BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

December 10, 1964

CONFIDENTIAL (FR)

TO: Federal Open Market Committee

FROM: Mr. Young

There is enclosed a copy of a memorandum from the Steering Group of the Government Securities Market Study dated December 7, 1964, entitled "Proposal for Obtaining Financial Statements from Nonbank Dealers in U.S. Government Securities." Authorization to proceed with the collection of financial statements from nonbank government securities dealers, beginning with data as of the end of the current year, will be requested at the meeting of the Committee to be held on December 15, 1964. As you will recall, the Committee authorized exploration of this general subject at its meeting on August 1, 1961 (see pages 50-55 of the minutes for that meeting).

Ralph A. Young

Ralph A. Young, Secretary,
Federal Open Market Committee.

Enclosure

To Federal Open Market Committee
and Treasury Department

December 7, 1964

From Steering Group of the Government
Securities Market Study

Subject: Proposal for Obtaining Financial Statements from Nonbank Dealers in U. S. Government Securities

The Treasury-Federal Reserve Study of the Government Securities Market in 1959-60, which grew out of the 1958 speculative boom and collapse in U. S. Government bonds, recommended a number of measures to improve public and official knowledge and understanding of the market. The Study found that: "The market for U. S. Government Securities should lead the way, both in developing trading procedures to serve the needs of all kinds of investors most effectively, and providing the fullest practicable range of information to serve as a basis for the judgments of those who participate in the market and those who study its performance."

To meet this objective, a specific program for the collection and publication of statistics on dealer positions, transactions, and financing was developed. The Market Statistics Department of the Federal Reserve Bank of New York was set up to implement the program which has now been in effect since 1960. The Steering Group, set up to implement the recommendations of the Study, then turned its attention to the matter of dealer financial statements. The Study had suggested obtaining more uniform balance sheets and income statements from the dealers in connection with "the possibility of eventual publication of some kind of consolidated balance sheet and income statement for the dealer community as a whole".

There is a strong case for more knowledge of dealers' activities and financial condition by the Treasury, Federal Reserve, and the public. Government securities dealers play a sensitive and key role in the Government securities market, a market whose smooth and sound functioning is vital to both the financing operations of the Treasury and the open market operations of the Federal Reserve. These dealers conduct massive operations in Treasury securities, generally on small margins and in some cases on small capital, and yet are largely free of Governmental supervision and regulation. Moreover, the Government securities market is regarded as a key market from which other sectors of the capital market take their cue. Accordingly, any untoward developments in the Government securities market could have a severe adverse impact on the entire financial structure and indirectly on the economy as a whole.

Moreover, dealers in recent years have increasingly criticized Federal Reserve open market operations and Treasury debt management technique for impairing the functioning of the market and reducing dealers' ability to earn profits adequate to the long run health of the industry. Nonbank dealers have also expressed concern about the growing number of banks engaging in a dealer or quasi-dealer function on the grounds that the banks have special advantages in the form of lower financing costs and the tax and loan account privilege which also hurts the profitability of the nonbank dealers. Reasoned evaluation of these questions necessarily requires more uniform information on dealer income and expenses than is currently available.

It is essentially for these reasons that the Steering Group recommends a new standardized system of financial reporting for Government security dealers. The Group feels that improved and more uniform dealer financial statements would contribute in no small way to sounder financial reporting and practices within the industry as well as to a firmer basis for appraisal of the financial health of the dealer market.

The new reports would supplement the data on dealer positions, transactions and financing that are currently being received, and would also be collected by the Market Statistics Department of the Federal Reserve Bank of New York. They would also supplement the annual dealer financial statements which the Federal Reserve Bank of New York has been receiving for many years and which, together with supplemental information, have met the operating needs of the Trading Department of that Bank in forming their judgments as to the credit worthiness of the dealers with whom they do business.

