How can this problem of integration be adequately addressed?

e. OTC Derivatives Dealer.

Question 41: Should the Commission amend the Rule so that all broker-dealers are eligible to use the methodology for calculating market and credit risk as in proposed Appendix F to the Rule?

Question 42: What minimum capital requirements should the Commission require a broker-dealer to meet to be eligible to use proposed Appendix F? Should the criteria be based on tentative net capital, net capital, or both? Are the $100 million tentative net capital and $20 million net capital requirements appropriate?

Question 43: Assuming that the Commission were to allow all broker-dealers to utilize Proposed Appendix F, what sections in Proposed Appendix F need to be modified for all broker-dealers? Are the market risk and credit risk sections in Proposed Appendix F appropriate for all broker-dealers? Are the qualitative and quantitative requirements for VAR models in Proposed Appendix F appropriate to VAR models used by non-OTC derivatives dealers?

f. Two Tiered Approach.

Question 44: Is a Two Tiered Approach a viable alternative to the current net capital rule? If so, what standards should the Commission utilize to determine which broker-dealers are required to utilize statistical models? Should the tier limits be based on capital, amount of customer business, level of proprietary trading, or some other factor(s)? Should these minimum net capital amounts be fixed dollar amounts or be based on financial ratios such as aggregate indebtedness or aggregate debit items as in the current rule? Please provide relevant data to support your response.

Question 45: Should the current haircut percentages be maintained? If not, what modifications should be made to the current haircut percentages? Please provide relevant data to support your response.

Question 46: What will be the impact on competition among firms in different tiers? In this regard, the Commission seeks comment on the effects of creating a two-tiered system from broker-dealers that do not currently use models in their risk management system and from broker-dealers that currently use models for risk management purposes but either lack sufficient capital or sufficiently diverse securities portfolios to use models for net capital purposes.

g. Base Approach with Pre-Commitment Feature.

Question 47: Is the Base Approach a viable alternative to the current net capital rule?

Question 48: Should the Base Approach only apply to firms that meet certain standards? If so, what are the appropriate standards?

Question 49: What minimum capital requirements should the Commission establish for certain broker-dealer activities? Should these minimum net capital amounts be fixed dollar amounts or based on financial ratios such as aggregate indebtedness or aggregate debit items as in the current rule? Should the current minimum levels be retained?

Question 50: What modifications should the Commission make to the current haircut percentages? Please provide relevant data to support your response.

Question 51: What should be the parameters for the pre-commitment feature? Should firms be penalized for differences between actual results and the results as projected by VAR models? If so, what criteria should be used to determine the additional capital requirements for these differences?

III. Summary of Requests for Comment

Following receipt and review of comments, the Commission will determine whether rulemaking or other action is appropriate. Commenters are invited to discuss the broad range of concepts and approaches described in this release concerning the Commission's regulation of broker-dealers' net capital requirements. In addition to responding to the specific questions presented in this release, the Commission encourages commenters to provide any information to supplement the information and assumptions contained herein regarding the current net capital rule, VAR models, and the other suggested alternatives. The Commission also invites commenters to provide views and data as to the costs and benefits associated with the possible changes discussed above in comparison to the costs and benefits of the current net capital rule. In order for the Commission to assess the impact of changes to the Rule, comment is solicited, without limitation, from investors, broker-dealers, SROs, and other persons involved in the securities markets.

Dated: December 17, 1997.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 97–33400 Filed 12–29–97; 8:45 am]

BILLING CODE 8010–01–P

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34–39457; File No. S7–33–97]

RIN 3235–AH28

Capital Requirements for Brokers or Dealers Under the Securities Exchange Act of 1934

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission (''Commission'') is proposing for comment amendments to Rule 15c3–1 under the Securities Exchange Act of 1934. The proposed amendments would define the term ''nationally recognized statistical rating organization'' (''NRSRO''). The proposed definition sets forth a list of attributes to be considered by the Commission in designating rating organizations as NRSROs and the process for applying for NRSRO designation.

DATES: Comments must be received on or before March 2, 1998.

ADDRESSES: Persons wishing to submit written comments should file three copies with Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Stop 6–9, Washington, D.C. 20549. Comments also may be submitted electronically at the following E-mail address: rule-comments@sec.gov. All comment letters should refer to File No. S7–33–97. This file number should be included on the subject line if E-mail is used. All comments received will be available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, N.W., Washington, D.C., 20549. Electronically submitted comment letters will be posted on the Commission's Internet web site (http://www.sec.gov).

