since a successful distribution of the issuer's securities directly benefits the member.

SUMMARY OF PROPOSED AMENDMENT

The NASD Corporate Financing Committee and the NASD Board of Governors reviewed this issue and determined that when a portion of the proceeds of a public offering is directed to a member that is responsible for pricing and due diligence, the member is subject to a potential conflict of interest. Particularly in the area of due diligence, the responsibility of the member to ensure disclosure of material facts adverse to the issuer may be influenced by the significant financial interest of the member in the offering and the incentive for the offering to be successful.

Therefore, the Committee and the Board of Governors believe an amendment to the Board of Governors' Interpretation on Corporate Financing under Article III, Section 1 of the Rules of Fair Practice is the most effective method of dealing with such potential conflicts of interest. The amendment would require participation of a qualified independent underwriter in any public offering in which 10 percent or more of the net proceeds of the offering will be directed to NASD members participating in the distribution of the offering, or to affiliated or associated persons of such members, or to members of the immediate family of such persons. The qualified independent underwriter would be required to provide an opinion that the yield is no lower (in a debt offering) or the price is no higher (in an equity offering) than it would recommend. The qualified independent underwriter would also perform due diligence in the preparation of the offering document.

To act as a qualified independent underwriter, an NASD member must meet the definition contained in Section 2(k) of Schedule E to the NASD By-Laws. Under the definition, a member must be and have been actively engaged in the investment banking or securities business and the underwriting of public offerings for at least five years preceding the offering; must have had net income from operations in at least three of the five years preceding the offering; and must have had a majority of its board of directors (if a corporation), a majority of its general partners (if a partnership), or its proprietor (if a sole proprietorship) actively engaged in the investment banking or securities business for the five-year period prior to the offering. In addition, the member must not be an affiliate of the issuer and must have agreed to undertake the legal responsibilities and liabilities of an underwriter under Section 11 of the Securities Act of 1933.

The NASD has historically relied on qualified independent underwriters to resolve potential conflicts of interest on behalf of underwriters in public offerings. Qualified independent underwriters have been used to resolve conflicts of interest in offerings by members of their own securities and offerings of affiliates since the adoption of Schedule E (the NASD's self-underwriting regulation) in 1972. In addition, in 1984, the NASD amended the "Venture Capital Restrictions" under the Corporate Financing Interpretation to provide an exemption from the restrictions if a qualified independent underwriter participated in the offering. The "Venture Capital Restrictions" apply to initial public offerings in which members participating in the offering own securities of the issuer. The exemption has been very effective in resolving problems that had been experienced by members prior to its adoption.

* * * * *

The NASD encourages all members and other interested persons to comment on the proposed amendment. The NASD requests that commentators address whether the participation of a qualified independent underwriter is necessary in an equity offering that has a bona fide independent market (as defined in Section 2(b)9 of Schedule E to the NASD By-Laws) or when the offering is of debt-rated investment grade, i.e., the four highest generic rating categories by a nationally recognized statistical rating organization. The NASD is also interested in receiving information on additional costs to members that may result from the proposed amendment.

In addition, the proposed amendment applies when 10 percent or more of the net proceeds of an offering are directed to members. Commentators may wish to address whether 10 percent is the appropriate level to use in determining that a qualified independent underwriter is required or whether a higher or lower level should be used.

Comments should be directed to:

Mr. Lynn Nellius
Secretary
National Association of Securities Dealers, Inc.
1735 K Street, N.W.
Washington, D.C. 20006-1506

Comments must be received no later than September 12, 1987. Comments received by this date will be reviewed by the NASD Corporate Financing Committee and the NASD Board of Governors. If the proposed amendment, or an amended version resulting from comments received, is approved by the Board, it must be filed with and approved by the Securities and Exchange Commission before becoming effective.

Questions regarding this notice may be directed to either Frank J. Formica or Richard J. Fortwengler, NASD Corporate Financing Department, at (202) 728-8258.

Sincerely,

Frank J. Wilson
Executive Vice President
and General Counsel

Attachment

Proposed Amendment to
The Interpretation of the
Board of Governors—Review of Corporate Financing
Under Article III, Section 1 of the NASD Rules of Fair Practice

(Follows section titled "Venture Capital Restrictions" at page 2033 of the NASD Manual.)

Proceeds Directed to a Member

No member shall participate in a public offering of an issuer's securities where more than 10 percent of the net offering proceeds are intended to be paid to members participating in the distribution of the offering or associated or affiliated persons of such members, or members of the immediate family* of such persons, unless the price at which an equity issue or the yield at which a debt issue is to be distributed to the public is established at a price no higher or yield no lower than that recommended by a qualified independent underwriter as defined in Section 2(k) of Schedule E to Article VII, Section 1(a)(4) of the By-Laws, who shall participate in the preparation of the registration statement and the prospectus, offering circular, or similar document and who shall exercise the usual standards of "due diligence" in respect thereto. For purposes of this provision, the term "net offering proceeds" means the gross offering proceeds less all expenses of issuance and distribution.