Summary and Recommendation

In June 1961 the Federal Open Market Committee, acting for the Federal Reserve System and the Department of the Treasury, authorized the Steering Group to confer with nonbank dealers concerning the possibilities of setting up a more standardized system of financial reporting. This approach had been suggested by the Steering Group in a memorandum dated June 15, 1961.

Since that time extensive conferences have been held by the Steering Group with the primary nonbank dealers in an effort to develop detailed information on dealer accounting practices and problems in order to lay the groundwork for a specific proposal which the Group could discuss with the dealers and ultimately present to the Committee. As a result, the Group has developed a basis for dealer reporting which it believes is practicable and should produce worthwhile results through greater knowledge of dealer financial positions, activities and income, obtained from data that have a reasonable degree of uniformity as between dealers.

The discussions with dealers brought to light or confirmed the following principal points of difficulty which have to be considered in developing a workable proposal:

1. There are wide differences in types of activities conducted by the various dealers, making comparisons of their financial statements difficult.

2. The financial facts relating to the various dealers activities receive quite diverse accounting treatment among dealers even for the same types of activity, thus adding to the difficulties of comparisons.

3. Present dealer financial statements are prepared for a variety of different statement dates.

4. Most dealers trade securities other than Governments in varying degrees. Most would be able to allocate gross income as between Government securities and other activities, but allocation of expenses would be more difficult. Allocation of net worth would be even more difficult for conceptual as well as for practical reasons. All of these items would probably involve, in varying degrees, estimates; but some dealers already make such estimates for internal purposes.

5. The basic financial differences between corporations and partnerships make comparisons of their net worth and net earnings data tenuous. Gross income comparisons would be more valid.

The Steering Group's proposal attempts to resolve most of the above problems as well as other problems of lesser degree, in such a manner that reasonably satisfactory, more uniform and more complete financial statements on nonbank dealer firms[1] should be obtainable without excessive cost to dealer organizations.

Initially, the proposal is designed to provide better dealer financial statements for use of the Federal Reserve System, the Treasury and other interested public bodies on a confidential basis. Eventual publication of some of the data in consolidated summary form is possible if it proves desirable after some trial period. The main features of the proposal are as follows:

1. All nonbank dealers which transact business in U. S. Government Securities with the Federal Reserve Bank of New York would submit financial statements to the Federal Reserve Bank of New York as of December 31 each year beginning this year, such statements to be audited where feasible, and where not audited, to be supplemented by information permitting reconcilement with the most recent audit available.

2. The content of the statements, as far as assets and liabilities are concerned, would conform as nearly as possible to the daily position and borrowing reports submitted to the Federal Reserve Bank of New York, but all securities holdings would be valued at market rather than at par value.

3. Long-term (over one year) subordinated debt would be reported separately from net worth.

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1. It is expected that some means of developing reasonably comparable data for dealer banks could be worked out when and if the nonbank dealer portion of the project is completed.

4. A reconcilement of net worth between statement dates would show adjustments in the various net worth accounts and an analysis of earnings and expenses for the period. Both net worth and earnings and expenses would be broken down to show the portions allocable to operations in Government securities.

5. Corporate dealers would show reserves for accrued tax liabilities, including taxes on realized profits but not on unrealized profits. Partnerships do not set up tax reserves and therefore would report none.

The proposal is set forth in more detail in the following pages as well as in the attachments consisting of specific financial statement forms (Forms A-1 and A-2), form for reconcilement of net worth and analysis of earnings (Form B), a list of required supplemental information (Form C), and explanatory instructions (Form D). Also attached is a proposed covering letter to be sent to each dealer.

The Steering Group recommends this plan and, if it is approved by the Federal Open Market Committee and the Treasury, would proceed to put it into effect. While preliminary discussions have indicated that most nonbank dealers can comply without undue difficulty, a closer look at the specific proposal by the dealers and further consideration by the Steering Group may, however, suggest certain additional minor changes.