FOR FURTHER INFORMATION CONTACT: Michael A. Macchiaroli, Associate Director, 202/942–0131, Peter R. Geraghty, Assistant Director, 202/942–0177, Louis A. Randazzo, Special Counsel, 202/942–0191, or Michael E. Greene, Staff Attorney, 202/942–4169, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION:

I. Introduction

A. The Commission's Concept Release

In August 1994, the Commission issued a concept release soliciting public comment on the Commission's role in using the ratings of NRSROs.[1] In the Concept Release, the Commission specifically solicited comments on: (1) Whether it should continue to use the NRSRO concept, and, if so, whether it should define the term ''NRSRO''; and (2) whether the current no-action letter process for designating a rating organization an NRSRO is satisfactory, and, if not, whether the Commission should establish an alternative procedure. The Commission is now

[1] Securities Exchange Act Release No. 34616 (August 31 1994), 59 FR 46314 (September 7, 1994) (''Concept Release'').

proposing to amend the net capital rule to provide a definition of the term ''NRSRO'' that sets forth the criteria that a rating organization must satisfy to be an NRSRO.

B. Summary of the Comments

The Commission received 25 comment letters in response to the Concept Release. The comments generally supported the continued use of the NRSRO concept, but recommended that the Commission adopt a formalized process for designating NRSROs. A few commenters set forth criteria that the Commission should consider to determine whether a rating organization is an NRSRO. In addition, commenters generally opposed formal regulatory oversight of NRSROs. These issues are discussed in greater detail in Sections III and IV below.

C. The Development and Expanded Use of the NRSRO Concept

The term ''NRSRO'' was initially adopted by the Commission in 1975 for the narrow purpose of distinguishing different grades of debt securities under the Commission's net capital rule, Rule 15c3–1.[2] Rule 15c3–1 requires a broker-dealer to reduce the value of the securities positions that it owns by specified percentages (''haircuts'') when calculating its net capital. Broker-dealers that own commercial paper, nonconvertible debt securities, and nonconvertible preferred stock are allowed to reduce their haircuts for these instruments when calculating net capital if the instruments are rated investment grade by at least two NRSROs.[3]

Since its adoption in 1975, the NRSRO concept has expanded beyond its originally intended use under the net capital rule. For example, Congress, in certain mortgage related legislation,[4] and the Commission, in its regulations pursuant to the Securities Act of 1933,[5] the Securities Exchange Act of 1934 (''Exchange Act''),[6] and the Investment Company Act of 1940,[7] use the ratings of NRSROs as proxies to distinguish ''investment grade'' from ''non-investment grade'' debt securities. These references are to an NRSRO as that term is used in Rule 15c3–1; however, the term ''NRSRO'' has not been defined for purposes of the federal securities laws.

D. Current Process for Determining Whether an Entity is an NRSRO

Currently, to determine whether a rating organization is an NRSRO, the Division of Market Regulation (''Division'') staff first reviews the rating organization's operations, position in the marketplace, and other criteria. If the Division staff determines that a rating organization may properly be labelled an NRSRO, the staff issues a letter stating that it will not recommend enforcement action to the Commission if the rating organization is considered by registered broker-dealers to be an NRSRO for purposes of applying the relevant portions of the net capital rule.

In determining whether a rating organization may be considered an NRSRO for purposes of the Commission's rules, the staff considers a number of criteria. The single most important criterion is that the rating organization is nationally recognized, which means the rating organization is recognized in the United States as an issuer of credible and reliable ratings by the predominant users of securities ratings. The Division also examines the operational capability and reliability of each rating organization in conjunction with this standard of national recognition. Included within this assessment are: (1) The organizational structure of the rating organization; (2) the rating organization's financial resources (to determine, among other things, whether it is able to operate independently of economic pressures or control from the companies it rates); (3) the size and quality of the rating organization's staff (to determine if the entity is capable of thoroughly and competently evaluating an issuer's credit); (4) the rating organization's independence from the companies it rates; (5) the rating organization's rating procedures (to determine whether it has systematic procedures designed to produce credible and accurate ratings); and (6) whether the rating organization has internal procedures to prevent the misuse of non-public information and whether those procedures are followed.

