

DEPARTMENT OF THE TREASURY

17 CFR Parts 400, 401, 402, 403, 405, and 420

RIN 1535-AA02

[Docket No. BPD GSRS 11-01]

Government Securities Act Regulations; Replacement of References to Credit Ratings and Technical Amendments

AGENCY: Office of the Assistant Secretary for Financial Markets, Treasury.

ACTION: Proposed rule.

SUMMARY: The Department of the Treasury (“Treasury” or “We”) is issuing this proposed rule to solicit public comment on a proposed amendment to the regulations issued under the Government Securities Act of 1986, as amended (“GSA”), to replace references to credit ratings in our rules with alternative requirements. Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 requires Federal agencies to remove from their applicable regulations any reference to or requirement of reliance on credit ratings and to substitute a standard of creditworthiness as the agency determines appropriate for such regulations. In this release Treasury is requesting comment on a substitute standard of creditworthiness for use in the liquid capital rule required by GSA regulations. Separately, we are proposing in this release several non-substantive, technical amendments to Treasury’s GSA regulations to update certain information or to delete certain requirements that are no longer applicable.

DATES: Submit comments on or before [insert date 60 days after publication in the Federal Register.]

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic comments:

Use the Federal eRulemaking Portal (<http://www.regulations.gov>) and follow the instructions for submitting comments through the website. You may download this proposed amendment from <http://www.regulations.gov> or the Bureau of the Public Debt's website at <http://www.treasurydirect.gov>.

Paper comments:

Send paper comments to Bureau of the Public Debt, Government Securities Regulations Staff, 799 9th Street N.W., Washington, DC 20239-0001.

Please submit your comments using only one method, along with your full name and mailing address. We will post all comments on the Bureau of the Public Debt's website at www.treasurydirect.gov. The proposed amendment and comments will also be available for public inspection and copying at the Treasury Department Library, Main Treasury Building, 1500 Pennsylvania Avenue, N.W., Washington, D.C., 20220. To visit the library, call (202) 622-0990 for an appointment. In general, comments received, including attachments and other supporting materials, are part of the public record and are available to the public. Do not submit any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

FOR FURTHER INFORMATION CONTACT: Lori Santamarena, Chuck Andreatta, or Kevin Hawkins, Department of the Treasury, Bureau of the Public Debt, Government Securities Regulations Staff, (202) 504-3632.

SUPPLEMENTARY INFORMATION

We are proposing to amend Treasury's liquid capital rule for registered government securities brokers and dealers under the GSA regulations at 17 CFR part 402 ("liquid capital

rule”) to remove references to credit ratings and substitute a standard of creditworthiness. We are proposing this amendment in order to comply with the requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act").¹ At the same time, we are seeking neither to narrow nor broaden the scope of financial instruments that would qualify for beneficial treatment under the existing rule. Section 939A(a) of the Dodd-Frank Act requires that Federal agencies, to the extent applicable, "review (1) any regulation issued by such agency that requires the use of an assessment of the creditworthiness of a security or money market instrument; and (2) any references to or requirements in such regulations regarding credit ratings." Section 939A(b) requires the agency to modify any regulations identified to "remove any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of creditworthiness" as the agency determines to be appropriate for such regulations.²

I. Current Liquid Capital Rule

Treasury's liquid capital rule (17 CFR § 402.2) prescribes minimum regulatory capital requirements for registered government securities brokers and dealers. In general, the liquid capital rule is a minimum ratio requirement of liquid capital to risk, as measured using various "haircuts."³ Specifically, a government securities broker or dealer may not permit its liquid capital to be below an amount equal to 120 percent of "total haircuts," which is the sum of "credit risk haircuts" and "market risk haircuts" calculated by each government securities broker or dealer.⁴

¹ Pub. L. 111-203, 124 Stat. 1376.

² See Section 939A of the Dodd-Frank Act.

³ A "haircut" in the context of Treasury's liquid capital rule refers to a deduction in the market value of securities or other instruments held by a government securities broker or dealer as part of net worth for calculating its liquid capital.

