

Cantor Fitzgerald

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April 28, 1998

Mr. Michael A. Macchiaroli
Associate Director
Division of Market Regulation
U.S. Securities and Exchange Commission
450 Fifth Street N.W.
Washington D.C. 20549

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

Dear Mr. Macchiaroli:

This letter responds to your request for confirmation of the treatment of collateral provided in an OTC Treasury options matched book that was reached in our meeting of November 18, 1997 and our February 26, 1998 conference call. Present at the meeting were representatives of the SEC, the Bureau of the Public Debt, NASDR, Cantor Fitzgerald Securities ("Cantor Fitzgerald"), and Roger G. Coffin, Coopers & Lybrand L.L.P. Set forth below is a brief description of the nature of the business and the regulatory treatment under SEC and Treasury rules that will apply to Cantor Fitzgerald's OTC Treasury options matched book business ("OTC Treasury options business").

Cantor Fitzgerald is a government securities broker-dealer registered with the Securities and Exchange Commission under Section 15C of the Securities Exchange Act of 1934 ("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 and transactions 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 rehypothecated by Cantor Fitzgerald to a counterparty without triggering the possession and control or customer reserve formula provisions of Rule 403.4.

To enhance the liquidity of its screen brokerage of OTC Treasury options business, Cantor Fitzgerald must include sophisticated institutional investors that are not broker-dealers, foreign dealers, or government securities dealers, and therefore are "customers" under Rule 15c3-3 and Treasury

requirements, which would prevent Cantor Fitzgerald from rehypothecating collateral received on any "customer" side of a transaction.¹

Representatives of Cantor Fitzgerald met with staff of the SEC and the Treasury in July 1996, and more recently to discuss potential regulatory alternatives that would afford protections consistent with those set forth in applicable SEC and Treasury rules and interpretations, while recognizing the special nature of Cantor Fitzgerald's OTC Treasury option matched book and the counterparties with whom Cantor Fitzgerald will be transacting business. Based on those meetings and conversations with SEC and Treasury staff, we confirm our understanding of the treatment of collateral as follows (to begin on or prior to the effective date of these procedures):

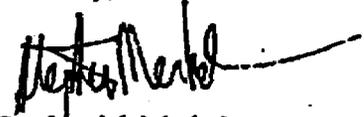
- Prior to participating as a counterparty in Cantor Fitzgerald's OTC Treasury options business and rehypothecating the collateral provided by any particular institutional counterparty, Cantor Fitzgerald will obtain a written agreement from each institutional counterparty² stating that the counterparty agrees to and understands that any collateral provided to Cantor Fitzgerald under an OTC option agreement can be rehypothecated to other counterparties in the course of the OTC Treasury options business and will not be subject to the possession and control requirements of the 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 attach the collateral or otherwise against the counterparty.
- Cantor Fitzgerald will perform a daily calculation of the "credits" and "debits" received as collateral from both non-customer broker-dealers and "customer" counterparties, and will rehypothecate collateral only to the extent needed in the conduct of its OTC Treasury options business. Cantor Fitzgerald will at all times maintain all counterparty collateral related to its OTC Treasury matched book business in an account separate and apart from the general assets of the firm similar to an account established under section (k)(2)(i) of Exchange Act Rule 15c3-3. All collateral not subject to rehypothecation contemplated above must be segregated and remain in the separate account. Cantor Fitzgerald will obtain a written acknowledgment from the bank holding collateral in such account that the collateral will not be subject to any right, charge, security interest, lien, or claim of any kind in favor of the bank or any person claiming through the bank. Cantor Fitzgerald will be permitted to rehypothecate collateral consistent with these requirements and will not otherwise be subject to the requirement for locking up collateral under applicable SEC and Treasury rules.

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1. Broker-dealer 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 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 as 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.

- Any non-cash collateral rehypothecated 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).
- For a period of one year and for any additional periods that the NASDR requires, Cantor Fitzgerald will provide to the NASDR quarterly reports describing the nature and number of the counterparties and the size of the OTC Treasury options matched book and collateral arrangements.

We believe the foregoing accurately reflects the understanding reached at our November 18, 1997 meeting and our February 26, 1998 conference call. Should you, Treasury or NASDR staff have any questions regarding the above, please call me at (212) 938-5445. Consistent with our conversations, the broker-dealer would like to begin following the treatment outlined herein as soon as practical. Thank you again for your assistance in this matter.

Sincerely,



Stephen M. Merkel
Senior Vice President
General Counsel

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