The Division's no-action position regarding NRSRO designation is based on representations made to the staff by the rating organization during the no-action process. The no-action letter directs the rating organization to advise the Division of any material change in the facts that serve as the basis for granting the no-action position. For example, material changes in an NRSRO's organizational structure or modifications of its rating practices could affect the NRSRO's standing as a credible evaluator in the credit market. The Division may withdraw a no-action letter designating a particular rating organization as an NRSRO under certain circumstances.

To date, the Commission regards five rating organizations as NRSROs for purposes of the net capital rule: (1) Standard & Poor's Corporation (''Standard & Poor's''); (2) Moody's Investors Service, Inc. (''Moody's''); (3) Fitch IBCA, Inc. (''Fitch IBCA'');[8] (4)

[2] 17 CFR 240.15c3–1.

[3] See 17 CFR 240.15c3–1(c)(2)(vi)(E) (haircuts applicable to commercial paper that has been rated in one of the three highest categories by at least two NRSROs); 17 CFR 240.15c3–1(c)(2)(vi)(F) (haircuts applicable to nonconvertible debt securities that are rated in one of the four highest rating categories by at least two NRSROs); 17 CFR 240.15c3–1(c)(2)(vi)(H) (haircuts applicable to cumulative, nonconvertible preferred stock rated in one of the four highest rating categories by at least two NRSROs).

[4] Pub. L. 98–440, Section 101, 98 Stat. 1689 (1984). See 15 U.S.C. 78c(a)(41).

[5] See, *e.g.*, Regulation S–K (17 CFR 229.10) (a registrant may include NRSRO ratings in its registration statements and periodic reports); Rule 436 (17 CFR 230.436) (rating assigned to a security by an NRSRO shall not be considered part of the registration statement prepared or certified by a person within the meaning of sections 7 and 11 of the Securities Act of 1933); Form S–3 (17 CFR 239.13) (Form S–3 may be used in primary offerings of non-convertible securities and asset-backed securities which are rated investment grade by at least one NRSRO); Forms F–2 and F–3 (17 CFR 239.32, 239.33) (non-convertible securities for purposes of Forms F–2 and F–3 are investment grade securities if, at the time of sale, at least one NRSRO has rated the security in one of its generic rating categories that signifies investment grade).

[6] See, *e.g.*, Rule 101 (17 CFR 242.101) and Rule 102 (17 CFR 242.102) (non-convertible debt securities, nonconvertible preferred securities and asset-backed securities which are rated investment grade by at least one NRSRO are exempt from the provisions of Rule 101 and Rule 102). See also Form 17–H (17 CFR 249.328T) (for each Material Associated Person of a broker-dealer, the broker-dealer must include the name of the NRSRO which has rated a Material Associated Person's commercial paper).

[7] See, e.g., Rule 2a–7(a)(9) (17 CFR 270.2a–7(a)(9)) (an ''eligible security'' is, among other things, a security that has received a short-term rating by the requisite NRSROs in one of the two highest short-term rating categories); Rule 10f–3 (17 CFR 270.10f–3) (municipal securities rated investment grade by at least one NRSRO are exempt from section 10–f of the Investment Company Act of 1940, which prohibits registered investment companies from purchasing certain securities); and Rule 3a–7 (17 CFR 270.3a–7) (issuers of asset-backed securities may not be deemed investment companies for purposes of the Investment Company Act of 1940 if, among other things, fixed-income securities sold by the issuer are rated in one of the four highest categories by at least one NRSRO).

[8] When the net capital rule became effective in 1975, Fitch Investors Service, L.P. (''Fitch''), Standard & Poor's and Moody's were designated as NRSROs by the Division for purposes of the net capital rule. Subsequently, based on requests from rating organizations, the Division provided no-action assurances to Duff & Phelps, BankWatch, IBCA Limited and IBCA Inc. (IBCA Limited and IBCA Inc. are collectively referred to as ''IBCA''). IBCA was designated as an NRSRO for limited purposes. In November 1997, Fitch and IBCA combined to create Fitch IBCA, a successor rating organization. By letter dated November 4, 1997, the Division stated that it would not recommend enforcement action to the Commission if Fitch IBCA succeeded to the NRSRO designation of Fitch for the purposes of applying paragraphs (c)(2)(vi)

Continued

Duff & Phelps Credit Rating Co. (''Duff & Phelps'');[9] and (5) Thomson BankWatch, Inc. (''Bankwatch'').[10]

II. The NRSRO Concept Release

The Concept Release requested comment on whether the Commission should continue to employ an NRSRO concept to distinguish various types of debt and other securities for purposes of its rules. Thirteen commenters discussed the NRSRO concept. Overall, the commenters generally supported the continued use of the NRSRO concept in the net capital and other Commission rules. For example, the Securities Industry Association Capital Committee (''SIA'') believes that the continued use of the NRSRO concept is an integral part of the net capital rule. Additionally, the SIA commented that the use of NRSRO ratings is a vital ingredient of the Commission's efforts to safeguard the capital markets against risks arising from fluctuations in the proprietary positions of securities firms.

