investigation, law enforcement personnel, and sources of information.

(D) To fulfill commitments made to protect the confidentiality of sources.

(E) To protect the identity of Federal employees who furnish a complaint or information to OIG, consistent with section 7(b) of the Inspector General Act of 1978, as amended, 5 U.S.C. App. 3.

(F) To assure access to sources of confidential information, including those contained in Federal, State, and local criminal law enforcement systems.

(G) To prevent disclosure of law enforcement techniques and procedures.

(H) To avoid endangering the life or physical safety of confidential sources and law enforcement personnel.

(iii) Records within this system of records comprised of investigatory material compiled solely for the purpose of determining suitability or eligibility for Federal civilian employment, Federal contractors, or access to classified information, are exempt under the provisions of 5 U.S.C. 552a(k)(5), but only to the extent that disclosure would reveal the identity of a source who furnished information to the Government under an express promise that the identity of the source would be held in confidence, or, prior to January 1, 1975, under an implied promise that the identity of the source would be held in confidence. This system of records is exempt for one or more of the following reasons:

(A) To fulfill commitments made to protect the confidentiality of sources.

(B) To assure access to sources of confidential information, including those contained in Federal, State, and local criminal law enforcement information systems.

Issued at Washington, DC, this 23rd of November 1992.

Office of Inspector General.

John J. Adair,

Inspector General, Resolution Trust Corporation.

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34–31511; File No. S7–28–89]

RIN 3235–AD79

Net Capital Rule

AGENCY: Securities and Exchange Commission.

ACTION: Final rule amendments.

SUMMARY: The Securities and Exchange Commission is amending its net capital rule under the Securities Exchange Act. The amendments will raise the absolute minimum net capital required of certain registered broker-dealers. Broker-dealers that hold customer funds or securities will be required to maintain at least $250,000 in net capital. Those firms that clear customer transactions but do not hold customer funds or securities beyond the settlement of the transaction will be subject to a $100,000 minimum net capital requirement. Broker-dealers that introduce customer accounts to other broker-dealers will be required to maintain $50,000 or $5,000 in minimum net capital, depending on whether or not they receive securities. Broker-dealers that make markets in certain securities will be required to maintain greater net capital in proportion to the number of securities in which they make markets. The maximum on this additional market maker minimum net capital requirement will be raised from $100,000 to $1,000,000. The minimum net capital requirement for certain mutual fund broker-dealers will be increased to $25,000. The increases to the minimum capital levels will be implemented over a period of eighteen months. Additionally, the two methods of computing deductions for equity securities positions (or "haircuts") will be standardized. Finally, certain changes will be made to the computation of aggregate indebtedness.

EFFECTIVE DATES: For the amendments relating to equity securities haircuts (paragraph (c)(2)(vi)(J)), charges to aggregate indebtedness (paragraph (c)(1)), and the capital requirements for market makers (paragraph (a)(4), except as to that provision raising the ultimate market maker capital requirement to $1,000,000, which shall become effective on June 30, 1993), the effective date shall be January 1, 1993. For the amendments relating to minimum net capital requirements contained in paragraph (a), see the temporary phase-in schedule set forth in Appendix E to Rule 15c3–1.

FOR FURTHER INFORMATION CONTACT: Michael A. Macchiaroli, (202) 272–2904, Michael P. Jamroz, (202) 272–2372 or Roger G. Coffin, (202) 272–7375, Division of Market Regulation, 450 Fifth Street, NW., Washington, DC 20549.

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I. Introduction

A. The Commission's Proposal

On September 15, 1989, the Commission issued a release requesting comment on proposed increases to the minimum net capital requirements applicable to broker-dealers.[1] The Commission was concerned that the minimum net capital requirements, which in some cases dated back to 1972, were no longer adequate.