⁴ See §§ 402.2(a) and 402.2(g).

In describing the method for registered government securities brokers and dealers to calculate their minimum capital requirements, the liquid capital rule categorizes certain dollar-denominated securities, debt instruments, and derivative instruments as "Treasury market risk instruments."⁵ These instruments receive a more favorable capital treatment than instruments that are more susceptible to changes in value due to market fluctuations, which receive a higher "other securities haircut."⁶ The definition of Treasury market risk instruments includes commercial paper, which, in order to receive the more favorable haircut treatment of Treasury market risk instruments must be, "of no more than one year to maturity [and] rated in one of the three highest categories by at least two nationally recognized statistical rating organizations."⁷

The liquid capital rule includes three references to a rating by a nationally recognized statistical rating organization ("NRSRO"), i.e., a credit rating, each in regard to commercial paper. NRSROs are credit rating agencies that are subject to Securities and Exchange Commission registration and oversight.

II. Proposed Amendments to the Liquid Capital Rule

In conformance with section 939A of the Dodd-Frank Act, Treasury is proposing to remove from the liquid capital rule the three references to credit ratings⁸ that currently are used to determine whether specific issues of commercial paper are eligible to be treated as Treasury market risk instruments for haircut purposes. In place of these references, and as a substitute alternative standard of creditworthiness, Treasury is proposing to amend the term "Treasury market risk instrument" in the liquid capital rule to include commercial paper that

⁵ See § 402.2(e).

⁶ See § 402.2a(b).

⁷ See § 402.2(e)(1)(v), § 402.2a - Schedule A Instructions for Line 3, and § 404.2a - Schedule B.

⁸ Id.

“has only a minimal amount of credit risk as reasonably determined by the government securities broker or dealer pursuant to written policies and procedures the government securities broker or dealer establishes, maintains, and enforces to assess creditworthiness.”

In making this assessment, the government securities broker or dealer would be required to follow written policies and procedures that it would establish, maintain, and enforce. In making an assessment of credit and liquidity risk, the government securities broker or dealer could consider the following factors, to the extent appropriate, with respect to commercial paper.⁹ The range and type of specific factors considered, and the frequency of their review, would vary depending on the particular commercial paper under review.

- Credit spreads (i.e., whether it is possible to demonstrate that a position in commercial paper is subject to a minimal amount of credit risk based on the spread between the commercial paper’s yield and the yield of Treasury or other securities, or based on credit default swap spreads that reference the security);
- Liquidity (i.e., whether the commercial paper can be sold quickly at a minimal transaction cost);
- Securities-related research (i.e., whether providers of securities-related research believe the issuer of the commercial paper will be able to meet its financial commitments, generally, or specifically, with respect to the commercial paper held by the government securities broker or government securities dealer);
- Internal or external credit risk assessments (i.e., whether credit assessments developed internally by the government securities broker or government securities dealer or

⁹ This list of factors is not exhaustive or mutually exclusive. It is patterned after the list of factors proposed by the Securities and Exchange Commission in its current proposed amendments to Exchange Act Rule 15c3-1, and the Rule's appendices, to remove references to credit ratings in the Commission's Net Capital Rule. 76 FR 26550 (May 6, 2011).

externally by a credit rating agency, irrespective of its status as an NRSRO, express a view as to the credit risk associated with a particular security);

- Default statistics (i.e., whether providers of credit information relating to securities express a view that the commercial paper has a probability of default consistent with other commercial paper with a minimal amount of credit risk);
- Inclusion on an index (i.e., whether a security, or issuer of the security, is included as a component of a recognized index of instruments that are subject to a minimal amount of credit risk);
- Price and/or yield (i.e., whether the price and yield of a security are consistent with other securities that the government securities broker or government securities dealer has reasonably determined are subject to a minimal amount of credit risk and whether the price resulted from active trading); and
- Factors specific to the commercial paper market (e.g., general liquidity conditions).