Some commenters suggested that the Commission discontinue the use of the NRSRO concept and instead employ statistical models or historical spreads to determine the level of risk associated with a particular instrument. As the SIA commented, however, continued use of the NRSRO concept in the net capital rule would give broker-dealers an objective, simple standard for determining the capital value of a debt instrument under the rule. In contrast, a modelling approach involves a possibly intricate statistical configuration. It is also likely that modelling will work only where there is a deep and liquid market for the instrument because of the difficulty in obtaining prices. It would not be adequate for debt issuers with no previously issued or very old public debt. In order to assist the Commission in determining whether statistical modelling may be appropriate in the future for purposes of the NRSRO concept, the Commission invites comments on practical approaches to the use of statistical models in the context of determining the credit risk of individual financial instruments.

(E), (F), and (H) of the net capital rule to all debt. Subsequent to the transfer of the ownership of IBCA to Fitch IBCA, IBCA was no longer considered to be an NRSRO. See Letter regarding Fitch IBCA Inc. (November 4, 1997).

[9] See Letter regarding Duff & Phelps, Inc. (February 24, 1982).

[10] See Letter regarding Thomson BankWatch, Inc. (August 6, 1991). BankWatch is recognized as an NRSRO only for the purposes of rating debt issued by banks, bank holding companies, non-bank banks, thrifts, broker-dealers, and broker-dealers' parent companies.

III. Description of the Proposed Amendments

As discussed in more detail below, the proposal would amend Rule 15c3–1 by adopting a new subparagraph (c)(13), which would define the term ''NRSRO.'' As proposed, the definition of NRSRO will include rating organizations designated as NRSROs by the Commission. Designation of such rating organizations as NRSROs would be based upon written application filed with the Director of the Commission's Division of Market Regulation in Washington, D.C.[11] The Commission would consider the attributes currently assessed by the Division in the no-action letter process in determining whether a rating organization is an NRSRO.

IV. Discussion of the Proposed Amendments

A. Proposed Definition of NRSRO in the Net Capital Rule

Having considered the comments received, the Commission proposes to define NRSRO in the net capital rule to include a list of attributes that will be considered by the Commission in designating rating organizations as NRSROs. These attributes are described in more detail below. Under the proposal, rating organizations that have received no-action assurances from the Division will retain whatever NRSRO designation status that they currently possess and will not be required to reapply for NRSRO designation; however, the Commission will conduct reviews of the current NRSROs to assure that they meet the requirements in the proposed definition. In the event the Commission determines that any such rating organization does not satisfy the requirements set forth in the proposed rule, the Commission will act to revoke the NRSRO designation.

The Commission believes that defining the term ''NRSRO'' in the net capital rule should provide clarity and limit concerns regarding any perceived arbitrariness in the current process of designating NRSRO status.

B. Criteria in the Definition of NRSRO

Commenters generally recommended that the Commission adopt procedures for designating NRSRO status that clearly identify the criteria a rating organization must possess. Specifically, commenters recommended that the Commission formalize the current no-action letter criteria for designating NRSROs in a Commission rule. For example, various rating organizations recommended including the requirement of national recognition and market acceptance of the organizations' ratings.

Consistent with the comment letters received, an NRSRO would include any rating organization designated by the Commission after considering a list of attributes similar to the criteria currently considered by the Division in the no-action letter process. The rating organization would have to meet each criterion in order to be designated as an NRSRO. The Commission's designation would apply only to a rating organization's opinion concerning the creditworthiness of debt instruments. The Commission notes that other opinions and views of the rating organization would be outside the scope of the NRSRO designation.