In that release, the Commission proposed increases in the minimum capital requirements for registered broker-dealers, based on the nature of the business of the firm, and the extent to which a broker-dealer has contact with customer funds or securities. Briefly, under the proposal, firms that carry customer accounts would be required to maintain at least $250,000 in net capital. Broker-dealers that clear customer accounts in accordance with Securities Exchange Act Rule 15c3–3(k)(2)(i) (and therefore, although they may receive funds or securities, they may not hold them beyond the settlement of a transaction) would be required to maintain at least $100,000 in net capital. Firms that introduce customer accounts to other broker-dealers would be required to maintain a

[1] Securities Exchange Act Release No. 27249 (September 15, 1989), 54 FR 40395 (October 2, 1989). All comments are available in File No. S7–28–89 at the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549.

minimum net capital of $100,000 or $50,000, depending upon whether the firm routinely or occasionally receives customer funds or securities. Under the proposal, broker-dealers that never receive customer funds or securities would be allowed to maintain minimum net capital of $5,000.

The minimum net capital required to be maintained by firms that make markets in securities also would be raised under the proposed amendments. Under the net capital rule, a market maker is required to maintain the greater of the base minimum net capital requirements referred to above or an amount of net capital determined by the number of securities in which the firms makes markets. The net capital rule currently draws a distinction in this regard based on the price of the security. Securities priced $5 and below require capital of $500 each, while securities priced above $5 require capital of $2,500 each. Under the proposal, the amount to be maintained for securities priced under $5 per share would be raised to $1,000 per security. The ceiling on this net capital requirement would have been raised to $1,000,000, from the present $100,000.

The proposed amendments also included provisions that would standardize the deductions under the rule for proprietary positions in equity securities. Currently, the applicable deduction (or "haircut") depends on the method the broker-dealer elects to compute its net capital requirement. Broker-dealers calculating their net capital under the basic method incur a different haircut charge than those computing haircuts on the alternative method, which generally results in lower haircut charges than the basic method.

Further, broker-dealers computing net capital under the basic method would realize reductions in aggregate indebtedness charges for liabilities associated with mutual fund and securities lending transactions. Finally, the Commission proposed that, for the purpose of calculating haircuts, stripped debt instruments be accorded the same treatment, for haircut purposes, as equity securities. The Commission's proposal will be discussed in greater detail in the appropriate sections of this release.

The Commission believes that the concerns articulated in the proposing release are valid, and is therefore adopting most of the proposed amendments. Certain changes to the original rule amendments have been made however, and these changes will necessitate the proposal of additional amendments to the net capital rule. Therefore, the Commission is issuing two releases that relate to the minimum net capital standards applicable to broker-dealers. This release discusses the proposals that are being adopted by the Commission. In a separate release, the Commission is proposing for comment further amendments to the minimum net capital standards.

B. Brief Summary of Comments

The Commission received almost 275 letters in response to the proposed rule changes. Approximately 200 of the commentators objected generally to the proposed increases in minimum net capital requirements. Most of the commentators writing in protest against the increases objected to the proposed increases to the net capital requirements for introducing and mutual fund broker-dealers. Primarily, these firms feared that an increase in minimum net capital requirements would restrict entry into the securities business and force existing entities to close. A frequently voiced complaint was that the proposal discriminated against smaller firms in favor of larger enterprises without sufficient justification.

Self-regulatory organizations and other groups including the New York Stock Exchange ("NYSE"), the Securities Industry Association ("SIA"), the American Bar Association, the Chicago Bar Association, the Philadelphia Stock Exchange ("Phlx"), and the Midwest Stock Exchange generally supported the proposal. These commentators acknowledged the need to increase minimum net capital requirements and concurred with the general concerns set forth in the release proposing the amendments for comment. In particular, the National Association of Securities Dealers, Inc. ("NASD") expressed support for raising minimum net capital levels generally and made specific recommendations regarding the appropriate levels for introducing firms. The NASD's recommendation has, in large part, served as the framework for the requirements for introducing firms set forth in the releases being issued today.

Comments with respect to the increased net capital requirements for firms that carry and clear customer accounts were split; a number of commentators objected to the potential anti-competitive effects of the increases. However, others recognized the risks created by firms that hold customer funds and securities and acknowledged the need for regulatory action.

The Commission received mixed comments with respect to its proposal to increase the minimum capital requirements of firms that make markets in over-the-counter securities. The NASD and the SIA supported the proposal; a number of broker-dealers criticized it, claiming that an increase in capital requirements would drive some market makers away from the over-the-counter securities market, reducing liquidity.