A more detailed discussion of the various aspects of the plan follows.

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STATEMENT DATES AND AUDITS

Uniformity of statement date is desirable if the statements are to be comparable and especially if a composite statement is to be prepared. The choice of a uniform December 31 statement date would minimize the number of dealers that would have to make special interim reports and would thus have to supply supplementary information to reconcile differences between the two reports. Three dealers now submit audited statements for December 31, including the firm which states that it would have the greatest difficulty in adjusting to a new statement date. The audit dates for the other firms are quite diverse (the three members of the New York Stock Exchange are audited on a surprise basis on random dates) but two of these firms prepare unaudited December 31 statements for their customers. All firms prepare month-end trial balances for their own use which, they agree, could be used as a basis for the preparation of a December 31 statement.

The dealers believe it is feasible to prepare a special <u>unaudited</u> report for a specified month-end date, with supplemental information, if necessary, to reconcile the special report to the most recent audit. They are willing to have the results made public in consolidated form.

An alternative would be to require all dealers to submit <u>audited</u> statements as of the same date, December 31. The Steering Group, however, feels that at this point this requirement would impose an undue burden of expense on those firms which are not audited on that date, unless they were able to shift their audit dates, which could also cause complications due to the fact that several dealers use the same accounting firms who might have difficulty in making the audits simultaneously.

It may be argued that a December 31 statement would show a distorted picture of a firm's assets and liabilities because of special year-end influences. However, this does not appear to be the case with the three firms now furnishing audited calendar year-end statements. Some distortions in assets and liabilities are likely to occur at the end of a firm's fiscal year, regardless of its date, for special transactions are often carried out at that time for tax reasons. On the other hand, the net worth and earnings position of a firm, especially of partnerships, would best be reflected at the end of the firm's fiscal year.

REPURCHASE AND RESALE AGREEMENTS

The proposal calls for the collection of repurchase and resale agreement data broken down between those with maturities under 15 days and those with longer maturities. The supplemental information accompanying the statements would show the relationship between the maturities of the securities underlying the longer-term agreements and the maturities of the agreements themselves. This would provide a measure of the market risk involved in the longer-term contracts, which could be a source of trouble if the maturities of the securities were too long. This detailed information would be for the use of the Federal Reserve and Treasury only, except that if composite figures are eventually released for publication or other public purpose with a sufficient time lag, the breakdown of short and long repurchase agreements would be shown.

VALUATION OF SECURITIES

Practices in valuing securities for financial statement purposes differ among dealers. Five value at market, two at cost, and six at cost or market whichever is lower. In computing cost, some use a FIFO basis, others a LIFO basis. Under the proposal, all would be asked to value at market prices, which they can readily do. This would give a more current picture of the value of the firm's holdings though not necessarily the most conservative picture; also, it would avoid the problem of determining the basis for computing costs.

BREAKDOWN OF SECURITIES HOLDINGS

Although not all dealers now break down their securities holdings in their statements by type and maturity, they would be willing to follow the breakdown in the proposed statement form and can all do so readily, with the exception of one large firm which expects to have problems in doing so because of its particular machine accounting system.

COMMITMENT VS. DELIVERY BASIS

Dealers follow widely divergent practices in the basis for reporting their trading positions in securities, that is, their long and short positions. Some report on a cash or delivered basis, others on a strictly commitment basis, and still others on a mixed basis. The result is that the securities positions shown in financial statements are not consistent among dealers. Moreover, in a majority of cases such positions could not be reconciled with the daily position reports submitted by the dealers to the Federal Reserve Bank of New York, all of which are on a commitment basis.

The proposal would require all dealers to show, for December 31 financial statement purposes, their holdings of United States Government securities, Federal agency issues and certificates of deposits on a commitment basis. This would be done either by preparing the statement itself on a commitment basis, or by supplying supplemental data which would enable us to put the statement on a commitment basis.