The attributes the Commission would consider are: (1) National recognition, which means that the rating organization is recognized as an issuer of credible and reliable ratings by the predominant users of securities ratings in the United States; (2) adequate staffing, financial resources, and organizational structure to ensure that it can issue credible and reliable ratings of the debt of issuers, including the ability to operate independently of economic pressures or control by companies it rates and a sufficient number of staff members qualified in terms of education and experience to thoroughly and competently evaluate an issuer's credit; (3) use of systematic rating procedures that are designed to ensure credible and accurate ratings; [12] (4) extent of contacts with the management of issuers, including access to senior level management of the issuers; [13] and (5) internal procedures to prevent misuse of non-public information and compliance with these procedures.[14] In addition to

[11] The Commission understands that a rating organization's application may contain commercial or financial information that is confidential. It is the responsibility of the rating organization to request confidentiality under the appropriate Commission rules. See 17 CFR 200.83. The Commission believes, however, that the cover letter from the rating organization requesting NRSRO designation and any response by the Commission would be publicly available.

[12] The Commission believes that a systematic rating procedure should help to ensure that the same or similar analysis is conducted for all issues rated. In addition, the ratings should be structured in such a way that the different rating categories are easily identifiable.

[13] The Commission believes that rating organizations that have access to senior management are better able to make subjective opinions regarding the risks associated with the issue.

[14] The Commission believes that maintaining these procedures should help ensure that the issuer's management is comfortable with providing the rating organization all information necessary for the rating organization to make reliable subjective opinions about the risks associated with the issue.

the attributes noted above, the proposal would require a rating organization to be registered with the Commission as an investment adviser under the Investment Advisers Act of 1940 (''Advisers Act'') in order to be designated as an NRSRO.[15]

By specifying required criteria in the definition of NRSRO, the Commission will be able to promulgate the characteristics that are necessary for NRSRO designation, thereby assuring rating organizations that if they possess such characteristics, they will likely be designated, and will remain, NRSROs. Similar to the no-action letter process, however, the Commission is reserving the ability to withdraw designation if a rating organization fails to maintain the requisite criteria. Accordingly, a rating organization designated as an NRSRO would be required to notify the Commission when it experiences material changes that may affect its ability to continue to meet any of the requisite criteria. For example, material changes in an NRSRO's organizational structure or modifications of its rating practices could affect the NRSRO's standing in the credit market that could warrant withdrawing NRSRO designation. Codifying the current NRSRO designation would ensure that the process is transparent and applied consistently.

C. Application Process

A rating organization seeking NRSRO designation would be required to file an application with the Director of the Commission's Division of Market Regulation in Washington, D.C. The rating organization would be required to include in the application detailed information explaining how the rating organization satisfies the attributes necessary for NRSRO designation. The rating organization also would be required to file any additional information subsequently requested by the Division.

D. Delegation of Authority to the Division

The Commission proposes to delegate authority to the Division to examine rating organizations' applications and to designate a rating organization as an NRSRO or to deny such designation.[16] Under the proposed amendments, the Division would not have delegated authority to revoke or withdraw any previously granted designation. Delegating authority to the Division will allow rating organizations that receive an adverse decision from the Division to seek Commission review. Pursuant to the Commission's Rules of Practice, any person aggrieved by an action made by delegated authority may seek Commission review of the action by filing a petition for review with the Commission.[17] The Commission may preside over or, if it so orders, designate a hearing officer to preside over any proceeding instituted to review a determination made pursuant to delegated authority. The Commission may, at its discretion, designate an administrative law judge as the hearing officer presiding over such proceedings.[18]

E. Charging Fees Based on the Size of the Transaction

In the Concept Release, the Commission requested comments on the practice of NRSROs charging issuers for ratings and whether it is appropriate for an NRSRO to charge an issuer fees based on the size of the transaction being rated.

Fourteen commenters offered views on this practice. As a general matter, they did not oppose NRSROs charging issuers for ratings. Various commenters expressed concern, however, regarding charging fees based upon the size of the transaction. For example, one rating organization commented that it is not appropriate for rating organizations to charge issuers based upon the size of the transaction because the large fees received may cause the rating organization to have an interest in whether the issue is successful or unsuccessful. In addition, the rating organization commented that basing fees on the size of an issue may compromise the rating organization's objectivity in rating the issue.

In particular, the Commission is concerned that a rating organization may be tempted to give a more favorable rating to a large issue because of the large fee and to encourage the issuer to submit future large issues to the rating organization. The Commission invites further comment on whether the use of this practice should be added as a criterion in the definition of an NRSRO.