If the government securities broker or dealer determines through its assessment that the commercial paper has more than a minimal amount of credit risk, the commercial paper would not be classified as a Treasury market risk instrument, and would therefore receive the less favorable "other securities haircut" in the liquid capital computation. Similarly, if the government securities broker or dealer does not have written policies and procedures to assess creditworthiness, all commercial paper would receive the "other securities haircut" treatment.

Under Treasury's GSA regulations that govern recordkeeping requirements,¹⁰ which generally incorporate the SEC's Rule 17a-4 recordkeeping requirements for brokers and dealers,¹¹ each government securities broker or dealer would be required to preserve for a

¹⁰ See § 404.3(a).

¹¹ See 17 CFR § 240.17a-4.

period of not less than three years, the first two years in an easily accessible place, the written policies and procedures that it establishes, maintains, and enforces for assessing credit risk for commercial paper. The SEC has proposed amending Rule 17a-4 to include in the list of records required to be preserved the written policies and procedures a broker-dealer establishes, maintains, and enforces to assess creditworthiness.¹² No amendment is necessary to Treasury's recordkeeping requirements in § 404.3 because they incorporate by reference the SEC's Rule 17a-4.

A government securities broker's or dealer's process for establishing creditworthiness and its written policies and procedures documenting that process would be subject to review in regulatory examinations by the SEC and self-regulatory organizations. There are three registered government securities brokers and dealers, none of which currently or routinely hold commercial paper.

We are requesting comment on all aspects of this proposed amendment. In addition, we request comment on the following specific questions:

- Is the proposed approach appropriate or are there alternative approaches that we should consider?
- What is the expected impact on government securities brokers and dealers and other market participants?
- Are there other factors a government securities broker or dealer should use when making an assessment of the credit risk of commercial paper?
- Should the list of factors be included in the text of the liquid capital rule? Should the list be published as guidance?

¹² 76 FR 26552 (May 6, 2011). OMB Control No. 3235-0279

- How often should a government securities broker or dealer be required to update its assessment of the credit risk of commercial paper to ensure that it remains current?
- Is the proposed recordkeeping requirement for government securities brokers' and dealers' written policies and procedures, as incorporated by reference to the SEC's Rule 17a-4 (and proposed amendments), adequate to ensure government securities brokers' and dealers' compliance with their written policies and procedures on an indefinite basis?
- What would be the appropriate level of regulatory oversight of a government securities broker or dealer's credit determination processes? How should a government securities broker or dealer be able to demonstrate to regulators the adequacy of the processes that it adopts and that it is following them?
- How consistent should credit determination criteria be across brokers and dealers?

III. Proposed Amendments to Reporting Requirements and Other Amendments

As part of our review of our Federal regulations required by Executive Order 13563, we are proposing to streamline the GSA regulations by deleting certain requirements. Specifically, we are proposing to delete the sections in our reporting requirements that refer to year 2000 ("Y2K") readiness reports because they are no longer needed.¹³ We are also proposing to delete references to various other requirements in the GSA regulations that are contingent on actions to be taken by specific dates in the past and therefore are no longer applicable.

IV. Special Analysis

Executive Orders 13563 and 12866 direct agencies to assess costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory

¹³ See § 405.2 paragraphs (a)(11) through (a)(14).

approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility. This rule has been designated a “significant regulatory action,” although not economically significant, under section 3(f) of Executive Order 12866. Accordingly, the rule has been reviewed by the Office of Management and Budget.

This proposed amendment would potentially affect three registered government securities brokers or dealers, none of which currently or routinely hold commercial paper. Accordingly, at this time, Treasury is not submitting a Paperwork Reduction Act submission related to the proposed rule’s information collection requirements. Additionally, because the proposed amendment would not have a significant economic impact on a substantial number of small entities, a regulatory flexibility analysis is not required under the Regulatory Flexibility Act (5 U.S.C. 601, et seq.).

List of Subjects in 17 CFR Part 400

Administrative practice and procedure, Banks, banking, Brokers, Government securities, Reporting and recordkeeping requirements.

