a signed statement of the transferor describing the circumstances giving rise to the transfer.

(e) **Reorganizations.** A creditor may, without regard to the other provisions of this part, effect for a customer the exchange of any margin or exempted security in a general account, special bond account, or special convertible security account, for the purpose of participating in a reorganization or recapitalization in which the security is involved: *Provided,* That if a non-margin non-exempted security is acquired in exchange the creditor shall not, for a period of 60 days following such acquisition, permit the withdrawal of such security or the proceeds of its sale from such account except to the extent that such security or proceeds could be withdrawn if the security were a margin security.

(f) **Time of receipt of funds or securities.** For the purposes of this part, a creditor may, at his option (1) treat the receipt in good faith of any check or draft drawn on a bank which in the ordinary course of business is payable on presentation, or any order on a savings bank with passbook attached which is so payable, as receipt of payment of the amount of such check, draft, or order; (2) treat the shipment of securities in good faith with sight draft attached as receipt of payment of the amount of such sight draft; and (3) in the case of the receipt in good faith of written or telegraphic notice in connection with a special omnibus account of a customer not located in the same city that a specified security or a check or draft has been dispatched to the creditor, treat the receipt of such notice as receipt of such security, check, or draft: *Provided, however,* That if the creditor receives notice that such check, draft, order, or sight draft described in subparagraphs (1), (2), or (3) of this paragraph is not paid on the day of presentation, or if such security, check, or draft described in subparagraph (3) of this paragraph is not received by the creditor within a reasonable time, the creditor shall promptly take such action as he would have been required to take by the appropriate provisions of this part if the provisions of this paragraph had not been utilized.

(g) **Interest, service charges, etc.** (1) Interest on credit maintained in a general account, special bond account, or special convertible security account, communication charges with respect to transactions in such account, shipping charges, premiums on securities borrowed in connection with short sales or to effect delivery, dividends or other distributions due on borrowed securities, and any service charges (other than commissions) which the creditor may impose, may be debited to such account in accordance with the usual practice and without regard to the other provisions of this part, but such items so debited shall be taken into consideration in calculating the net credit or net debit balance of such account.

(2) A creditor may permit interest, dividends, or other distributions received by the creditor with respect to securities in a general account, special bond account, or special convertible security account, to be withdrawn from such account only on condition that the adjusted debit balance of such account does not exceed the maximum loan value of the securities in such account after such withdrawal, or on condition that (i) such withdrawal is made within 35 days after the day on which, in accordance with the creditor's usual practice, such interest, dividends, or other distributions are entered in such account, (ii) such entry in the account has not served in the meantime to permit in the account any transaction which could not otherwise have been effected in accordance with this part, and (iii) any cash withdrawn does not represent any arrearage on the security with respect to which it was distributed, and the current market value of any securities withdrawn does not exceed 10 per cent of the current market value of the security with respect to which they were distributed. Failure by a creditor to obtain in a general account, special bond account, or special convertible security account, any cash or securities that are distributed with respect to any security in such account shall, except to the extent that withdrawal would be permitted under the preceding sentence, be deemed to be a transaction in such account which occurs on the day on which the distribution is payable and which requires the creditor to obtain in accordance with § 220.3(b) a deposit of cash or securities having a maximum loan value at least as great as that of the distribution.

(h) **Borrowing and lending securities.** Without regard to the other provisions of this part, a creditor (1) may make a *bona fide* deposit of cash in order to borrow securities (whether margin or non-margin) for the purpose of making delivery of such securities in the case of short sales, failure to receive securities he is required to deliver, or other similar cases, and (2) may lend securities for such purpose against such a deposit.

(i) **Credit for clearance of securities.** The extension or maintenance of any credit which is maintained for only a fraction of a day (that is, for only part of the time between the beginning of business and midnight on the same day) shall be disregarded for the purposes of this part, if it is incidental to the clearance of transactions in securities directly between members of a national securities exchange or through an agency organized or employed by such members for the purpose of effecting such clearance.

(j) **Foreign currency.** If foreign currency is capable of being converted without restriction into United States currency, a creditor acting in good faith may treat any such foreign currency in an account as a credit to the account in an amount determined in accordance with customary practice.

(k) **Innocent mistakes.** If any failure to comply with this part results from a mechanical mistake made in good faith in executing a transaction, recording, determining, or calculating any loan, balance, market price or loan value, or other similar mechanical mistake, the creditor shall not be deemed guilty of a violation of this part if promptly after the discovery of such mistake he takes whatever action may be practicable in the circumstances to remedy such mistake.

SECTION 220.7—MISCELLANEOUS PROVISIONS

(a) **Arranging for loans by others.** A creditor may arrange for the extension or maintenance of credit to or for any customer of such creditor by any person upon the same terms and conditions as those upon which the creditor, under the provisions of this part, may himself extend or maintain such credit to such customer, but only upon such terms and conditions, except that this limitation shall not apply with respect to the arranging by a creditor for a bank subject to Part 221 of this Chapter (Regulation U) to extend or maintain credit on margin securities or exempted securities.

(b) **Maintenance of credit.** Except as otherwise specifically forbidden by this part, any credit initially extended without violation of this part may be maintained regardless of (1) reductions in the customer's equity resulting from changes in market prices, (2) the fact that any security in an account ceases to be margin or exempted, and (3) any change in the maximum loan values or margin requirements prescribed by the Board under this part. In maintaining any such credit, the creditor may accept or retain for his own protection additional collateral of any description, including non-margin securities.

(c) **Statement of purpose of loan.** Every extension of credit on a margin security (other than an exempted security) shall be deemed to be for the purpose of purchasing or carrying or trading in securities, unless the creditor has accepted in good faith a written statement to the contrary in conformity with the requirements of Form F.R. T-4 executed by the customer and executed and accepted in good faith by the creditor prior to such extension. The creditor shall retain such statement in his records for at least 3 years after such credit is extinguished. To accept the customer's statement in good faith, the creditor must (1) be alert to the circumstances surrounding the extension of credit and (2) if he has any information which would cause a prudent man not to accept the statement without inquiry, have investigated and be satisfied that the customer's statement is truthful. A creditor may rely upon such a written statement if accepted in accordance with this paragraph.

(d) **Reports.** Every creditor shall make such reports as the Board may require to enable the Board to perform the functions conferred upon it by the Act.

(e) **Additional requirements by exchanges and creditors.** Nothing in this part shall (1) prevent any exchange or national securities association from adopting and enforcing any rule or regulation further restricting the time or manner in which its members must obtain initial or additional margin in customer's accounts because of transactions effected in such accounts, or requiring such members to secure or maintain higher margins, or further restricting the amount of credit which may be extended or maintained by them, or (2) modify or restrict the right of any creditor to require additional security for the maintenance of any credit, to refuse to extend credit, or to sell any securities or property held as collateral for any loan or credit extended by him.

(f) Credit by insurance companies that issue variable annuity contracts. (1) Except as provided in subparagraph (2) of this paragraph, Part 207 of this chapter (Regulation G) rather than this Part shall apply to any credit extended, maintained, or arranged for by a life insurance company which (i) meets the definition of "insurance company" set forth in section 2(a)(17) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(17))

and (ii) is engaged in issuing or participating in the issuance of any variable annuity contract, or of any interest in a separate account established by such insurance company, registered under the Securities Act of 1933 (15 U.S.C. 77) or exempt from such registration by Rule 156 of the Securities and Exchange Commission (17 CFR 230.156).

(2) The provisions of this Part shall apply to any credit extended to or maintained or arranged for a customer by a life insurance company described in subparagraph (1) of this paragraph that has registered, or is required to register, as a broker or dealer pursuant to section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o) in connection with its activities as such a broker or dealer, including:

(i) the offer or sale of any security or securities registered under the Securities Act of 1933 (15 U.S.C. 77) or exempt from such registration by Rule 156 of the Securities and Exchange Commission (17 CFR 230.156) issued by (*a*) such insurance company, or (*b*) an investment company registered pursuant to section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8) for which the insurance company is an underwriter, investment advisor or dealer; and

(ii) those activities which are not part of the conventional lending activities of such life insurance companies and which, in accordance with the ordinary usage of the trade, would be considered part of the business of a broker or dealer.

[SECTION 220.8—SUPPLEMENT, containing maximum loan values, margin for short sales, retention requirement, and requirements for inclusion on list of OTC margin stock, is printed separately.]

F. R. Form T-4
6-69

SPECIMEN ONLY

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENT OF PURPOSE OF AN EXTENSION OF CREDIT BY A CREDITOR
(FEDERAL RESERVE FORM T–4)

A FALSE OR DISHONEST STATEMENT BY THE CUSTOMER OR THE CREDITOR ON THIS FORM MAY BE PUNISHABLE BY FINE OR IMPRISONMENT (U.S. CODE, TITLE 15, SECTION 78ff AND TITLE 18, SECTION 1001)

Instructions:

(1) Please print or type (if space is inadequate attach separate sheet).

(2) In Part II "source of valuation" need be filled in only if such source is other than regularly published information in journal of general circulation.

(3) This form need be obtained only if the purpose of the credit is other than to purchase, carry, or trade in securities (see § 220.7(c) of Regulation T).

PART I (to be completed by customer(s))

(1) The purpose of this credit in the amount of $....., which is unsecured or secured in whole or in part by the collateral listed in Part II, is not to purchase or carry or trade in securities. It is for the purpose of (describe in detail) .....

.....

.....

.....

(2) This creditor, ... (Name of creditor), has outstanding, or has agreed to extend, to the undersigned, the following other credits, which are not for the purpose of purchasing or carrying or trading in securities, in addition to the credit described on this form (itemize and describe briefly, including amounts and collateral if any). If none, so state .....

.....

(3) Is any of the collateral listed in Part II (A) or (B) to be delivered, or has any such collateral been delivered, from a bank, broker, dealer, or person other than the undersigned? Yes ☐ No ☐

If yes, from whom?..... Against payment? Yes ☐ No ☐

(4) Has any of the collateral listed in Part II (A) or (B) been owned less than six months? Yes ☐ No ☐ If yes, identify all such collateral so owned .....

.....

The undersigned has (have) read this form and hereby certifies and affirms that to the best of my (our) knowledge and belief the information contained on this form is true, accurate, and complete.

SIGNED ..... (Manual signature) (Date)

..... (Print or type name)

SIGNED ..... (Manual signature) (Date)

..... (Print or type name)

PART II (to be completed by creditor)

(A) Collateral consisting of margin stock or margin securities consisting of debt securities convertible into margin stock. The loan value of such stock under the current Supplement to Regulation T is ..... per cent; the loan value of such debt securities is ..... per cent.

No. of shares or other unit	Itemize separately by issue	Market price per share	Source of valuation	Total market price per issue

(B) Collateral consisting of other securities, e.g., mutual fund shares, registered non-equity securities.

Par value or other denomination	Itemize separately by issue	Market price	Source of valuation	Total market price per issue

(C) Other collateral.

Itemize	Current market value	Source of valuation	Good faith loan value

The undersigned, a duly authorized representative of the creditor has read this form, has accepted the customer's statement on Part I in good faith as defined below*, and hereby certifies and affirms that to the best of his knowledge and belief all the information contained on this form is true, accurate, and complete.

Date ..... SIGNED .....
(Manual signature)

.....
(Print or type name and title)

* *Regulation* T requires that the customer's statement on this form be accepted by the creditor acting in good faith. Good faith requires that the creditor or his duly authorized representative (1) must be alert to the circumstances surrounding the credit, and (2) if he has any information which would cause a prudent man not to accept the statement without inquiry, has investigated and is satisfied that the statement is truthful. Among the facts which would require such investigation are receipt of the statement through the mail or from a third party.

THIS FORM MUST BE RETAINED BY THE CREDITOR FOR AT LEAST THREE YEARS AFTER THE TERMINATION OF THIS CREDIT

REGULATION U

(12 CFR 221)

As amended effective July 10, 1971

CREDIT BY BANKS FOR THE PURPOSE OF PURCHASING OR CARRYING MARGIN STOCKS *

SECTION 221.1—GENERAL RULE

(a) **Purpose credit secured by stock.** (1) Except as provided in subparagraph (2) of this paragraph (a) and in § 221.3(q) no bank shall extend any credit secured directly or indirectly [1] by any stock [2] for the purpose of purchasing or carrying any margin stock [3] in an amount exceeding the maximum loan value of the collateral, as prescribed from time to time for stocks in § 221.4 (the Supplement to Regulation U) and as determined by the bank in good faith for credit subject to § 221.3(s) for any collateral other than stocks: *Provided,* That unless held as collateral for such credit on October 20, 1967, and continuously thereafter, any collateral other than stock shall have loan value for the purpose of this part only as collateral for a credit which is not secured by stock, as described in § 221.3(s), and any collateral consisting of convertible debt securities described in § 221.3(t) shall have loan value only for the purpose of that section, and not for other credit subject to this part.

(2) Credit extended prior to July 8, 1969, for the purpose of purchasing or carrying any OTC margin stock [4] or any debt security convertible into such stock (and no other margin stock) is not purpose credit, except that with respect to any OTC margin stock such date shall be August 7, 1969, if extended to a member of a national securities exchange or a broker or dealer registered under section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o).

(b) **Substitutions and withdrawals.** Except as permitted in paragraph (c) of this section, while a bank maintains any credit subject to this part, whenever extended, the bank shall not at any time permit any withdrawal or substitution of collateral unless either (1) the credit would not exceed the maximum loan value of the collateral after such withdrawal or substitution, or (2) the credit is reduced by at least the amount by which the maximum loan value of any collateral deposited is less than the "retention requirement" of any collateral withdrawn. The "retention requirement" of collateral other than stock is the same as its maximum loan value and the "retention requirement" of collateral consisting of stock is prescribed from time to time in § 221.4 (the Supplement to Regulation U).

* This text corresponds to the Code of Federal Regulations, Title 12, Chapter II, part 221, cited as 12 CFR 221. The words "this part," as used herein, mean Regulation U.

[1] As defined in § 221.3(c).

[2] As defined in § 221.3(*l*).

[3] Sometimes referred to as a "purpose credit". See § 221.3(b). The term "margin stock" is defined in § 221.3(v).

[4] As defined in § 221.3(d), "OTC stock" hereinafter refers to stock traded "over the counter."

(c) **Same-day transactions.** Except as provided in § 221.3(r)(1), a bank may permit a substitution of stock whether margin or non-margin, effected by a purchase and sale on orders executed within the same day: *Provided,* That (1) if the proceeds of the sale exceed the total cost of the purchase, the credit is reduced by at least an amount equal to the "retention requirement" with respect to the sale less the "retention requirement" with respect to the purchase, or (2) if the total cost of the purchase exceeds the proceeds of the sale, the credit may be increased by an amount no greater than the maximum loan value of the stock purchased less the maximum loan value of the stock sold. If the maximum loan value of the collateral securing the credit has become less than the amount of the credit, the amount of the credit may nonetheless be increased if there is provided additional collateral having maximum loan value at least equal to the amount of the increase.

(d) **Single credit rule.** For the purpose of this part, except for credit subject to § 221.3(s) or (t), the entire amount of the purpose credit extended to any customer by any bank at any time shall be considered a single credit; and all the collateral securing such credit shall be considered in determining whether or not the credit complies with this part.

SECTION 221.2—EXCEPTIONS TO GENERAL RULE

Notwithstanding the provisions of § 221.1, a bank may extend and may maintain any credit for the purpose specified in § 221.1, without regard to the limitations prescribed therein, or in § 221.3(t), if the credit comes within any of the following descriptions.

(a) Any credit extended to a bank or to a foreign banking institution;

(b) Any credit extended to a "plan-lender" as defined in § 207.4(a) of Part 207 of this Chapter (Regulation G) to finance a plan described therein: *Provided,* That in no event does the bank have recourse to any stock purchased pursuant to such plan;

(c) Any credit extended to a dealer, or to two or more dealers, to aid in the financing of the distribution of securities to customers not through the medium of a national securities exchange;

(d) Any credit extended to a broker or dealer that is extended in exceptional circumstances in good faith to meet his emergency needs;

(e) Any credit extended to a member of a national securities exchange or a broker or dealer registered under section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o) secured by any securities which, according to written notice received by the bank from the broker or dealer pursuant to a rule of the Securities and Exchange Commission concerning the hypothecation of customers' securities (Rule 8c-1 (17 CFR 240.8c-1) or Rule 15c2-1 (17 CFR 240.15c2-1)), are securities carried for the account of one or more customers;

(f) Any credit extended to finance the purchase or sale of securities for prompt delivery which is to be repaid in the ordinary course of business upon completion of the transaction: *Provided,* That the advance is not made to a person described in § 221.3(q): *And provided further,* That it is either (1) extended to a broker or dealer, or (2) extended for a purpose other than to enable the borrower to pay for stock purchased in an account subject to Part 220 of this Chapter (Regulation T);

(g) Any credit extended against securities in transit, or surrendered for transfer, which is payable in the ordinary course of business upon arrival of the securities or upon completion of the transfer: *Provided,* That the credit is not extended to a person described in § 221.3(q): *And provided further,* That it is either (1) extended to a broker or dealer, or (2) extended for a purpose other than to enable the customer to pay for stock purchased in an account subject to Part 220 of this Chapter (Regulation T);

(h) Any credit which is to be repaid on the calendar day on which it is extended: *Provided,* That the credit is not extended to a person described in § 221.3(q): *And provided further,* That it is either (1) extended to a broker or dealer, or (2) extended for a purpose other than to enable the customer to pay for stock purchased in an account subject to Part 220 of this Chapter (Regulation T);

(i) Any credit extended outside the States of the United States and the District of Columbia;

(j) Any credit extended to a member of a national securities exchange for the purpose of financing his or his customers' *bona fide* arbitrage transactions in securities. For the purposes of this paragraph, the term "arbitrage" means (1) a purchase or sale of a security in one market together with an offsetting sale or purchase of the same security in a different market at as nearly the same time as practicable, for the pur-

pose of taking advantage of a difference in prices in the two markets, or (2) a purchase of a security which is, without restriction other than the payment of money, exchangeable or convertible within 90 calendar days following the date of its purchase into a second security together with an offsetting sale at or about the same time of such second security, for the purpose of taking advantage of a disparity in the prices of the two securities, except that when the security purchased is solely a due bill for, or other evidence of the right to receive, only the security that is sold, and the security that is sold is trading as a when-issued security, such period shall be 180 calendar days;

(k) Any credit extended to a member of a national securities exchange for the purpose of financing such members' transactions as an odd-lot dealer in securities with respect to which he is registered on such national securities exchanges as an odd-lot dealer;

(*l*) Any loan for the purpose of making a loan or providing capital to a person who is subject to Part 220 of this Chapter (Regulation T), which loan has been exempted by the Board of Governors of the Federal Reserve System, by Order, from the requirements of this Part, either unconditionally or upon specified terms and conditions or for stated periods, upon a finding that the granting of such an exemption is necessary or appropriate, in the public interest or for the protection of investors; *Provided*, That the Securities Investor Protection Corporation shall have certified to the Board that such action is appropriate under the circumstances, and

(m) Any credit extended to or maintained for a customer for the purpose of making a loan or contribution of capital to a broker or dealer subject to Part 220 (Regulation T) if the loan or contribution is in conformity with the requirements regarding satisfactory subordination agreements or equities in the accounts of partners of a rule of the Securities and Exchange Commission (Rule 15c3-1(c)(2)(A), (c)(4), and (c)(7)) (17 CFR 240.15c3-1(c)(2)(A), (c)(4), and (c)(7)) or the capital rules of an exchange of which the broker or dealer is a member if the members thereof are exempt therefrom by Rule 15c3-1(b)(2) of the Commission (17 CFR 240.15c3-1(b)(2)) or to purchase stock in a broker or dealer which is a corporation when such stock is purchased directly from the issuer and not as part of a public distribution: *Provided*, That any such credit extended after April 16, 1971, shall become subject upon renewal to such additional restrictions as the Board of Governors may impose by regulation concerning the conditions upon which credit may be extended for the purpose of making such loan or contribution: *And provided further*, That (1) all of the proceeds of such extension of credit are so loaned or contributed to the capital of the broker or dealer and (2) that all of the proceeds of any withdrawal of such loan or contribution of capital from the broker or dealer by the customer or redemption of such stock shall be used to reduce or retire said extension of credit.

SECTION 221.3—MISCELLANEOUS PROVISIONS

(a) **Required statement as to stock-secured credit.** In connection with an extension of credit secured directly or indirectly by any stock, the bank shall obtain and retain in its records for at least 3 years after such credit is extinguished a statement in conformity with the requirements of Federal Reserve Form U-1 executed by the recipient of such extension of credit (sometimes referred to as the "customer") and executed and accepted in good faith by a duly authorized officer of the bank prior to such extension: *Provided*, That this requirement shall not apply to any credit described in paragraphs (o) or (w) of this section or § 221.2 of this part except for credit described in paragraphs 221.2(f), (g), and (h) extended to persons who are not brokers or dealers subject to Part 220 of this Chapter (Regulation T). In determining whether or not an extension of credit is for the purpose specified in § 221.1 or for any of the purposes specified in § 221.2 the bank may rely on the statement executed by the customer if accepted in good faith. To accept the customer's statement in good faith, the officer must (1) be alert to the circumstances surrounding the credit and (2) if he has any information which would cause a prudent man not to accept the statement without inquiry, have investigated and be satisfied that the customer's statement is truthful.

(b) **Purpose of a credit.** The "purpose of a credit" is determined by substance rather than form.

(1) Credit which is for the purpose, whether immediate, incidental, or ultimate, of purchasing or carrying a margin stock is "purpose credit", despite

any temporary application of funds otherwise.

(2) Credit to enable the customer to reduce or retire indebtedness which was originally incurred to purchase a margin stock is for the purpose of "carrying" such a security.

(3) An extension of credit provided for in a plan, program, or investment contract offered or sold or otherwise initiated after August 31, 1969, which provides for the acquisition both of any securities described in paragraph (v) of this section and of goods, services, property interests, other securities, or investments, is "purpose credit".

(c) **Indirectly secured.** The term "indirectly secured" includes any arrangement with the customer under which the customer's right or ability to sell, pledge, or otherwise dispose of stock owned by the customer is in any way restricted so long as the credit remains outstanding, or under which the exercise of such right, whether by written agreement or otherwise, is or may be cause for acceleration of the maturity of the credit: *Provided,* That the foregoing shall not apply (1) if such restriction arises solely by virtue of an arrangement with the customer which pertains generally to the customer's assets unless a substantial part of such assets consists of stock, or (2) if the bank in good faith has not relied upon such stock as collateral in the extension or maintenance of the particular credit: *And provided further,* That the foregoing shall not apply to stock held by the bank only in the capacity of custodian, depositary, or trustee, or under similar circumstances, if the bank in good faith has not relied upon such stock as collateral in the extension or maintenance of the particular credit.

(d) **OTC margin stock.** (1) The term "OTC margin stock" means stock not traded on a national securities exchange which the Board of Governors of the Federal Reserve System has determined to have the degree of national investor interest, the depth and breadth of market, the availability of information respecting the stock and its issuer, and the character and permanence of the issuer to warrant subjecting such stock to the requirements of this part.

(2) The Board will from time to time publish a list of OTC margin stocks as to which the Board has made the determination described in subparagraph (1) of this paragraph (d). Except as provided in subparagraph (4) of this paragraph (d) such stocks shall meet the requirements of § 221.4(d) (the Supplement to Regulation U).

(3) The Board will from time to time remove from the list described in subparagraph (2) of this paragraph (d) stocks that cease to:

(i) Exist or of which the issuer ceases to exist, or

(ii) Meet substantially the provisions of subparagraph (1) of this paragraph (d) and of § 221.4(d) (The Supplement to Regulation U).

(4) The foregoing notwithstanding, the Board may, upon its own initiative, or upon application by any interested party, omit or remove any stock that is not traded on a national securities exchange from or add any such stock to such list of OTC margin stocks, if in the judgment of the Board, such action is necessary or appropriate in the public interest.

(5) It shall be unlawful for any bank to make, or cause to be made, any representation to the effect that the inclusion of a security on such list of OTC margin stocks is evidence that the Board or the Securities and Exchange Commission has in any way passed upon the merits of, or given approval to, such security or any transaction therein. Any statement in an advertisement or other similar communication containing a reference to the Board in connection with such stocks or such list shall constitute such an unlawful representation.

(e) **Renewals and extensions of maturity.** The renewal or extension of maturity of a credit need not be treated as the extension of a credit if the amount of the credit is not increased except by the addition of interest or service charges in respect to the credit or of taxes on transactions in connection with the credit.

(f) **Transfers.** A bank may, without following the requirements of this part as to the extension of a credit,

(1) Permit the transfer of a credit from one customer to another, or to others: *Provided,* That a statement by the transferor, describing the circumstances giving rise to the transfer, is accepted in good faith [5] and signed by an officer of the bank as having been so accepted, and kept with each such transferee account, or

(2) Accept the transfer of a credit originally extended in conformity with the requirements of this part directly from another bank: *Provided,* That the statement of purpose, executed by the customer in connection with the original extension of credit and accepted in good faith and signed by an officer of the bank originally extending such credit in conformity with the requirements of § 221.3(a), is obtained and kept with each such transferee account: *And provided further,* That any transfer pursuant to this paragraph is made as a *bona fide*

[5] As described in § 221.3(a).

incident to a transaction not undertaken for the purpose of avoiding the requirements of this part, the amount of the credit is not increased, and the collateral for the credit is not changed; and, after such transfer, a bank may permit such withdrawals and substitutions of collateral as are permitted in respect to a credit it extends subject to this part.

(g) **Reorganizations and recapitalizations.** Nothing in this part shall be construed to prevent a bank from permitting withdrawals or substitutions of securities to enable a customer to participate in a reorganization or recapitalization.