V. Request for Comments

In response to the Concept Release, some commenters suggested using objective criteria in the definition of NRSRO. The Commission's concerns about using objective criteria is that it could lead to unintended results and possible manipulation of the NRSRO designation process. A rating organization may meet the basic objective criteria standard, but have no credibility in the marketplace. For example, using the number of persons employed by a rating organization as one of the criteria would not take into consideration qualifications of the employees with respect to rating issuer's securities. On the other hand, a rating organization may have a solid reputation for publishing reliable ratings, but may not meet an objective criteria, such as a minimum number of employees. The Commission, however, invites comment on whether objective criteria should be used to determine NRSRO designation and the types of objective criteria that should be considered.

The Commission also invites comment on whether a specific time period should be established for the Commission to act on an application. If such a period is considered appropriate, the Commission also seeks comment on whether a time period in the range of 180 to 365 calendar days would be appropriate.

In addition, concerns have been raised to the Commission about the fact that some ratings may not be generally available to the public and may be restricted only to subscribers. Because the Commission is proposing to provide rating organizations with the NRSRO designation, the Commission invites comment on whether NRSROs should be required to provide their ratings to the public. The Commission also invites interested persons to submit written data, views, arguments and/or comments on the other aspects of the proposed amendments.

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[15] All currently designated NRSROs are registered with the Commission under the Advisers Act. Although section 203A of the Advisers Act prohibits investment advisers that have less than $25 million of assets under management to register with the Commission, the Commission has exempted investment advisers that are designated as NRSROs from this prohibition. See rule 203A–2 [17 CFR 275.203A–2].

As proposed, a rating organization must be registered as an investment adviser under the Advisers Act and maintain such registration as a condition of receiving and retaining its NRSRO designation. A rating organization applying for designation as an NRSRO that is not registered as an investment adviser, because, for example, it does not have $25 million of assets under management, would have to register under rule 203A–2(d) under the Advisers Act, which permits an investment adviser that reasonably expects to be eligible for Commission registration within 120 days of registering with the Commission to register with the Commission even though it may not otherwise meet the criteria for Commission registration under section 203A of the Advisers Act. Once a rating organization is registered as an investment adviser, it must maintain its registration. Otherwise, its NRSRO designation will void automatically.

[16] The Commission proposes to amend Rule 200.30–3, which provides for delegation of authority to the Director of the Division of Market Regulation, to include the designation of NRSROs. See 17 CFR 200.30–3.

[17] See 17 CFR 201.430.

[18] See 17 CFR 201.110.

VI. Costs and Benefits of the Proposed Amendments and Their Effects on Competition

To assist the Commission in its evaluation of the costs and benefits that may result from the proposed rule amendments, commenters are requested to provide analyses and data relating to the costs and benefits associated with any of the proposals herein. The Commission believes the benefit of the proposed definition will be to make its current practice of designating NRSROs more transparent and formalized. The Commission preliminarily believes that the proposed amendments will benefit all market participants by clarifying the basis for designating NRSROs and making the designation process more transparent. The amendments also will provide an appeal process for rating organizations that have been denied NRSRO designation. The amendments will impose no additional compliance burdens on broker-dealers and will not impede efficiency, competition, and capital formation, because they merely codify the current criteria a credit rating organization must meet in order to be designated as an NRSRO. The costs associated with the rule proposal would not differ significantly from those incurred under the current no-action letter process.[19] The proposed amendments would not change the basis by which broker-dealers determine the deductions applicable to their proprietary securities. Section 23(a) of the Exchange Act, 15 U.S.C. 78w(a)(2), requires the Commission, in adopting rules under the Exchange Act, to consider the anti-competitive effect of the rule, if any. The Commission has considered the proposed amendments in light of this standard and believes, preliminarily, that if adopted, they would not likely impose any significant burden on competition that is not necessary or appropriate in furtherance of the Exchange Act. The Commission solicits comment on this preliminary view.

VII. Summary of Initial Regulatory Flexibility Analysis

In accordance with 5 U.S.C. 603, the Commission has prepared an Initial Regulatory Flexibility Analysis (''IRFA'') concerning the proposed amendments. The IRFA notes that the purpose of the proposed amendments is to make the NRSRO designation process open and transparent by defining the term ''NRSRO'' for purposes of the net capital rule to provide a list of attributes that would be considered by the Commission in designating rating organizations as NRSROs. The IRFA indicates that the proposed amendments would apply to all credit rating organizations that request NRSRO designation.