Firms that commented on the proposed new haircuts for zero-coupon and stripped securities opposed the measure on the ground that the proposed haircut was not reflective of the risks or volatility associated with stripped debt securities. In this regard, the Public Securities Association ("PSA") provided data on the volatility of stripped securities to be used in determining haircuts for these instruments. The proposals to standardize haircuts and alter the computation of aggregate indebtedness were generally supported by the commentators.

C. The Net Capital Rule

The Commission's net capital rule requires that every registered broker-dealer maintain a certain specified minimum level of net capital.[2] Rule 15c3–1 requires registered broker-dealers to maintain sufficient liquid assets to enable those firms that fall below the minimum net capital requirements to liquidate in an orderly fashion without the need for a formal proceeding.[3] The rule prescribes required minimum levels based upon both the method the firm adopts in computing its net capital and the type of securities business it conducts. A firm engaging in a general securities business (which would include the ability to clear and carry customer accounts) calculating its net capital under the basic (or aggregate indebtedness method) must maintain a minimum net capital level of the greater of $25,000 or 6⅔ percent of its liabilities (with certain exclusions). If the firm chooses the alternative method of computing its net capital (presently found in paragraph (f) of the rule), it must maintain net capital equal to the greater of $100,000 or 2 percent of its customer-related receivables.

The current rule prescribes different minimum levels of net capital for firms based on categories of business activity. These levels were designed to address

[2] Generally, net capital, as defined by Rule 15c3–1, is a broker-dealer's net worth plus liabilities subordinated in accordance with Appendix D of the rule, minus assets "not readily convertible into cash" and certain percentages, or haircuts, of a firm's securities and commodities positions.

[3] Self-liquidation of a securities firm in or approaching financial difficulty is specifically contemplated by section 5(a)(2) of the Securities Investor Protection Act of 1970 ("SIPA").

the risks perceived in the different types of businesses engaged in by broker-dealers. For example, if a broker-dealer carries no customer accounts and limits its business to certain specified activities, it needs to maintain only $5,000 in net capital, rather than the $25,000 that would otherwise be required under the basic method of computing net capital.[4] One of the specified activities permitted is the introducing, on a fully disclosed basis, of customer accounts to another broker-dealer that clears and carries the accounts.

II. Rule Amendments—Minimum Net Capital Requirements

The following section of this release addresses, in greater detail, the Commission's amendments to the net capital rule concerning minimum net capital requirements.

A. Clearing Firms

(i) The Commission's Proposal and the Need for Increases

The Commission's proposal would raise the minimum net capital requirements of firms that clear customer accounts and hold customer funds and securities from $25,000 (or $100,000 for firms on the alternative method) to $250,000. Because of the reduced risk, clearing firms that receive customer funds and securities but do not maintain custody of such assets beyond the settlement of a transaction (and are therefore exempt from the customer protection rule by virtue of paragraph (k)(2)(i)) would have a minimum net capital requirement of only $100,000.[5]

The Commission believes it is appropriate to require the highest minimum level of net capital for broker-dealers that are entrusted with the money and securities of customers, who are, in most instances, incapable of assessing the financial condition of custodian firms. The required minimum net capital level for custodian firms should not be such that the slightest financial adversity will cause the collapse of the broker-dealer, an event that may cause delays and possible losses to customers and the Securities Investor Protection Corporation ("SIPC") fund.

Several liquidations supervised by the NASD illustrate the potential dangers more dramatically. One firm held $70 million of customer securities, although it maintained only $61,000 of net capital. Another held $8 million of customer securities against only $42,000 in net capital. In both instances, the NASD became aware of financial difficulties in time to have the firms transfer the customer accounts to other broker-dealers, thereby avoiding SIPC liquidations.

During a self-liquidation, the expenses of a firm continue while its revenues drop significantly, often to zero. For example, employees of the firm being liquidated are retained in order to perform the services associated with transferring customer accounts to other firms. The salaries of these employees, along with the costs associated with maintaining the premises of the firm and transferring securities are borne out of the remaining capital of the firm. A self-liquidation can take from three weeks to several months, depending on the condition of the records of the broker-dealer and whether other broker-dealers willing to take the customer accounts can be readily located.