(h) **Mistakes in good faith.** No mistake made in good faith in connection with the extension or maintenance of a credit shall be deemed to be a violation of this part.

(i) **Action for bank's own protection.** Nothing in this part shall be construed as preventing a bank from taking such action as it shall deem necessary in good faith for its own protection.

(j) **Reports.** Every bank, and every person engaged in the business of extending credit who, in the ordinary course of business, extends credit for the purpose of purchasing or carrying margin stock shall make such reports as the Board of Governors of the Federal Reserve System may require to enable it to perform the functions conferred upon it by the Securities Exchange Act of 1934 (15 U.S.C. 78).

(k) **Definitions.** For the purposes of this part, unless the context otherwise requires, the terms herein have the meanings assigned to them in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)), except that the term "bank" does not include a bank which is a member of a national securities exchange.

(l) **Stock.** The term "stock" includes any security commonly known as a stock; any voting trust certificate or other instrument representing such a security; and any security convertible, with or without consideration, presently or in the future, into such security, certificate, or other instrument, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right.

(m) **Credit subject to § 221.1.** A "credit subject to § 221.1" is a credit which is (1) secured directly or indirectly by any stock (or made to a person described in paragraph (q) of this section), (2) extended for the purpose of purchasing or carrying any margin stock, and (3) not excepted by § 221.1 (a)(2) or § 221.2.

(n) **Segregation of collateral.** (1) The bank shall identify all the collateral used to meet the requirements of § 221.1 (the entire credit being considered a single credit and collateral being similarly considered, as required by § 221.1(d)) and shall not cancel the identification of any portion thereof except in circumstances that would permit the withdrawal of that portion. Such identification may be made by any reasonable method.

(2) Only the collateral required to be so identified shall have loan value for purposes of § 221.1 or be subject to the restrictions therein specified with respect to withdrawals and substitutions; and

(3) For any credit extended to the same customer that is not subject to § 221.1 (other than a credit described in § 221.2(b), (d), (f), (g), or (h)), the bank shall in good faith require as much collateral not so identified as the bank would require (if any) if it held neither the indebtedness subject to § 221.1 nor the identified collateral. This shall not be construed, however, to require the bank, after it has extended any credit, to obtain any collateral therefor because of any deficiency in collateral already existing at the opening of business on June 15, 1959, or any decline in the value or quality of the collateral or in the credit rating of the customer.

(4) Nothing in this part shall require a bank to waive or forego any lien, and nothing in this part shall apply to a credit extended to enable the customer to meet emergency expenses not reasonably foreseeable, provided the extension of credit is supported by a statement executed by the customer and accepted in good faith and signed by an officer of the bank as having been so accepted in conformity with the requirements of § 221.3(a). For this purpose, such emergency expenses shall include expenses arising from circumstances such as the death or disability of the customer, or some other change in his circumstances involving extreme hardship, not reasonably foreseeable at the time the credit was extended. The opportunity to realize monetary gain is not a "change in his circumstances" for this purpose.

(o) **Specialist.** In the case of a credit extended to a member of a national securities exchange who is registered and acts as a specialist in securities on the exchange for the purpose of financing such member's transactions as a specialist in such securities, the maximum loan value of any stock shall be as determined by the bank in good faith: *Provided*, That the specialist's exchange, in addition to other requirements applicable to specialists, is designated by the Board of Governors of the Federal Reserve

System as requiring reports suitable for supplying current information regarding specialists' use of credit pursuant to this section.

(p) **Subscriptions issued to stockholders.** An extension of credit need not comply with the other requirements of this part if it is to enable the customer to acquire a stock by exercising a right to acquire such stock which is evidenced by a warrant or certificate issued to stockholders and expiring within 90 days of issuance: *Provided,* That:

(1) Each such acquisition under this paragraph shall be treated separately, and the credit when extended shall not exceed 75 per cent of the current market value of the stock so acquired as determined by any reasonable method;

(2) After October 20, 1967, at the time credit is extended pursuant to this paragraph, the bank shall compute the amount by which the credit exceeds the maximum loan value of the collateral as prescribed by § 221.4 and the customer shall reduce the credit by an amount at least equal to one-fourth of such sum by the end of each of the 4 succeeding 3-calendar-month periods or until the credit does not exceed the current maximum loan value of the stock, whichever shall occur first, and if the bank fails to obtain the required quarterly reduction or a portion thereof with respect to a particular acquisition within 5 full business days after such reduction is due, the bank shall promptly sell a portion of the collateral so acquired and apply the proceeds of the sale to reduce the credit in an amount at least equal to twice the required payment or portion thereof for the first 2 such reductions, at least equal to the required payment or portion thereof for the third such reduction, and at least sufficient so that the remaining credit does not exceed the current maximum loan value of the remaining collateral after the fourth such reduction: *Provided,* That no such reduction need be in an amount greater than is necessary so that the remaining credit does not exceed the maximum loan value of the remaining collateral determined as of the date when the credit was extended;

(3) While the customer has any credit outstanding at the bank under this paragraph no withdrawal of cash or substitution or withdrawal of stock used as collateral for such extension of credit shall be permissible, except that when the remaining credit has become equal to or less than the maximum loan value of the remaining stock as prescribed for § 221.1 or § 221.3(t) in § 221.4 (the Supplement to Regulation U) whichever is applicable (or with respect to credit extended after October 20, 1967, the requirements of the preceding clause have been fulfilled) the remaining stock and related credit shall thereafter be treated as subject to § 221.1 or § 221.3(t), whichever is applicable, instead of this paragraph. In order to facilitate the exercise of a right under this paragraph, a bank may permit the right to be withdrawn from a credit subject to § 221.1 without regard to any other requirement of this part.

(q) **Credit to certain lenders.** Any credit extended to a customer not subject to this part or to Part 220 of this Chapter (Regulation T) engaged principally, or as one of the customer's important activities, in the business of extending credit for the purpose of purchasing or carrying margin stocks is a credit for the purpose of purchasing or carrying such stocks unless the credit and its purposes are effectively and unmistakably separated and disassociated from any financing or refinancing, for the customer or others, of any purchasing or carrying of such stocks. Any credit extended to any such customer, unless the credit is so separated and disassociated or is excepted by § 221.2, is a credit "subject to § 221.1" regardless of whether or not the credit is secured by any stock; and no bank shall extend any such credit subject to § 221.1 to any such customer, without collateral or without the credit being secured as would be required by this part if it were secured by any stock. Any such credit subject to § 221.1 to any such customer shall be subject to the other provisions of this part applicable to credit subject to § 221.1, including provisions regarding withdrawal and substitution of collateral.

(r) **Convertible securities.** (1) If, after June 15, 1959, and prior to October 21, 1967, credit was extended for the purpose of purchasing or carrying a security convertible into a stock registered on a national securities exchange and the credit was secured by such a security, and after October 20, 1967, there is substituted any stock as direct or indirect collateral for such credit, the credit shall thereupon be treated as subject to § 221.1 or § 221.3(t), whichever is applicable. In any such case, the amount of the outstanding credit, or such amount plus any increase therein to enable the customer to acquire a stock so registered through the conversion of the security pursuant to its terms, shall not be permitted on the date of such substitution to exceed the maximum loan value of the collateral for the credit: *Provided,* That any reduction in the credit or deposit of collateral required on that date to meet this requirement may be brought about within 30 days of such substitution.

(2) Any credit extended after October 20, 1967, for the purpose of purchasing or carrying a security convertible into a stock registered on a national securities exchange, and any credit extended after July 8, 1969, for the purpose of purchasing or carrying a security convertible into margin stock, if the credit is secured, directly or indirectly, by any stock, is a credit subject to § 221.1 or § 221.3(t), whichever is applicable.

(s) **Credit secured by collateral other than stocks.** A bank may extend credit for the purpose of purchasing or carrying a margin stock secured by collateral other than stock, and, in the case of such credit, the maximum loan value of the collateral shall be as determined by the bank in good faith.

(t) **Credit on convertible debt securities.** (1) A bank may extend credit for the purpose specified in § 221.1 on collateral consisting of any debt security (i) convertible with or without consideration, presently or in the future, into a margin stock or (ii) carrying a warrant or right to subscribe to or purchase such a stock (such a debt security is sometimes referred to herein as a "convertible security").

(2) Credit extended under this paragraph shall be subject to the same conditions as if it were subject to § 221.1 except: (i) the entire amount of such credit shall be considered a single credit treated separately from the single credit specified in § 221.1 (d) and all the collateral securing such credit shall be considered in determining whether or not the credit complies with this part, and (ii) the maximum loan value of the collateral shall be as prescribed from time to time in § 221.4 (the Supplement to Regulation U).

(3) Any convertible security originally eligible as collateral for a credit extended under this paragraph shall be treated as such as long as continuously held as collateral for such credit even though it ceases to be convertible or to carry warrants or rights.

(4) In the event that any stock other than a convertible security is substituted for a convertible security held as collateral for a credit extended under this paragraph, the stock and any credit extended on it in compliance with this part shall thereupon be treated as subject to § 221.1 and the credit extended under this paragraph shall be reduced by an amount equal to the maximum loan value of the security withdrawn.

(u) **Arranging for credit.** No bank shall arrange for the extension or maintenance of any credit for the purpose of purchasing or carrying any margin stock, except upon the same terms and conditions on which the bank itself could extend or maintain such credit under the provisions of this part.

(v) The term **"margin stock"** means any stock [6] which is (1) a stock registered on a national securities exchange, (2) an OTC margin stock,[7] (3) a debt security (i) convertible with or without consideration, presently or in the future, into a margin stock or (ii) carrying any warrant or right to subscribe to or purchase, presently or in the future, a margin stock, (4) any such warrant or right, (5) any security issued by an investment company other than a small business investment company licensed under the Small Business Investment Company Act of 1958 (15 U.S.C. 661) registered pursuant to section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8), unless at least 95 per cent of the assets of such company are continuously invested in exempted securities.[8]

(w) **OTC market maker exemption.** (1) In the case of credit extended to an OTC market maker, as defined in subparagraph (2) of this paragraph (w), for the purpose of purchasing or carrying an OTC margin stock in order to conduct the market making activity of such a market maker, the maximum loan value of any OTC margin stock (except stock that has been identified as a security held for investment pursuant to a rule of the Commissioner of Internal Revenue (Regs. Section 1-1236-1(d)) shall be determined by the bank in good faith: *Provided,* That in respect of each such stock he shall have filed with the Securities and Exchange Commission a notice of his intent to begin or continue such market making activity (Securities and Exchange Commission Form X-17A-12(1)) and all other reports required to be filed by market makers in OTC margin stocks pursuant to a rule of the Commission (Rule 17a-12 (17 CFR 240.17a-12)) and shall not have ceased to engage in such market making activity: *And provided further,* That the bank shall obtain and retain in its records for at least 3 years after such credit is extinguished a statement in conformity with the requirements of Federal Reserve Form U-2, executed by the OTC market maker who is the recipient of such credit and executed and accepted in good faith by a duly authorized officer of the bank prior to such extension. In determining whether or not an extension of credit is for the purpose of conducting such market making activity, a bank may rely on such a statement if executed and accepted in accordance with

[6] As defined in § 221.3(*l*).
[7] As defined in § 221.3(d).
[8] As defined in 15 U.S.C. 78c(a)(12).

the requirements of this paragraph (w) and § 221.3(a).

(2) An OTC market maker with respect to an OTC margin stock is a dealer who has and maintains minimum net capital, as defined in a rule of the Securities and Exchange Commission (Rule 15c3-1 (17 CFR 240.15c3-1)) or in the capital rules of an exchange of which he is a member if the members thereof are exempt therefrom by Rule 15c3-1(b)(2) of the Commission (17 CFR 240.15c3-1(b)(2)), of $25,000 plus $5,000 for each such stock in excess of 5 in respect of which he has filed and not withdrawn the notice on Commission Form X-17A-12(1) (but in no case does this subparagraph (2) require net capital of more than $250,000), who is in compliance with such rule of the Commission or exchange and who, except when such activity is unlawful, meets all of the following conditions with respect to such stock: (i) he regularly publishes *bona fide,* competitive bid and offer quotations in a recognized inter-dealer quotation system, (ii) he furnishes *bona fide,* competitive bid and offer quotations to other brokers and dealers on request, (iii) he is ready, willing, and able to effect transactions in reasonable amounts, and at his quoted prices, with other brokers and dealers, (iv) he has a reasonable average rate of inventory turnover.

(3) If all or a portion of the credit extended pursuant to this paragraph (w) ceases to be for the purpose specified in subparagraph (1) or the dealer to whom the credit is extended ceases to be an OTC market maker as defined in subparagraph (2), the credit or such portion thereof shall thereupon be treated as "a credit subject to § 221.1."

(x) **Combined purchase of mutual funds and insurance.** (1) An extension of purpose credit provided for in a plan, program, or investment contract that is registered with the Securities and Exchange Commission under the Securities Act of 1933 (15 U.S.C. 77) and provides for the acquisition both of a security issued by an investment company described in paragraph (v)(5) of this section and an insurance policy or contract shall be subject to all the provisions of this Part, except that, where the credit is secured by the security and does not exceed the premium on such policy (plus any applicable interest), the maximum loan value of such security shall be 40 per cent of its current market value, as determined by any reasonable method.

(2) Sections 221.1 and 221.3(t) of this Part shall not apply to any credit extended to a person registered pursuant to § 207.1(a) of this Chapter (Regulation G) who extends credit pursuant to § 207.4(f)(1) of this Chapter, *Provided,* That:

(i) the credit extended pursuant to this subparagraph is secured by securities that are issued by an investment company described in paragraph (v)(5) of this section, and are carried for the account of one or more customers under a plan, program, or investment contract described in subparagraph (1) of this paragraph (and the bank receives written notice from the recipient of the credit to this effect); and

(ii) the provisions of such plan, program, or investment contract conform to the provisions of Rule 15c2-1 of the Securities and Exchange Commission concerning hypothecation of customers' securities (17 CFR 240.15c2-1).

[SECTION 221.4—SUPPLEMENT, containing maximum loan values, retention requirement, and requirements for inclusion on list of OTC margin stock, is printed separately.]

F. R. Form U-1
Rev. 6-69

SPECIMEN ONLY

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENT OF PURPOSE OF A STOCK-SECURED
EXTENSION OF CREDIT BY A BANK
(FEDERAL RESERVE FORM U-1)

A FALSE OR DISHONEST STATEMENT BY THE CUSTOMER OR THE OFFICER OF THE BANK ON THIS FORM MAY BE PUNISHABLE BY FINE OR IMPRISONMENT (U.S. CODE, TITLE 15, SECTION 78ff AND TITLE 18, SECTION 1001)

Instructions:

(1) Please print or type (if space is inadequate attach separate sheet).
(2) The term "stock" is defined in § 221.3(*l*) of Regulation U.
(3) Part I (3) and (4) need be filled in only if the purpose of the credit described in Part I (1) is other than to purchase or carry margin stock.
(4) In Part II "source of valuation" need be filled in only if such source is other than regularly published information in journal of general circulation.
(5) Part II need not be completed in the case of a credit of $5,000 or less which is not for the purpose of purchasing or carrying margin stock. However, in such cases, Part I must be completed as if Part II were completed.

PART I (to be completed by customer(s))

(1) The purpose of this credit in the amount of $....., secured in whole or in part by the stock listed in Part II (A) and (B) is (describe in detail) .....

.....

.....

.....

(2) This bank, ... (Name of bank), has outstanding, or has agreed to extend, to the undersigned, the following credits in addition to the credit described on this form (itemize and describe briefly, including amounts and collateral if any). If none, so state .....

.....

(3) Is any of the collateral listed in Part II (A) or (B) to be delivered, or has any such collateral been delivered, from a bank, broker, dealer, or person other than the undersigned? Yes ☐ No ☐

If yes, from whom?..... Against payment? Yes ☐ No ☐

(4) Has any of the collateral listed in Part II (A) or (B) been owned less than six months?

Yes ☐ No ☐ If yes, identify all such collateral so owned. .....

.....

The undersigned has (have) read this form and hereby certifies and affirms that to the best of my (our) knowledge and belief the information contained on this form is true, accurate, and complete.

SIGNED ..... (Manual signature) (Date)

..... (Print or type name)

SIGNED ..... (Manual signature) (Date)

..... (Print or type name)

PART II (to be completed by bank)

(A) Collateral consisting of stock, other than debt securities convertible into margin stock. The loan value of such stock under the current Supplement to Regulation U is ..... per cent.

No. of shares	Itemize separately by issue	Market price per share	Source of valuation	Total market price per issue

(B) Collateral consisting of debt securities convertible into margin stock. The loan value of such securities under the current Supplement to Regulation U is ..... per cent.

Par value	Itemize separately by issue	Market price	Source of valuation	Total market price per issue

(C) Other collateral.

Describe briefly (itemize where 10 per cent or more)	Current market value	Source of valuation	Good faith loan value

The undersigned, a duly authorized officer of the bank, is aware that this stock-secured credit may be subject to Regulation U, has read this form, has accepted the customer's statement on Part I in good faith as defined below*, and hereby certifies and affirms that to the best of his knowledge and belief all the information contained on this form is true, accurate, and complete.

Date ..... SIGNED .....

(Manual signature)

.....

(Print or type name and title)

* Regulation U requires that the customer's statement on this form be accepted by an officer of the bank acting in good faith. Good faith requires that such officer (1) must be alert to the circumstances surrounding the credit, and (2) if he has any information which would cause a prudent man not to accept the statement without inquiry, has investigated and is satisfied that the statement is truthful. Among the facts which would require such investigation are receipt of the statement through the mail or from a third party.

THIS FORM MUST BE RETAINED BY THE BANK FOR AT LEAST THREE YEARS AFTER THE TERMINATION OF THIS CREDIT

STATUTORY APPENDIX

SECURITIES EXCHANGE ACT OF 1934

Act of June 6, 1934 (48 Stat. 881)
(U.S. Code, Title 15, Sec. 78)

Definitions

SEC. 3. (a) When used in this title, unless the context otherwise requires—

(1) The term **"exchange"** means any organization, association, or group of persons, whether incorporated or unincorporated, which constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood, and includes the market place and the market facilities maintained by such exchange.

* * *

(3) The term **"member"** when used with respect to an exchange means any person who is permitted either to effect transactions on the exchange without the services of another person acting as broker, or to make use of the facilities of an exchange for transactions thereon without payment of a commission or fee or with the payment of a commission or fee which is less than that charged the general public, and includes any firm transacting a business as broker or dealer of which a member is a partner, and any partner of any such firm.

(4) The term **"broker"** means any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank.

(5) The term **"dealer"** means any person 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 a part of a regular business.

(6) The term **"bank"** means (A) a banking institution organized under the laws of the United States, (B) a member bank of the Federal Reserve System, (C) 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 under section 11 (k) of the Federal Reserve Act, as amended, and which is supervised and examined by State or Federal authority having supervision over banks, and which is not operated for the purpose of evading the provisions of this title, and (D) a receiver, conservator, or other liquidating agent of any institution or firm included in clauses (A), (B), or (C) of this paragraph.

* * *

(8) The term **"issuer"** means any person who issues or proposes to issue any security; except that with respect to certificates of deposit for securities, voting-trust certificates, or collateral-trust certificates, or with respect to certificates of interest or shares in an unincorporated investment trust not having a board of directors or of the fixed, restricted management, or unit type, the term **"issuer"** means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued; and except that with respect to equipment-trust certificates or like securities, the term **"issuer"** means the person by whom the equipment or property is, or is to be, used.

(9) The term **"person"** means an individual, a corporation, a partnership, an association, a joint-stock company, a business trust, or an unincorporated organization.

(10) The term **"security"** means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall

not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

(11) The term **"equity security"** means any stock or similar security; or any security convertible, with or without consideration, into such a security; or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any other security which the Commission* shall deem to be of similar nature and consider necessary or appropriate, by such rules and regulations as it may prescribe in the public interest or for the protection of investors, to treat as an equity security.

(12) The term **"exempted security"** or **"exempted securities"** includes securities which are direct obligations of or obligations guaranteed as to principal or interest by the United States; such securities issued or guaranteed by corporations in which the United States has a direct or indirect interest as shall be designated for exemption by the Secretary of the Treasury as necessary or appropriate in the public interest or for the protection of investors; securities which are direct obligations of or obligations guaranteed as to principal or interest by a State or any political subdivision thereof, or by 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 in section 103(c)(2) of Title 26) the interest on which is excludable from gross income under section 103(a)(1) of Title 26 if, by reason of the application of paragraph (4) or (6) of section 103(c) of Title 26 (determined as if paragraphs (4)(A), (5), and (7) were not included in such section 103(c)), paragraph (1) of such section 103(c) does not apply to such security; any interest or participation in any common trust fund or similar fund maintained by a bank exclusively for the collective investment and reinvestment and reinvestment of assets contributed thereto by such bank in its capacity as trustee, executor, administrator, or guardian; any interest or participation in a collective trust fund maintained by a bank or in a separate account maintained by an insurance company which interest or participation is issued in connection with (A) a stock-bonus, pension, or profit-sharing plan which meets the requirements for qualification under section 401 of Title 26, or (B) an annuity plan which meets the requirements for the deduction of the employer's contribution under section 404(a)(2) of Title 26, other than any plan described in clause (A) or (B) of this paragraph which covers employees some or all of whom are employees within the meaning of section 401(c)(1) of Title 26; and such other securities (which may include, among others, unregistered securities the market in which is predominantly intrastate) as the Commission may, by such rules and regulations as it deems necessary or appropriate in the public interest or for the protection of investors, either unconditionally or upon specified terms and conditions or for stated periods, exempt from the operation of any one or more provisions of this chapter which by their terms do not apply to an "exempted security" or to "exempted securities."

(13) The terms **"buy"** and **"purchase"** each include any contract to buy, purchase, or otherwise acquire.

(14) The term **"sale"** and **"sell"** each include any contract to sell or otherwise dispose of.

* * *

(16) The term **"State"** means any State of the United States, the District of Columbia, Puerto Rico, the Canal Zone, the Virgin Islands, or any other possession of the United States.

* * *

SEC. 3. (b) The Commission and the Board of Governors of the Federal Reserve System, as to matters within their respective jurisdictions, shall have power by rules and regulations to define technical, trade, and accounting terms used in this title insofar as such definitions are not inconsistent with the provisions of this title.

* * *

[U.S.C., title 15, sec. 78c.]

Registration of national securities exchanges

SEC. 6. (a) Any exchange may be registered with the Commission as a national securities exchange under the terms and conditions hereinafter provided in this section, by filing a registration statement in such form as the Commission may prescribe, containing the agreements, setting forth the information, and accompanied by the documents, below specified:

(1) An agreement (which shall not be construed as a waiver of any constitutional right or any right to contest the validity of any rule or

* As used here and elsewhere in the 1933 Act, "Commission" means the Securities and Exchange Commission.

regulation) to comply, and to enforce so far as is within its powers compliance by its members, with the provisions of this title, and any amendment thereto and any rule or regulation made or to be made thereunder; * * *

(b) No registration shall be granted or remain in force unless the rules of the exchange include provision for the expulsion, suspension, or disciplining of a member for conduct or proceeding inconsistent with just and equitable principles of trade, and declare that the willful violation of any provisions of this title or any rule or regulation thereunder shall be considered conduct or proceeding inconsistent with just and equitable principles of trade.

(c) Nothing in this title shall be construed to prevent any exchange from adopting and enforcing any rule not inconsistent with this title and the rules and regulations thereunder and the applicable laws of the State in which it is located.

* * *

[U.S.C., title 15, sec. 78f.]

Margin requirements

SEC. 7. (a) For the purpose of preventing the excessive use of credit for the purchase or carrying of securities, the Board of Governors of the Federal Reserve System shall, prior to the effective date of this section and from time to time thereafter, prescribe rules and regulations with respect to the amount of credit that may be initially extended and subsequently maintained on any security (other than an exempted security). For the initial extension of credit, such rules and regulations shall be based upon the following standard: An amount not greater than whichever is the higher of—

(1) 55 per centum of the current market price of the security, or

(2) 100 per centum of the lowest market price of the security during the preceding thirty-six calendar months, but not more than 75 per centum of the current market price.

Such rules and regulations may make appropriate provision with respect to the carrying of undermargined accounts for limited periods and under specified conditions; the withdrawal of funds or securities; the substitution or additional purchases of securities; the transfer of accounts from one lender to another; special or different margin requirements for delayed deliveries, short sales, arbitrage transactions, and securities to which paragraph (2) of this subsection does not apply; the bases and the methods to be used in calculating loans, and margins and market prices; and similar administrative adjustments and details. For the purposes of paragraph (2) of this subsection, until July 1, 1936, the lowest price at which a security has sold on or after July 1, 1933, shall be considered as the lowest price at which such security has sold during the preceding thirty-six calendar months.

(b) Notwithstanding the provisions of subsection (a) of this section, the Board of Governors of the Federal Reserve System, may, from time to time, with respect to all or specified securities or transactions, or classes of securities, or classes of transactions, by such rules and regulations (1) prescribe such lower margin requirements for the initial extension or maintenance of credit as it deems necessary or appropriate for the accommodation of commerce and industry, having due regard to the general credit situation of the country, and (2) prescribe such higher margin requirements for the initial extension or maintenance of credit as it may deem necessary or appropriate to prevent the excessive use of credit to finance transactions in securities.