For the reasons set out in the preamble, we propose that 17 CFR § 400.2 be revised as follows:

PART 400—RULES OF GENERAL APPLICATION

1. The authority citation for part 400 continues to read as follows:

15 U.S.C. 78o-5.

2. Section 400.2 is amended by revising the last sentence of paragraph (c)(7)(i) to read as follows:

§ 400.2 Office responsible for regulations; filing of requests for exemption, for interpretations and of other materials.

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(c) * * *

(7) * * *

(i) * * * These documents will be made available at the following location: Treasury Department Library, Main Treasury Building, 1500 Pennsylvania Avenue N.W., Washington, DC 20220.

List of Subjects in 17 CFR Part 401

Banks, banking, Brokers, Government securities.

For the reasons set out in the preamble, we propose that 17 CFR §§ 401.7 and 401.8 be deleted.

PART 401—EXEMPTIONS

1. The authority citation for part 401 continues to read as follows:

Authority: Sec. 101, Pub. L. 99-571, 100 Stat. 3209 (15 U.S.C. 78o-5(a)(4)).

2. Sections 401.7 and 401.8 are deleted and section 401.9 is redesignated as section 401.7.

List of Subjects in 17 CFR Part 402

Brokers, Government securities.

For the reasons set out in the preamble, we propose that 17 CFR § 402.2e be deleted and that §§ 402.1, 402.2 and 402.2a be amended as follows:

PART 402—FINANCIAL RESPONSIBILITY

1. The authority citation for part 402 continues to read as follows:

Authority: 15 U.S.C. 78o-5(b)(1)(A), (b)(4), Pub. L. 111-203, 124 Stat. 1376.

2. Section 402.1 is amended by revising paragraph (f) to read as follows:

§ 402.1 Application of part to registered brokers and dealers and financial institutions; special rules for futures commission merchants and government securities interdealer brokers; effective date.

* * * * *

(f) This part shall be effective July 25, 1987.

3. Section 402.2 is amended by revising paragraphs (b)(1), (b)(2), (c)(1), (c)(2), and (e)(1)(v) to read as follows:

§ 402.2 Capital requirements for registered government securities brokers and dealers.

* * * * *

(b)(1) Minimum liquid capital for brokers or dealers that carry customer accounts.

Notwithstanding the provisions of paragraph (a) of this section, a government securities broker or dealer that carries customer or broker or dealer accounts and receives or holds funds or securities for those persons within the meaning of §240.15c3-1(a)(2)(i) of this title, shall have and maintain liquid capital in an amount not less than \$250,000, after deducting total haircuts as defined in paragraph (g) of this section.

(2) Minimum liquid capital for brokers or dealers that carry customer accounts, but do not generally hold customer funds or securities. Notwithstanding the provisions of paragraphs (a) and (b)(1) of this section, a government securities broker or dealer that carries customer or broker or dealer accounts and is exempt from the provisions of §240.15c3-3 of this title, as made applicable to government securities brokers and dealers by §403.4 of this chapter,

pursuant to paragraph (k)(2)(i), shall have and maintain liquid capital in an amount not less than \$100,000, after deducting total haircuts as defined in paragraph (g) of this section.

(c)(1) Minimum liquid capital for introducing brokers that receive securities.

Notwithstanding the provisions of paragraphs (a) and (b) of this section, a government securities broker or dealer that introduces on a fully disclosed basis transactions and accounts of customers to another registered or noticed government securities broker or dealer but does not receive, directly or indirectly, funds from or for, or owe funds to, customers, and does not carry the accounts of, or for, customers shall have and maintain liquid capital in an amount not less than \$50,000, after deducting total haircuts as defined in paragraph (g) of this section.

* * *

(2) Minimum liquid capital for introducing brokers that do not receive or handle customer funds or securities. Notwithstanding the provisions of paragraphs (a), (b) and (c)(1) of this section, a government securities broker or dealer that does not receive, directly or indirectly, or hold funds or securities for, or owe funds or securities to, customers, and does not carry accounts of, or for, customers and that effects ten or fewer transactions in securities in any one calendar year for its own investment account shall have and maintain liquid capital in an amount not less than \$25,000, after deducting total haircuts as defined in paragraph (g) of this section.

