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SECURITIES AND EXCHANGE COMMISSION
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September 13, 1989

DIVISION OF MARKET REGULATION

Ms. Laura M. Homer
Securities Credit Officer
Division of Banking Supervision and Regulation
Board of Governors of the
Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, DC 20551

Dear Ms. Homer:

Enclosed please find the Prime Broker Committee's amended letter regarding the applicability of Regulation T to prime broker transactions. This letter supersedes our previous letter dated June 6, 1989. I have also enclosed a second copy of our amended letter which is marked to show all changes from the original June 6, 1989 letter.

The amended letter is issued by the unanimous consent of the Prime Broker Committee which consists of representatives from both Prime Brokers and Executing Brokers and also the Securities Industry Association's Credit Division.

The Committee would be happy to discuss the above with you in more detail at your convenience.

Very truly yours,



Jeffrey E. Bernstein
On Behalf of the Committee

cc: Michael A. Macchiarolo, Securities and Exchange Commission
Members of the Prime Broker Committee

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Ms. Laura M. Homer
Securities Credit Officer
Division of Banking Supervision and Regulation
Board of Governors of the
Federal Reserve System
20th Street & Constitution Avenue, N.W.
Washington, DC 20551

Dear Ms. Homer:

This letter is written on behalf of the Prime Broker Committee (the "Committee") regarding the applicability of Regulation T to prime broker transactions. The Committee consists of representatives from both prime brokers and executing brokers, including Bear, Stearns & Co. Inc., Goldman, Sachs & Co., Morgan Stanley & Co. Incorporated and Paine Webber Incorporated and the Securities Industry Association's Credit Division (the "SIA"). On behalf of the Committee, we are requesting an interpretation of Regulation T that would facilitate the continuation of the prime broker business and ensure that it is fair and equitable to all parties involved.

The Committee was organized to review and evaluate the way in which prime broker transactions currently take place and to recommend appropriate changes to applicable regulations in order to clarify the responsibilities of the parties involved in prime broker transactions, improve the settlement process and reduce unnecessary risk associated with the transactions. As you are aware, certain members of the Committee have met with the staffs of the Federal Reserve Board (the "Board"), the Securities and Exchange Commission (the "SEC") and the New York Stock Exchange, Inc. (the "NYSE").

The Committee has concluded that there is significant confusion among executing brokers, prime brokers and industry regulators concerning the applicability and relevance of the current regulatory scheme to the prime broker business. Consequently, the Committee has attempted to document and clarify the respective rights and obligations of the executing broker and the prime broker. The Committee's proposed agreement with respect thereto (the "Proposal") is set forth in Exhibit A. Certain aspects of the Proposal presuppose issuance of regulatory interpretations not only from the Board but also the SEC and possibly certain self-regulatory organizations. The Committee has therefore engaged in contemporaneous discussions with these regulators. The Committee has been advised by the SEC, however, that obtaining the Board interpretation being requested in this letter is an essential

prerequisite to obtaining the other appropriate regulatory clarifications.

In order to assist your evaluation of our requested Board action, a description of the mechanics involved in the establishment of the prime broker relationship and the settlement of a typical prime broker transaction is set forth below.

Description of the Prime Broker Business

Prime broker clearing is a service offered by many leading broker-dealers which provides a clearing facility for substantial retail and institutional investors. This service is designed for active market participants who execute trades at more than one broker-dealer but wish to have their assets held at a different firm. The prime broker relationship is established and a typical prime broker transactions is currently processed as follows:

- o The prime broker issues a letter to the executing broker indicating that it has entered into a prime broker relationship with a customer and that the prime broker will be responsible for ensuring that prime broker transactions conform to Regulation T and any other applicable margin requirements.
- o The executing broker establishes a single customer account in the name of the prime broker for the benefit of the customer.

- o The executing broker uses the prime broker's tax identification number on the account in order to avoid the duplicate reporting of 1099 information. The prime broker thereafter is responsible for the collection of all dividends and interest on behalf of the customer and the issuance of all appropriate 1099 forms.
- o The prime broker obtains the customer's acknowledgement of all trades executed by executing brokers on trade date.
- o The prime broker records these transactions on trade date in a customer cash or margin account. The prime broker then issues confirmations to the customer and, as necessary, collects all applicable margin or Regulation T payments.
- o The prime broker also records these transactions in a fail to receive/fail to deliver account from/to the executing broker.
- o The executing broker confirms the transaction to the prime broker through the Depository Trust Company Institutional Delivery System (the "ID System"). The prime broker then compares the information on the ID confirmation with the information on its books and records; if the information matches, the prime broker affirms the trade through the ID System.
- o The executing broker delivers/ receives the securities versus payment to the prime broker on settlement date. The prime broker receives/delivers the securities versus its fail to receive/deliver account with the executing broker. The prime broker's customer account is not affected by this broker-to-broker settlement process.
- o The prime broker issues a monthly statement of account to its customer which includes all security transactions, regardless of which firm the customer selects to execute the transaction. The monthly statement also includes the resultant security positions and money balance.