The IRFA further indicates that in the past, the Commission has only designated seven credit rating organizations as NRSROs. In addition, only seven other credit rating organizations have requested designation as an NRSRO. Because the Commission cannot determine the number of entities that may request NRSRO designation in the future, it is difficult to estimate the number of small entities that may be subject to the proposed amendments. However, due to the fact that only seven credit rating organizations have been designated as NRSROs and only seven other entities have requested NRSRO designation, the IRFA adds that it appears that very few small entities, if any, as contemplated by the Regulatory Flexibility Act[20], will be subject to the proposed amendments. In addition, the IRFA states that the proposed amendments require the filing of an application and notification of any material changes in the NRSROs business and that no federal rules duplicate, overlap, or conflict with, the proposed amendments. Furthermore, the IRFA states that the Commission does not believe that any less burdensome alternatives are available to accomplish the objectives of the proposed amendments.

The Commission encourages the submission of comments with respect to any aspect of the IRFA. Comment specifically is requested on the number of small entities that would be affected by the proposed rules. Such comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed rules are adopted, and will be placed in the same public file as comments on the proposed rules themselves. Comment letters should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Stop 6–9, Washington, D.C. 20549. Comments also may be submitted electronically at the following E-Mail address: rule-comments@sec.gov. All comment letters should refer to File No. S7–33–97. This file number should be included on the subject line if E-mail is used. All comments received will be available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, N.W., Washington, D.C., 20549. Electronically submitted comment letters will be posted on the Commission's Internet web site (http://www.sec.gov). A copy of the IRFA may be obtained by contacting Michael E. Greene, Securities and Exchange Commission, 450 Fifth Street, N.W., Mail Stop 2–2, Washington, D.C. 20549.

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 (''SBREFA''), the Commission is also requesting information regarding the potential impact of the proposed rule on the economy on an annual basis. The Commission preliminarily believes that the proposed amendments do not constitute a ''major rule'' for purposes of SBREFA based on the criteria used to determine what constitutes a ''major rule'' under SBREFA. Commenters should provide empirical data to support their views.

VIII. Paperwork Reduction Act

Certain provisions of the proposed amendments contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 (''PRA''),[21] and the Commission has submitted them to the Office of Management and Budget for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title for the collection of information is: ''Net Capital Requirements for Brokers or Dealers: Definitions: NRSRO.''

A. Collection of Information Under Proposed Amendments

The proposed amendments would require credit rating organizations that desire designation as NRSROs to submit certain information to the Commission in order to obtain such designation and to report to the Commission in the event of any material change in their status.

[19] The average time to complete an application is estimated to be 100 hours. *See infra* section VIII D.

[20] 5 U.S.C. 601 *et seq.* The Regulatory Flexibility Act states that the term ''small entity'' shall have the same meaning as the term ''small business'' under the Regulatory Flexibility Act. According to section 601(3) under the Regulatory Flexibility Act, ''the term 'small business' has the same meaning as the term 'small business concern'' under section 3 of the Small Business Act (15 U.S.C. 632), unless an agency, after consultation with the Small Business Administration and after opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition(s) in the **Federal Register**''. If the agency has not defined the term for a particular purpose, the Small Business Act states that ''a small business concern, * * *, shall be deemed to be one which is independently owned and operated and which is not dominant in its field of operation.'' Because the Commission has not defined the term ''small entity'' in the context of NRSROs for purposes of the Regulatory Flexibility Act, for purposes of this rulemaking, the Commission is using the broader definition of ''small business concern'' as defined in the Small Business Act. Furthermore, based on this broader definition, it appears that none of the current NRSROs would be considered small entities for purposes of the Regulatory Flexibility Act.

[21] 44 U.S.C. 3501 *et seq.*

B. Proposed Use of Information

The information collected pursuant to the proposed amendments would be used only by the Commission. No other governmental agency or third party would regularly receive any of the information described above. The Commission would use the information required by the proposed amendments in determining whether to designate a credit rating organization as an NRSRO.

C. Respondents

The proposed amendments would apply to those credit rating organizations that desire designation as an NRSRO by the Commission.