Self-liquidation costs incurred by the self-regulatory authorities are difficult to measure, because a large portion of the expenses are for non-incremental employee salaries, although for broker-dealers located outside the commuting distance of an NASD regional office, there could be substantial employee per diem and travel expenses. The staff of the NASD has advised the Commission that, on average, even the smallest self-liquidation requires two to three NASD employees on premises for a minimum of two weeks. By contrast, a recent large liquidation required approximately 25 NASD employees on premises for almost ten weeks.

Above the beyond accounting for costs, the Commission notes that customers of a firm undergoing a SIPC liquidation are usually unable to access their accounts during the liquidation. Aside from possible financial harm to customers, the delay in a liquidation causes considerable customer anxiety. Although every attempt is made to transfer the accounts of the insolvent broker-dealer to a healthy firm as quickly as possible, or to disburse the assets of the accounts directly to customers, delays can occur for many different reasons. A supervised self-liquidation can avoid the delays that might arise in the context of a court-imposed liquidation.

While requiring additional amounts of capital will not prevent firms from failing, the additional capital serves as a fund from which the expenses associated with a liquidation can be paid. Moreover, the greater sum will act as a more reliable cushion against the use of SIPC money to liquidate a failed broker-dealer. In most instances, a $250,000 minimum net capital requirement should prove to be a sufficient cushion for a reasonably conducted self-liquidation before a broker-dealer's insolvency. The self-regulatory organizations will be less hesitant to intervene and supervise a self-liquidation if there are thereby fewer questions concerning the liquidity of the firm's assets or if there is less of a threat by outside creditors to move against the broker-dealer. This is the most desirable situation for the customers of a firm that is no longer viable.

Other organizations have expressed concern about the minimum levels of net capital. The Commodity Futures Trading Commission ("CFTC") recently approved amendments to National Futures Association ("NFA") rules that increased the minimum net capital requirements of futures commission merchants from $50,000 to $250,000.[6] The Options Clearing Corporation requires its new members to maintain $1 million in net capital and other members to maintain $750,000 in net capital.[7] The National Securities Clearing Corporation requires its member broker-dealers to maintain $50,000 in excess net capital over that required by Rule 15c3–1.[8]

(ii) Industry Response

Generally, the self-regulatory organizations, SIPC, and the SIA expressed approval of the higher requirements. Both the NYSE and the NASD specifically endorsed the proposal for clearing and carrying firms. However, approximately twenty-five broker-dealers expressed their opposition to the proposed $250,000 requirement. Many of these firms are small to mid-size regional firms that carry customer accounts and clear their own securities transactions but do not clear the accounts of other broker-

[4] See Securities Exchange Act Rule 15c3–1(a)(2); 17 CFR 240.15c3–1(a)(2).

[5] Under paragraph (k)(2)(i) of Rule 15c3–3, a broker-dealer that does not carry margin accounts, promptly transmits all customer funds and securities to a carrying firm and effectuates all financial transactions with customers through a specially designated bank account is exempt from the possession and control and Reserve Formula requirements of the customer protection rule.

[6] See National Futures Association Amendments to NFA Financial Requirements Sections 1 and 6, January 25, 1990, (Nat'l Fut. Ass'n Man. (P–H) ¶¶ 7011 and 7041, NFA Financial Requirements sections 1 and 6. The NFA is a self regulatory organization composed of futures commission merchants, commodity pool operators, commodity exchanges, banks and other organizations that is responsible for regulating the financial responsibility of its members.

[7] See Options Clearing Corp. Guide (CCH) Rules 301(a) and 302(a).

[8] See Nat'l Sec. Clearing Corp. Rules Addendum B ¶ I.B.1.a.

dealers. Primarily, these firms feared that the proposal would drive them out of the securities business and therefore reduce competition. It should be noted however, that even among this group of firms that objected to the proposed minimum, almost one-half stated that some increase in minimum net capital requirements is warranted. One firm candidly acknowledged that the current minimum of $25,000 is far below what is needed to operate a securities business.

Other small broker-dealers opposed the increase and disagreed with the contention that clearing firms could avoid the increased costs associated with obtaining the capital necessary to comply with the amendments by opting to become introducing broker-dealers.[9]

(iii) Impact of Increased Requirements

It is clear that the recommended amendments will require some firms to raise additional capital. The firms that will need extra capital to comply are, the Commission believes, currently operating a securities business with an inappropriately, and in some instances dangerously, low level of net capital. While the Commission agrees with those commentators who point out that regional clearing firms provide important services to investors, the Commission also believes that undercapitalized firms endanger investors and undermine the consumer confidence upon which all firms rely. Investors who choose to leave their funds and securities with a regional self-clearing firm will be better served if that firm maintains an amount of net capital sufficient to ensure its continuity and stability in the industry.