(c) It shall be unlawful for any member of a national securities exchange or any broker or dealer, directly or indirectly, to extend or maintain credit or arrange for the extension or maintenance of credit to or for any customer—

(1) On any security (other than an exempted security), in contravention of the rules and regulations which the Board of Governors of the Federal Reserve System shall prescribe under subsections (a) and (b) of this section;

(2) Without collateral or on any collateral other than securities, except in accordance with such rules and regulations as the Board of Governors of the Federal Reserve System may prescribe (A) to permit under specified conditions and for a limited period any such member, broker, or dealer to maintain a credit initially extended in conformity with the rules and regulations of the Board of Governors of the Federal Reserve System, and (B) to permit the extension or maintenance of credit in cases where the extension or maintenance of credit is not for the purpose of purchasing or carrying securities or of evading or circumventing the provisions of paragraph (1) of this subsection.

(d) It shall be unlawful for any person not subject to subsection (c) to extend or maintain credit or to arrange for the extension or maintenance of credit for the purpose of purchasing or carrying any security, in contravention of such rules and regulations as the Board of Governors of the Federal Reserve System shall prescribe to prevent the excessive use of credit for the purchasing or carrying of or trading in securities in circumvention of the other provisions of this section. Such rules and regulations may impose upon all loans made for the purpose of purchasing or carrying securities limitations similar to those imposed upon members, brokers, or dealers by subsection (c) of this section and the rules and regulations thereunder. This subsection and the rules and regulations thereunder shall not apply (A) to a loan made by a person not in the ordinary course of his business, (B) to a loan on an exempted security, (C) to a loan to a dealer to aid in the financing of the distribution of securities to customers not through the medium of a national securities exchange, (D) to a loan by a bank on a security other than an equity security, or (E) to such other loans as the Board of Governors of the Federal Reserve System shall, by such rules and regulations as it may deem necessary or appropriate in the public interest or for the protection of investors, exempt, either unconditionally or upon specified terms and conditions or for stated periods, from the operation of this subsection and the rules and regulations thereunder.

* * *

(f)(1) It is unlawful for any United States person, or any foreign person controlled by a United States person or acting on behalf of or in conjunction with such person, to obtain, receive, or enjoy the beneficial use of a loan or other extension of credit from any lender (without regard to whether the lender's office or place of business is in a State or the transaction occurred in whole or in part within a State) for the purpose of (A) purchasing or carrying United States securities, or (B) purchasing or carrying within the United States of any other securities, if, under this section or rules and regulations prescribed thereunder, the loan or other credit transaction is prohibited or would be prohibited if it had been made or the transaction had otherwise occurred in a lender's office or other place of business in a State.

(2) For the purposes of this subsection—

(A) The term "United States person" includes a person which is organized or exists under the laws of any State or, in the case of a natural person, a citizen or resident of the United States; a domestic estate; or a trust in which one or more of the foregoing persons has a cumulative direct or indirect beneficial interest in excess of 50 per centum of the value of the trust.

(B) The term "United States security" means a security (other than an exempted security) issued by a person incorporated under the laws of any State, or whose principal place of business is within a State.

(C) The term "foreign person controlled by a United States person" includes any noncorporate entity in which United States persons directly or indirectly have more than a 50 per centum beneficial interest, and any corporation in which one or more United States persons, directly or indirectly, own stock possessing more than 50 per centum of the total combined voting power of all classes of stock entitled to vote, or more than 50 per centum of the total value of shares of all classes of stock.

(3) The Board of Governors of the Federal Reserve System may, in its discretion and with due regard for the purposes of this section, by rule or regulation exempt any class of United States persons or foreign persons controlled by a United States person from the application of this subsection.

[U.S.C., title 15, sec. 78g.]

Restrictions on borrowing by members, brokers, and dealers

SEC. 8. It shall be unlawful for any member of a national securities exchange, or any broker or dealer who transacts a business in securities through the medium of any such member, directly or indirectly—

(a) To borrow in the ordinary course of business as a broker or dealer on any security (other than an exempted security) registered on a national securities exchange except (1) from or through a member bank of the Federal Reserve System, (2) from any nonmember bank which shall have filed with the Board of Governors of the Federal Reserve System an agreement, which is still in force and which is in the form prescribed by the Board, undertaking to comply with all provisions of this Act, the Federal Reserve Act, as amended, and the Banking Act of 1933, which

are applicable to member banks and which relate to the use of credit to finance transactions in securities, and with such rules and regulations as may be prescribed pursuant to such provisions of law or for the purpose of preventing evasions thereof, or (3) in accordance with such rules and regulations as the Board of Governors of the Federal Reserve System may prescribe to permit loans between such members and/or brokers and/or dealers, or to permit loans to meet emergency needs. Any such agreement filed with the Board of Governors of the Federal Reserve System shall be subject to termination at any time by order of the Board, after appropriate notice and opportunity for hearing, because of any failure by such bank to comply with the provisions thereof or with such provisions of law or rules or regulations; and, for any willful violation of such agreement, such bank shall be subject to the penalties provided for violations of rules and regulations prescribed under this title. The provisions of sections 21 and 25 of this title shall apply in the case of any such proceeding or order of the Board of Governors of the Federal Reserve System in the same manner as such provisions apply in the case of proceedings and orders of the Commission.

(b) To permit in the ordinary course of business as a broker his aggregate indebtedness to all other persons, including customers' credit balances (but excluding indebtedness secured by exempted securities), to exceed such percentage of the net capital (exclusive of fixed assets and value of exchange membership) employed in the business, but not exceeding in any case 2,000 per centum, as the Commission may by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors.

(c) In contravention of such rules and regulations as the Commission shall prescribe for the protection of investors to hypothecate or arrange for the hypothecation of any securities carried for the account of any customer under circumstances (1) that will permit the commingling of his securities without his written consent with the securities of any other customer, (2) that will permit such securities to be commingled with the securities of any person other than a *bona fide* customer, or (3) that will permit such securities to be hypothecated, or subjected to any lien or claim of the pledgee, for a sum in excess of the aggregate indebtedness of such customers in respect to such securities.

(d) To lend or arrange for the lending of any securities carried for the account of any customer without the written consent of such customer.

[U.S.C., title 15, sec. 78h.]

* * *

Segregation and limitation of functions

* * *

SEC. 11. (d) It shall be unlawful for a member of a national securities exchange who is both a dealer and a broker, or for any person who both as a broker and a dealer transacts a business in securities through the medium of a member or otherwise, to effect through the use of any facility of a national securities exchange or of the mails or of any means or instrumentality of interstate commerce, or otherwise in the case of a member, (1) any transaction in connection with which directly or indirectly, he extends or maintains or arranges for the extension or maintenance of credit to or for a customer on any security (other than an exempted security) which was a part of a new issue in the distribution of which he participated as a member of a selling syndicate or group within thirty days prior to such transaction: *Provided*, That credit shall not be deemed extended by reason of a *bona fide* delayed delivery of any such security against full payment of the entire purchase price thereof upon such delivery within thirty-five days after such purchase, * * *

[U.S.C., title 15, sec. 78k.]

* * *

Registration of securities

* * *

SEC. 12. (f) * * * Any security for which unlisted trading privileges are continued or extended pursuant to this subsection shall be deemed to be registered on a national securities exchange within the meaning of this Title. * * *

[U.S.C., title 15, sec. 78l.]

* * *

Accounts and records, reports, and examinations

* * *

SEC. 17. (b) Any broker, dealer, or other person extending credit who is subject to the rules and regulations prescribed by the Board of Governors of the Federal Reserve System pursuant to this title shall make such reports to the Board as it may require as necessary or appropriate to enable it to perform the functions conferred upon it by this title. If any such broker, dealer, or other

person shall fail to make any such report or fail to furnish full information therein, or, if in the judgment of the Board it is otherwise necessary, such broker, dealer, or other person shall permit such inspections to be made by the Board with respect to the business operations of such broker, dealer, or other person as the Board may deem necessary to enable it to obtain the required information.

[U.S.C., title 15, sec. 78q.]

* * *

Rules and regulations

SEC. 23. (a) The Commission and the Board of Governors of the Federal Reserve System shall each have power to make such rules and regulations as may be necessary for the execution of the functions vested in them by this title, and may for such purpose classify issuers, securities, exchanges, and other persons or matters within their respective jurisdictions. No provision of this title imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule or regulation of the Commission or the Board of Governors of the Federal Reserve System, notwithstanding that such rule or regulation may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason.

* * *

[U.S.C., title 15, sec. 78w.]

* * *

Unlawful representations

SEC. 26. No action or failure to act by the Commission or the Board of Governors of the Federal Reserve System, in the administration of this title shall be construed to mean that the particular authority has in any way passed upon the merits of, or given approval to, any security or any transaction or transactions therein, nor shall such action or failure to act with regard to any statement or report filed with or examined by such authority pursuant to this title or rules and regulations thereunder, be deemed a finding by such authority that such statement or report is true and accurate on its face or that it is not false or misleading. It shall be unlawful to make, or cause to be made, to any prospective purchaser or seller of a security any representation that any such action or failure to act by any such authority is to be so construed or has such effect.

[U.S.C., title 15, sec. 78z.]

Validity of contracts

SEC. 29. (a) Any condition, stipulation, or provision binding any person to waive compliance with any provision of this title or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

(b) Every contract made in violation of any provision of this title or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this title or any rule or regulation thereunder, shall be void (1) as regards the right of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule or regulation: * * *

(c) Nothing in this title shall be construed (1) to affect the validity of any loan or extension of credit (or any extension or renewal thereof) made or of any lien created prior or subsequent to the enactment of this title, unless at the time of the making of such loan or extension of credit (or extension or renewal thereof) or the creating of such lien, the person making such loan or extension of credit (or extension or renewal thereof) or acquiring such lien shall have actual knowledge of facts by reason of which the making of such loan or extension of credit (or extension or renewal thereof) or the acquisition of such lien is a violation of the provisions of this title or any rule or regulation thereunder, or (2) to afford a defense to the collection of any debt or obligation or the enforcement of any lien by any person who shall have acquired such debt, obligation, or lien in good faith for value and without actual knowledge of the violation of any provision of this title or any rule or regulation thereunder affecting the legality of such debt, obligation, or lien.

[U.S.C., title 15, sec. 78cc.]

Foreign securities exchanges

SEC. 30. (a) It shall be unlawful for any broker or dealer, directly or indirectly, to make

use of the mails or of any means or instrumentality of interstate commerce for the purpose of effecting on an exchange not within or subject to the jurisdiction of the United States, any transaction in any security the issuer of which is a resident of, or is organized under the laws of, or has its principal place of business in, a place within or subject to the jurisdiction of the United States, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors or to prevent the evasion of this title.

(b) The provisions of this title or of any rule or regulation thereunder shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States, unless he transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of this title.

[U.S.C., title 15, sec. 78dd.]

* * *

Penalties

SEC. 32. (a) Any person who willfully violates any provision of this title, or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this title, or any person who willfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed under this title or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 15 of this title, which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than $10,000, or imprisoned not more than two years, or both, except that when such person is an exchange, a fine not exceeding $500,000 may be imposed; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.

* * *

[U.S.C., title 15, sec. 78ff.]

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

SUPPLEMENT TO REGULATION G[1]

Effective December 6, 1971

SECTION 207.5—SUPPLEMENT

(a) **Maximum loan value of margin securities.** For the purpose of § 207.1, the maximum loan value of any margin security, except convertible securities subject to § 207.1(d), shall be 45 per cent of its current market value, as determined by any reasonable method.

(b) **Maximum loan value of convertible debt securities subject to § 207.1(d).** For the purpose of § 207.1, the maximum loan value of any security against which credit is extended pursuant to § 207.1(d) shall be 50 per cent of its current market value, as determined by any reasonable method.

(c) **Retention requirement.** For the purpose of § 207.1, in the case of a loan which would exceed the maximum loan value of the collateral following a withdrawal of collateral, the "retention requirement" of a margin security and of a security against which credit is extended pursuant to § 207.1(d) shall be 70 per cent of its current market value, as determined by any reasonable method.

(d) **Requirements for inclusion on list of OTC margin stock.** Except as provided in subparagraph (4) of § 207.2(f), such stock shall meet the requirements that:

(1) The stock is subject to registration under section 12(g)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78*l*(g)(1)), or if issued by an insurance company subject to section 12(g)(2)(G) (15 U.S.C. 78*l*(g)(2)(G)) the issuer had at least $1 million of capital and surplus.

(2) Five or more dealers stand willing to, and do in fact, make a market in such stock including making regularly published *bona fide* bids and offers for such stock for their own accounts, or the stock is registered on a securities exchange that is exempted by the Securities and Exchange Commission from registration as a national securities exchange pursuant to section 5 of the Securities Exchange Act of 1934 (15 U.S.C. 78e),

(3) There are 1,500 or more holders of record of the stock who are not officers, directors, or beneficial owners of 10 per cent or more of the stock,

(4) The issuer is organized under the laws of the United States or a State[9] and it, or a predecessor in interest, has been in existence for at least 3 years,

(5) The stock has been publicly traded for at least 6 months, and

(6) Daily quotations for both bid and asked prices for the stock are continuously available to the general public;

and shall meet 3 of the 4 additional requirements that:

(7) There are 500,000 or more shares of such stock outstanding in addition to shares held beneficially by officers, directors, or beneficial owners of more than 10 per cent of the stock,

(8) The shares described in subparagraph (7) of this paragraph have a market value in the aggregate of at least $10 million,

(9) The minimum average bid price of such stock, as determined by the Board in the latest month, is at least $10 per share, and

(10) The issuer had at least $5 million of capital, surplus, and undivided profits.

---

[9] As defined in 15 U.S.C. 78c(a)(16).

---

[1] This Supplement supersedes Supplement effective May 6, 1970.

(G) (15 U.S.C. 78*l*(g)(2)(G)), the issuer had at least $1 million of capital and surplus,

(2) Five or more dealers stand willing to, and do in fact, make a market in such stock including making regularly published *bona fide* bids and offers for such stock for their own accounts, or the stock is registered on a securities exchange that is exempted by the Securities and Exchange Commission from registration as a national securities exchange pursuant to section 5 of the Act (15 U.S.C. 78e),

(3) There are 1,500 or more holders of record of the stock who are not officers, directors, or beneficial owners of 10 per cent or more of the stock,

(4) The issuer is organized under the laws of the United States or a State[6] and it, or a predecessor in interest, has been in existence for at least 3 years,

[6] As defined in 15 U.S.C. 78c(a)(16).

(5) The stock has been publicly traded for at least 6 months, and

(6) Daily quotations for both bid and asked prices for the stocks are continuously available to the general public;

and shall meet 3 of the 4 additional requirements that:

(7) There are 500,000 or more shares of such stock outstanding in addition to shares held beneficially by officers, directors, or beneficial owners of more than 10 per cent of the stock,

(8) The shares described in subparagraph (7) of this paragraph have a market value in the aggregate of at least $10 million,

(9) The minimum average bid price of such stock, as determined by the Board in the latest month, is at least $10 per share, and

(10) The issuer had at least $5 million of capital, surplus, and undivided profits.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

SUPPLEMENT TO REGULATION T[1]

Effective December 6, 1971

SECTION 220.8—SUPPLEMENT

(a) **Maximum loan value for general accounts.** The maximum loan value of securities in a general account subject to § 220.3 shall be:

(1) of a registered non-equity security held in the account on March 11, 1968, and continuously thereafter, and of a margin equity security (except as provided in § 220.3(c) and paragraphs (b) and (c) of this section), 45 per cent of the current market value of such securities.

(2) of an exempted security held in the account on March 11, 1968, and continuously thereafter, the maximum loan value of the security as determined by the creditor in good faith.

(b) **Maximum loan value for a special bond account.** The maximum loan value of an exempted security and of a registered non-equity security pursuant to § 220.4(i) shall be the maximum loan value of the security as determined by the creditor in good faith.

(c) **Maximum loan value for special convertible debt security account.** The maximum loan value of a margin security eligible for a special convertible security account pursuant to § 220.4(j) shall be 50 per cent of the current market value of the security.

(d) **Margin required for short sales.** The amount to be included in the adjusted debit balance of a general account, pursuant to § 220.3(d)(3), as margin required for short sales of securities (other than exempted securities) shall be 55 per cent of the current market value of each security.

(e) **Retention requirement.** In the case of an account which would have an excess of the adjusted debit balance of the account over the maximum loan value of the securities in the account following a withdrawal of cash or securities from the account, pursuant to § 220.3(b)(2):

(1) The "retention requirement" of an exempted security held in the general account on March 11, 1968, and continuously thereafter, shall be equal to its maximum loan value as determined by the creditor in good faith, and the "retention requirement" of a registered non-equity security held in such account on March 11, 1968, and continuously thereafter, and of a margin security, shall be 70 per cent of the current market value of the security.

(2) In the case of a special bond account subject to § 220.4(i), the retention requirement of an exempted security and of a registered non-equity security shall be equal to the maximum loan value of the security.

(3) In the case of a special convertible security account subject to § 220.4(j) which would have an excess of the adjusted debit balance of the account over the maximum loan value of the securities in the account following a withdrawal of cash or securities from the account, the retention requirement of a security having loan value in the account shall be 70 per cent of the current market value of the security.

(4) For the purpose of effecting a transfer from a general account to a special convertible security account subject to § 220.4(j), the retention requirement of a security described in § 220.4(j), shall be 70 per cent of its current market value.

(f) **Security having no loan value in general account.** No securities other than an exempted security or registered non-equity security held in the account on March 11, 1968, and continuously thereafter, and a margin security, shall have any loan value in a general account except that a margin security eligible for the special convertible security account pursuant to § 220.4(j) shall have loan value only if held in the account on March 11, 1968, and continuously thereafter.

(g) **Requirements for inclusion on list of OTC margin stock.** Except as provided in subparagraph (4) of § 220.2(e), OTC margin stock shall meet the requirements that:

(1) The stock is subject to registration under section 12(g)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78*l*(g)(1)), or if issued by an insurance company subject to section 12(g)(2)

[1] This Supplement supersedes Supplement effective May 6, 1970.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

SUPPLEMENT TO REGULATION U [1]

Effective December 6, 1971

SECTION 221.4—SUPPLEMENT

(a) **Maximum loan value of stocks.** For the purpose of § 221.1, the maximum loan value of any stock, whether or not registered on a national securities exchange, shall be 45 per cent of its current market value, as determined by any reasonable method.

(b) **Maximum loan value of convertible debt securities subject to § 221.3(t).** For the purpose of § 221.3(t), the maximum loan value of any security against which credit is extended pursuant to § 221.3(t) shall be 50 per cent of its current market value, as determined by any reasonable method.

(c) **Retention requirement.** For the purpose of § 221.1, in the case of a credit which would exceed the maximum loan value of the collateral following a withdrawal of collateral, the "retention requirement" of a stock, whether or not registered on a national securities exchange, and of a convertible debt security subject to § 221.3(t), shall be 70 per cent of its current market value, as determined by any reasonable method.

(d) **Requirements for inclusion on list of OTC margin stock.** Except as provided in subparagraph (4) of § 221.3(d), OTC margin stock shall meet the requirements that:

(1) The stock is subject to registration under section 12(g)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78*l*(g)(1)), or if issued by an insurance company subject to section 12(g)(2)(G) (15 U.S.C. 78*l*(g)(2)(G)), the issuer had at least $1 million of capital and surplus,

(2) Five or more dealers stand willing to, and do in fact, make a market in such stock including making regularly published *bona fide* bids and offers for such stock for their own accounts, or the stock is registered on a securities exchange that is exempted by the Securities and Exchange Commission from registration as a national securities exchange pursuant to section 5 of the Act (15 U.S.C. 78e),

(3) There are 1,500 or more holders of record of the stock who are not officers, directors, or beneficial owners of 10 per cent or more of the stock,

(4) The issuer is organized under the laws of the United States or a State[2] and it, or a predecessor in interest, has been in existence for at least 3 years,

(5) The stock has been publicly traded for at least 6 months, and

(6) Daily quotations for both bid and asked prices for the stock are continuously available to the general public;

and shall meet 3 of the 4 additional requirements that:

(7) There are 500,000 or more shares of such stock outstanding in addition to shares held beneficially by officers, directors, or beneficial owners of more than 10 per cent of the stock,

(8) The shares described in subparagraph (7) of this paragraph have a market value in the aggregate of at least $10 million,

(9) The minimum average bid price of such stock, as determined by the Board in the latest month, is at least $10 per share, and

(10) The issuer had at least $5 million of capital, surplus, and undivided profits.

[2] As defined in 15 U.S.C. 78c(a)(16).

[1] This Supplement supersedes Supplement effective May 6, 1970.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
500 NORTH CAPITOL STREET WASHINGTON, D. C. 20549

Information on Registration and Regulation of BROKER-DEALERS

DIVISION OF TRADING AND MARKETS - SECURITIES AND EXCHANGE COMMISSION

GENERAL REQUIREMENTS

Among the measures in the Securities Exchange Act of 1934, enacted in the public interest and for public investor protection in the securities trading markets, are provisions designed to regulate the conduct of and to establish competency standards for brokers and dealers.

With minor exceptions, the threshold requirement applied to brokers and dealers is that they become registered with the Securities and Exchange Commission. The application for registration seeks information concerning the background of the applicant, its principals, its controlling persons, and its employees, and is designed to determine whether the applicant meets the statutory requirements to engage in a business which, at a minimum, involves high professional standards, and quite often, the more rigorous responsibilities of a fiduciary. Accordingly, it is a paramount obligation of a registered broker or dealer to acquaint himself and to comply with the provisions of the federal securities laws which govern his business.

WHO IS REQUIRED TO REGISTER

Section 15(a)(1) of the Act makes it unlawful for any broker or dealer (other than one whose business is exclusively intrastate) to use the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange unless such broker or dealer is registered pursuant to Section 15(b).

DEFINITIONS

"Broker" is defined in Section 3(a)(4) to mean any person engaged in the business of effecting transactions in securities for the account of others, but does not include a bank.

"Dealer" is defined in Section 3(a)(5) to mean any person engaged in the business of buying and selling securities for his own account, through a broker or otherwise, but it 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 a part of a regular business.

The terms "exempted security" and "interstate commerce" are defined in Sections 3(a)(12) and (17), respectively.

INTRASTATE EXEMPTION - LIMITATIONS

The exemption from registration contained in Section 15(a)(1) for a broker or dealer whose business is "exclusively intrastate" is of very limited application. To be available to a broker or dealer all of his business must be transacted within his state. Both sides of the transaction and all aspects of his business must be considered, and it would not be available if he effects transactions, or otherwise does business, for or with persons outside the state, whether such persons are public investors, other broker-dealers or issuers. More specifically, he cannot participate in any transaction executed on a securities exchange no matter where the exchange is located, and cannot, as agent, represent an out-of-state principal even if the transaction is consummated with a customer in the broker-dealer's own state. He cannot sell to or buy from a person outside his state and cannot advertise in newspapers or other publications distributed outside his state unless the advertisement makes it clear that he is doing an "exclusively intrastate" business and can act only for or with a person within his state in a wholly intrastate transaction.

APPLICATION FOR REGISTRATION AND INITIAL FINANCIAL STATEMENT

Application for registration as a broker-dealer may be made by filing duplicate executed copies of Form BD with the headquarters office of the Commission in Washington, D. C. The application must be accompanied by a statement of financial condition as required by Rule 15b1-2 of the rules and regulations. This statement must be in such detail as will disclose the nature and amount of assets and liabilities and the net worth of the applicant as of a date within 30 days of the date on which such statement is filed, and securities of the broker or dealer, or in which the broker or dealer has an interest, must be set forth in a separate schedule and valued at the market. An application will be returned to the applicant if all items have not been answered in the manner required, or if it is otherwise not acceptable for filing.

REQUIRED BOOKS AND RECORDS AND FINANCIAL REPORTS

Rules 17a-3, 17a-4 and 17a-5 under the Exchange Act should also be noted. Rules 17a-3 and -4 require brokers and dealers to make, keep current and preserve certain books and records. Rule 17a-5 requires them to file with the Commission a report of financial condition as of a date within each calendar year. This report generally must be certified by an independent accountant.

NET CAPITAL REQUIREMENTS

Rule 15c3-1 under the Act sets forth the "net capital" requirements for certain brokers and dealers. Its object is to require a broker or dealer to have at all times sufficient liquid assets to cover his current indebtedness. It provides that a subject broker or dealer shall not permit his "aggregate indebtedness" to all other persons to exceed 20 times his "net capital" as those terms are defined in the rule. The rule also provides that they shall have and maintain the minimum "net capital" set forth in paragraph (a)(2) of the rule. The operation and application of

the rule have been explained in Securities Exchange Act Release No. 8024, a copy of which will be made available on request.

SPECIAL REQUIREMENTS FOR NON-ASSOCIATION BROKER-DEALERS

If a registered broker or dealer is not a member of a securities association registered with this Commission under Section 15A of the Act (The National Association of Securities Dealers, Inc.), Rule 15b8-1 establishes specified qualification requirements for the broker-dealer's associated persons (which includes but is not limited to those commonly known as registered representatives) and, in general, principals of the broker-dealer.

Whether or not the qualification requirements of Rule 15b8-1 apply in a given case, other applicable rules establish other requirements, including fees and other charges to be paid by registered broker-dealers who are not members of a registered securities association.

ANTI-FRAUD PROVISIONS

The anti-fraud provisions of the federal securities laws are contained in Section 17 of the Securities Act of 1933, Sections 10(b) and 15(c) of the Securities Exchange Act of 1934 and the rules thereunder. These provisions prohibit misstatements or misleading omissions of material facts, and fraudulent acts and practices, in connection with the purchase or sale of securities. In this connection, a broker-dealer engaged in the sale of mutual fund shares should be familiar with the Commission's Statement of Policy regarding the sale of such shares. A copy of this will be made available on request.