Use of a commitment basis would have the advantages of (1) reflecting all potential risks in the Government securities position, (2) making the statements comparable to the daily position reports, and (3) providing a cross check on the accuracy of the daily reports.

To require reports on other securities on a commitment basis would create many reporting problems. Therefore, it is proposed, initially at least, to permit dealers to report such securities as they normally do in their financial statements, making proper identification as to whether such reporting is on a commitment or delivery basis.

RESERVES FOR INCOME TAXES

Practically all incorporated dealer firms now set up reserves for income taxes, including taxes on realized profits; none set up taxes against unrealized profits. Partnerships do not accrue tax liabilities or set up reserves against them because the partners are individually liable for the taxes. Thus, the tax amounts due from any partner in any one tax period depend on his over-all taxable status.

It seems reasonable to require all the corporations to show accrued reserves for taxes on earned income and realized profits, as this is standard accounting practice. Most of the corporate dealers have indicated that they could also estimate taxes on unrealized profits on a given date. If their securities holdings are to be valued at market, this would tend to show a truer picture of the current status of the firm's net worth. However, such an estimate would have little significance because of frequent, sizable changes in market values.

It is proposed, therefore, to require all corporate dealers to show a reserve for taxes on realized profits but not on unrealized profits; partnerships would not be required to show any tax reserves. While this results in an inconsistency as between corporations and partnerships there seems to be no good way of resolving it.

LONG-TERM DEBT

"Long-term debt" is defined to include any debt with a maturity of one year or longer. Such debt is not part of net worth, but since it is subordinated to other liabilities, it represents a cushion against market risks in trading operations which are essentially short-run. Ordinarily such debt would be in the form of debentures, capital or long-term notes, subordinated to other liabilities, such as loans to carry securities in portfolio and repurchase agreements. The cut-off at one year is arbitrary, and the terms of the various indentures or loan agreements differ between dealers. Detailed information on specific long-term debt arrangements would be requested as supplementary information.

RESERVES FOR CONTINGENCIES

Those few firms which carry reserves for contingencies would show them as a separate item on the liability side of the balance sheet. Whether or not this item would be considered as part of net worth would depend on the character of the reserve in the particular case.

NET WORTH

The status and composition of each individual dealer's net worth as shown by his balance sheet would be made clear by the use of supplemental information to accompany the statement. A composite net worth figure for all dealers will necessarily be a mixture reflecting the different types of firms in the business--corporations and partnerships--having various types of capitalization, i.e., various classes of stock and partners' capital having different withdrawal features.

The significance of the individual net worth figures will depend to a considerable extent on whether the December 31 statement is for a normal fiscal year or for an interim period. Under the proposal, the net worth of a firm using December 31 as its fiscal year-end would reflect, as nearly as possible, its true net worth position because substantial adjustments in certain expense items, such as income taxes on profits, bonuses to employees and other special payments, are normally made at the end of the fiscal year. By comparison, the net worth of the firm with a September 30 fiscal year-end, could be substantially inflated in its interim report as of December 31 because these special expense items might not have been taken care of. Another but different and possibly offsetting inconsistency might be created between firms having different fiscal years by a bunching up of profits or losses such as are often realized by various firms at the end of their fiscal year for tax reasons. Proposed dealer financial reports may provide more information on the dimensions of these types of discrepancies among dealers as well as the extent to which they may offset one another in the aggregate figures.

Similar problems arise in connection with the proposed reconcilement of net worth from one year to another. Some dealers provide a reconcilement with their regular annual statements but most do not, even though practically all dealers prepare a reconcilement for their own use covering their fiscal year. The dealers are all willing to try to prepare a reconcilement for interim dates, although for some it would be a real burden, as they do not now keep the accounting records needed to do so.

A question with respect to net worth of partnerships is whether any of the partners' individual net worth should be considered as part of the firm's net worth since it unquestionably underlies the risk of the business. This would also be a very difficult matter to deal with. Therefore, no attempt is made to cover it in the current proposal.