D. Total Annual Reporting and Recordkeeping Burden

The proposed amendments require a one-time application process, which includes any amendments to the initial application. Therefore, there is no recurring reporting or recordkeeping requirement and thus no annual reporting or recordkeeping requirement. However, it is estimated that on an annual basis there will be ten respondents to this collection of information. It is also estimated that the time to complete the proposed collection of information is 100 hours.

E. General Information About the Collection of Information

The collection of information under the proposed amendments would be required in order to obtain NRSRO designation. There would be no obligation on the NRSRO to retain the information submitted to the Commission to obtain NRSRO designation. Any information received by the Commission pursuant to the proposed amendments would be kept confidential (except the cover letter), subject to the provisions of the Freedom of Information Act, 5 U.S.C. 552 and the Commission's regulations thereunder (17 CFR 200.80). The proposed amendments do not mandate a time period for retaining the information submitted to the Commission by credit rating organizations applying for NRSRO designation. Seeking the NRSRO designation is voluntary; however, for rating organizations that desire the NRSRO designation, the obligation to respond to the collection of information is mandatory. Persons should be aware that the Commission may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

F. Request for Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to:

(i) evaluate whether the proposed collection of information is necessary for the proposed performance of the functions of the agency, including whether the information shall have practical utility;

(ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information;

(iii) enhance the quality, utility, and clarity of the information to be collected; and

(iv) minimize the burden of collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons desiring to submit comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, D.C. 20503, and should also send a copy of their comments to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549, and refer to File No. S7–33–97. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this release in the **Federal Register**, so a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of this publication.

IX. Statutory Analysis

Pursuant to the Securities Exchange Act of 1934 and particularly Sections 3(b), 15(c)(3), 17, and 23 thereof, 15 U.S.C. 78c(b), 78o(c)(3), 78q, and 78w, the Commission proposes to amend 240.15c3–1 of Title 17 of the Code of Federal Regulations in the manner set forth below.

X. List of Subjects in 17 CFR Part 240

Reporting and recordkeeping requirements, Securities.

XI. Text of the Proposed Rule Amendments

In accordance with the foregoing, Title 17, Chapter II of the Code of Federal Regulation is proposed to be amended as follows:

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

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

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78i, 78j, 78k, 78k–1, 78*l*, 78m, 78n, 78o, 78p, 78q, 78s, 78u–5, 78w, 78x, 78*ll*(d), 79q, 79t, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4 and 80b–11, unless otherwise noted.

* * * * *

2. Section 240.15c3–1 is amended by adding paragraph (c)(13) to read as follows:

§ 240.15c3–1 Net capital requirements for brokers or dealers.

* * * * *

(c) * * *

* * * * *

(13)(i) The term *nationally recognized statistical rating organization* (''NRSRO'') means any entity that:

(A) Issues ratings which are current assessments of the creditworthiness of obligors with respect to specific securities or money market instruments and that is registered under the Investment Advisers Act of 1940 (15 U.S.C. 80b–1 *et seq.*) and

(B) Is designated as an NRSRO by the Commission.

(ii) The Commission will consider the following attributes in determining whether to grant NRSRO status:

(A) Recognition of the rating organization in the United States as an issuer of credible and reliable ratings by users of securities ratings;

(B) Adequate staffing, financial resources, and organizational structure to ensure that it can issue credible and reliable ratings of the debt of issuers, including a sufficient number of qualified staff members and the ability to operate independently of economic pressures or control by companies that it rates;

(C) Use of systematic rating procedures that are designed to ensure credible and accurate ratings;

(D) Extent of contacts with the management of issuers, including access to senior level management of issuers; and

(E) Internal procedures to prevent misuse of non-public information and compliance with these procedures.

(iii) A rating organization seeking NRSRO designation shall file an application with the Director of the Commission's Division of Market Regulation in Washington, DC. The application should provide detailed information explaining how the rating organization satisfies the attributes set forth in paragraph (c)(13)(i) of this section. The rating organization shall also file any additional information subsequently requested by the Commission relating to the attributes set forth in paragraph (c)(13)(i) of this section.

(iv) An NRSRO shall notify the Director of the Commission's Division of Market Regulation of any material changes that occur in the facts and circumstances of this application for an NRSRO designation.

(v) In the event it is determined that an NRSRO no longer satisfies all of the attributes set forth in (c)(13)(i) of this section, the Commission may revoke or withdraw NRSRO designation.

* * * * *

Dated: December 17, 1997.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 97–33402 Filed 12–29–97; 8:45 am]

BILLING CODE 8010–01–P