RESPONSIBILITY FOR COMPLIANCE - SEC ASSISTANCE

Although attention has been directed to selected provisions of the Act and Rules, this is not to be regarded as relieving any broker-dealer from complying with all regulatory provisions applicable to his conduct at any given time. The staff of the Securities and Exchange Commission is available to broker-dealer applicants and registrants to discuss problems with regard to the registration and other provisions of the Securities Exchange Act which may pertain to specific proposed activities. Interested persons may find it convenient to contact the Regional or Branch Office of the Commission in their area. A list of these offices is attached.

STATE REQUIREMENTS

Many states have their own requirements with respect to persons conducting business as broker-dealers within that state. Information with respect to the requirements of any particular state should be addressed to the appropriate official in that state.

REGIONAL AND BRANCH OFFICES

ZONE 1 - New York and New Jersey: 23rd Floor, 225 26 Federal Plaza
New York, New York 10007

ZONE 2 - Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, and Connecticut: Suite 2203, John F. Kennedy Federal Bldg., Government Center,
Boston, Massachusetts 02203

ZONE 3 - Tennessee, Virgin Islands, Puerto Rico, North Carolina, Alabama, South Carolina, Georgia, Florida, Mississippi, and that part of Louisiana lying east of the Atchafalaya River: Suite 138, 1371 Peachtree Street, N. E.,
Atlanta, Georgia 30309

BRANCH:

Room 1504, Federal Office Building, 51 S.W. First Ave.,
Miami, Florida 33130

ZONE 4 - Michigan, Ohio, Kentucky, Indiana, Illinois, Wisconsin, Minnesota, Iowa, Missouri, and Kansas City (Kansas): Room 1708,
Everett McKinley Dirksen Building, 219 South Dearborn St.,
Chicago, Illinois 60604

BRANCHES:

Federal Office Building, Room 899, 1240 East 9th at Lakeside,
Cleveland, Ohio 44199

1044 Federal Building
Detroit, Michigan 48226

Room 1452, 210 North Twelfth Street
St. Louis, Missouri 63101

ZONE 5 - Oklahoma, Arkansas, Texas, that part of Louisiana lying west of the Atchafalaya River, and Kansas (except Kansas City): 503 U. S. Court House, 10th & Lamar Sts.,
Fort Worth, Texas 76102

BRANCH:

Room 2606, Federal Office & Courts Bldg., 515 Rusk Avenue,
Houston, Texas 77002

ZONE 6 - North Dakota, South Dakota, Utah, Wyoming, Nebraska, Colorado, and New Mexico: 7224 Federal Building, 1961 Stout Street,
Denver, Colorado 80202

BRANCH:

Federal Reserve Bank Building
Third Floor, 120 South State Street
Salt Lake City, Utah 84111

ZONE 7 - Nevada, Arizona, California, Hawaii and Guam: 450 Golden Gate Avenue, Box 36042,
San Francisco, California 94102

BRANCH:

Room 1043 U. S. Court House
312 North Spring Street
Los Angeles, California 90012

ZONE 8 - Montana, Idaho, Washington, Oregon, and Alaska: 900 Hoge Building,
Seattle, Washington 98104

ZONE 9 - Pennsylvania, Delaware, Maryland, Virginia, West Virginia, and District of Columbia:
Ballston Centre Tower No. 13
4015 Wilson Boulevard
Arlington, Virginia 22203

For RELEASE Wednesday, January 18, 1967

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

SECURITIES EXCHANGE ACT OF 1934
Release No. 8024

ACCOUNTING SERIES
Release No. 107

Net Capital Requirements for Brokers and Dealers -- Interpretation and Guide

The Securities and Exchange Commission today released the following staff interpretation of, and guide to computations under, its "net capital" Rule 15c3-1 under the Securities Exchange Act of 1934 (the "Act"). 1/ This material, which was prepared jointly by the Commission's Division of Trading and Markets (the "Division") and Office of Chief Accountant, is intended to assist brokers and dealers in complying with Rule 15c3-1.

This release is divided into two parts. Part I explains the operation of Rule 15c3-1, including the exemptions therefrom, and discusses the application of the rule with respect to questions frequently presented to the Division for interpretation. Part II of this release consists of an example of the computation of "net capital" pursuant to Rule 15c3-1 made by a hypothetical broker-dealer, and includes a detailed trial balance work sheet with explanatory notes. The work sheet is merely illustrative of the application of Rule 15c3-1.

PART I.

A. Introduction

Rule 15c3-1 was adopted to provide safeguards for public investors by setting standards of financial responsibility to be met by brokers and dealers. 2/ The basic concept of the rule is liquidity; its object being to require a broker or dealer to have at all times sufficient liquid assets to

---

1/ All references to Rule 15c3-1 are to the rule as currently amended (see Securities Exchange Act Release No. 7611, dated May 26, 1965). The text of the amended rule, including an explanation of the effective dates of the amended provisions thereof, is set out in the Appendix hereto.

2/ The rule was adopted under Section 15(c)(3) which in effect prohibits any broker or dealer from using the mails or interstate facilities to effect, induce or attempt to induce any over-the-counter transaction in a non-exempted security in contravention of rules or regulations prescribed by the Commission as necessary or appropriate in the public interest or for the protection of investors to provide safeguards with respect to financial responsibility of brokers and dealers.

cover his current indebtedness. 3/ The applicability of the rule does not depend on whether or not a broker or dealer is required to be registered with the Commission, since the exemptive provisions of Section 15(a)(1) of the Act provide exemptions only from the registration requirements of that section, and not from other applicable provisions of the Act or the rules and regulations.

Rule 15c3-1 is made up of three parts: a statement of the minimum standards of liquidity to be maintained by brokers and dealers; 4/ provisions for exemption from the rule for certain brokers or dealers; 5/ and definitions of terms for the purpose of determining liquidity under the rule. 6/ Each part will be discussed separately.

B. General Requirements as to Net Capital Ratio and Minimum Net Capital

The rule prohibits a broker or dealer from permitting his "aggregate indebtedness" from exceeding 2,000% of his "net capital," as those terms are defined in paragraphs (c)(1) and (c)(2) of the rule. 7/ This has often been referred to as "the twenty to one rule."

In addition, every broker or dealer subject to the rule is required to have and maintain a minimum "net capital" of $5,000. 8/ However, the rule permits a minimum "net capital" of only $2,500 for a broker or dealer meeting the following conditions: (i) his dealer transactions (as principal for his own account) are limited to the purchase, sale and redemption of redeemable shares of registered investment companies (mutual funds); (ii) his transactions as broker (agent) are limited to the sale and redemption of mutual funds, the solicitation of share accounts for certain insured savings and loan associations, and the sale of securities for the account of a customer to obtain funds for immediate reinvestment in mutual funds; and (iii) he promptly transmits all funds and delivers all securities received in connection with his activities as a broker or dealer, and does not otherwise hold funds or securities for, or owe money or securities to, customers. 9/ In this connection, the rule provides 10/

3/ The need for such liquidity has long been recognized as vital to the public interest and for the protection of investors. As early as 1942, the Commission stated, "Customers do not open accounts with a broker relying on suit, judgment and execution to collect their claims - they are opened in the belief that a customer can, on reasonable demand, liquidate his cash or securities position." Guy D. Marianette, 11 S.E.C. 967, 970-1.

4/ Paragraph (a) of the rule. (All paragraph references in the footnotes are to Rule 15c3-1.)

5/ Paragraph (b).

6/ Paragraph (c).

7/ Paragraph (a)(1).

8/ Paragraph (a)(2).

9/ A broker or dealer must comply with both requirements: he must maintain a minimum "net capital" of at least $5,000 (or $2,500, if applicable), and such "net capital" may not be less than 1/20th of the amount of his "aggregate indebtedness." Thus, depending upon the amount of a broker or dealer's "aggregate indebtedness," his required "net capital" could be considerably greater than the specified minimum.

10/ Paragraph (a)(2)(A).

that a sole proprietor broker or dealer who otherwise qualifies for the reduced minimum "net capital" requirement of $2,500 may also effect occasional transactions in other securities for his own personal account with or through another registered broker-dealer without having to maintain a minimum "net capital" of more than $2,500 (unless, of course, additional "net capital" is needed to comply with the ratio requirement). 11/

C. Exemptions from the Rule

An exemption from the rule is available for a broker who is also licensed as an insurance agent, whose securities business is limited to selling variable annuity contracts as agent for the issuer, who promptly transmits 12/ all funds and delivers all variable annuity contracts, and who does not otherwise hold funds or securities for, or owe money or securities to, customers; and only if the issuer files with the Commission a satisfactory undertaking that it assumes responsibility for all valid claims arising out of the securities activities of the agent. 13/ The rule also provides that this exemption will not be lost to a person conducting such limited type of brokerage business as a sole proprietor simply because he effects occasional transactions in other securities for his own personal account with or through another registered broker-dealer.

An exemption from the rule is also provided for members in good standing and subject to specific capital requirements of the American, Boston, Midwest, New York, Pacific Coast, Philadelphia-Baltimore-Washington and Pittsburgh Stock Exchanges. 14/ The Commission has reviewed the rules, settled practices and applicable regulatory procedures of those securities exchanges and deems them to impose requirements more comprehensive than those of Rule 15c3-1. However, this exemption is not available to a member of any such exchange if he is not subject to the capital requirements of the exchange; and a suspended member of any such exchange would become subject to Rule 15c3-1, and would have to be in compliance therewith, immediately upon such suspension. 15/

The rule further provides that the Commission may, upon written application, exempt from the rule, either unconditionally or on specified terms and conditions, a broker or dealer who satisfies the Commission that because of (i) the special nature of his business, (ii) his financial position, and (iii) the safeguards he has established for the protection of customers' funds and securities, it is not necessary in the public interest or for the protection of investors to subject the particular broker or dealer to the provisions of the rule. 16/ This provision is strictly construed; it is not intended to afford an exemption to any particular class or category of brokers or dealers. Only a broker or dealer who has substantial net worth and who, because of the special nature of his business, has safeguards for the protection of customers' funds

---

11/ Such a sole proprietor broker or dealer should be aware, however, that all such transactions, whether he considers them to be part of his business or for his personal account, must be reflected in his books and records in accordance with Rule 17a-3; and that securities so held are treated for "net capital" purposes as provided in Rule 15c3-1. (See also the separate discussion, infra, with respect to sole proprietor-broker-dealers.)

12/ The term "promptly transmits" is interpreted to mean as soon as reasonably possible, but not later than four business days after receiving the funds.

13/ Paragraph (b)(1).

14/ Paragraph (b)(2).

15/ See Strand Investment Co., Securities Exchange Act Release No. 6705 (1961).

16/ Paragraph (b)(3).

and securities should apply for this exemption. A broker or dealer should not apply for this exemption simply because he is having difficulty in raising the necessary capital. Any application for this exemption should contain detailed information demonstrating that the applicant can meet all the conditions mentioned above, so that the matter may ordinarily be considered on the basis of the information contained in such application.

D. Definitions

1. "Aggregate Indebtedness"

(a) General

As defined in the rule, 17/ "aggregate indebtedness" is the total money liabilities (except those specifically excluded as indicated below) of a broker or dealer arising in connection with any transaction whatsoever, including, among other things, money borrowed, customers' free credit balances, credit balances in customers' accounts having short positions in securities, and equities in customers' commodities futures accounts.

A broker or dealer which is also engaged in some other business in addition to its business as a broker or dealer must include the money liabilities of such other business in its "aggregate indebtedness." For example, where a broker-dealer also sells life insurance and accepts payments of premiums that are deposited in a special account pending transmission to the insurance company or return to the applicant, the premium represents a liability of the broker-dealer during the time the funds are in its possession, and therefore should be included in "aggregate indebtedness." 18/ In fact, where two partners have exactly the same interest in two partnerships, one partnership conducting a securities business and the other conducting another business, the liabilities and assets of both partnerships should be taken into consideration in determining whether the broker or dealer is in compliance with the "net capital" requirements.

However, not all liabilities of a broker or dealer are taken into account in determining his "aggregate indebtedness"; certain items are specifically excluded, as discussed below. 19/

17/ Paragraph (c)(1).

18/ The question of whether the assets of such other business may be included in "net capital" depends on the nature of such assets. (See discussion of "net capital," infra.)

19/ "Aggregate indebtedness" is not a factor in the computation of "net capital"; it is merely one element in computing "the twenty to one" ratio. Therefore, while certain liabilities are specifically excluded from the definition of "aggregate indebtedness," they are not ordinarily excluded from total liabilities for the purposes of computing "net capital" under paragraph (c)(2).

(b) Exclusions from "Aggregate Indebtedness"

(1) Collateralized Indebtedness

The rule specifically excludes from "aggregate indebtedness" any indebtedness adequately collateralized 20/ by securities (including exempted securities 21/) or spot commodities owned by the broker or dealer. 22/ In this connection, since time deposit certificates of a bank are securities within the meaning of Section 3(a)(10) of the Act, bank loans adequately collateralized by such certificates owned by the broker or dealer may ordinarily be excluded from "aggregate indebtedness." 23/

Fixed liabilities which are adequately secured by real estate or any other asset which is not included in the computation of "net capital" under paragraph (c)(2) of the rule 24/ are also excluded from "aggregate indebtedness." 25/

(2) Securities Loaned and Securities Failed to Receive

Amounts payable against securities loaned which securities are owned by the broker or dealer are excluded from "aggregate indebtedness." 26/ Also, amounts payable against securities "failed to receive" which were purchased for the account of, and have not been sold by, the broker or dealer are excluded from "aggregate indebtedness." 27/ Except for these two exclusions, the amounts payable against other securities loaned and securities "failed to receive" are specifically included in "aggregate indebtedness."

20/ Paragraph (c)(6) provides that indebtedness shall be deemed to be "adequately collateralized" when the difference between the amount of the indebtedness and the market value of the collateral is sufficient to make the loan acceptable as a fully secured loan to banks regularly making comparable loans to brokers or dealers in the community.

21/ However, as to exempted securities, the exclusion applies only to indebtedness arising from loans where exempted securities are given as collateral; not to indebtedness arising out of the failure to receive exempted securities. Securities "failed to receive" are discussed in the text. The term "exempted securities" is defined in paragraph (c)(3) to mean those securities specifically defined as "exempted securities" in Section 3(a)(12) of the Act.

22/ Paragraphs (c)(1)(A), (c)(1)(B) and (c)(1)(E).

23/ The treatment of time deposit certificates for purposes of computing "net capital" is discussed in footnote 49, infra.

24/ Paragraph (c)(2) excludes from the computation of "net capital" fixed assets and assets which are not readily convertible into cash, including, among other things, real estate, furniture and fixtures, etc. (This is discussed separately in the section dealing with the definition of "net capital.")

25/ Paragraph (c)(1)(G).

26/ Paragraph (c)(1)(C).

27/ Paragraph (c)(1)(D).

(3) Contractual Commitments 28/

The rule also excludes from "aggregate indebtedness" liabilities on open contractual commitments. 29/ This exclusion is intended generally to apply to liabilities in connection with firm commitment underwriting contracts, because in computing "net capital" any securities position contemplated by a firm commitment underwriting contract would be subject to a deduction from "net worth" based on the market value of the securities. 30/ Therefore, it is not considered necessary to require a broker-dealer to maintain additional "net capital" under the "twenty to one rule" to carry that commitment.

In addition, since a traditional "best-efforts" underwriting ordinarily imposes no obligation on a broker-dealer to pay for the securities being offered until certain events occur (e.g., the sale of the security) the broker-dealer does not ordinarily incur a liability to pay for such securities for purposes of computing his "aggregate indebtedness" until such time as he is under a legally binding obligation to pay funds to the issuer (or to the managing underwriter). 31/ However, if the broker-dealer receives advances from the issuer (e.g., for expenses) in connection with a best-efforts underwriting, any liability of the broker-dealer to return the unexpended portion of such advances is not excluded from "aggregate indebtedness."

(4) Satisfactorily Subordinated Debt; Amounts Segregated under the Commodity Exchange Act

Other items specifically excluded from "aggregate indebtedness" are: indebtedness subordinated to the claims of general creditors pursuant to a "satisfactory subordination agreement" 32/ (however, any interest on such satisfactorily subordinated debt, whether in arrears or currently due, should be included in "aggregate indebtedness" unless the debt arising from failure to pay the interest is also subordinated under the subordination agreement); and amounts segregated in accordance with the Commodity Exchange Act and the rules and regulations thereunder. 33/

(5) Other Excludable Items

(i) Funds held as Agent or Trustee; Escrow Accounts

Questions have frequently arisen as to whether funds held either (1) in a separate account by a broker-dealer as agent or trustee, or

---

28/ This term is defined in paragraph (c)(5). (See also footnote 52, infra.)

29/ Paragraph (c)(1)(H).

30/ See discussion under "Haircuts," infra.

31/ See Investment Bankers of America, Inc., Securities Exchange Act Release Nos. 6886 (August 16, 1962) and 6994 (January 21, 1963). See also discussion under "Other Excludable Items," infra, with respect to funds held by a broker-dealer as agent or trustee.

32/ The term "satisfactory subordination agreement," which is defined in paragraph (c)(7) of the rule, is discussed separately, infra.

33/ Title 17, Chapter I, Code of Federal Regulations ("CFR").

(2) in an escrow account by a bank, pursuant to Rule 15c2-4 of the Act, 34/ are part of "aggregate indebtedness." Where funds are held in a separate bank account by a broker-dealer as agent or trustee, the amount due to the issuer or the purchasing customers is an obligation of the broker-dealer which must be considered as part of his "aggregate indebtedness." If, on the other hand, the funds are promptly transmitted to an escrow bank under an agreement which contains the provisions contemplated by Rule 15c2-4 that the funds will be transmitted directly to the persons entitled thereto at the appropriate time, and the broker-dealer has no control over such funds, the funds held by the escrow bank are not treated as part of "aggregate indebtedness."

(ii) Contingent Liabilities

Questions also arise occasionally with respect to whether various items of contingent liabilities are to be included in "aggregate indebtedness." Where a judgment has been rendered against a broker or dealer, the amount of the judgment would have to be included in "aggregate indebtedness" even though an appeal from that judgment may be pending. 35/ Whether claims which have not been reduced to judgment are to be included in "aggregate indebtedness" would depend on the particular facts. No general rule can be given that would be applicable to all cases. Accordingly, situations involving contingent liabilities should be presented to the Division for consideration on the basis of the facts in the particular case.

2. "Net Capital"

(a) General

The "net capital" of a broker or dealer is essentially his adjusted "net worth." As defined in the rule, 36/ it is the excess of his total assets over his total liabilities, 37/ adjusted by adding unrealized profits (or deducting unrealized losses) in the accounts of the broker or dealer, or if such

---

34/ Rule 15c2-4 requires, in effect, that where a broker or dealer participates in the distribution of securities on any basis other than a firm-commitment underwriting, any money received for such securities on any basis whereby payment is not to be made to the person on whose behalf the distribution is being made until some further event or contingency occurs must be (A) promptly deposited in a separate bank account, as agent or trustee for the persons who have the beneficial interests therein, and promptly transmitted or returned to such persons upon the occurrence of the appropriate event or contingency, or (B) promptly transmitted to a bank which has agreed in writing to hold such funds in escrow for the persons having beneficial interests therein and to transmit or return such funds to such persons when the appropriate event or contingency occurs.

35/ Any claim for indemnity that such broker or dealer might have would not be considered to be an asset readily convertible into cash for purposes of computing "net capital."

36/ Paragraph (c)(2).

37/ As noted earlier, liabilities which are excluded from the definition of "aggregate indebtedness" are included in total liabilities for the purpose of computing "net capital."

broker or dealer is a partnership, by adding the equities (or deducting the deficits) in the accounts of partners. 38/

As pointed out in the introductory material, the principal purpose of the rule is to require that the capital position of a broker or dealer will always be sufficiently liquid to cover his current indebtedness, in order to be able at all times to promptly meet the demands of customers. Therefore, the rule provides that certain assets not readily convertible into cash, although saleable by negotiation, are excluded from "net capital" even though such assets are a part of "net worth." Also, certain other assets, although liquid, are valued at less than their market value in order to provide a cushion for market fluctuations. (The required percentage deductions from "net worth" for those assets are referred to as "haircuts." These are discussed separately.) 39/

(b) Fixed and Other Assets not Readily Convertible into Cash

In computing "net capital," a broker or dealer must deduct from his "net worth" all fixed assets and all other assets not readily convertible into cash, to the extent that such assets do not constitute bona fide collateral for actual bona fide indebtedness. 40/ The rule contains specific examples 41/ of some of the assets which for purposes of computing "net capital" are considered as not readily convertible into cash, including: real estate; furniture and fixtures; exchange memberships; prepaid rent, insurance and expenses; good will; organization expenses; deficits in customers' accounts, except in bona fide cash accounts within the meaning of Section 4(c) of Regulation T of the Board of Governors of the Federal Reserve System; 42/ all unsecured advances and loans; and customers' unsecured notes and accounts. Thus, unsecured insurance accounts receivable of a broker-dealer also engaged in the insurance business would be deducted from "net worth" in computing "net capital." Similarly, a broker-dealer's earned commissions receivable, being generally unsecured, would also be excluded from

---

38/ "Accounts of partners" are defined in paragraph (c)(4) as the accounts of partners who have agreed in writing that the equities in such accounts maintained with such partnership shall be included as partnership property.

39/ Paragraph (c)(2) also contains provisions excluding liabilities in connection with "satisfactory subordination agreements" when computing "net capital," and relating to the treatment of liabilities of sole proprietor-broker-dealers where such liabilities were not incurred in the course of business as a broker or dealer. These will be discussed infra in those sections dealing separately with "sole proprietor-broker-dealers" and "satisfactory subordination agreements."

40/ Where additional collateral is used to secure the indebtedness, it would be up to the broker-dealer to prove the extent to which the assets not readily convertible into cash are collateral for the indebtedness.

41/ Paragraph (c)(2)(B).

42/ 12 C.F.R. 220.4(c).

"net capital." 43/

Of course, the specific exclusion from "net capital" of unsecured loans and advances and of customers' unsecured notes and accounts does not mean that every secured loan, advance, note or account is included as part of a broker-dealer's "net capital." A secured receivable may be excluded from "net capital" if, because of the nature of the collateral or for some other reason, the broker-dealer cannot demonstrate that the account is readily convertible into cash. 44/ For example, advances made by a broker-dealer to his sales representatives against their commissions to be earned upon monthly payments by planholders of contractual plans for the accumulation of shares of a mutual fund are excluded from "net capital" (on the basis that they are not adequately secured), even though the sales representatives signed loan agreements providing (1) that the amounts owed by them are payable on demand, and (2) that the broker-dealer has liens on all commissions due and to become due to such sales representatives until the indebtedness is satisfied. In addition, notes receivable secured by titles on house trailers, by insurance premium finance contracts, and by second mortgages or second deeds of trust are excluded from a broker-dealer's "net capital" unless the broker-dealer is able to furnish convincing evidence to demonstrate that the notes are readily convertible into cash (i.e., that there is a ready market for the securities -- notes). 45/

Securities for which there is no independent market, 46/ and securities which cannot be publicly offered and sold by the broker or dealer because of contractual arrangements or other restrictions, also fall within the category of assets which are not readily convertible into cash, and are given no value when computing "net capital." In this connection, the Commission held, in Whitney-Phoenix Co., Inc., 39 S.E.C. 245 (1959), that securities which can be publicly offered or sold by the broker or dealer only after registration under the Securities Act of 1933 or pursuant to some exemption under Section 3(b) of that Act should be given no value for "net capital" purposes until such

---

43/ For example, some dealers sell shares of a mutual fund pursuant to a program whereby the customers make their checks payable to a custodian bank which (1) acts as agent for the various parties in effecting the sale of such shares, (2) confirms the transactions to the customers, and (3) periodically forwards to the dealer the commissions due him. Under those circumstances, the commissions due the dealer, but not yet forwarded by the bank, are treated as an unsecured account which should be deducted from the dealer's "net worth." (However, if a dealer can submit an unequivocal written statement from a custodian bank that the sums due the dealer are payable on demand, such receivables would not be deducted from "net worth" when computing that dealer's "net capital.")

44/ See footnote 40, supra.

45/ If it can be demonstrated that there is such a market for the notes, then instead of the exclusion under clause (B) of paragraph (c)(2) for the amount of the receivable, there would be a "haircut" applied to the market value of the security (the note) in accordance with the provisions of clause (C) of that paragraph. (See discussion of "haircuts," infra.)

46/ See S.E.C. v. C. H. Abraham & Co., Inc., 186 F. Supp. 19 (S.D. N.Y. 1960); Pioneer Enterprises, Inc., 36 S.E.C. 199, 207 (1955).

securities have been effectively registered or there has been compliance with an appropriate exemption under Section 3(b). 47/

Other examples of assets ordinarily considered to be assets not readily convertible into cash include a "good faith" deposit by a broker-dealer in connection with a bid for exempted or non-exempted securities; a cash deposit in lieu of, or as security for, statutory or other required bonds of a broker-dealer; oil royalties (unless it can be demonstrated that there is a ready market for such oil royalties); a bank account in which a sole proprietor-broker-dealer is a joint tenant; and the cash surrender value of a life insurance policy, unless such cash surrender value and the face amount of such policy are payable (1) to the estate of a sole proprietor-broker-dealer, or (2) to the broker-dealer, if a partnership or corporation.

Questions have been raised as to how to treat deposits in savings and loan associations which are ordinarily considered to be securities in the form of shares in the association. Generally, if such deposits are in a solvent, federally insured savings and loan association and the broker-dealer can furnish assurances to the Division that the particular federally insured association has been paying such deposits on demand, such deposits may be treated for "net capital" purposes as though they were cash in a bank.