* * * * *

(e) * * *

(1) * * *

(v) Commercial paper of no more than one year to maturity and which has only a minimal amount of credit risk as reasonably determined by the government securities broker

or dealer pursuant to written policies and procedures the government securities broker or dealer establishes, maintains, and enforces to assess creditworthiness;

* * * * *

4. Section 402.2a is amended by revising the Instructions to Schedule A, Line 3, paragraph c., and Instructions to Schedule B, Columns 3 and 4, paragraph (5) to read as follows:

§ 402.2a Appendix A—Calculation of market risk haircut for purposes of §402.2(g)(2).

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INSTRUCTIONS TO SCHEDULES A THROUGH E

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Schedule A—Liquid Capital Requirement Summary Computation

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c. Enter the credit volatility haircut which equals a factor of 0.15 percent applied to the larger of the gross long or gross short position in money market instruments qualifying as Treasury market risk instruments which mature in 45 days or more, in futures and forwards on these instruments that are settled on a cash or delivery basis, and in futures and forwards on time deposits described in §402.2(e)(1)(vii), that mature in 45 days or more, settled on a cash or delivery basis. Money market instruments qualifying as Treasury market risk instruments are (1) marketable certificates of deposit with no more than one year to maturity, (2) bankers acceptances, and (3) commercial paper of no more than one year to maturity and which has only a minimal amount of credit risk as reasonably determined by the government securities broker or dealer pursuant to written policies and procedures the government securities broker

or government securities dealer establishes, maintains, and enforces to assess creditworthiness.

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Schedule B—Calculation of Net Immediate Position in Securities and Financings

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(5) Commercial paper of no more than one year to maturity and which has only a minimal amount of credit risk as reasonably determined by the government securities broker or dealer pursuant to written policies and procedures the government securities broker or dealer establishes, maintains, and enforces to assess creditworthiness; and

* * * * *

5. Section 402.5a is deleted.

List of Subjects in 17 CFR Part 403

Banks, banking, Brokers, Government securities.

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

PART 403—PROTECTION OF CUSTOMER SECURITIES AND BALANCES

1. The authority citation for part 403 continues to read as follows:

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

2. Section 403.7 is amended by deleting paragraphs (d) and (e).

List of Subjects in 17 CFR Part 405

Brokers, Government securities, Reporting and recordkeeping requirements.

For the reasons set forth in the preamble, we propose that 17 CFR §§ 405.2 and 405.5 be amended as follows:

PART 405—REPORTS AND AUDIT

1. The authority citation for part 405 continues to read as follows:

Authority: 15 U.S.C. 78o-5 (b)(1)(B), (b)(1)(C), (b)(2), (b)(4).

2. Section 405.2 is amended by deleting paragraphs (a)(11) through (a)(14) and redesignating paragraphs (a)(15) and (a)(16) as paragraphs (a)(11) and (a)(12), respectively.

3. Section 405.5 is amended by deleting paragraph (a)(7).

List of Subjects in 17 CFR Part 420

Foreign investments in U.S., Government securities, Investments, Reporting and recordkeeping requirements.

For the reasons stated in the preamble, we propose that 17 CFR part 420 be amended as follows:

PART 420—LARGE POSITION REPORTING

1. The authority citation for part 420 continues to read as follows:

Authority: 15 U.S.C. 78o-5(f).

2. Section 420.4 is amended by deleting paragraphs (a)(2) and (a)(3), and redesignating paragraph (a)(1) as paragraph (a) to read as follows:

§ 420.4 Recordkeeping.

(a) An aggregating entity that controls a portion of its reporting entity's reportable position in a recently-issued Treasury security, when such reportable position of the

reporting entity equals or exceeds the minimum large position threshold, shall be responsible for making and maintaining the records prescribed in this section.

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Mary J. Miller,

Assistant Secretary for Financial Markets.

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