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* See definition of "immediate family," Interpretation of the Board of Governors—Free-Riding and Withholding, under Article III, Section 1 of the NASD Rules of Fair Practice.

NASD
National Association of Securities Dealers, Inc.
1735 K St., N.W. • Washington, D.C. 20006 • (202) 728-8000
notice to members 87-53

August 12, 1987

TO: All NASD Members and Other Interested Persons

RE: Request for Comments on Proposed Amendments to NASD By-Laws and Rules of Fair Practice, and Proposed New Government Securities Rules

LAST DATE FOR COMMENT: SEPTEMBER 11, 1987.

EXECUTIVE SUMMARY

On October 28, 1986, President Reagan signed the Government Securities Act of 1986, providing for the regulation of government securities activities by brokers and dealers. This legislation created a new section 15C of the Securities Exchange Act of 1934, which requires SEC registration and either NASD or exchange membership for government securities brokers and dealers.

The NASD requests comments on proposed amendments to the NASD By-Laws and Rules of Fair Practice, and on proposed new government securities rules designed to permit the NASD to carry out its regulatory responsibilities under the Government Securities Act.

The texts of the proposed amendments are attached.

BACKGROUND

Public Law 99-571 (the "Government Securities Act of 1986"), enacted by the Congress in October 1986, amended the Securities Exchange Act of 1934 (1934 Act) by adding a new Section 15C that requires registration of government securities brokers and dealers and provides for adoption of rules for such brokers and dealers by the Treasury Department. In addition, the Government Securities Act amended Section 15A(f) of the 1934 Act to provide the NASD with the authority to adopt and implement rules applicable to its members; to enforce compliance with the provisions of the Government Securities Act and rules and regulations adopted thereunder;

to discipline members for violations of the Government Securities Act and rules; to examine members' books and records; and to implement the provisions of the 1934 Act relating to denial of membership, or association with members, of persons or entities subject to statutory disqualifications.

In addition, the Government Securities Act provided the NASD with the authority to adopt rules to prohibit fraudulent, misleading, deceptive, and false advertising. A proposed amendment to Article III, Section 35 of the NASD Rules of Fair Practice relating to advertising was circulated for member comment in Notice to Members 87-24, dated April 14, 1987.

SUMMARY OF PROPOSED AMENDMENTS

The proposed amendments and new rules are designed to provide the NASD with the ability to carry out its responsibilities under the Government Securities Act. These proposals are divided into four parts:

- Amendments to the NASD By-Laws;
- Amendments to Schedule C to the NASD By-Laws regarding registration of individuals;
- An amendment to Article I, Section 5 of the NASD Rules of Fair Practice; and
- A rule package designated as "Government Securities Rules."

- <u>NASD By-Laws</u>

These amendments incorporate into existing By-Law provisions appropriate references to government securities brokers and dealers or to the rules of the Treasury Department.

Substantive changes to the By-Laws include a new Section 8 to Article VII that allows the Board of Governors to adopt government securities rules subject to member vote and a new Section 6 to Article XVI that applies to limitations of powers. New Section 6 states that the By-Law provisions governing qualifications of members and rulemaking authority conferred upon the NASD shall not be inconsistent with the Government Securities Act. This provision is similar to an existing provision in the By-Laws relating to municipal securities brokers and dealers.

The amendments also contain changes to Article II, Sect:on 4 of the By-Laws that define the term "disqualification." These changes conform the NASD definition with the definition in the 1934 Act.

- <u>Schedule C to the NASD By-Laws</u>

The proposed amendments to Schedule C to the By-Laws add a new Part X. This section defines government securities principals and representatives. It also requires registration of government securities principals and representatives and exempts from registration persons serving in an exclusively clerical or ministerial capacity. The definitions of the categories of individuals required to be registered either as principals or representatives track the provisions of Section 400.3(c) of the Treasury regulations. Such registration is required to provide the NASD with the information needed to make a determination of potential statutory disqualification and identify a firm's principals for purposes of contact with and examination of those firms.

- NASD Rules of Fair Practice

The amendment to Article I, Section 5 of the Rules of Fair Practice is intended to clarify that the applicable Rules of Fair Practice do not apply to members that are registered with the SEC under Section 15C as sole government securities brokers or dealers. The provisions of the Rules of Fair Practice will, of course, remain fully applicable to members registered under Section 15(b) of the 1934 Act.

- Government Securities Rules

The remaining provisions of the proposed rule package are designated as "Government Securities Rules." These rules are substantially parallel to the NASD Rules of Fair Practice in those areas where the NASD believes that such rules are consistent with NASD obligations under the provisions of Section 15A(f) of the 1934 Act.

The proposed rules include provisions relating to the maintenance of books and records, supervisory procedures, and regulation of activities of members that are experiencing financial or operational difficulties or that are changing their exemptive status under the customer protection provisions applicable to government securities brokers and dealers. In addition, the rules provide the framework for the NASD to bring disciplinary actions pursuant to the NASD Code of Procedure.