(c) "Haircuts"

In computing "net capital," the rule requires deductions from "net worth" of certain specified percentages of the market values of marketable securities and future commodity contracts, long and short, in the capital and proprietary accounts of the broker or dealer, and in the "accounts of partners." (These deductions are generally referred to in the industry as "haircuts.") It also requires a deduction with respect to total long or total short futures contracts in each commodity carried for all customers. 48/ The purpose of these deductions from "net worth," is to provide a margin of safety against losses incurred by a broker or dealer as a result of market fluctuations in the prices of such securities or future commodity contracts.

(1) "Haircuts" for Marketable Securities

The amount of the "haircut" required with respect to marketable securities depends on the nature of the particular security, as follows: (1) in the case of a non-convertible debt security having a fixed interest rate and a fixed maturity date, and which is not in default, the "haircut" ranges between 5 and 30 per cent, depending on the percentage by which the

---

47/ However, as discussed earlier, where any of the securities discussed above are in fact pledged as bona fide collateral to secure a bona fide indebtedness, the amount to be deducted from "net worth" in computing "net capital" is the difference between the book value of such securities and the amount of the indebtedness actually secured thereby. See footnote 41, supra. (In such a situation the borrower would ordinarily be expected to tell the lender of restrictions on their sale.)

48/ Clauses (C) and (E) of paragraph (c)(2) in the case of securities, and clauses (D) and (F) in the case of future commodity contracts.

market value is less than the face value of such security; (2) in the case of cumulative, non-convertible, preferred stock not in arrears as to dividends and ranking prior to all other classes of stock of the same issuer the "haircut" is 20 per cent of market value; and (3) in the case of all other marketable securities, the "haircut" is 30 per cent of market value. 49/

The above "haircuts" are also applicable to securities loaned to a broker or dealer pursuant to a "satisfactory subordination agreement," 50/ and to other marketable securities owned by a broker or dealer which he has pledged as collateral to secure his indebtedness to another. However, no "haircut" need be taken with respect to securities which belong to a person other than the broker or dealer and which are in his possession as collateral for an indebtedness to such broker or dealer. Also, the rule provides 51/ that no "haircut" need be taken with respect to the following: (i) a security which is convertible into or exchangeable for other securities within a period of 30 days, subject to no conditions other than the payment of money, if the other securities into which such security is convertible, or for which it is exchangeable, are short in the accounts of such broker or dealer or in the "accounts of partners"; or (ii) a security which has been called for redemption and which is redeemable within 90 days. However, this latter exemption is not ordinarily available for redeemable investment company shares for two reasons: first, because they are not "called for redemption"; and second, even though they may be redeemable within 90 days, their redemption value is subject to fluctuation with changes in the market value of the portfolio securities held by the investment companies.

The rule applies the above "haircut" provisions to securities positions contemplated by open contractual commitments. 52/ In this connection, a firm commitment underwriting is a contractual commitment, and the required "haircut" is applied to the net long position contemplated by the commitment. This "haircut" is applicable even though there is no public market for the security until after the offering begins. (If, however, no market has developed for the security after the offering has begun, and the underwriter has a position in the security, consideration would then have to be given to whether the securities should be given no value as assets not readily convertible into cash.) As the

---

49/ Subclauses (i), (ii) and (iii) of paragraph (c)(2)(C). A negotiable time certificate of deposit issued by a bank is considered to be a debt security, and if there is a ready, independent market for such security, and if it is not in default, it is subject to the "haircut" required by subclause (i). A nonnegotiable time certificate of deposit would ordinarily be treated as an asset not readily convertible into cash, but if the broker-dealer can demonstrate that the bank will pay the certificate on demand before maturity it may be given substantial value, depending on all the surrounding circumstances in the particular case.

50/ See footnote 58, infra, and related textual discussion.

51/ Paragraph (c)(2)(C).

52/ Paragraph (c)(2)(E). The term "contractual commitments" is defined in paragraph (c)(5) to include underwriting, when-issued, when-distributed and delayed delivery contracts; endorsement of puts and calls; commitments in foreign currencies; and spot (cash) commodities contracts; but does not include uncleared regular way purchases and sales of securities and contracts in commodities futures.

underwriter sells shares to customers, the number of shares which he is obligated to take down decreases, and the "haircut" is reduced pro tanto. 53/ However, the rule provides that no "haircut" shall apply to "exempted securities" as defined in Section 3(a)(12) of the Act. 54/

(2) "Haircuts" for Futures Commodity Contracts

The rule requires that "haircuts" also be taken with respect to future commodity contracts, as follows: a "haircut" of 30 per cent with respect to the market value of all long and all short future commodity contracts (other than those contracts representing spreads or straddles in the same commodity and those contracts offsetting or hedging any "spot" commodity positions) carried in the capital, proprietary or other accounts of the broker or dealer, and if a partnership, in the "accounts of partners"; and a "haircut" of 1-1/2 per cent with respect to the total long or total short futures contracts in each commodity, whichever is greater, carried for all customers.

3. Subordinated Debt; "Satisfactory Subordination Agreement" 55/

It was previously pointed out that indebtedness subordinated to the claims of general creditors pursuant to a "satisfactory subordination agreement" is excluded from "aggregate indebtedness," 56/ and from total liabilities in the computation of "net capital." 57/ The combined effect of these exclusions is to treat such subordinated loans as if they were part of the broker-dealer's capital 58/ in computing his "net capital."

53/ In a "rights" offering where the underwriter has a firm commitment to take down the unsubscribed portion of the underlying securities, if the underwriter can demonstrate that less than 50% of the underlying securities will remain unsubscribed he may be permitted to deduct only 50% of the required "haircut" during the "rights" offering period.

54/ It also provides that the "haircut" with respect to any individual commitment shall be reduced by the unrealized profit (or increased by the unrealized loss) in such commitment; except that the amount of such reduction shall not exceed the amount of the required "haircut," and in no event shall an unrealized profit on any closed transaction operate to increase "net capital." A series of contracts of purchase or sale of the same security conditioned, if at all, only upon issuance may be treated as an individual commitment.

55/ The term "satisfactory subordination agreement" is defined in paragraph (c)(7).

56/ Paragraph (c)(1)(I).

57/ Paragraph (c)(2)(G).

58/ If the loan consists in whole or in part of securities, such securities would, of course, be subject to the applicable "haircuts" required by paragraph (c)(2)(C) of the rule.

In substance, the rule requires that in order to be considered a "satisfactory subordination agreement," a binding and enforceable written agreement must be executed by both the broker-dealer and the lender, whereby a specific amount of cash or specific securities are loaned to the broker-dealer for a period of not less than one year (and giving the broker-dealer the right to the use of such cash or securities as though they were in fact his own) under conditions which effectively subordinate any right of the lender to demand or receive repayment to the claims of all present and future creditors of the broker-dealer. The agreement must provide that it may not be cancelled by either party, and that the loan may not be repaid or the agreement in any way be terminated, rescinded or modified by mutual consent or otherwise if the effect would be to put the broker-dealer out of compliance with the "net capital" requirements of the rule. The agreement must also provide that no default of any kind shall have the effect of accelerating the maturity of the indebtedness; and that any note or other written instrument evidencing the indebtedness shall bear on its face an appropriate legend stating that it is issued subject to the provisions of a subordination agreement which shall be adequately referred to and incorporated by reference.

Thus, the rule contemplates that, if the proceeds of a subordinated loan are to be considered as part of the capital of a broker-dealer, cash or securities will be turned over to the broker-dealer for his use as part of his capital and subject to the risks of his business, and subject further only to an obligation of repayment at the end of the term of the loan. 59/ Accordingly, the agreement must contemplate that if repayment cannot be made without reducing the broker-dealer's "net capital" below the amount required by the rule, the subordination must continue, even though the indebtedness is not repaid at maturity. However, the loan may be repaid and the subordination agreement terminated by mutual consent if, after repayment, the broker-dealer's required "net capital" is not impaired.

The rule also requires that two copies of the subordination agreement, and of any notes or written instruments evidencing the indebtedness, must be filed, within 10 days after the agreement is entered into, with the Regional Office of the Commission for the region in which the broker-dealer maintains his principal place of business, together with a statement of the name and address of the lender, the business relationship of the lender to the broker-dealer, and information as to whether the broker-dealer carried funds or securities for the lender at or about the time the agreement was entered into. (If each copy of the agreement is bound separately and marked "Non-Public", such agreements will be maintained in a non-public file.) A broker-dealer should give notice of any proposed repayment of the loan, or of termination of or any other change in the agreement, to the Regional Office with which the agreement is filed so that the information on file with that Regional Office is always current and accurate. 60/

E. Sole Proprietor-Broker-Dealer

As indicated earlier, there are special considerations under the rule with respect to determining the "net capital" position of a sole proprietor-broker-dealer. For purposes of computing "aggregate indebtedness" and "net capital," a broker or dealer who is a sole proprietor must also take into account his personal

---

59/ Where funds or securities are loaned under any conditions which permit the lender to retain domination or control over, or otherwise inhibit the broker-dealer's unrestricted use of, such funds or securities, the agreement would not be a "satisfactory subordination agreement" within the meaning of the rule.

60/ If a broker-dealer has any question concerning whether he may properly effect any such repayment, or termination or other change in the agreement, he should request interpretive assistance from that Regional Office with which the agreement is filed.

assets and liabilities not related to the business; 61/ and where he conducts some other business in addition to the securities business, the assets and liabilities of such other business must also be taken into account. 62/

A sole proprietor-broker-dealer who is also engaged in some other business activity as a sole proprietor may record the assets and liabilities and transactions of such other business in the same books of account as he uses for his broker-dealer business or in a separate set of books. A consistent test of protection for the customer of such a sole proprietor requires that "aggregate indebtedness" in this situation must include all of the money liabilities in connection with his business as a broker-dealer and all money liabilities in connection with any other business in which he is engaged as a sole proprietor, less the specific exclusions provided by clauses (A) through (I) of paragraph (C)(1) of the rule. In computing "net capital," his "net worth" must be determined from the combined assets and liabilities of all of his businesses as a sole proprietor; and, in addition to the adjustments to "net worth" required of all brokers or dealers, whether or not sole proprietors, he is required by clause (H) of paragraph (c)(2) to make a further deduction from "net worth" of any excess of his personal liabilities over his personal assets.

This situation suggests the advisability of the formation of one or more corporations to carry on the securities business or any other business conducted by the sole proprietor. The separate incorporation of the other business will tend to relieve the securities business of the jeopardy from the liabilities of the other business and eliminate the question of whether the assets and liabilities of such other business should be taken into account in determining aggregate indebtedness and net capital.

F. Availability of Interpretative Advice

While this release endeavors to answer questions frequently raised, it is not possible to cover every question which may arise under Rule 15c3-1. Moreover, the general opinions expressed herein will not necessarily be applicable to situations which differ factually from those on which such opinions are based. Consequently, a broker or dealer who has a question as to the application of Rule 15c3-1 to a specific matter may request interpretative assistance from the Division of Trading and Markets. While the Commission provides such interpretative assistance through its staff wherever possible, the responsibility for compliance rests with the broker or dealer.

PART II

The following example based on the trial balance of a hypothetical broker-dealer shows the evaluation of the assets and liabilities required to be made in the determination of aggregate indebtedness and net capital. The example includes many situations frequently found in calculations made by small and medium sized broker-dealers. The trial balance work sheet shows (a) money balances of ledger accounts, (b) long and short security valuations related to certain ledger accounts, (c) net losses or gains in commodity contracts, (d) ledger balances included in aggregate indebtedness, and (e) and (f) adjusted balances of assets and liabilities and percentage deductions. Explanatory notes following the example are referenced to certain of the captions and details of open commodity contracts in both customers' and firm accounts are shown on a separate schedule.

61/ See footnote 11, supra, with respect to recordkeeping requirements.

62/ These assets and liabilities must be taken into account whether or not reflected in the records of his business as a broker or dealer. For example, where a sole proprietor-broker or dealer also is engaged in the insurance business, any insurance accounts payable would be included in "aggregate indebtedness," notwithstanding the fact that the sole proprietor maintains a separate bank account and separate books and records for each business. Also, his insurance accounts receivable, being ordinarily unsecured, would be excluded from "net capital."

ASSETS		Trial Balance (a)	Security Valuations Long (b)	Security Valuations Short (b)	Commodity Contracts Losses (Gains) (c)	Aggregate Indebtedness (d)	Adjusted Balances Assets (e)	Adjusted Balances Liabilities and Deductions (f)
Cash:								
In banks and on hand		$ 25,000					$ 25,000	
Good faith deposit	(g)	2,800						
Segregated under Commodity Exchange Act		6,900					6,900	
Deposits on future commodity contracts		1,100					1,100	
Failed to deliver		3,000	$ 3,100				3,000	
Deposit against securities borrowed		10,000	10,200				10,000	
Customers' securities accounts:								
Cash	(h)	10,000	11,000				10,000	
Fully secured	(h)	81,500	112,000				81,500	
Partly secured	(i)	5,000	3,000				3,000	
Unsecured	(j)	200						
Customers' commodity accounts:								
Future commodity contracts	(k)	(5,700)			$(350)			$ 5,700
Spot (cash) commodities	(h)	4,500	35,300				4,500	
Accounts of partners	(l)	5,000	8,000				8,000	
Firm trading accounts:								
Exempted securities - long	(m)	3,000	3,200				3,200	
Non-exempted securities - long	(m)	12,000	18,000				18,000	
- short	(m)	(2,000)		$ 1,600				1,600
Securities not readily marketable	(n)	2,000						
Future commodity contracts	(o)				(500)		500	
Land and building	(p)	48,000						
Furniture and fixtures	(p)	6,000						
Exchange memberships	(q)	10,000						
Notes receivable - unsecured	(q)	1,500						
Advances - unsecured	(q)	900						
Dividends receivable	(q)	500						
Earned commissions receivable	(q)	1,400						
Prepaid expenses	(q)	500						
Other assets	(q)	1,500						
		$234,600						
LIABILITIES AND NET WORTH								
Bank loans collateralized by:								
Firm securities	(r)	$ 10,000		20,000				10,000
Customers' securities		75,000		105,000		$ 75,000		75,000
Failed to receive:								
Firm securities - long	(s)	1,000		1,100				1,000
Customers' securities		5,000		5,200		5,000		5,000
Deposits against securities loaned:								
Firm securities	(s)	3,000		3,200				3,000
Customers' securities		2,000		2,100		2,000		2,000
Customers' free credit balances		21,000				21,000		21,000
Accounts payable		7,350				7,350		7,350
Accrued expenses and taxes		6,500				6,500		6,500
Dividends payable		1,400				1,400		1,400
Mortgage payable on land and building	(p)	30,000						

		Trial Balance (a)	Security Valuations Long (b)	Security Valuations Short (b)	Commodity Contracts Losses (Gains) (c)	Aggregate Indebtedness (d)	Adjusted Balances Assets (e)	Adjusted Balances Liabilities and Deductions (f)
Commodity "difference" account	(t)	850			850			850
Valuation of securities and spot (cash) commodities in "box" and transfer	(u)			77,600				
Contractual commitment	(v)	$163,100						
Subordinated borrowings:								
Loan payable	(w)	13,000						
Non-exempted securities	(w)		4,000				4,000	
Capital:								
Ledger balances		50,000						
Non-exempted securities	(x)		8,000				8,000	
Profit and loss		8,500						
		$234,600	$215,800	$215,800				
"Haircuts"								
Firm securities	(y)							11,880
Firm commodities	(z)							7,755
Contractual commitments	(aa)							7,500
Customers' commodities	(bb)							780
AGGREGATE INDEBTEDNESS						$118,250		
							$186,700	$168,315
NET CAPITAL	(cc)							18,385
							$186,700	$186,700

"Net capital" required - greater of $5,000 or 1/20th of "aggregate indebtedness" of $118,250 $ 5,913

"Net capital" as computed $ 18,385

Ratio of "aggregate indebtedness" to "net capital" ($118,250÷$18,385) 643%

The "net capital" of $18,385 is the result of the following adjustments:

Capital	$ 50,000	
Profit and loss	8,500	
Securities contributed as capital	8,000	$ 66,500
Subordinated borrowings:		
Loan payable	$ 13,000	
Securities	4,000	17,000
		$ 83,500
Add:		
Unrealized profits:		
Partners' accounts	$ 3,000	
Exempted securities - long	200	
Non-exempted securities - long	6,000	
Non-exempted securities - short	400	
Future commodity contracts	500	10,100
		$ 93,600
Deduct:		
Land and building	$ 48,000	
Mortgage payable	30,000	
	$ 18,000	
Furniture and fixtures	6,000	
Cash - good faith deposit	2,800	
Deficits in partly secured customers' accounts	2,000	
Unsecured customers' accounts	200	
Securities not readily marketable	2,000	
Exchange memberships	10,000	
Notes receivable - unsecured	1,500	
Advances - unsecured	900	
Dividends receivable	500	
Earned commissions receivable	1,400	
Prepaid expenses	500	
Other assets	1,500	
"Haircuts"		
Firm securities	11,880	
Firm commodities	7,755	
Contractual commitments	7,500	
Customers' commodities	780	75,215
"Net Capital"		$ 18,385

(a) The trial balance column includes the ledger balances of all asset, liability and capital accounts. One account, profit and loss, represents the net balance of all income and expense accounts for the period.

(b) The market value of security and spot (cash) commodity positions is entered in these two columns. Generally, long positions indicate ownership or right of possession (customers' securities; firm trading accounts) and short positions indicate location or responsibility to deliver (pledged as collateral on bank loans; sold short; in physical possession - "box"). In order to show a balanced securities position, in this example values have been shown for all accounts in which there is a securities position although not all such values are used in making the evaluations necessary for determination of "aggregate indebtedness" and "net capital." Valuations used in making the "net capital" computation should be supported by schedules showing for each security or spot (cash) commodity: title of issue or other description, market price and total market value.

(c) Balances in this column represent the net unrealized appreciation or depreciation (market value compared to cost) of future commodity contracts and the offset of such amounts to the commodity "difference" account.

(d) All liabilities are included as "aggregate indebtedness," except those specifically excluded by paragraph (c)(1).

(e) The asset balances extended to column (e) reflect certain of the adjustments specified in paragraph (c)(2) for determining "net capital."

(f) Column (f) includes all liabilities, except those specifically excluded by provisions of paragraph (c)(2), and the "haircut" on marketable securities, future commodity contracts, and contractual commitments.

(g) A good faith deposit made in connection with an underwriting is considered a balance not readily convertible into cash and is not assigned any value in the "net capital" computation. 63/

(h) Customers' cash accounts, fully secured accounts, and spot (cash) commodities accounts are included in the computation of "net capital" at the amount of their ledger balances. Although such accounts also contain securities or commodities which have a market value greater than the balance due to the broker-dealer, no consideration is given to such excess since these assets belong to the customers.

(i) Partly secured customers' accounts are assigned a value no greater than the market value of the security collateral. In this case, receivables of $5,000 are taken into account at the liquidating value of the related securities, $3,000. 63/

(j) Unsecured customers' accounts are not assigned any value. 63/

(k) The credit balance in customers' future commodity accounts, properly segregated in accordance with the Commodity Exchange Act and the rules and regulations thereunder, is excluded from "aggregate indebtedness" but included in liabilities considered in determining "net capital." 64/

63/ Paragraph (c)(2)(B).

(l) Recognition is given to unrealized profits or losses in the accounts of partners who have agreed in writing that the equity in their accounts with the firm shall be included as partnership property. In the example the ledger balances of these accounts is $5,000, but in determining "net capital" the accounts are included at the amount of the market value of the securities, $8,000. If the accounts were not subject to these signed agreements they would be considered as customers' accounts and evaluated only at the amount of the ledger balance, $5,000. 65/

(m) Recognition is given to unrealized profits or losses in the firm securities and investment accounts. In the example the ledger balances of firm trading accounts are stated at book value; consequently, in determining "net capital," security valuations are substituted. The long position in exempted securities is increased from $3,000 to market value of $3,200 and that in non-exempted securities from $12,000 to market value of $18,000. The credit balance in the short position is decreased from $2,000 to $1,600 because the market value of securities necessary to cover the liability is less than the ledger balance. 66/

(n) Securities not readily marketable because no independent public market exists, or which are subject to some restriction as to their sale, are considered as assets not readily convertible into cash and are not assigned any value in determining "net capital." 67/

(o) The unrealized gain of $500 on future commodity contracts in firm trading accounts is taken into consideration in the "net capital" computation since this equity applies to partnership property. 68/

(p) Fixed assets such as land and building, and furniture and fixtures, which in the example are stated net of related reserves for depreciation, are not assigned any value in determining "net capital." The mortgage payable, a fixed liability adequately secured by the land and building, is excluded from both "aggregate indebtedness" and liabilities considered in determining "net capital." 69/

(q) Assets which cannot be readily converted into cash are not assigned any value in determining "net capital." 70/

(r) Indebtedness adequately collateralized by securities owned by the firm is excluded from "aggregate indebtedness" but is included in liabilities considered in determining "net capital." 71/

65/ Paragraphs (c)(2)(A) and (c)(4).

66/ Paragraph (c)(2)(A).

67/ Paragraph (c)(2)(B).

68/ Paragraph (c)(2)(A).

69/ Paragraphs (c)(1)(G) and (C)(2)(B).

70/ Paragraph (c)(2)(B).

71/ Paragraph (c)(1)(A).

(s) Amounts payable against securities "failed to receive," which were purchased for the account of the firm and have not been sold, are excluded from "aggregate indebtedness" but are included in liabilities considered in determining "net capital." 72/ Similarly, amounts payable against securities loaned, which are owned by the firm, are excluded from "aggregate indebtedness" but not from liabilities considered in determining "net capital." 73/

(t) The commodity "difference" account represents the balance of daily settlements with clearing houses on open future commodity contracts which customarily are not allocated to the customers' and firm accounts until final settlement of the contract. Of the balance of $850 a portion, $350, represents net gains on contracts in customers' accounts (see (k) above), and the remainder, $500, applies to net gains on contracts in firm accounts (see (o) above). Since sufficient funds have been segregated in a separate bank account or deposited with clearing houses the amount is excluded from "aggregate indebtedness." 74/

(u) The amount of $77,600 in column (b) represents the valuation of securities and spot (cash) commodities in customers' accounts ($49,000) and firm and partners' accounts ($28,600) held in "box" or in transfer.

(v) Liabilities on open contractual commitments are usually not recorded in the ledger accounts and are not included in either "aggregate indebtedness" or in liabilities considered in determining "net capital." 75/ In the example a contractual commitment to purchase for $26,750 common stock which has a current market value of $27,500 has not been recorded in the ledger accounts.

(w) A loan payable of $13,000 and non-exempted securities borrowed under "satisfactory subordination agreements" are considered as if they were capital and consequently are excluded from "aggregate indebtedness" and liabilities considered in determining "net capital."

(x) In determining "net capital," securities contributed to capital are considered as assets of the firm.

(y) In the example, as a quick test of compliance, a "haircut" is taken at the maximum rate of 30 per cent on the aggregate market value of all non-exempted securities in long and short positions in firm capital and proprietary accounts, including securities in accounts of partners and securities borrowed pursuant to "satisfactory subordination agreements."

72/ Paragraph (c)(1)(D).

73/ Paragraph (c)(1)(C).

74/ Paragraph (c)(1)(F).

75/ Paragraphs (c)(1)(H) and (c)(5).

The "haircut" is determined in the following manner:

Firm trading accounts:	
Non-exempted securities	
Long	$18,000
Short	1,600
Partners' accounts	8,000
Subordinated borrowings:	
Non-exempted securities	4,000
Capital:	
Non-exempted securities	8,000
Aggregate market value	$39,600
30 per cent	$11,880

Since the use of the maximum rate of 30 per cent does not result in a "haircut" which reduces "net capital" below the amount required, no further computation is necessary. If schedules of securities are prepared in accordance with the classifications of paragraph (c)(2)(C) then "haircuts" of lesser amounts may be applied as appropriate. 76/

(z) A "haircut" is taken on the aggregate market value of all future commodity contracts in long and short positions in firm accounts. As shown on Schedule A, short positions amount to $19,250 and long positions are $6,600 for an aggregate of $25,850, and consequently the "haircut" at 30 per cent equals $7,755. 77/

(aa) A "haircut" of $7,500 is based on the contractual commitment to purchase for $26,750, common stock which has a current market value of $27,500 (see (v) above). The "haircut" represents 30 per cent of market value, $8,250, reduced by the unrealized profit of $750. 78/

76/ If, for example, the firm trading account included long positions in non-convertible debt securities with face and market values of $4,000, and cumulative, non-convertible preferred stocks with market values of $2,000, the computation could be made in the following manner:

	Market Value	Rate	"Haircut"
Non-convertible debt securities	$ 4,000	5%	$ 200
Cumulative, non-convertible preferred stocks	2,000	20%	400
All other securities	33,600	30%	10,080
Aggregate market value	$39,600		
"Haircut"			$10,680

77/ Paragraph (c)(2)(D).

78/ Paragraph (c)(2)(E).

(bb) The "haircut" of $780 on customers' commodities represents 1½ per cent of the market values of the greater of the total long or total short future commodity contracts in each commodity carried in customers' accounts. Analysis of the market values of customers' accounts on Schedule A shows that short contracts in wheat of $14,000 exceed long contracts in that commodity, and that short contracts in corn of $38,000 exceed long contracts in that commodity. Thus the "haircut" of $780 is based on the aggregate of $52,000. 79/

(cc) As developed in the example the application of the adjustments and "haircuts" converts "net worth," including subordinated borrowings, of $83,500 into "net capital" of $18,385; "aggregate indebtedness" is $118,250; and the ratio of "aggregate indebtedness" to "net capital" is 643 per cent. Since the ratio does not exceed 2,000 per cent and "net capital" exceeds the required minimum of $5,000, the firm is in compliance with the rule.