Partnership net worth and earnings data present additional difficulties of interpretation. For example, their computation is clouded by the question of the extent to which partners' drawings are in effect expenses (payments for services) or withdrawal of capital. Since there is no way of differentiating among types of partnerships withdrawals, it is proposed that normally all withdrawals would be reported as one total. Payments clearly made in the form of salary or for specific services rendered would, however, be treated as expense.

ALLOCATION OF NET WORTH

Each nonbank dealer would be asked to distribute the firm's net worth between the portion used in the Government securities business and that used in other operations. This allocation is designed to furnish a yardstick against which earnings from Government securities operations can be measured and to indicate the amount of capital which would normally be available at the risk of the Government securities business. Only one dealer has specifically allocated a fixed portion of net worth in this manner. Those dealers whose activities are confined largely to Government securities would probably be able to make reasonably accurate estimates but those who do a widespread business in various types of securities expect to have difficulty because their accounting methods are not designed to fit the concept of allocating net worth. These firms consider their net worth available to the extent needed by any part of their business at any given time.

In view of the wide divergency of dealer views as to a reasonable basis for making such an allocation, each dealer would be asked to prepare the allocation according to his own judgment and to furnish an explanation of the method used. It is hoped that the resulting information would be useful in itself or would point toward a way of obtaining more uniform data in this area. Unless or until the allocations clearly are meaningful, they would not be used for summary statistical purposes.

In the interest of consistency with the earnings figures to be obtained from the dealers, the Government securities business would be construed to include activities in securities of the U. S. Government and Federal Agencies and in bank certificates of deposit.

NET INCOME ANALYSIS

Gross income would be broken down into three major categories, trading profits, interest and dividend income and discount earned, and other income. All income on Treasury bills would be included as discount earned. Most dealers do not break down discount on bills between trading profit and interest earned since it would be an expensive, time-consuming process. Gross expenses would reflect two categories, interest on borrowed funds, and all other expenses except income taxes.

Income and expenses, both gross and net, would be allocated between those arising from Government securities, Agency securities and bank certificates of deposit and those arising from other securities operations. This allocation should present little difficulty, except in the category of other expenses, such as salaries, telephone charges and rents. As most dealers do not keep accounting records from which they can allocate these overhead costs, they would have to make estimates, at least to some extent. The dealers would be asked to explain any such estimates with the hope that the explanations would suggest a way of obtaining more meaningful and uniform figures.

Attachments

<u>Steering Group</u>

Daniel S. Ahearn
Albert R. Koch
Spencer S. Marsh, Jr.

DRAFT FOR[illegible]
(CORPORATIONS)

STATEMENT OF FINANCIAL CONDITION

A S S E T S

1.	Cash			$
2.	Cash pledged against securities borrowed			
3.	Due from brokers and dealers			
4.	Receivable on Resale Agreements			
	Securities owned (at market prices)			
5.	United States Government Securities (total)			
6.	Treasury Bills		$	
7.	Certificates of Indebtedness			
8.	Notes and Bonds			
9.	Due in 1 year or less	$		
10.	Due after 1 year but within 5 years			
11.	Due after 5 years but within 10 years			
12.	Due after 10 years			
13.	Securities of Federal Agencies (total)			
14.	Due in 1 year or less	$		
15.	Due after 1 year			
16.	Municipal and State Securities			
17.	Corporate Bonds			
18.	Corporate Stocks			
19.	Other Securities			
20.	Bankers' Acceptances			
21.	Time Certificates of Deposit and Short-term Bank Notes			
22.	Securities carried for participants in joint accounts			
23.	Securities sold, but not delivered (at selling prices)			
24.	Accrued interest on securities owned			
25.	Cash surrender value of life insurance on partners or officers			
26.	Furniture and fixtures (net) and other assets			
	TOTAL			$

No assets or liabilities are to be stated net of other liabilities or assets, unless specified.