The principal uncertainty which arises under Regulation T with respect to the matters described above is whether the 90 day freeze referred to in Section 220.8(c) applies to an executing broker absent receipt of the necessary "letter of

free funds" prescribed by Section 220.8(c)(2). It is the view of the Committee that the letter of free funds should not be required in these circumstances because enforcement of the 90 day freeze should be the responsibility of the prime broker and not the executing broker.

Requested Board Action

The Committee hereby requests that the Board issue an opinion substantially in the form set forth below with respect to Section 220.8(c) of Regulation T:

An exception to the 90 day freeze referred to in Section 220.8(c) will be available to an executing broker who has entered into an agreement with a prime broker, substantially in the form of the Proposal, with respect to a purchased security which is delivered to a prime broker for deposit in either a cash or margin account.

Discussion of Recommended Action

Currently, when a customer places its first order with an executing broker to purchase securities to be delivered to a prime broker, the executing broker will request a "letter of free funds" from the prime broker in order to comply with the requirements of Section 220.8(c)(2) of Regulation T. It is

impractical, due to the large number of transactions normally involved, for the prime broker to supply a letter of free funds for each such transaction. The NYSE has not objected to the use of the form letter that has been used by most prime brokers for over four years. This letter authorizes the executing broker to accept orders from the customer in the prime broker's name, to be "carried on your books and records as broker-to-broker transactions". The letter further states that the prime broker accepts "full responsibility for insuring that all such transactions upon our books conform to Regulation T and the NYSE margin requirements. Therefore, no letter of free funds is required in order to settle these transactions."

The imprecise and to some extent inaccurate language of the letter has been the source of much of the confusion regarding the respective responsibilities of a prime broker and an executing broker. The Committee believes that this letter misstates and miscasts the intended relationship of the parties. The Committee therefore recommends that the currently used letter be replaced by the Proposal, which the Committee believes more accurately sets forth the settlement and regulatory compliance obligations of both the executing broker and the prime broker.

The reasoning and justification for the requested Board action is based upon analysis of the crux of the Proposal,

i.e., that a prime broker trade will, after completion of the affirmation process specified in the Proposal, be transformed from a customer-broker transaction into a broker-to-broker transaction. This metamorphosis will obviate the need for the protections contemplated by the use of a letter of free funds and will provide an appropriate basis for allowing the deposit of a purchased security into a sufficiently funded margin account. This transformation should also substantially reduce or eliminate problems in settling prime broker transactions since the customer will be removed from the settlement process at least two days earlier than in a standard delivery versus payment ("DVP") transaction. In the standard DVP transaction, the executing broker may not be aware of any potential settlement problems until the securities are first delivered to the custodial bank on settlement date.

As specified in the Proposal, the prime broker will have two business days to disaffirm trades before finally accepting settlement responsibility for trades executed on behalf of its prime broker clients. The Committee believes that providing the prime broker with two business days to disaffirm trades is necessary for two reasons. First, the two day period allows the prime broker sufficient time to conduct its normal credit review and ensure that the trade is within the credit limits that it has established for the customer's account. Second, the additional time requires the executing broker to undertake

its own credit review to ensure that transactions are prudent and suitable at the time of the acceptance of the order. The executing broker will thus be precluded from asserting that another broker, whose name has been "given up" by the customer but who had no knowledge of a particular trade at the time it was effected, should be the responsible party for consummating settlement of the transaction. Consequently, the executing broker will be appropriately compelled to fulfill its compliance responsibilities with respect to the particular transaction and customer.

If the prime broker disaffirms the trade in accordance with the provisions of the Proposal, then the transaction will be treated as a customer transaction on the books of the executing broker, subject to the provisions of Regulation T.

Conclusion

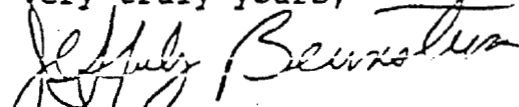
The Committee believes that the Proposal provides a concise, clear and balanced statement regarding the responsibilities of an executing broker and a prime broker, both with respect to settlement obligations and regulatory compliance obligations. The Proposal addresses, inter alia, buy-in procedures, responsibilities regarding short sales and extension of credit on new issues, and "know your customer" rules, as well as Regulation T and margin maintenance requirements. The Proposal also requires the prime broker to register with its designated self-regulatory

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organization as a prime broker. The Committee believes that the suggested framework provides the necessary guidance to executing and prime brokers engaged in this important business, satisfies the concerns thusfar raised by the regulators with whom the Committee has met, and serves to further the regulatory scheme to which prime broker transactions are subject. For the reasons set forth above, the Committee hereby requests that the Board issue the opinion set forth on page 5.

The Committee would be happy to discuss the above with you in more detail at your convenience.

Very truly yours,



Jeffrey C. Bernstein
On Behalf of the Committee

cc: Michael A. Macchiaroli
Securities and Exchange Commission

New York Stock Exchange, Inc.

David Marcus
Edward A. Kwalwasser
Salvatore Pallante
Raymond J. Hennessy
Donald Van Weezel
Richard Nowicki