In any event, the Commission's analysis of cost of capital data and the present net capital of clearing firms tends to refute the arguments of the commentators. Based on data received from the NASD reflecting financial information for firms designated to the NASD for examination ("NASD Data"), the approximate effect the increased requirements will have on the marketplace was calculated.[10] Of the 458 NASD firms that clear customer accounts or hold customer property, 349 had net capital in excess of $250,000. These firms had a total combined revenue of $9.7 billion that represented 99 percent of the total revenue generated by all NASD clearing firms during the past year. Put another way, the rule amendments will affect 109 firms whose combined revenues of $105 million represent about 1 percent of the total $9.8 billion of clearing firm revenues. The Commission believes that this data demonstrates that the amendments will have a minimal effect on competition among clearing firms because, for the most part, investors already deal with well capitalized entities when making investment decisions.

The Commission recognizes that a precise estimate of the costs the recommended amendments would impose on clearing firms is difficult, if not impossible to calculate, especially considering the so-called "opportunity costs" involved in tying up additional resources in minimum net capital. Nonetheless, rough estimates based on the relative cost of capital demonstrate that the effect of the amendments should not be unduly harsh.

Typically, broker-dealers are organized as corporations or partnerships. In either instance, the individual or individuals who establish the firm can deposit into the entity money either as equity capital or subordinated debt that has been borrowed personally. These deposits are deemed to be the net capital of the broker-dealer, so long as the broker-dealer incurs no liability on the personal loan.

Once in the entity, the net capital of the broker-dealer may be invested in high-grade commercial paper, bank certificates of deposit or short-term government securities, all of which, as money market instruments, receive little or no haircut under the net capital rule. The Commission estimates the difference between the lending rate and the rate a broker-dealer could earn on the above-mentioned instruments to be approximately three to four percent annually before taxes. Based on the NASD data, the analysis shows that 109 clearing firms would need, on average, an additional $120,520 each to comply with the $250,000 requirement. Using a four percent spread to determine the cost of capital, it would cost each of the 109 clearing firms on average approximately $4,821 per year to comply with the new requirement. This is a small insurance premium to pay to protect the investing public and the SIPC fund.

Rather than raise additional capital, many of the self-clearing firms that would be unable to meet the $250,000 net capital requirement would have another option available. These firms could lower their minimum required capital by conducting business in accordance with paragraph (k)(2)(i) of Rule 15c3–3, or by introducing their customer accounts to a clearing firm. All but 41 of the 109 NASD clearing firms that would not meet the $250,000 requirement would meet the $100,000 minimum capital requirement applicable to (k)(2)(i) firms. All but 12 of these firms would be able to meet the $50,000 requirement applicable to introducing firms.

With respect to those firms that receive funds and securities, but do not hold them pursuant to paragraph (k)(2)(i) of Rule 15c3–3, the NASD data indicates that, at the end of 1991, 62 out of the 242 firms that conduct a general securities business and operate under that exemption would be unable to meet the $100,000 standard. Those firms would need a total of $2.7 million, or an average of $43,000 per firm, to meet the new requirements. Further, in 1991, NASD firms conducting business under the paragraph (k)(2)(i) exemption produced revenues of $3.1 billion. The 62 firms that would not be able to meet the new $100,000 standard had $24 million of revenues or .75 percent of the total amount. Thus, it does not appear that the $100,000 standard will have a significant impact on competition among this class of clearing firms.