DRAFT FORM A-2
(CORPORATIONS)

L I A B I L I T I E S

1. Loans Payable...$________

			Govts.	Other Sec.
2.	Banks	(Unsecured $________); (Secured	$________	$________)
3.	Other	(Unsecured $________); (Secured	$________	$________)

4. Liability on Repurchase Agreements (at purchase price)...................... ________

		Govts.	Municipals	Other Sec.
5.	Contracts maturing in 15 days or less..	$________	$________	$________
6.	Contracts maturing in more than 15 days	$________	$________	$________

7. Liability for securities held under Resale Agreements (at selling price)... ________
8. Deposits on securities loaned... ________
9. Due to customers.. ________

Securities sold but not yet purchased (at market prices)

10. United States Government Securities (total).............................. ________
11. Treasury Bills...$________
12. Certificates of Indebtedness.......................... ________
13. Notes and Bonds....................................... ________
14. Due in 1 year or less.......................$________
15. Due after 1 year but within 5 years........... ________
16. Due after 5 years but within 10 years.......... ________
17. Due after 10 years........................... ________
18. Securities of Federal Agencies (total)................................... ________
19. Due in 1 year or less..................................$________
20. Due after 1 year...................................... ________
21. Municipal and State Securities... ________
22. Corporate Bonds.. ________
23. Corporate Stocks... ________
24. Other Securities... ________

25. Securities purchased but not received (at purchase price)................ ________
26. Accrued interest on securities sold but not yet purchased................ ________
27. Reserve for Income Taxes... ________
28. Reserve for other expense items.. ________
29. Other Liabilities.. ________

30. Long-term Debt... ________

31. Reserves for contingencies... ________

Net Worth

32. Capital Stock (______shares outstanding, net of Treasury stock).......... ________
33. Capital Surplus.. ________
34. Earned Surplus... ________
35. Other Accounts (Explain in Supplementary Information, Form C)............ ________

TOTAL...$________

DRAFT

FORM
(CORPORATIONS)

COMPARISON OF NET WORTH

		Dec. 31, 1963	Dec. 31, 1964
1.	Capital stock	$	$
2.	Capital surplus		
3.	Earned surplus		
4.	Total net worth		
5.	Amount of net worth allocable to activities in Government and Agency issues and certificates of deposit (see instructions)	$	$

RECONCILEMENT OF CHANGE IN EARNED SURPLUS
(Item 3 above)

6.	Balance at beginning of calendar year	$
7.	Net income for the year	
8.	Income taxes	
9.	Adjustments (Explain in supplemental information)	
10.	Dividends paid	
11.	Earned surplus at end of calendar year (same as Item 3 above)	$

NET INCOME ANALYSIS
(Item 7 above)

		Allocable to: Government & Agency securities & certificates of deposit	Allocable to: All other securities & activities	Total
Income				
12.	Trading and underwriting profit on coupon issues	$	$	$
13.	(Includes unrealized appreciation or depreciation on securities owned)	( )	( )	( )
14.	Interest and dividend income and discount earned			
15.	(Includes all income on Treasury bills)	( )	( )	( )
16.	Other income			
17.	Total income	$	$	$
Expense				
18.	Interest on borrowed funds	$	$	$
19.	All other expenses, including taxes other than income taxes			
20.	Total expenses	$	$	$
21.	Net income (same as Item 7 above)	$	$	$

DRAFT FORM C (CORPORATIONS)

LIST OF SUPPLEMENTARY INFORMATION TO BE FURNISHED WITH FORMS A-1, A-2 and B
(See also instructions Form D)