79/ Paragraph (c)(2)(F).

SCHEDULE OF OPEN FUTURE AND SPOT (CASH) COMMODITY CONTRACTS

	Delivery Month	Cost		Market Value		Losses (Gains)	Ledger Balance	
		Short	Long	Short	Long		Debit	Credit
Customers' accounts:								
Future commodities -								
Wheat								
2 contracts - short	Sept	$14,400		$14,000		$ (400)		$1,500
1 contract - long	Sept		$ 7,100		$ 7,000	100		850
Corn								
3 contracts - short	July	18,750		19,800		1,050		750
2 contracts - long	July		12,500		13,200	(700)		500
1 contract - short	Sept	6,200		6,300		100		250
2 contracts - long	Sept		12,400		12,600	(200)		550
2 contracts - short	Dec	12,200		11,900		(300)		1,300
		$51,550	$32,000	$52,000	$32,800	$ (350)		$5,700
Spot (cash) commodities -								
Wheat								
2 contracts - long			$14,200		$14,600		$2,000	
Corn								
3 contracts - long			18,750		20,700		2,500	
			$32,950		$35,300		$4,500	
Firm trading accounts -								
Future commodities								
Wheat								
1 contract - short	Sept	$ 7,100		$ 7,000		$ (100)		
Corn								
1 contract - long	July		$ 6,250		$ 6,600	(350)		
1 contract - short	Sept	6,200		6,300		100		
1 contract - short	Dec	6,100		5,950		(150)		
		$19,400	$ 6,250	$19,250	$ 6,600	$ (500)		

A P P E N D I X

The following amended text of Rule 15c3-1 under the Securities Exchange Act of 1934 became effective, with two exceptions, on July 1, 1965. The exceptions are that the minimum net capital requirements of paragraph (a)(2) did not become effective until December 1, 1965, and that the amendment of the exemptive provisions of paragraph (b)(1) did not become effective until September 1, 1965.

Rule 15c3-1. Net Capital Requirements for Brokers and Dealers

(a) Every broker or dealer shall have the net capital necessary to comply with all the following conditions:

(1) his aggregate indebtedness to all other persons shall not exceed 2,000 per centum of his net capital; and

(2) he shall have and maintain net capital of not less than $5,000; except that the minimum net capital to be maintained by a broker or dealer meeting all of the following conditions shall be $2,500:

(A) his dealer transactions (as principal for his own account) are limited to the purchase, sale and redemption of redeemable shares of registered investment companies; except that a broker or dealer transacting business as a sole proprietor may also effect occasional transactions in other securities for his own account with or through another registered broker-dealer;

(B) his transactions as broker (agent) are limited to: (i) the sale and redemption of redeemable securities of registered investment companies; (ii) the solicitation of share accounts for savings and loan associations insured by an instrumentality of the United States; and (iii) the sale of securities for the account of a customer to obtain funds for immediate reinvestment in redeemable securities of registered investment companies; and

(C) he promptly transmits all funds and delivers all securities received in connection with his activities as a broker or dealer, and does not otherwise hold funds or securities for, or owe money or securities to, customers.

(b) Exemptions.

(1) The provisions of this rule shall not apply to any broker who is also a licensed insurance agent under the laws of any state or the District of Columbia, whose securities business is limited to effecting transactions in variable annuity contracts as general agent for the issuer, who promptly transmits all funds and delivers all variable annuity contracts received in connection therewith, and who does not otherwise hold funds or securities for or owe money or securities to customers, if the issuer files with the Commission an undertaking satisfactory to it that the issuer will assume responsibility for all valid claims arising out of all activities of such agent in effecting transactions in such variable annuity contracts:

Provided, however, That a broker transacting business as a sole proprietor who meets all other conditions of this subparagraph (b)(1) may also effect occasional transactions in other securities for his own account with or through another registered broker-dealer.

(2) The provisions of this rule shall not apply to any member in good standing and subject to the capital rules of the American Stock Exchange, the Boston Stock Exchange, the Midwest Stock Exchange, the New York Stock Exchange, the Pacific Coast Stock Exchange, the Philadelphia-Baltimore-Washington Stock Exchange, or the Pittsburgh Stock Exchange, whose rules, settled practices and applicable regulatory procedures are deemed by the Commission to impose requirements more comprehensive than the requirements of this rule: Provided, however, That the exemption as to the members of any exchange may be suspended or withdrawn by the Commission at any time, by sending ten (10) days written notice to such exchange, if it appears to the Commission to be necessary or appropriate in the public interest or for the protection of investors so to do.

(3) The Commission may, upon written application, exempt from the provisions of this rule, either unconditionally or on specified terms and conditions, any broker or dealer who satisfies the Commission that, because of the special nature of his business, his financial position, and the safeguards he has established for the protection of customers' funds and securities, it is not necessary in the public interest or for the protection of investors to subject the particular broker or dealer to the provisions of this rule.

(c) Definitions. For the purpose of this rule:

(1) The term "aggregate indebtedness" shall be deemed to mean the total money liabilities of a broker or dealer arising in connection with any transaction whatsoever, including, among other things: money borrowed; money payable against securities loaned and securities "failed to receive"; the market value of securities borrowed (except for delivery against customers' sales) to the extent to which no equivalent value is paid or credited; customers' free credit balances; credit balances in customers' accounts having short positions in securities; and equities in customers' commodities futures accounts; but excluding

(A) indebtedness adequately collateralized, as hereinafter defined, by securities or spot commodities owned by the broker or dealer;

(B) indebtedness to other brokers or dealers adequately collateralized, as hereinafter defined, by securities or spot commodities owned by the broker or dealer;

(C) amounts payable against securities loaned which securities are owned by the broker or dealer;

(D) amounts payable against securities failed to receive which securities were purchased for the account of, and have not been sold by, the broker or dealer;

(E) indebtedness adequately collateralized, as hereinafter defined, by exempted securities;

(F) amounts segregated in accordance with the Commodity Exchange Act and the rules and regulations thereunder;

(G) fixed liabilities adequately secured by real estate or any other asset which is not included in the computation of "net capital" under this rule;

(H) liabilities on open contractual commitments; and

(I) indebtedness subordinated to the claims of general creditors pursuant to a satisfactory subordination agreement, as hereinafter defined.

(2) The term "net capital" shall be deemed to mean the net worth of a broker or dealer (that is, the excess of total assets over total liabilities), adjusted by

(A) adding unrealized profits (or deducting unrealized losses) in the accounts of the broker or dealer and, if such broker or dealer is a partnership, adding equities (or deducting deficits) in accounts of partners, as hereinafter defined;

(B) deducting fixed assets and assets which cannot be readily converted into cash (less any indebtedness secured thereby) including, among other things, real estate; furniture and fixtures; exchange memberships; prepaid rent, insurance and expenses; good will; organization expenses; all unsecured advances and loans; customers' unsecured notes and accounts; and deficits in customers' accounts, except in bona fide cash accounts within the meaning of section 4(c) of Regulation T of the Board of Governors of the Federal Reserve System;

(C) deducting the percentages specified below of the market value of all securities, long and short (except exempted securities) in the capital, proprietary and other accounts of the broker or dealer, including securities loaned to the broker or dealer pursuant to a satisfactory subordination agreement, as hereinafter defined, and if such broker or dealer is a partnership, in the accounts of partners, as hereinafter defined:

(i) in the case of nonconvertible debt securities having a fixed interest rate and a fixed maturity date which are not in default, if the market value is not more than 5 percent below the face value, the deduction shall be 5 percent of such market value; if the market value is more than 5 percent but not more than 30 percent below the face value, the deduction shall be a percentage of market value, equal to the percentage by which the market value is below the face value; and if the market value is 30 percent or more below the face value, such deduction shall be 30 percent;

(ii) in the case of cumulative, nonconvertible preferred stock ranking prior to all other classes of stock of the same issuer, which is not in arrears as to dividends, the deduction shall be 20 percent;

(iii) on all other securities, the deduction shall be 30 percent;

Provided, however, That such deduction need not be made in the case of (1) a security which is convertible into or exchangeable for other securities within a period of 30 days, subject to no conditions other than the payment of money, and the other securities into which such security is convertible, or for which it is exchangeable, are short in the accounts of such broker or dealer or partner, or (2) a security which has been called for redemption and which is redeemable within 90 days;

(D) deducting 30 percent of the market value of all "long" and all "short" future commodity contracts (other than those contracts representing spreads or straddles in the same commodity and those contracts offsetting or hedging any "spot" commodity positions) carried in the capital, proprietary or other accounts of the broker or dealer and, if such broker or dealer is a partnership, in the accounts of partners as hereinafter defined;

(E) deducting, in the case of a broker or dealer who has open contractual commitments, the respective percentages specified in subparagraph (C) above of the value (which shall be the market value whenever there is a market) of each net long and each net short position contemplated by any existing contractual commitment in the capital, proprietary and other accounts of the broker or dealer and, if such broker or dealer is a partnership, in accounts of partners, as hereinafter defined: Provided, however, That this deduction shall not apply to exempted securities, and that the deduction with respect to any individual commitment shall be reduced by the unrealized profit, in an amount not greater than the percentage deduction provided for in subparagraph (C), (or increased by the unrealized loss) in such commitment; and that in no event shall an unrealized profit on any closed transactions operate to increase net capital;

(F) deducting an amount equal to 1½ percent of the market values of the total long or total short futures contracts in each commodity, whichever is greater, carried for all customers;

(G) excluding liabilities of the broker or dealer which are subordinated to the claims of general creditors pursuant to a satisfactory subordination agreement, as hereinafter defined; and

(H) deducting, in the case of a broker or dealer who is a sole proprietor, the excess of (1) liabilities which have not been incurred in the course of business as a broker or dealer over (2) assets not used in the business.

(3) The term "exempted securities" shall mean those securities specifically defined as exempted securities in section 3(a) of the Act;

(4) the term "accounts of partners," where the broker or dealer is a partnership, shall mean accounts of partners who have agreed in writing that the equity in such accounts maintained with such partnership shall be included as partnership property;

(5) the term "contractual commitments" shall include underwriting, when-issued, when-distributed and delayed delivery contracts, endorsement of puts and calls, commitments in foreign currencies, and spot (cash) commodities contracts, but shall not include uncleared regular way purchases and sales of securities and contracts in commodities futures; a series of contracts of purchase or sale of the same security conditioned, if at all, only upon issuance may be treated as an individual commitment;

(6) indebtedness shall be deemed to be "adequately collateralized" within the meaning of this rule, when the difference between the amount of the indebtedness and the market value of the collateral is sufficient to make the loan acceptable as a fully secured loan to banks regularly making comparable loans to brokers or dealers in the community;

(7) the term "satisfactory subordination agreement" shall mean a written agreement duly executed by the broker or dealer and the lender, which agreement is binding and enforceable in accordance with its terms upon the lender, his creditors, heirs, executors, administrators, and assigns, and which agreement satisfies all of the following conditions:

(A) it effectively subordinates any right of the lender to demand or receive payment or return of the cash or securities loaned to the claims of all present and future creditors of the broker or dealer;

(B) the cash or securities are loaned for a term of not less than 1 year;

(C) it provides that the agreement shall not be subject to cancellation by either party, and that the loan shall not be repaid and the agreement shall not be terminated, rescinded or modified by mutual consent or otherwise if the effect thereof would be to make the agreement inconsistent with the conditions of this rule or to reduce the net capital of the broker or dealer below the amount required by this rule;

(D) it provides that no default in the payment of interest or in the performance of any covenant or condition by the broker or dealer shall have the effect of accelerating the maturity of the indebtedness;

(E) it provides that any notes or other written instruments evidencing the indebtedness shall bear on their face an appropriate legend stating that such notes or instruments are issued subject to the provisions of a subordination agreement which shall be adequately referred to and incorporated by reference;

(F) it provides that any securities or other property loaned to the broker or dealer pursuant to its provisions may be used and dealt with by the broker or dealer as part of his capital and shall be subject to the risks of the business; and

(G) two copies of such agreement, and of any notes or written instruments evidencing the indebtedness, are filed, within 10 days after such agreement is entered into, with the Regional Office of the Commission for

the region in which the broker or dealer maintains his principal place of business, together with a statement of the full name and address of the lender, the business relationship of the lender to the broker or dealer, and whether the broker or dealer carried funds or securities for the lender at or about the time the agreement was entered into. If each copy of such agreement is bound separately and clearly marked "Non-Public" such agreements shall be maintained in a non-public file: Provided, however, That they shall be available, for official use, to any official or employee of the United States or any state; to any national securities exchange and any registered national securities association of which the broker or dealer filing such agreements is a member; and to any other person to whom the Commission authorizes disclosure in the public interest;

(8) the term "customer" shall mean every person except the broker or dealer: Provided, however, That partners who maintain "accounts of partners" as herein defined shall not be deemed to be customers insofar as such accounts are concerned.

FOR RELEASE Monday, November 8, 1971

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

SECURITIES EXCHANGE ACT OF 1934
Release No. 9376

ADOPTION OF RULE 17a-13, AMENDMENT OF
FORM X-17A-5, AND AMENDMENT OF RULE 17a-3
UNDER THE SECURITIES EXCHANGE ACT OF 1934

The Securities and Exchange Commission announced today that it has adopted Rule 17a-13 under the Securities Exchange Act of 1934 ("the Act") to require a quarterly "box-count" and verification of all securities not in a broker's physical possession. At the same time the Commission has amended Rule 17a-3 to require the making and keeping of records with respect to stock record differences. Finally, the Commission has adopted a related proposal to amend existing Form X-17A-5 with respect to stock record differences and the scope of the auditors' review. The adopted rule and amendments to existing Rule 17a-3 and Form X-17A-5 were published for comment on April 19, 1971, in Securities Exchange Act Release No. 9140. The Commission has considered the comments which were submitted in response to that release. Rule 17a-13 and amendments to existing Rule 17a-3 and Form X-17A-5, as adopted herein, have been modified to reflect certain suggestions contained in the comments.

Rule 17a-13 applies to all members of national securities exchanges who do business with or for others than members of national securities exchanges, and to all brokers and dealers except broker-dealers who limit their business to the sale and redemption of securities of registered investment companies and interests or participations in an insurance company separate account and those who solicit accounts for federally insured savings and loan associations, provided that such persons promptly transmit all funds and securities and hold no customer funds and securities. However, the Rule does not apply to insurance companies which are registered broker-dealers, solely by reason of their purchase and sale of securities on behalf of their general and separate accounts, provided that they otherwise meet the exemptive conditions of the Rule. The member, broker or dealer subject to Rule 17a-13 must, once every calendar quarter: (1) physically examine and count all securities held (this includes firm securities and customer securities); (2) account for all securities in transfer, in transit, pledged, loaned, borrowed, deposited, failed to receive, and failed to deliver 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, pledged, loaned, borrowed, deposited, failed to receive, and failed to deliver 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; (4) compare the results of the examination and verification with the firm's record; and (5) post the unresolved differences to the firm's books and records within seven business days. The examination, count, verification and comparison conducted by the firm's auditors in connection with the firm's annual report of financial condition (Form X-17A-5) may be substituted for the firm's examination, count, verification and comparison for the quarter in which the audit date falls. The quarterly examination, count, verification and comparison are to be made no less than two nor more than four months apart. The Rule specifically allows cyclical counts, whereby all locations would be counted for a specific security, and all security positions would be counted within the prescribed period. The examination, count, verification and comparison are to be conducted or supervised by persons not normally responsible for handling securities or making the subject records.

The amendment to Rule 17a-3, adding a new clause (a)(4)(F) creates a security difference account to which the unresolved long and short differences have to be posted after each examination, count, verification and comparison, by date, showing for each security the number of shares of long or short count differences. All subsequent adjustments to the differences posted also have to be posted to this account. The other amendment to Rule 17a-3, a change in existing clause (a)(5), requires that the securities record which reflects all long and short securities positions also reflect the unresolved differences remaining from each of the required quarterly examinations, counts, verifications and comparisons, and all subsequent adjustments thereto. The securities record, being the main accounting record for the location and movement of securities, should reflect these unresolved stock differences and the subsequent adjustments. Retention of the supporting documentation, required under Rule 17a-4(b)(5), is necessary so that the auditors will have adequate documentation for their review under the amendments to the audit requirements of Form X-17A-5.

The final change amends Form X-17A5. This change is applicable to any form of questionnaire used by a member of a national securities

exchange in lieu of Form X-17A-5. Question 13 is amended to require reporting of: the value of unresolved differences (long and short), classified in accordance with the date of their discovery; the value of long differences sold and short differences bought-in since the previous annual audit, classified in accordance with the date of their discovery; the number of securities in which there were long or short differences; and the total number of securities in which there were positions as of the audit date. Also, the audit requirements are amended to require the accountant to review and comment on the practices and procedures employed in complying with Rule 17a-13 and in the resolution of differences uncovered by the procedures required by Rule 17a-13.

Deficiencies in the accounting system, internal control and procedures for safeguarding securities are reflected by material amounts of unresolved security differences, suspense balances, unverified transfer items and differences in dividend accounts which represent potential losses. The extent of such deficiencies or the absence of appropriate provisions for estimated losses may require the independent public accountant to qualify or disclaim an opinion on the financial statements.

Rule 17a-13 establishes a minimum standard of control over securities for all subject members, brokers and dealers. The rule is not intended to discourage the practice of certain brokers and dealers who examine, count, verify and compare their securities more frequently than once a calendar quarter. The Commission encourages all brokers and dealers to make such additional examinations, counts, verifications and comparisons as good business practice would require, and as are necessary and appropriate to comply with the requirements from time to time of the self-regulatory organizations.

STATUTORY BASIS

The Securities and Exchange Commission, acting pursuant to the provisions of the Securities Exchange Act of 1934, particularly Sections 17(a) and 23(a) thereof, and deeming it necessary for the exercise of the functions vested in it, and necessary and appropriate in the public interest and for the protection of investors, hereby adopts Rule 17a-13, amends the existing Rule 17a-3 and Form X-17A-5, effective January 1, 1972.

THE TEXT OF RULE 17a-13

QUARTERLY SECURITY COUNTS TO BE MADE BY CERTAIN EXCHANGE MEMBERS, BROKERS AND DEALERS

(a) This rule shall apply to every member of a national securities exchange who transacts a business in securities directly with or for others than members of a national securities exchange, every broker or dealer (other than a member) who transacts a business in securities through the medium of any member of a national securities exchange, and every broker or dealer registered pursuant to Section 15 of the Act; except that a broker or dealer meeting all of the following conditions shall be exempt from the provisions of this rule:

(1) His dealer transactions (as principal for his own account) are limited to the purchase, sale and redemption of redeemable shares of registered investment companies or of interests or participations in an insurance company separate account, whether or not registered as an investment company; except that a broker or dealer transacting business as a sole proprietor may also effect occasional transactions in other securities for his own account with or through another registered broker-dealer;

(2) His transactions as broker (agent) are limited to: (A) the sale and redemption of redeemable securities of registered investment companies or of interests or participations in an insurance company separate account, whether or not registered as an investment company; (B) the solicitation of share accounts for savings and loan associations insured by an instrumentality of the United States; and (C) the sale of securities for the account of a customer to obtain funds for immediate reinvestment in redeemable securities of registered investment companies; and

(3) He promptly transmits all funds and delivers all securities received in connection with his activities as a broker or dealer, and does not otherwise hold funds or securities for, or owe money or securities to, customers.

Notwithstanding the foregoing, this rule shall not apply to any insurance company which is a registered broker-dealer, and which otherwise meets all of the conditions in clauses (1), (2) and (3) of this paragraph, solely by reason of its participation, in transactions that are a part of the business of insurance, including the purchasing, selling or holding of securities for or on behalf of such company's general and separate accounts.

(b) Any member, broker or dealer who is subject to the provisions of this rule shall at least once in each calendar quarter-year:

(1) physically examine and count all securities held;

(2) account for all securities in transfer, in transit, pledged, loaned, borrowed, deposited, failed to receive, and failed to deliver 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, pledged, loaned, borrowed, deposited, failed to receive, and failed to deliver 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;

(4) compare the results of the count and verification with his records; and

(5) record on the books and records of the member, broker or dealer all unresolved differences setting forth the security involved and date of comparison in a security count difference account no later than seven business days after the date of each required quarterly security examination, count, and verification in accordance with the requirements provided in (c) hereof,

provided, however, that such procedures need not be carried out by the member, broker or dealer for the calendar quarter-year during which the date of his annual report of financial condition (pursuant to Rule 17a-5) falls; and further

provided, that no examination, count, verification and comparison for the purpose of this rule shall be within two months nor more than four months following a prior examination, count, verification and comparison made hereunder.

(c) The examination, count, verification and comparison may be made either as of a date certain or on a cyclical basis covering the entire list of securities. In either case the recordation shall be effected within seven business days subsequent to the examination, count, verification and comparison of a particular security. In the event that an examination, count, verification and comparison is made on a cyclical basis, it shall not extend over more than one calendar quarter-year, and no security shall be examined, counted, verified or compared for the purpose of this rule less than two months or more than four months after a prior examination, count, verification and comparison.

(d) The examination, count, verification and comparison shall be made or supervised by persons whose regular duties do not require them to have direct responsibility for the proper care and protection of the securities or the making or preservation of the subject records.

(e) The Commission may, upon written request, exempt from the provisions of this rule, either unconditionally or on specified terms and conditions, any member, broker or dealer who satisfies the Commission that it is not necessary in the public interest and for the protection of investors to subject the particular member, broker or dealer to certain or all of the provisions of this rule, because of the special nature of his business, the safeguards he has established for the protection of customers' funds and securities, or such other reason as the Commission deems appropriate.

TEXT OF AMENDMENT TO FORM X-17A-5

Form X-17A-5 is amended to read as follows: [additions have been underlined]

Question 13 - Other Accounts, etc.

State details (ledger balances, valuations of securities and spot (cash) commodities; status of future commodity positions; and any other relevant information) of any accounts which have not been included in one of the answers to the above questions. These shall include: accounts for exchange memberships; furniture, fixtures, and other fixed assets; valuation reserves; funds provided or deposited by the respondent as margin in joint accounts; revenue stamps; dividends receivable, payable, and unclaimed; floor brokerage receivable and payable, commissions receivable and payable, advances to salesmen and other employees; commodity difference account; goodwill; organization expense; prepaid expenses and deferred charges; liability reserves; mortgage payable; other liabilities and deferred credits; market value of securities borrowed (other than for delivery against customers'

sales) to the extent to which no equivalent value is paid or credited; long security count difference valuations; short security count difference valuations; and other accounts not specifically mentioned herein.

Note 1. Any liability reported under this question secured by collateral in any form shall be identified by reference to the related collateral.

Note 2. State in a footnote (a) long security count difference valuations and short security count difference valuations classified in accordance with the date of the physical count and verification pursuant to Rule 17a-5 or 17a-13 in which they were discovered, and (b) the value of long security count differences sold and short security count differences bought-in to resolve differences since the last report on Form X-17A-5 classified in accordance with the date that the related differences were discovered.

Note 3. State in a footnote the number of securities in which there were long security count differences; the number in which there were short security count differences; and the total number of securities in which there were positions as of the audit date.

AMENDMENT TO AUDIT REQUIREMENTS OF FORM X-17A-5 [Additions have been underlined]

The audit shall be made in accordance with generally accepted auditing standards and shall include a review of the accounting system, the internal accounting control and procedures for safeguarding securities including appropriate tests thereof for the period since the prior examination date. It shall include all procedures necessary under the circumstances to substantiate the assets and liabilities and securities and commodities positions as of the date of the responses to the financial questionnaire and to permit the expression of an opinion by the independent public accountant as to the financial condition of the respondent at that date. Based upon such audit, the accountant shall comment upon any material inadequacies found to exist in: (a) the accounting system; (b) the internal accounting control; (c) procedures for safeguarding securities; (d) the practices and procedures employed in complying with Rule 17a-13 and in the resolution of securities differences; and shall indicate any corrective action taken or proposed.

* * *

(9) Review the practices and procedures employed for the making of the securities examinations, counts, verifications, comparisons and the recordation of differences required by Rule 17a-13, and the methods employed in the resolution of the differences uncovered.

TEXT OF AMENDMENTS TO RULE 17a-3

A new clause is added to Rule 17a-3 as follows:

17a-3(a)(4)

Ledgers (or other records) reflecting the following:

(F) All long and all short stock 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 shares of long or short count differences).

Subparagraph (a)(5) of Rule 17a-3 is amended to read as follows: [additions have been underlined]

> A securities record or ledger reflecting separately for each security as of the clearance dates all "long" or "short" positions (including securities in safekeeping) carried by such member, broker or dealer for his account or for the account of his customers or partners and showing the location of all securities long and the offsetting position to all securities short, <u>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</u>, and in all cases the name or designation of the account in which each position is carried.

By the Commission.

Ronald F. Hunt
Secretary

FOR RELEASE Friday, July 30, 1971

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

SECURITIES EXCHANGE ACT OF 1934
Release No. 9268

ADOPTION OF RULE 17a-11 AND FORM X-17A-11
UNDER THE SECURITIES EXCHANGE ACT OF 1934

The Securities and Exchange Commission announced today that it has adopted Rule 17a-11 and Form X-17A-11 under the Securities Exchange Act of 1934 (the "Act") to provide the Commission and the self-regulatory bodies with an adequate and timely flow of information on the financial and operational condition of broker-dealers. The rule was published for comment on April 20, 1971, in Securities Exchange Act Release No. 9128. The Commission has considered the several comments on the proposed rule which were submitted in response to that release. The rule, as adopted herein, has been modified to reflect certain suggestions contained in the comments.