Several commentators disputed the Commission's cost of capital estimates. Others argued that a four percent spread was too low. The Commission recognizes that broker-dealers may incur economic costs other than the estimated four percent cost of capital. For example, if a principal of a broker-dealer borrows funds personally, he or she will likely be required to pledge personal assets as collateral for the loan. Additionally, there may be other inestimable opportunity costs associated with raising and using additional capital

[9] Several commentators objected to the Commission's characterization of the risks created by clearing firms. These firms argued that the Commission should draw distinctions based on the manner in which clearing firms hold their customer securities in order to allow firms that hold customer securities in non-negotiable form to operate under reduced minimum. Presumably, this means that the broker-dealer would have no powers of attorney. The Commission does not believe that developing a minimum requirement containing such a distinction would be a practical solution. It would be virtually impossible to examine for compliance with this type of a requirement. If a clearing firm is holding hundreds of customer securities, examiners would have to inspect for powers of attorney for each customer. Furthermore, the essential risks inherent in allowing firms with little capital to hold securities would still be present under such a scheme. If it means that the broker-dealer would hold powers of attorney, the practical effect of this arrangement diminishes the distinction that the commentators would draw in the way securities are held at the firm. In the event of a SIPC liquidation, these securities are treated as part of the fungible bulk that is shared by all customers in a pro rata form (See SIPA Section 8), although SIPC would make every effort to return specific securities to customers.

[10] None of the firms designated to the NYSE appear to have a problem meeting the new minimum requirements.

to comply with the amendments. However, even if the estimated cost of capital were eight percent, the average cost of capital for the 109 clearing firms that need to acquire extra capital would only be $9,642 per year, before taxes. It does not appear that these costs will be prohibitive, given the added protection the rule amendments will provide.

As a concession to those firms required to meet the higher minimum requirements, the Commission's proposal would have relaxed the haircut charge associated with securities underwritings, known as the "contractual commitment haircut". The contractual commitment haircut applies to firm commitment underwritings and requires a charge on each net long securities position contemplated by any open contractual commitment in the broker-dealer's proprietary account. Currently, firms are required to take a 30 percent haircut (minus unrealized profits) on their open contractual commitments in equities. The size of this contractual commitment haircut can discourage smaller firms from participating in securities offerings, since the haircut could threaten their net capital compliance.

Because small broker-dealers play an important role in the local capital formation process, the Commission believes that those firms meeting the higher minimum capital requirement should be permitted to enter into small firm commitment underwritings without incurring a significant contractual commitment charge. Therefore, under the rule amendments, broker-dealers that meet the $250,000 minimum will not be required to charge its capital for any contractual commitment haircut to the extent that the haircut would not exceed $150,000. For instance, if a broker-dealer participates in an underwriting in which it has a firm commitment to purchase securities, and the appropriate contractual commitment deduction would be $150,000 or less, the broker-dealer would incur no haircut. Commitments resulting in potential charges in excess of $150,000 would result in deductions on the amount in excess of $150,000. This will benefit smaller broker-dealers that wish to engage in underwritings but were previously subject to the full amount of the contractual commitment charge.

In order to clarify the application of the $250,000 minimum net capital standard, the amendments contain the following definitions. A broker-dealer shall not be deemed to receive funds from customers if it receives checks, drafts, or other evidences of indebtedness made payable to an entity other than itself (such as another broker-dealer, escrow agent, etc.) and the receiving broker-dealer promptly forwards such funds to the other broker-dealer or escrow agent.[11] With regard to securities, a broker-dealer shall be deemed to hold securities if it does not promptly forward such securities received by the firm to a clearing firm, escrow agent or other appropriate entity.

Finally, firms that choose not to meet the new levels, or are unable to do so, will not, as some commentators suggest, be forced to close their doors. Specifically, the lower net capital requirement afforded broker-dealers that operate under the (k)(2)(i) exemption from Rule 15c3–3 will provide many firms that currently hold the assets of their customers an alternative to the higher minimum for clearing and carrying firms. Moreover, they may elect to remain in the securities business with an even lower amount of capital and introduce their accounts to another firm.

The Commission believes that the combined effect of the variety of options contained in the recommended amendments will allow each firm to select an appropriate amount of net capital and tailor its business activities accordingly to meet the requirement it chooses. Thus, firms will not be drawn out of the industry, and the impact on competition will be minimal. For these and the reasons stated above, the Commission is adopting the amendments regarding clearing and carrying firm net capital requirements as proposed.

B. Dealers, Market Makers and Trading Firms

The Commission's proposal would have raised the minimum net capital requirement applicable to dealers, market makers and trading firms to $100,000 (although market makers are subject to additional net capital requirements discussed below).