1. Reconcilement to audit -- if audited statement is for a different date.
2. Matched repurchase and resale agreements -- list.
3. With respect to holdings of securities other than Governments, Agencies and certificates of deposit specify the basis of valuation and whether shown on a commitment basis or otherwise (Form A-1, Items #16-19).
4. Explanation of other assets (Form A-1, Item #26).
5. Explanation of "other" loans payable (Form A-2, Item #3).
6. Market value of securities sold under repurchase agreements maturing in more than 15 days and relationship of maturities of securities to maturities of contracts. (Form A-2, Item #6)
7. Explanation of long-term debt, if any (Form A-2, Item #30).
8. Explanation of nature of Reserves for Contingencies, if any (Form A-2, Item #31).
9. Breakdown of classes of capital stock where there is more than one class, with explanation of special provisions. (Form A-2, Item #32).
10. Explanation of significant changes in capital stock and capital surplus (Form B, Items #1 and 2).
11. Explanation of allocation of net worth (Form B, Item #5).
12. If available, furnish breakdown of income on Treasury bills (included in Item #14, Form B) between portion considered trading profits and portion considered interest income.
13. Contingent liability as endorser on bankers' acceptances.
14. Nature and amount of other contingent liabilities.
15. Nature and amount of commitments not reflected on balance sheet.

DRAFT FORM D (CORPORATIONS)

NONBANK DEALERS - CORPORATIONS

Instructions for Preparing Financial Statement Data
Forms A-1, A-2, B and C

Statement Dates and Audits

Statements (Forms A-1 and A-2), reconcilements (Form B) and supplementary information (Form C) are to be submitted to the Federal Reserve Bank of New York in the proposed form as of December 31 each year, such statements to be unaudited unless December 31 is an audit date for the firm. Firms having audits on other dates are to furnish supplementary information to permit reconcilement of the audited statements to the December 31 statements (Item #10 of Supplementary Information - Form C).

ASSETS - FORM A-1 (Instructions given only on items for which they are needed)

Line #4 -- Receivable on Resale Agreements

Do not include matched resale agreements.

Lines #5 - 15 and line 21 -- Government and Federal Agencies Securities and Certificates of Deposit and Short-term Bank Notes

Report holdings on a commitment basis in same manner as daily position reports to Federal Reserve Bank of New York, but at market prices.

Lines #16 - 20 -- Municipal and State Securities, Corporate Bonds, Corporate Stocks, Other Securities, Bankers' Acceptances

Reporting basis at discretion of the dealer but basis must be specified in Supplementary Information - Form C, Item #13.

Line #23 -- Securities Sold But Not Delivered (at selling prices) Include

(a) Forward commitments for sale of securities owned, including regular delivery. Offset -- The securities are deducted from Assets #5 - 19.

(b) Failure to deliver securities owned and sold. Offset -- Securities are deducted from Assets #5 - 19.

(c) Forward commitments and failures to deliver securities sold short. Offset -- Securities are included in Liabilities #10 - 24.

Line #26 -- Other Assets

Include all special items such as investments in and loans to subsidiaries or loans to officers and explain in Supplementary Information Item #4.

LIABILITIES - FORM A-2 (Instructions given only on items for which they are needed)

Lines #2 - 3 -- Loans Payable - Unsecured
Include

(a) Any unsecured loans in the form of loans.

(b) Any repurchase agreements wherein the securities sold were not owned and were not delivered to the buyer -- otherwise known as "due bills" sold.

Lines #4 - 6 -- Liability on Repurchase Agreements

Securities underlying contracts are included in Assets, Lines #5 - 21. Do not include matched repurchase agreements.

Line #7 -- Liability for Securities Held Under Resale Agreements

Do not include matched resale agreements.

Lines #10 - 24 -- Securities Sold Not Yet Purchased (at market prices)

Report Government and Agency securities (Lines #10 - 20) on commitment basis. Reporting basis on all other securities (Lines #21 - 24) at discretion of the dealer but basis must be specified in Supplemental Information Form C, Item #13.

Include

(a) Securities sold short and borrowed to make delivery.

Offset -- Cash received.