The rule has four major provisions. First, it provides that when the net capital of a broker-dealer is less than required by any capital rule to which it is subject (in total or relative to the firm's aggregate indebtedness), immediate telegraphic notice must be given to the Commission and the self-regulatory organizations to which it belongs, and a report setting forth the firm's financial condition must be filed with them within 24 hours after such net capital deficiency occurs.

Second, the rule provides that when a broker-dealer's net capital computation, made and recorded pursuant to Rule 17a-3(a)(11), indicates that its aggregate indebtedness exceeds 1200% of its net capital or that its total net capital is less than 120% of the minimum net capital required of it, measured under any net capital rule to which the firm is subject, the firm must file a report on Form X-17A-11, furnishing data as to its financial and operational condition. Such report must be filed within 15 days after the end of any month for which the net capital computation showing a net capital ratio in excess of 1200% (or total net capital less than 120% of the minimum required) was made, and within 15 days after the end of each month thereafter until three successive months have elapsed during which the net capital computation does not reflect a net capital ratio in excess of 1200% (or total net capital less than 120% of the minimum required).

Third, the rule provides that, if any broker-dealer subject to Rule 17a-3 is not making and keeping current the books and records specified therein, immediate telegraphic notice of that fact, specifying the books and records not made or kept current, must be given to the Commission and the self-regulatory organizations to which it belongs. Within 48 hours thereafter, the broker-dealer must file a written report stating what steps have been taken to correct the situation.

Fourth, the rule provides that any self-regulatory body which learns that a member firm has failed to give a notice or file a report as required by the rule must itself give notice of that fact.

Form X-17A-11, which is designed to furnish the Commission and the self-regulatory bodies with financial and operational information on firms experiencing problems, consist of two parts. Part I requests the data called for by the NASD Form Q questionnaire, which all NASD members are required to fill in on a routine basis quarterly. Part II requests specific data which has proven to be of significance in the past with regard to brokerage failures.

To meet comments which pointed out the need to maintain surveillance of brokers whose net capital was close to the minimum required by the applicable net capital rule, and not merely of brokers whose net capital ratio was close to the ceiling permitted, paragraph (b) of the proposed rule was modified to require a monthly report from firms whose net capital was less than 120% of the minimum required. To meet comments suggesting the need for clarifying the requirement that brokers file a report of "financial condition" within 24 hours of falling into net capital violation, paragraph (a)(2) of the proposed rule was modified to specify the financial information required, which information is substantially the same as that required under Rule 17a-5(j) for the firms which cease to be a member in good standing of a national securities exchange.

The Commission expects that the requirement in paragraph (e) of the rule that all notices and reports be filed not only with the Commission but also with the appropriate self-regulatory bodies will materially increase the interchange of information and the co-ordination of action with respect to filing firms.

The rule will become effective on September 15, 1971. Copies of Form X-17A-11 may be obtained on request, on or after the effective date, from the Publications Division, Securities and Exchange Commission, Washington, D. C. 20549 or from any of its Regional Offices.

The Securities and Exchange Commission, acting pursuant to the provisions of the Securities Exchange Act of 1934, particularly Sections 8(b), 15(c)(3), 17(a) and 23(a) thereof, and deeming it necessary for the exercise of the functions vested in it, and necessary and appropriate in the public interest and for the protection of investors, hereby adopts Rule 17a-11 and its accompanying Form X-17A-11, effective September 15, 1971.

TEXT OF RULE 17a-11

Rule 17a-11. Supplemental Current Financial and Operational Reports to be Made by Certain Exchange Members, Brokers, and Dealers

(a) Every broker, dealer or member of a national securities exchange or of a registered securities association, subject to Rule 15c3-1 or to a net capital rule of a national securities exchange or registered securities association, whose net capital at any time is less than the minimum required by any capital rule to which such person is subject, shall:

(1) give telegraphic notice as set forth in paragraph (e) hereof that such person's net capital is less than is required by any such capital rule, identifying the applicable net capital rule or rules. The notice shall be given on the same day that such person's capital becomes less than required by any of the aforesaid rules to which such person is subject; and

(2) within 24 hours thereafter file a report of his financial condition as of the date which required the giving of the notice in subparagraph (a)(1) hereof. Such report of financial condition shall consist of:

(A) A proof of money balances of all ledger accounts in the form of a trial balance;

(B) A computation of aggregate indebtedness and net capital made in accordance with Rule 15c3-1;

(C) An analysis of the aggregate market value of fully paid securities in customers' security accounts not segregated showing the location of such securities;

(D) Ledger net credit balances of money borrowed from banks, trust companies and other financial institutions and from others, which are fully or partially secured by securities carried for the account of any customer, showing, for each loan, an analysis of the market value of all collateral for such borrowings by source of collateral, stating separately the market value of: (a) securities carried for the accounts of customers, (b) securities owned by the

broker or dealer or by any general or special partner or any director or official of such broker or dealer, and (c) any other securities;

(E) The aggregate amount of customers' ledger debit balances;

(F) The aggregate amount of customers' credit balances, stating the amount of free credit balances separately; and

(G) The approximate number of customer accounts and the date business was suspended. (If business is continuing, state specifically the nature of the business being conducted.)

(b) If a computation made and recorded by a member, broker or dealer pursuant to the requirements of Rule 17a-3(a)(11) shows that his aggregate indebtedness is in excess of 1,200 per centum of his net capital, or that his total net capital is less than 120 per centum of the minimum net capital required of him, such person shall file a report on Form X-17A-11 within 15 calendar days after the end of the month for which such computation was required to be made and recorded, and within 15 calendar days after the end of each month thereafter until three successive months shall have elapsed during which his aggregate indebtedness does not exceed 1,200 per centum of his net capital, and his total net capital does not fall below 120 per centum of the minimum net capital required of him.

(c) At any time when a member, broker or dealer subject to Rule 17a-3 fails to make and keep current the books and records specified therein, he shall immediately give telegraphic notice of such fact, specifying the books and records which have not been made or which are not current, and within 48 hours of the telegraphic notice file a report stating what steps have been and are being taken to correct the situation.

(d) Whenever any national securities exchange or national securities association learns that a member, broker or dealer has failed to file a notice or file a report as required by paragraphs (a), (b) or (c) of this rule, such organization shall immediately report such failure as provided in paragraph (e) of this rule.

(e) Every notice and report required to be given or filed by this rule shall be given to or filed with the principal office of the Commission in Washington, D. C., with the Regional Office of the Commission for the region in which the member, broker or dealer has his or its principal place of business, and with each national securities exchange and registered securities association of which such person is a member.

By the Commission.

Theodore L. Humes
Associate Secretary

For RELEASE February 20, 1970

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

SECURITIES EXCHANGE ACT OF 1934
Release No. 8825

ADOPTION OF AMENDMENT OF BROKER-DEALER FORM X-17A-5 UNDER THE SECURITIES EXCHANGE ACT OF 1934

On May 8, 1969, in Securities Exchange Act Release No. 8601, the Commission published a proposal to amend Note 2 to Question 4 of Form X-17A-5 to require that the separate list of securities transactions in the "Securities failed to deliver" account outstanding 30 days or longer be classified in accordance with the period such transactions have been outstanding. In order to conform the reporting requirements of the note to a recent amendment of Rule 15c3-1 */ (the net capital rule) providing for certain specified deductions on outstanding items in the failed to deliver account, it was proposed that the transactions be classified according to the length of time that they have been outstanding: 30 to 39 calendar days; 40 to 49 calendar days; 50 to 59 calendar days; and 60 or more calendar days. Form X-17A-5 specifies certain financial information required to be filed as of a date within each calendar year by members of national securities exchanges and certain other brokers and dealers.

Comments which have been received did not object to the proposal but raised a question as to the need for the detailed listings of money balance and security valuation of each security transaction outstanding 30 days or longer included in the total reported as securities failed to deliver and securities failed to receive under Questions 4.B. and 4.D., respectively, of Form X-17A-5. The comments stated that the requirement for detailed listings imposed a substantial burden of preparation and that the information was of minimal value.

After consideration of the comments received, the Commission has decided to eliminate the requirement for detailed listing of failed transactions outstanding 30 days or longer and to adopt the proposed amendment of Note 2 in a modified form. Note 2 as revised requires that the total money balance and security valuation of security transactions outstanding 30 days or longer included in Question 4.B., Securities failed to deliver, and Question 4.D., Securities failed to receive, be reported separately or in a note and that the amounts reported as securities failed to deliver be classified in accordance with the periods that they have been outstanding.

---

*/ Securities Exchange Act Release No. 8508, January 30, 1969.

Statutory Basis

The Securities and Exchange Commission, acting pursuant to the provisions of the Securities Exchange Act of 1934, particularly Sections 17(a) and 23(a) thereof, and deeming it necessary for the exercise of the functions vested in it, and necessary and appropriate in the public interest and for the protection of investors, hereby amends Note 2 to Question 4 of Form X-17A-5 as set forth below, effective February 20, 1970.

Text of the Amendment

Note 2 to Question 4 of Form X-17A-5 is hereby amended to read as follows:

> 2. State separately or in a footnote the totals of ledger debit balances; ledger credit balances; long security valuations; short security valuations, for transactions outstanding 30 calendar days or longer included in the answers to Question 4.B. (Securities Failed to Deliver) and Question 4.D. (Securities Failed to Receive). The amounts reported for Question 4.B. shall be classified in accordance with the period that the transactions have been outstanding: 30 to 39 calendar days; 40 to 49 calendar days; 50 to 59 calendar days; and 60 or more calendar days.

By the Commission.

Orval L. DuBois
Secretary

FOR RELEASE Thursday, January 27, 1972

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

Securities Exchange Act of 1934
Release No. 9468

RESPONSIBILITIES OF REGISTERED BROKER-DEALERS WITH RESPECT TO THEIR FINANCIAL AND OPERATIONAL CONDITION.

The Commission on December 28, 1971 submitted to the Congress its "STUDY OF UNSAFE AND UNSOUND PRACTICES OF BROKERS AND DEALERS" pursuant to Section 11(h) of the Securities Investor Protection Act of 1970 ("Study"). This Study documents the severe financial and operational problems experienced by the securities industry generally in the period 1968-1970 and certain broker-dealers in particular. The Study noted that a contributing factor to these problems may have been the inability or reluctance of management of troubled firms to identify and promptly resolve financial and operational problems.

The Commission has recommended certain legislative changes to strengthen its ability to oversee compliance with and enforcement of the Federal securities laws by broker-dealers. The Commission also has received a special supplemental appropriation from Congress to undertake a rapid and significant expansion of personnel in its Washington and Regional Offices. The new personnel will be responsible primarily for carrying out more extensive and more frequent inspections of broker-dealers in accordance with the inspection program for overseeing compliance by broker-dealers with the Securities Exchange Act of 1934 outlined by the Commission in the Study.

Consequently, the Commission is hereby advising registered broker-dealers of its expanded and intensified inspection and review program and reminding them of their ongoing responsibility to comply with the financial, recordkeeping and reporting requirements specified in Sections 8, 15 and 17 of the Securities Exchange Act of 1934, and the rules and regulations promulgated thereunder, in particular Rules 8c-1, 15c2-1, 15c3-1, 17a-3 and 17a-5, and also 17a-5(j) and 17a-11. Meticulous adherence to these requirements is essential for the protection of investors, as well as for the proper functioning of the securities industry.

The Commission will take prompt action to insure compliance with these rules and regulations, and the failure of broker-dealers to comply may result in revocation of their broker-dealer registrations.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
500 NORTH CAPITOL STREET WASHINGTON, D. C. 20549

Information on Registration and Regulation of INVESTMENT-ADVISERS

DIVISION OF TRADING AND MARKETS - SECURITIES AND EXCHANGE COMMISSION

GENERAL REQUIREMENTS - REGISTRATION

The Investment Advisers Act of 1940 was enacted by Congress upon a finding that the activities of persons in the business of furnishing investment advice or investment advisory materials through the use of the mails or any means or instrumentality of interstate commerce were of national concern because of their effect on the securities markets, interstate commerce, the national banking system, and the national economy, and that it was accordingly necessary to regulate such activities. One of the central elements of the regulatory program is the requirement that, unless exempt, such persons should become registered with the Securities and Exchange Commission as investment advisers.

WHO IS AN INVESTMENT ADVISER

With certain exceptions, the term "investment adviser" is defined in Section 202(a)(11) of the Act to include, ". . . [A]ny person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities." This is a very broad definition and applies not only to persons who make recommendations concerning securities, but also to person whose analyses, reports or other materials are to be used by others in making decisions as to what securities to buy or sell or when to buy or sell them.

REGISTRATION REQUIREMENTS

Section 203(a) prohibits any investment adviser, unless exempt, from using the mails or any means or instrumentality of interstate commerce in connection with his investment advisory business, unless registered with the Commission. Section 203(d) sets out the bases on which registration may be denied or revoked.

APPLICATION FOR REGISTRATION

Application for registration is made by filing two executed copies of Form ADV with the headquarters office of the Commission in Washington, D.C. The application for registration as an investment adviser seeks information concerning the nature of the investment adviser's business; the background, education and experience of the principals, controlling persons and employees of the investment adviser firm; and whether the applicant and persons associated with him meet statutory requirements.

EXEMPTIONS FROM REGISTRATION

Section 203(b) provides certain limited exemptions from registration. Of particular interest is the exemption contained in paragraph (3) of Section 203(b) for those investment advisers who during the course of the preceding 12 months have had fewer than 15 clients (i.e., 14 clients or less) and who do not hold themselves out generally to the public as investment advisers. This provision is of very limited application and would not be available unless both conditions contained therein are met. Thus, even if an investment adviser has fewer than 15 clients, this exemption would not be available if he holds himself out to the public as an investment adviser in any manner. The maintenance of a listing as an investment adviser in a telephone, business, building or other directory, or the expression of willingness to existing clients or others to accept new clients, or the use of a letterhead indicating any activity as an investment adviser, would be included among the acts that would constitute a holding out to the public as an investment adviser and make the exemption contained in Section 203(b)(3) unavailable.

BOOKS AND RECORDS - INSPECTIONS

Section 204 and Rule 204-2 thereunder provide for the making, preservation, and inspection of certain specified books and records.

PROHIBITED CONTRACTUAL AND FEE PROVISIONS

Section 205 requires contracts to contain certain provisions, and prohibits a fee arrangement based on capital appreciation of a client's funds.

RESTRICTION ON USE OF TERM "INVESTMENT COUNSEL"

Section 208(c) prohibits a registered investment adviser from using the term "investment counsel," unless his principal business consists of acting as an investment adviser and a substantial part of his business consists of rendering "investment supervisory services" as that term is defined in Section 202(a)(13) of the Act.

ANTI-FRAUD PROVISIONS

Section 206 prohibits fraudulent activities by investment advisers. This section applies to all investment advisers whether or not required to be registered. Rules 206(4)-1 and 206(4)-2 thereunder are concerned respectively with advertisements of investment advisers and their custody or possession of clients' funds or securities.

Section 206 and the other applicable anti-fraud provisions of the federal securities laws (namely, Section 17 of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder) prohibit misstatements or misleading omissions of material facts and fraudulent acts and practices in connection with the purchase or sale of securities or the conduct of an investment advisory business. An investment adviser is a fiduciary who owes his clients undivided loyalty, and is prohibited from engaging in activity in conflict with the interest of any client. Every investment adviser should familiarize him-

self with the opinion of the Supreme Court in S.E.C. v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963). In this case the Supreme Court held that "scalping" by an investment adviser involves a violation of Sections 206(1) and (2) of the Investment Advisers Act. Generally speaking, "scalping" refers to the practice whereby an investment adviser effects transactions for his own account in a security shortly before recommending the purchase or sale of that security to his clients and then shortly thereafter effects further transactions for himself to profit from the market activity in the security resulting from his recommendation.

RESPONSIBILITY FOR COMPLIANCE - SEC ASSISTANCE

Although attention has been directed to selected provisions of the Act and Rules, this is not to be regarded as relieving any investment adviser from complying with all regulatory provisions applicable to his conduct at any given time. The staff of the Securities and Exchange Commission is available to investment adviser applicants and registrants to discuss problems with regard to the registration and other provisions of the Investment Advisers Act which may pertain to specific proposed activities. You may find it convenient to contact the Regional or Branch Office of the Commission in your area. A list of these offices is attached for your convenience.

STATE REQUIREMENTS

Many states have their own requirements with respect to persons conducting business as investment advisers within that state. Information with respect to the requirements of any particular state should be addressed to the appropriate official in that state.

REGIONAL AND BRANCH OFFICES

ZONE 1 - New York and New Jersey
26 Federal Plaza
New York, New York 10007

ZONE 2 - Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, and Connecticut: Suite 2203, John F. Kennedy Federal Bldg., Government Center,
Boston, Massachusetts 02203

ZONE 3 - Tennessee, Virgin Islands, Puerto Rico, North Carolina, Alabama, South Carolina, Georgia, Florida, Mississippi, and that part of Louisiana lying east of the Atchafalaya River: Suite 138, 1371 Peachtree Street, N. E.,
Atlanta, Georgia 30309

BRANCH:

Room 1504, Federal Office Building, 51 S.W. First Ave.,
Miami, Florida 33130

ZONE 4 - Michigan, Ohio, Kentucky, Indiana, Illinois, Wisconsin, Minnesota, Iowa, Missouri, and Kansas City (Kansas): Room 1708, Everett McKinley Dirksen Building, 219 South Dearborn St.,
Chicago, Illinois 60604

BRANCHES:

Federal Office Building, Room 899, 1240 East 9th at Lakeside,
Cleveland, Ohio 44199

1044 Federal Building
Detroit, Michigan 48226

Room 1452, 210 North Twelfth Street
St. Louis, Missouri 63101

ZONE 5 - Oklahoma, Arkansas, Texas, that part of Louisiana lying west of the Atchafalaya River, and Kansas (except Kansas City): 503 U. S. Court House, 10th & Lamar Sts.,
Fort Worth, Texas 76102

BRANCH:

Room 2606, Federal Office & Courts Bldg., 515 Rusk Avenue,
Houston, Texas 77002

ZONE 6 - North Dakota, South Dakota, Utah, Wyoming, Nebraska, Colorado, and New Mexico: 7224 Federal Building, 1961 Stout Street,
Denver, Colorado 80202

BRANCH:

Federal Reserve Bank Building
Third Floor, 120 South State Street
Salt Lake City, Utah 84111

ZONE 7 - Nevada, Arizona, California, Hawaii and Guam: 450 Golden Gate Avenue, Box 36042,
San Francisco, California 94102

BRANCH:

Room 1043 U. S. Court House
312 North Spring Street
Los Angeles, California 90012

ZONE 8 - Montana, Idaho, Washington, Oregon, and Alaska: 900 Hoge Building,
Seattle, Washington 98104

ZONE 9 - Pennsylvania, Delaware, Maryland, Virginia, West Virginia, and District of Columbia:
Ballston Centre Tower No. 13
4015 Wilson Boulevard
Arlington, Virginia 22203

STUDY OUTLINE FOR THE SECURITIES AND EXCHANGE COMMISSION GENERAL SECURITIES EXAMINATION

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

STUDY OUTLINE FOR THE SECURITIES AND EXCHANGE COMMISSION GENERAL SECURITIES EXAMINATION

Section 15(b)(8) of the Securities Exchange Act of 1934 gives the Commission authority by which it may "appropriately classify brokers and dealers and persons associated with brokers and dealers (taking into account relevant matters, including types of business done and nature of securities sold)" and "require persons in any such class to pass examinations."

The Special Study of Securities Markets, transmitted to Congress by the Commission in 1963, recognized the qualifications examination as a "basic regulatory control in respect to competence." The prevailing practice of the majority of State and self-regulatory bodies in requiring the completion of a general securities examination as a prerequisite for entry into the securities business by salesmen and others gave added impetus to the adoption by the Commission of Rule 15b8–1.

Rule 15b8–1 prohibits any nonmember broker or dealer, as defined by the rule, from effecting any transactions over-the-counter unless every associated person within certain defined categories has successfully completed a general securities examination covering a "core of basic subjects."

The General Securities Examination which is administered to associated persons of nonmember brokers and dealers is designed to determine the extent of the applicant's knowledge of subjects considered essential to his work. This Study Outline has been prepared with a view toward aiding associated persons in their preparation for the General Securities Examination by highlighting those subject areas which form the basis for the examination questions. It should be used in conjunction with the Training Guide and the bibliographic materials suggested.

STUDY OUTLINE FOR QUALIFICATION EXAMINATION

I. Fundamentals of Securities

A. Elements of Finance—Basic concepts and definitions of terms in the fields of corporation finance and accounting, taxation, money and banking, and public finance.

1. Corporation Finance and Accounting

a. Common Stock—authorized, outstanding, unissued
Treasury stock
Preferred stock
Par value
Equity
Equity security
Market value
Rights
Warrants
Splits
When issued
Dividends
Stock dividends
Bearer and registered certificates

b. Bonds, general
Premium
Discount
Debenture bonds
Convertible bonds
Mortgage bonds
Serial bonds
Revenue bonds
Retirement of bonds
Coupons
Income bonds

c. Guaranteed stocks and bonds
Sinking fund
Collateral trust certificates
Voting trust certificates

d. Capitalization
Asset value
Gross capital
Funded debt
Net tangible asset value
Stated value
Fiscal year
Amortization
Depletion
Depreciation
Retained earnings
Good will
Book value
Diversification
Current assets

e. Rights of stockholders
Liability of stockholders
Voting
Proxies
Pre-emptive rights

f. Stock registrar — Transfer agent
Street name

2. Analysis and Interpretation of Financial Statements

The income statement
Managerial performance
Evaluation of reported earnings
Inventory
Contingencies
Earnings
Margin of profit
Price-earnings ratio
Operating profit
The balance sheet
Capital structure
Risk
Working capital
Current ratio and standard minimum
Acid test
Cash holdings
Total sales to merchandise inventory
Operating deficit

3. Taxation—Definitions and Basic Concepts

Capital gains
Dividend tax credit and exclusion
Short and long-term gains
Realization of gains
Five-year carryover
Establishing a securities tax loss or gain
Tax-exempt securities
Double taxation of dividends
Gifts in anticipation of death
Passing of securities at death to estate at current market value
Transfer tax rates
Referring legal questions to counsel

4. Money and Banking

Role of the U.S. Treasury and the Federal Reserve in the monetary system
Changes in interest rates
Definition of bills, notes, commercial paper, call loans to brokers, prime rate

B. The Analysis of Securities
1. Sources of Financial Information
2. Industry Analyses

3. Factors in Stock Analysis

- Growth stock
- Blue chip
- Special situation
- Income stock and defensive issue concepts and standards
- Investment vs. speculation
- Stock valuation
- Leverage analysis
- Mergers
- Consolidations
- Refinancing
- Recapitalization
- Receivership or reorganization
- "Watered stock"

4. Corporate Senior Securities

Analysis and standards for corporate bonds, preferred stock, income bonds, and guaranteed stocks

- Effect of premium and discount on yield
- Bond ratings
- Convertible bond price correlation to stock or bond market
- Appraisal of conversion privilege
- Callable provisions

5. Governments

Analysis and standards for Federal, state, municipal and statutory authority bonds

- Comparative yields
- Investment appeal of Treasury notes and certificates
- Tax status
- Definition of Treasury bills and notes
- Series E bonds

6. Market Analysis

- Popular short and long-term forecasting systems
- Popular stock indexes

II. Securities Markets

A. Comparative Markets

1. Kind of businesses whose securities are traded on the principal national securities exchanges and over-the-counter markets

2. Nature of each securities market (auction, negotiated, etc.)

B. Investment Banking

Functions of the investment banker
Underwriting procedures
Primary and secondary distributions
"Red herring" or preliminary prospectus
Indication of interest
Buying syndicates
Stabilization
Competitive bidding
Best efforts
Private vs. public offerings

C. Over-the-Counter Trading

How over-the-counter market operates
Types of securities traded
Agency and dealer relationship with customers
Quotations spread
The National Daily Quotation Service ("Pink Sheets," etc.)
"Boiler Room"

D. Foreign Securities

E. Arbitrage

III. Investment Companies

A. Applicable Law

1. Securities Act of 1933—provisions covering registration, prospectus and shareholder report

2. Securities Exchange Act of 1934—provisions covering proxies and periodic reports of portfolio changes

3. Investment Company Act of 1940

Definitions and provisions
"Regulated investment company"
Maintaining the public offering price

4. SEC Statement of Policy—and published interpretations of Statement of Policy

Rates of return	Cost averaging and contractual plans
Capital gains vs. income	Sales commissions
Explanation of risks	
Government regulation	
Custodial services	
Redemption	
Comparisons	
Management claims	
Continuous investment programs	

5. Internal Revenue Code

   a. Passing through of taxation of dividends paid to and capital gains realized by mutual funds

   b. Required dividend and interest payout

   c. Capital gains distribution

   d. Individual reporting of income and gains from mutual funds

B. Sources of information

   1. Prospectus

   2. Annual Reports

   3. Newspaper Price Tables

C. Fundamentals of Investment Companies

   1. Understanding of Terms such as:

Capitalization	Custodians
Fund appreciation	Dividend and capital gains distribution
Unrealized appreciation	Custodian charges
Leverage	Custodian or trustee fee
Management	

Management fees
Operating costs
Expense ratio
Sponsor
Net investment income

2. Types and Characteristics

   a. Diversified common stock

   b. Balanced

   c. Income

   d. Bond and Preferred stock

3. Purchases and Sales—Open-End Investment Companies

   a. Selling charges
      Purchase by dollar amounts
      Quantity discounts
      Dollar cost averaging

   b. Changing number of shares
      Basis for offering and redemption price
      Methods of issue and redemption
      Marketability

   c. Automatic dividend reinvestment

   d. Accumulation plans

      (1) Level charge-open account (voluntary plan)
          Life insurance features
          Liquidation provisions

      (2) Prepaid charges—contractual
          Penalty of front-end load
          Fixed period
          Specified payment or investment
          Life insurance feature
          Liquidation provisions

      (3) Regular withdrawal plans

IV. Federal Laws

A. Securities Act of 1933
Prospectus
False statements
Secret profits
Improper sales of securities
Sales of unregistered securities

B. Securities Exchange Act of 1934
Section 3(a)(12) exempt securities
Section 15(b)(1)–(3)—registration of brokers and dealers
Section 10—regulation of the use of manipulative and deceptive devices
Section 9—manipulation, wash sales, inducing purchases or sales, false and misleading statements, unlawful use of puts, calls, and other options
Section 15A—(Maloney amendment)
Section 15c(1)—manipulation, deceptive or fraudulent devices or contrivances
Section 26—unlawful representation

C. Regulation T; Regulation U

V. State Laws

A. Blue Sky

B. Prudent Man Rule

REFERENCES FOR

GENERAL SECURITIES EXAMINATION

Unless otherwise noted, copies of the following books and reference material should be obtained directly from the publisher indicated below or from a book store.