* * * * *

The NASD encourages members and other interested persons to comment on this proposed rule package. The NASD requests that commentators specifically address the need and authority for the adoption, either by the NASD or the Treasury Department, of rules making the NASD's Code of Arbitration Procedure applicable to government securities brokers and dealers registered under Section 15C of the 1934 Act; the need for a fidelity bonding requirement for government securities brokers and dealers similar to that contained in Article III, Section 32 of the NASD Rules of Fair Practice and Appendix C thereunder; and development of margin maintenance standards such as those contained in Appendix A to Article III, Section 30 of the Rules of Fair Practice.

Comments should be directed to:

Mr. Lynn Nellius
Secretary
National Association of Securities Dealers, Inc.
1735 K Street, N.W.
Washington, D.C. 20006-1506

Comments must be received no later than September 11, 1987. Comments received by this date will be considered by the NASD Ad Hoc Committee on Government Securities and the NASD Board of Governors. Any amendments to the NASD By-Laws and Rules of Fair Practice and new Government Securities Rules that are approved by the Board must be submitted to the membership for a vote. Thereafter, the proposed rule package must be filed with and approved by the Securities and Exchange Commission before becoming effective.

Questions concerning this notice may be directed to T. Grant Callery, NASD Associate General Counsel, at (202) 728-8285.

Sincerely,

Frank J. Wilson
Executive Vice President
and General Counsel

Attachments

PROPOSED AMENDMENTS TO NASD BY-LAWS*

ARTICLE I

Definitions

When used in these By-Laws, and any rules of the Corporation, unless the context otherwise requires, the term:

(a) "Act" means the Securities Exchange Act of 1934 as amended;

(b) "bank" means (1) a banking institution organized under the laws of the United States, (2) a member bank of the Federal Reserve System, (3) any other banking institution, whether incorporated or not, doing business under the laws of any state or of the United States, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks and which is supervised and examined by a State or Federal authority having supervision over banks, and which is not operated for the purpose of evading the provisions of the Act, and (4) a receiver, conservator, or other liquidating agent of any institution or firm included in clauses (1), (2) or (3) of this subsection;

(c) "branch office" means an office located in the United States which is owned or controlled by a member, and which is engaged in the investment banking or securities business;

(d) "broker" means any individual, corporation, partnership, association, joint stock company, business trust, unincorporated organization or other legal entity engaged in the business of effecting transactions in securities for the account of others, but does not include a bank;

(e) "Commission" means the Securities and Exchange Commission;

(f) "Corporation" means the National Association of Securities Dealers, Inc.;

(g) "dealer" means any individual, corporation, partnership, association, joint stock company, business trust, unincorporated organization or other legal entity engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but does not include a bank, or any person insofar as he buys or sells securities for his own account, either individually or in some fiduciary capacity, but not as part of a regular business;

(h) "investment banking or securities business" means the business, carried on by a broker, dealer, [or] municipal securities dealer (other than a bank or department or division of a bank), or government securities broker or dealer of

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* New language is underlined; deleted language is bracketed.

underwriting or distributing issues of securities, or of purchasing securities and offering the same for sale as a dealer, or of purchasing and selling securities upon the order and for the account of others;

(i) "member" means any broker or dealer admitted to membership in the Corporation;

(j) "municipal securities" means securities which are direct obligations of, or obligations guaranteed as to principal or interest by, a State or any political subdivision thereof, or any agency or instrumentality of a State or any political subdivision thereof, or any municipal corporate instrumentality of one or more States, or any security which is an industrial development bond as defined by Section 3(a)(29) of the Act;

(k) "municipal securities dealer" means any person, except a bank or department or division of a bank, engaged in the business of buying and selling municipal securities for his own account, through a broker or otherwise, but does not include any person insofar as he buys or sells securities for his own account either individually or in some fiduciary capacity but not as a part of a regular business;

(l) "municipal securities broker" means a broker, except a bank or department or division of a bank, engaged in the business of effecting transactions in municipal securities for the account of others;

(m) "person associated with a member" or "associated person of a member" means every sole proprietor, partner, officer, director, or branch manager of any member, or any natural person occupying a similar status or performing similar functions, or any natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by such member, whether or not any such person is registered or exempt from registration with the Corporation pursuant to these By-Laws;

(n) "registered broker, dealer, [or] municipal securities broker or dealer, or government securities broker or dealer" means any broker, dealer, [or] municipal securities broker or dealer, or government securities broker or dealer which is registered with the Commission under the Act;

(o) "rules of the Corporation" means all rules of the Corporation including the Certificate of Incorporation, By-Laws, Rules of Fair Practice, Government Securities Rules, Code of Procedure, Uniform Practice Code, and any Interpretations thereunder.

(p) "government securities broker" shall have the same meaning as in Section 3(a)(43) of the Act except that it shall not include financial institutions.

(q) "government securities dealer" shall have the same meaning as in Section 3(a)(44) of the Act except that it shall not include financial institutions.