(b) Securities sold short but not yet delivered -- forward commitments or failures to deliver. Offset -- Included in securities sold not delivered Assets #23.

Line #25 -- Securities Purchased But Not Received (at purchase prices)

Include

(a) Forward commitments to buy, including regular delivery.

Offset -- Securities are included in Assets #5 - 19.

(b) Failures to receive securities purchased.

Offset -- Securities are included in Assets #5 - 19.

Line #27 -- Reserve for Income Taxes

Show reserves for accrued taxes on earned income and realized profits, but not on unrealized profits. Such reserves are to be estimated if necessary.

Line #30 -- Long-term Debt

Include any subordinated debt with maturity of one year longer. (Show details in Supplementary Information Form C, Item #9.

COMPARISON OF NET WORTH - FORM B

Line #5 -- Amount of net worth allocable to activities in Government and Agency securities and certificates of deposit

If net worth is normally not apportioned, make best estimate and explain basis of estimate in supplementary information.

NET INCOME ANALYSIS - FORM B

Line #8 -- Income Taxes

Include all accruals and transfers to Reserves for Income Taxes to cover income taxes on income for the current calendar year. Do not include actual payment of taxes on income for prior calendar years.

Lines #12 and 13 - Trading and underwriting profit on coupon issues (Includes unrealized appreciation or depreciation on securities owned)

Since all Government and Agency securities and certificates of deposit are to be valued at market, trading profits and losses in Line #11 will include some unrealized profits or losses on securities which are still owned and are included in the assets. Such profits should be shown as a memorandum item on Line #12.

Line #18 -- Interest on Borrowed Funds

Include interest from repurchase agreements.

Line #19 -- All other expenses including taxes other than income taxes

If certain types of expenses are not normally apportioned between activities in different types of securities, make best estimate and explain basis of estimate in supplementary information.

DRAFT OF LETTER TO BE ADDRESSED TO ALL NONBANK DEALERS

Dear Mr.____________:

When the project for improving the available information on the Government securities market was initiated in January 1960, Chairman Martin and Secretary of the Treasury Anderson wrote you under date of January 22, 1960 requesting your cooperation and mentioning, among other things, that the program would include dealer balance sheet and income statement information. Since that time extensive conferences have been held with dealers to lay the groundwork for a specific plan for improving dealer financial statements. As a result of these discussions a basis for nonbank dealer financial statements has been developed which should produce worthwhile results through greater knowledge of dealer financial status, activities and income, obtained from data that has a reasonable degree of uniformity as between dealers. The need for such knowledge is, if anything, greater than it was in 1960.

The plan is designed initially to provide better financial statements for the use of the Federal Reserve System, the Treasury and other interested public bodies on a confidential basis. Eventual publication of some of the data in consolidated summary form is contemplated if it proves desirable after a trial period.

The details of the plan are set forth in the attached statement forms and instructions. The salient features are:

1. All nonbank dealers are to submit financial statements to the Federal Reserve Bank of New York as of December 31 each year, such statements to be audited, where feasible, and where not audited to be supplemented by information permitting reconcilement with the most recent audit.

2. The content of the statement so far as assets and liabilities are concerned will conform as nearly as possible to the daily position and borrowing reports submitted to the Federal Reserve Bank of New York, with all securities holdings to be valued at market rather than at par value.

3. A reconcilement of net worth between statement dates will show adjustments in the various net worth accounts and an analysis of net earnings for the period. Both net worth and net income will be broken down to show the portions allocable to operations in Government securities.

It is expected that dealers will be able to comply with the requirements of the plan without assuming undue burdens. Some minor adjustments in the details of the plan may have to be made after each dealer has had an opportunity to apply the requirements to his own situation. It is hoped that statements as of December 31, 1964 can be obtained from all dealers.

We shall be pleased to answer any questions you may have regarding this project.

Very truly yours,

Alfred Hayes,
President.

Enclosures