



DIVISION OF
MARKET REGULATION

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

October 7, 1998

Mr. Stephen M. Merkel
Senior Vice President
General Counsel
Cantor Fitzgerald Securities
One World Trade Center
New York, New York 10048

Re: Treatment of OTC Treasury Options Matched Book Collateral for Cantor Fitzgerald Securities

Dear Mr. Merkel:

In your letter dated April 28, 1998, you ask that certain collateral of customers obtained in connection with Cantor Fitzgerald Securities ("Cantor Fitzgerald") OTC Treasury options matched book business ("OTC Treasury options business") not be deemed to be subject to Department of the Treasury ("Treasury") Rule 403.4 (17 C.F.R. 403.4) which incorporates Securities Exchange Act of 1934 ("Exchange Act") Rule 15c3-3 (17 C.F.R. 240.15c3-3) for government securities broker-dealers.

Based on your letter and discussions with the staff of the Division of Market Regulation, I understand the following facts to be pertinent to your request. Cantor Fitzgerald is a government securities broker-dealer registered with the Securities and Exchange Commission under Section 15C of the Exchange Act and is subject to the rules adopted by the Department of the Treasury under Section 15C. Cantor Fitzgerald is not a member of the Securities Investor Protection Corporation. Cantor Fitzgerald engages in a variety of government securities activities, including principal brokering of OTC options on U.S. Treasury securities. In conducting its OTC Treasury options business, Cantor Fitzgerald acts as riskless principal in entering into matching OTC Treasury options simultaneously bought from, and sold to, different counterparties. Cantor Fitzgerald acts as a principal to each counterparty. For example, Cantor Fitzgerald will buy an option from Dealer A and sell an identical option to Dealer B. Based on this arrangement, there is no market risk and limited credit risk to Cantor Fitzgerald.

Currently, the vast majority of Cantor Fitzgerald's counterparties in matched OTC Treasury option transactions are broker-dealers, foreign dealers, or government securities dealers that are not "customers" for purposes of Exchange Act Rule 15c3-3 and Treasury Rule 403.4. Thus, any collateral received from a broker-dealer counterparty for whom Cantor Fitzgerald has purchased an OTC Treasury option may be pledged by Cantor Fitzgerald to a counterparty without triggering the possession and control or customer reserve formula provisions of Treasury Rule 403.4.

To enhance the liquidity of its brokerage of OTC Treasury options business, Cantor Fitzgerald intends to include sophisticated institutional investors that are not broker-dealers, foreign dealers, or government securities dealers, and therefore are "customers" under Exchange Act Rule 15c3-3 and Treasury Rule 403.4, which would prevent Cantor Fitzgerald from pledging collateral received on any "customer" side of a transaction.¹

In connection with your request, you have suggested that Treasury Rule 403.4 be deemed not applicable to this collateral under the following circumstances:

- (1) Prior to participating as a counterparty in Cantor Fitzgerald's OTC Treasury options business and pledging the collateral provided by any particular institutional counterparty, Cantor Fitzgerald will obtain a written agreement from each institutional counterparty² stating that the counterparty agrees to and understands that any collateral provided to Cantor Fitzgerald under an OTC option agreement can be pledged to other counterparties in the course of the OTC Treasury options business and will not be subject to the requirements of Exchange Act Rules 15c3-3, 8c-1 or 15c2-1. The agreement will further state that the counterparty recognizes that in the event of a default or failure of Cantor Fitzgerald, the counterparty will become an unsecured creditor of Cantor Fitzgerald and will have no rights to trace or otherwise attach collateral pledged to other counterparties.
- (2) Cantor Fitzgerald will on a daily basis calculate the amount of collateral obtained from both non-customer broker-dealers and customer counterparties in connection with its OTC Treasury options business and the amount of collateral delivered to counterparties in connection with its OTC Treasury options business. All securities positions will be marked to the market. All collateral not delivered to counterparties as contemplated above must be segregated and remain in a separate account, apart from the general assets of the firm, similar to an account established under section (k)(2)(i) of rule 15c3-3. All collateral received from the counterparties will be deposited into this account until delivered to a counterparty to an OTC options contract, or returned to the person from whom the

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1. Cantor Fitzgerald operates pursuant to the exemption from the customer protection rule prescribed by paragraph (k)(2)(i) of Rule 15c3-3 under the Exchange Act, as that exemption applies to Section 15C registered government securities broker-dealers under Treasury Rule 403.4. With respect to collateral provided to the broker-dealer by customers, all such collateral is retained in a "Special Account for the Exclusive Benefit of Customers" maintained in accordance with paragraph (f) of Exchange Act Rule 15c3-3, pursuant to an SEC June 9, 1988 no-action letter issued to Mr. Thomas Cassella, Vice President of the National Association of Securities Dealers, Inc.
 2. For purposes of this letter, "institutional counterparty" means any counterparty or person acting on its behalf that would be deemed a "customer" for purposes of Rule 15c3-3 and Treasury requirements, acting for its own account or for the accounts of other institutional counterparties, that in the aggregate owns or invests on a discretionary basis at least \$100 million in securities of issuers that are not affiliated with the counterparty.

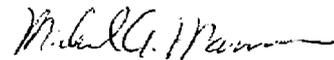
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collateral was initially obtained. The collateral may not otherwise be used in the business of the firm.

- (3) Any non-cash collateral pledged to an institutional counterparty by Cantor Fitzgerald will be transmitted to that counterparties' account at a registered broker-dealer or bank (as defined by the Exchange Act).
- (4) For a period of one year and for any additional periods that NASD Regulation, Inc. ("NASDR") requires, Cantor Fitzgerald will provide to NASDR quarterly reports describing the nature and number of the counterparties and the size of the OTC Treasury options matched book and collateral arrangements.

Based on the circumstances set forth above, the Division of Market Regulation will not recommend enforcement action to the Securities and Exchange Commission if Cantor Fitzgerald treats the collateral described above as not subject to Department of the Treasury Rule 403.4 under the conditions specified in your letter. The Department of the Treasury concurs in this letter.

Sincerely,



Michael A. Macchiaroli
Associate Director

MAM/mma

cc: Lori Santamorena, Department of the Treasury
Samuel Luque, Jr., NASD Regulation, Inc.