1. A standard text on Corporation Finance may be used in reviewing definitions of basic terms, *e.g.*, Barnes and Noble College Outline Series, *Corporation Finance*, New York: Barnes and Noble, Inc., $1.75. Order from Barnes and Noble, Inc., 105 Fifth Avenue, New York, N.Y., 10003.

2. Loll, L. M., Jr., & Buckley, J. G. *The Over-the-Counter Securities Markets: A Review Guide*. Englewood Cliffs, N.J.: Prentice-Hall, Inc., 1967. $8.95. Quantity price and discount available for training purposes. Order from Prentice-Hall, Inc., Englewood Cliffs, N.J., 07631.

3. Leffler, G. L. Revised by L. C. Farwell. *The Stock Market* (3d ed.) New York: Ronald Press, 1963. $8.50. Order from Ronald Press Co., 15 East 26th Street, New York, N.Y., 10010.

4. Jordan, D. F. & Dougall, H. E. *Investments* (7th ed.) Englewood Cliffs, N.J.: Prentice-Hall, Inc., 1960. $9.75. Quantity price and discount available for training purposes. Order from Prentice-Hall, Inc., Englewood Cliffs, N.J., 07631.

5. Loeser, J. C. *The Over-the-Counter Securities Market*. New York: National Quotation Bureau, Inc., 1940. $2. Order from National Quotation Bureau, Inc., 46 Front Street, New York, N.Y.

6. Graham, B. & McGolrick, C. *The Interpretation of Financial Statements*. (Rev. ed.) New York: Harper & Bros., 1964. $2.95. Order from Harper & Bros., 49 East 33d Street, New York, N.Y.

SUPPLEMENTAL READINGS

7. Wiesenberger, A. *Investment Companies*. New York: Arthur Wiesenberger & Co., $40, includes quarterly supplements on performance. Order from Arthur Wiesenberger Services, Division of Nuveen Corporation, 61 Broadway, New York, N.Y., 10006.

8. Loss, L. *Securities Regulation* (2d ed.) Boston: Little, Brown & Co., 1961, 3 vols. $60. Order from Little, Brown & Co., 34 Beacon Street, Boston, Mass., 02106.

9. Investment Bankers Association of America. *Fundamentals of Municipal Bonds*. Washington, D.C.: $3. Order from Investment Bankers Association of America, 425 13th Street NW., Washington, D.C., 20004.

U.S. GOVERNMENT PRINTING OFFICE: 1967 O—281-664

SUITABILITY OUTLINE

I

Distinction Between Fraud Concept and the Unethical Practice Concept

There are innumerable fact situations in which an investor could be sold a security which is unsuited to his financial status and needs. In many situations, the anti-fraud provisions of the Federal Securities Laws would be violated, and some of these may give rise to a common law cause of action. Where a fraud has been committed it may also involve a violation of the applicable rules on suitability. However, the suitability rules of the NASD [1/] and the SEC [2/] were intended to cover situations even where fraud is not involved. In short, the rules go beyond fraud concepts.

II

Application of the Anti-Fraud Provisions of the Federal Securities Laws

"(T)he obligation imposed by the anti-fraud provisions of the securities acts are not limited to those recognized in conventional

---

1/ Art. III, Sec. 2, NASD Rules of Fair Practice.

2/ Rules 15b10-3 and 15b10-6 under the Securities Exchange Act of 1934.

common-law fraud doctrines."[3/] Cohen and Rabin, Broker-Dealer Selling Practice Standards, 29 Law and Contemporary Problems 691 702 (1964).

The Supreme Court has noted that "the doctrines of fraud and deceit which developed around transactions involving land and other tangible items of wealth are ill-suited to the sale of such intangibles as advice and securities and that accordingly, the doctrines must be adapted to the merchandise in issue". S.E.C. v Capital Gains Research Bureau, Inc., 375 U. S. 180 (1963).

In the development of fraud law under the federal securities laws, two general theories have evolved to rationalize the duties of broker-dealers to their customers -- the "shingle" theory and the "trust and confidence" theory.

1. Shingle Theory. When a dealer who acts as a principal for his own account rather than an agent (broker) "hangs out his shingle" he impliedly represents that he will deal fairly with the public and the disclosure obligation and other duties he assumes are in many respects

---

3/ Common Law Bases. (a) Under the common law of torts, where a seller, possessed of expertise or special knowledge which the purchaser lacks expressly represents that his recommendations are suitable and "either knew or intended it to be false, or made the representation with reckless disregard of the facts," the seller is liable for the damages resulting from the sale. Anderson v. Knox, 297 F. 2d 702, 721 (9th Cir. 1961), cert. denied, 370 U. S. 915 (1962); quoting Restatement of the Law of Torts §542(a) and Harper and James, The Law of Torts, §78. (b) Under the common law of agency, an agent has a duty to give his principal timely notice of all material facts coming to his knowledge and "to conduct himself with the utmost loyalty and fidelity to the interests of his principal, and not to place himself or voluntarily permit himself to be placed in a position where his own interests or those of any other person whom he has undertaken to represent may conflict with the interests of his principal". Mechem, Outlines of the Law of Agency, §§345, 372 (4th ed. 1952). See Opper v. Hancock Securities Corp., 250 F. Supp. 668 (S. D. N. Y. 1966).

similar to those he would have if he were acting as an agent (broker). Duker & Duker 6 S.E.C. 386, 388-89 (1939). See also, Charles Hughes & Co., Inc. v. S.E.C., 139 F. 2d 434 (2d Cir. 1943), cert. denied 321 U. S. 786; E. M. Rollins & Sons, Inc. 18 S.E.C. 347, 362 (1945); Carl J. Bliedung, 38 S.E.C. 518, 521 (1958); Mac Robbins & Co., 41 S.E.C. 116 (1962); J. Logan & Co., Sec. Ex. Act Rel. No. 6848 (July 9, 1962).

2. Trust and Confidence Theory. When a dealer permits a relationship of trust and confidence to develop between himself and his customer, he is bound by fiduciary principles and must act in his customer's best interests and disclose all information adverse to his customer. Looper & Co., 38 S.E.C. 294, 300 (1958); Mason, Moran and Company, 35 S.E.C. 84 (1953); Ramey Kelly Corporation, 39 S.E.C. 756 (1960).

3. On the basis of the shingle theory and the trust and confidence theory the Commission has held that the anti-fraud provisions were violated in several situations where an unsuitable security was offered or sold. This has occurred in "churning," "boiler-room," excessive mark-up, and fraudulent misrepresentation cases.

FRAUDULENT MISREPRESENTATIONS:

Shearson, Hammill and Co., Securities Exchange Act Release No. 7743 (November 15, 1965), p. 22.

The Ramey Kelly Corporation, 39 S.E.C. 756; 759-60 (1960).

BOILER-ROOM CASES:

J. A. Winston & Co., Inc., Securities Exchange Act Release No. 7337 (June 8, 1964), p. 4.

Ross Securities, Inc., Securities Exchange Act Release No. 7069 (April 30, 1963), p. 7.

Alexander Reid & Co., Inc., Securities Exchange Act Release No. 7016 (February 7, 1963), pp. 3-5.

B. Fennekohl & Co., Securities Exchange Act Release No. 6898 (September 18, 1962), p. 6.

MacRobbins & Co., Inc., Securities Exchange Act Release No. 6846 (July 11, 1962), p. 4.

N. Pinkser & Co., Inc., Securities Exchange Act Release No. 6401 (October 21, 1960), pp. 7-8.

Barnett & Co., Inc., 40 S.E.C. 1, 4 (1960).

Best Securities, Inc., 39 S.E.C. 931, 933-34 (1960).

CHURNING:

Reynolds & Co., et al., 39 S.E.C. 902 (1960).

Looper and Company, 38 S.E.C. 294 (1958).

R. H. Johnson and Company, et al., 36 S.E.C. 467 (1955).

EXCESSIVE MARK-UPS:

William Harrison Keller, Jr., 38 S.E.C. 900, 905 (1959).

Carl J. Bliedung, 38 S.E.C. 518 521 (1958).

III

SUITABILITY RULES

A. NASD Suitability Rule

"In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs." Art. III, Sec. 2, NASD Rules of Fair Practice.

NASD proceedings under its suitability rule involve fact situations which for the most part fit the typical "boiler-room," "churning," or excessive mark-up pattern. See NASD District Business Conduct Committee for District No. 12 v. Robert Martin & Co., Inc. et al (November 8, 1962) (boiler-room); First Securities Corporation, 40 S.E.C. 589 (1961) (churning); Boren & Co., 40 S.E.C. 217 (1960) (mark-up).

The leading case involving the NASD suitability rule is Gerald M. Greenberg 40 S.E.C. 133 (1960). The release is entitled Greenberg and Leopold, Securities Exchange Act Release No. 6320 (July 21, 1960).

B. S.E.C. Suitability Rule

Rule 15b10-3 provides:

Every nonmember broker or dealer and every associated person who recommends to a customer the purchase, sale or exchange of any security shall have reasonable grounds to believe that the recommendation is not unsuitable for such customer on the basis of information furnished b-

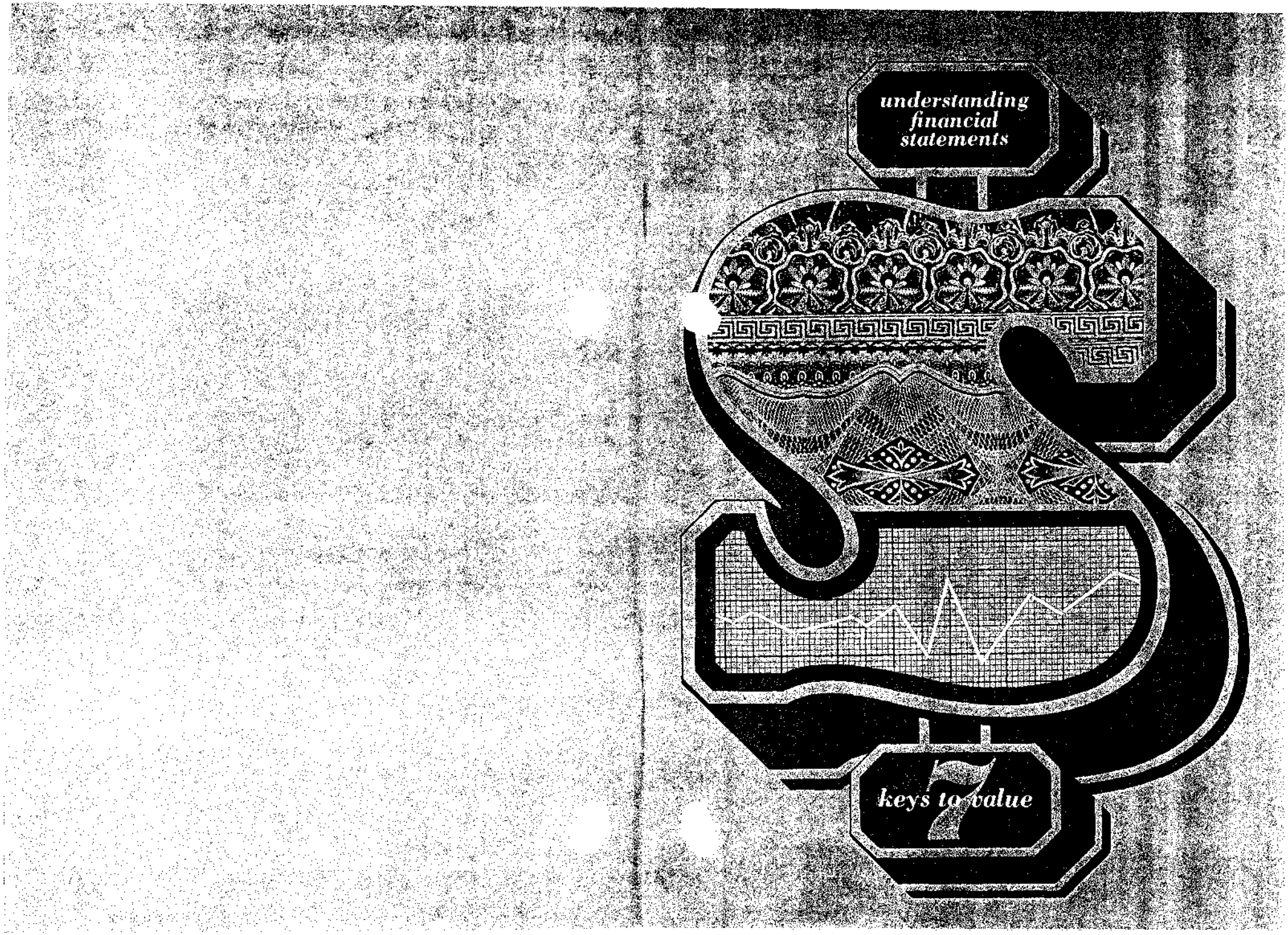
such customer after reasonable inquiry concerning the customers investment objectives, financial situation and needs, and any other information known by such broker or dealer or associated person.

Rule 15b10-6 provides:

If the broker or dealer, or any associated person, has made any recommendation to the customer to purchase sell or exchange any security, the record for such customer shall also state the customer's occupation, marital status, investment objectives, other information concerning the customer's financial situation and needs which the broker or dealer or the associated person considered in making the recommendation, and the signature of the broker or dealer or associated person who made the recommendation to the customer.

In the release announcing the adoption of the above rules, the Commission stated that the rules were not adopted under the anti-fraud provisions.

Branch of Non-NASD Regulation
Division of Trading and Markets


understanding
financial
statements
keys to value

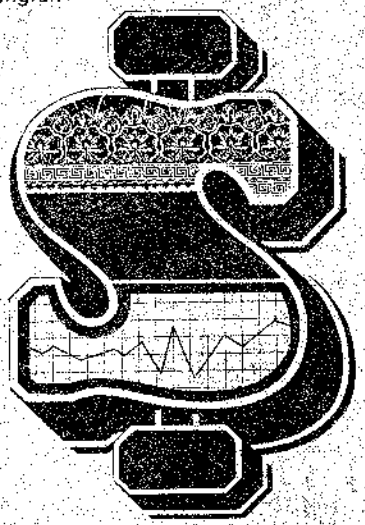
7 keys to value

The Member Firms of the New York Stock Exchange throughout the nation are always happy to furnish facts they have available and help you interpret financial information about companies in which you are interested.

Business conditions, credit policy, economic and political trends, and psychology all influence stock prices. But a study of financial statements provides basic knowledge for determining investment values.

The purpose of this booklet is to show you a way brokers extract from statements helpful information to evaluate a company. The approach is also used by commercial bankers, credit men and industrial executives in reviewing a business enterprise. And more than ever, corporations include in their annual reports to stockholders certain key ratios discussed in the following pages.

If you are an educator, a student or an investor who prefers to study financial statements yourself, this booklet will point up some of the keys that can help make these statements more meaningful.



Published by The New York Stock Exchange, Inc., with data compiled as of February 15, 1972.

introduction

The annual report is an account of American industry in action. It is economics come to life. The annual report records the past, reflects the present and often looks to the future.

For thoughtful Americans who are interested in the corporate enterprises which produce a large share of the nation's goods and services, the annual report amounts to meaningful—and often exciting—reading. It is especially important to all those people who happen to own shares in American busines. For more than anything else, the annual report portrays a corporation's financial progress growing out of the soundness of its operations.

The companies whose stocks are bought and sold on the New York Stock Exchange cast long shadows virtually everywhere. They earn about 70 per cent of the profits reported by American corporations, pay stockholders more than half of all the dividends disbursed, and the taxes they pay are a vital source of revenue to the government.

All the companies with securities listed on the New York Stock Exchange are required to publish extensive annual financial statements. What's more, most all listed companies supplement these annual reports with quarterly reports. As a result, American investors are better informed than investors anywhere else in the world.

But these annual reports haven't always been so informative. Shortly after the Civil War a railroad, whose stock was listed on the Stock Exchange, was brief and to the point when it was invited to contribute its report. The company replied that it makes "no reports and publishes no statements—and have done nothing of the sort for the last five years."

While that particular incident was rather unusual even for those times, it does illustrate a point. For a period of many years some companies simply did not publish reports regularly.

In a way, there was little or no justification for elaborate annual reports. Corporations such as banks and mills were largely local enterprises with only a handful of stockholders. These owners were generally either affiliated with the company or else they were on intimate terms with the management. The state of business was one of the town's chief topics of conversation, and the annual meeting could be attended by nearly everyone. Under these circumstances, an annual report no bigger than a single sheet containing the financial statement sufficed.

As the times began to change, the need for more complete reports was obvious. Corporations expanded, capital needs increased, the number of shareowners grew far beyond the boundaries of a particular region. The expense or trouble of attending an annual meeting, especially for smaller stockholders, hardly seemed worthwhile.

FINANCIAL STATEMENTS/GREATER DISCLOSURE

At the turn of the century the Stock Exchange got the first industrial company to agree to publish an annual statement. The report would include statements of income and expenditures, along with a balance sheet showing a statement of the company's condition. An age of greater financial disclosure had set in. One after the other, companies listed on the Stock Exchange brought out annual reports. Companies that wanted to qualify for listing agreed to publish reports of their earnings, and the Exchange gradually applied more rigid requirements. Later, the Federal Securities Acts and rules required disclosure of financial information for the protection of investors.

As the Stock Exchange standards of disclosure were raised, annual reports grew more voluminous, more detailed, more statistical. They were refined in the 1920's and 1930's and in the 1940's too, until today the annual report usually represents a condensed accounting of a company's e gs, and its changes in financial position. Often it discusses such things the company's prospects, research activities and new products.

Today some 1,200 leading corporations distribute an estimated 40,000,000 copies of these reports every year. They go not only to stockholders, but also to the press, company employees, schools of business administration, investment firms and other financial organizations. And anyone—whether he owns securities or not—can usually obtain an annual report merely by mailing a written request to the company.

FINANCIAL RATIOS/THEIR SIGNIFICANCE

In this booklet *(pp. 6-9)* the items in the balance sheet and income account of a hypothetical company are explained and a running commentary highlights the results in the year of the annual report and the preceding year. Some significant financial ratios often used in analysis appear under "7 Keys to Value." These ratios are developed from the company's financial statements.

Sometimes there is disagreement on the conclusions which can be drawn from an interpretation of these financial ratios. Moreover, investment analysis naturally requires judgment and takes into account many other factors concerning the industry, company and security under consideration. In fact, financial ratios themselves vary among different industries and the significance of the various ratios may change from time to time.

Since financial statements covering a single year are not by themselves especially meaningful, two successive statements are employed for the purpose of our hypothetical study. Most annual reports now include statements for both the current and the previous year, and in many instances summaries for 5- to 10-year periods are provided. By measuring one against another, a pattern may emerge that can be helpful to the investor.

As professionals in the financial community realize, both the me account and balance sheets must be carefully analyzed. All too often people get a distorted picture by reviewing only the earnings statement. What may

appear to be "good" earnings may not be especially healthy if the company concerned has borrowed too heavily. Similarly an improvement in earnings may not necessarily be commensurate with additional investments that have been made.

Briefly, the income statement may be considered a narrative covering a period of time, while the balance sheet is a candid snapshot of the current financial condition at a given date. Since many items are estimates, financial statements may be better understood if the figures are not taken too literally. And obviously, the statement should be interpreted in view of other related factors.

Further, the reader should be able to obtain a better understanding of financial statements by applying the material in this booklet to the annual report of a company in which he has an interest. Although the standards naturally vary according to economic characteristics peculiar to particular dustries the general pattern will apply to most of them.

And while financial statements reveal a company's economic condition, they are, after all, the result of management policies—nothing more. The prudent investor will seek to learn all he can about the management.

A comprehensive glossary of the expressions used in America's investment world may be obtained at no cost from member firms of the New York Stock Exchange, Inc. Simply ask for a copy of "The Language of Investing."

Balance Sheet

ASSETS

Current assets. Company had current assets on December 31, 1971 of $48.4 million—"current" because they may be turned into cash more readily than fixed assets.

Cash requires no explanation. The bulk will be in the form of bank deposits.

Receivables are usually amounts due from customers for goods sold or services rendered. In different industries, the ordinary terms of payment vary. It is conservative practice to set up a reserve to cover any amounts that may not be collectible.

Inventories are the raw materials, work in process, supplies used in operations nd the finished goods ready for sale. Sometimes these items are shown separately. Since the value of inventories changes with price fluctuations, it is important to know how the inventories are valued. Statements usually indicate the

(continued on page 10)

Balance Sheet "Your Company"

Assets, Liabilities & Stockholders' Equity

	Dec. 31 1970	Dec. 31 1969
ASSETS		
Current Assets		
Cash	$ 9.0	$ 6.2
U. S. Government securities		2.0
Accounts and notes receivable	12.4	11.4
Inventories	27.0	24.6
Total Current Assets	$ 48.4	$ 44.2
Other Assets		
Surrender value of insurance	.2	
Investments in subsidiaries	4.7	
Prepaid insurance	.6	
Total Other Assets	$ 5.5	$ 4.6
Fixed Assets		
Buildings, machinery and equipment at cost	104.3	92.7
Less accumulated Depreciation	27.6	25.0
	$ 76.7	$ 67.7
Land	.9	.7
Total Fixed Assets	$ 77.6	$ 68.4
Total Assets	$131.5	$117.2
Liabilities & Stockholders' Equity		
Current Liabilities		
Accounts payable	$ 6.1	$ 5.0
Accrued liabilities	3.6	3.3
Current maturity of long-term debt	1.0	.8
Federal income and other taxes	9.6	8.4
Dividends payable	1.3	1.1
Total Current Liabilities	$ 21.6	$ 18.6
Reserves	3.6	2.5
Long-Term Debt		
5% Sinking-Fund Debentures, due July 31, 1980	26.0	20.0
Stockholders' Equity		
5% Cum. Preferred Stock ($100 par)	6.0	6.0
Common Stock ($10 par)	18.3	18
Capital Surplus	9.6	
Earned Surplus	16.4	
Total Stockholders' Investment	$ 80.3	$ 76.1
Total Liabilities, and Stockholders' Investment	$131.5	$117.2

The Company Owned	*explanation*
Cash and U. S. Government securities, the latter generally at either cost or market value, whichever is lower.	
	Amounts owed the company by its customers and others.
Raw materials, work in process and finished merchandise.	
	Miscellaneous assets, and advance payments for insurance. Investments in nonconsolidated subsidiary companies.
Land, buildings and equipment and deductions for wear and tear on these properties.	

The Company Owed	
For materials, supplies, wages and salaries to employees, and such things as dividends declared, real estate, social security and income taxes, etc.	
	May be either a liability of a more or less definite nature, such as provision for possible inventory losses, or a part of earnings not available for dividends and segregated so as not to be included in surplus available for dividends.
For money borrowed (excluding portion due in next 12 months shown as a current liability).	
	Amount originally invested in the business by the stockholders. Additional capital received from sale of Capital Stock above par value.
...tained earnings reinvested in the business.	

Statement of Income

	Dec. 31 1971	Million	Dec. 31 1970
SALES	$115.8		$110.0
Less:			
Costs and Expenses:			
Cost of goods sold	74.8		73.2
Selling, general and administrative expenses	14.2		13.0
Depreciation and depletion	4.2		3.5
	$ 93.2		$
Operating Profit	$ 22.6		$ 20.3
Interest Charges	1.3		1.0
Earnings before Income Taxes	$ 21.3		$ 19.3
Provision for Federal and State Taxes on Income	11.4		9.8
Net Income for the Year	$ 9.9		$ 9.5
Dividend on Preferred Stock	.3		.3
Balance of Net Income Available for Common Stock	$ 9.6		$ 9.2

Statement of Retained Earnings

	Dec. 31 1971	Million	Dec. 31 1970
Balance at beginning of year	$ 42.2		$ 37.6
Add -- Net Income for the year	9.9		9.5
	52.1		47.1
Less Dividends Paid on			
Preferred Stock	.3		.3
Common Stock	5.4		
Balance at End of Year	$ 46.4		$

explanation

Amount received or receivable from customers.

Part of income used for wages, salaries, raw materials, fuel and supplies and certain taxes.

Part of income used for salesmen's commissions, advertising, officers' salaries and other general expenses.

Provision from income for e reduction of the service life machinery and buildings and use of minerals in mines.

The remainder after deducting the foregoing expenses from sales, but before providing for interest charges and taxes.

Amount required for interest on borrowed funds.

Amount paid or payable for taxes.

This amount was earned for stockholders.

Amount paid to preferred stockholders.

Amount remaining for common stockholders.

Surplus or retained earnings reinvested in the business. Usually not all of the year's earnings can be paid out in dividends, a part being retained in the business for expansion or other purposes.