(i) Dealers

The types of broker-dealers that fall under the dealer category take risks that far outweigh their present minimum net capital requirements. A minimum net capital level of only $25,000 is an extremely thin cushion against the risks in a dealer's business, because of the potential for severe market volatility. Additionally, the proliferation of complex securities, including interest-only and principal-only mortgage-backed securities and various option products have added elements of risk not envisioned when the current minimum standards were adopted. There were no substantial adverse comments to the dealer proposals. Accordingly, the Commission believes firms that fall into this category should have a minimum net capital requirement of at least $100,000 and is adopting the amendments.

For the purposes of determining whether a person is subject to the higher net capital requirements applicable to dealers, the term "dealer" for that purpose would include those persons that endorse or write over-the-counter options, and any broker-dealer that effects more than ten transactions in any one year for its own investment account, but would exclude firms that underwrite securities on a best efforts or all or none basis, those that engage in certain kinds of riskless principal trading, and certain firms engaged in the sale of redeemable shares of registered investment companies.

(ii) Over-the-Counter Market Makers

In addition to raising the base minimum requirements for market makers, the proposed amendments would raise the additional market maker capital requirement. Currently, securities priced $5 and below require net capital of $500 each, while securities priced above $5 require net capital of $2,500 each. Under the proposal, the amount to be maintained for securities priced under $5 per share would be raised from $500 to $1,000 per security. The ceiling on this additional net capital requirement would be raised to $1,000,000, from the present $100,000. No change to the existing capital requirement of $2,500 per share for securities priced over $5 was proposed. The Commission is adopting these amendments as proposed.[12]

Market maker capital requirements have been a cause for considerable concern since at least the market break of 1987. In its Market Break Report, the Division of Market Regulation (the "Division") stated that there should be a review of the minimum amount of capital necessary to qualify as an over-the-counter market maker. The Division noted that the review should include an analysis of the amount of capital necessary for each security, as well as the appropriateness of the capital ceiling of $100,000. The Division's concern was precipitated by the cessation of business by 12 over-the-

[11] The term "promptly forward" is defined in the net capital rule to mean when "such transmission or delivery is made no later than noon of the next business day after the receipt of such funds or securities." Rule 15c3–1(c)(9).

[12] Separately, the Commission is proposing for comment an amendment that would require market makers to maintain capital of $2,500 per share, regardless of the price of the security.

counter market makers immediately following the October 1987 market break. In some cases, the prices of the securities in which they made a market fell dramatically. Customer obligations, which in some cases were secured by the securities, became uncollectible. The Division pointed out that other broker-dealers and customers are also exposed to potential market losses when a significant market maker in a particular security fails. Other, less significant market makers may withdraw from the system or may restrict their purchases, often resulting in a free-fall in the prices of the securities.[13]

The NASD reacted promptly to the 1987 market break by approving amendments to its Small Order Execution System ("SOES"), which required not only mandatory participation in the SOES for all market makers in certain securities, but also maximum SOES order size limits based on the market characteristics of the securities.[14] Under mandatory SOES participation, market makers are required to accept small orders received through the SOES system. Because the financial requirements resulting from the mandatory SOES obligations require higher capital levels of market makers, the NASD's Quality of Markets Committee recommended that the Commission substantially increase capital requirements for market makers.[15]

Despite these recommendations, a number of commentators opposed the Commission's proposal, arguing that increases would discourage firms from making markets, resulting in reduced liquidity, particularly in lower priced stocks. The Commission believes this concern is mainly unfounded. Market makers play an integral role in the securities markets and the Commission believes it is essential for these firms to maintain sufficient capital to discharge their market making activities without disruptions that can interrupt the liquidity in a particular security. Market makers that maintain the bare minimum amount of net capital are, however, frequently unable to assume even the smallest positions in the stocks in which they make markets. Indeed, the Commission believes it is those firms that maintain the bare minimum amount of capital that pose a threat to liquidity. To the extent such a firm's capital falls below the minimum, the firm is compelled to withdraw as a market maker in some of its market making securities, which could impair the market. This has been a particular problem in the marketplace for those securities priced under $5 per share, where the failure of market making firms has resulted in the virtual elimination of a public market for many of the securities in which they made markets. When a broker-dealer holds itself out as making a market in a particular security, it should maintain sufficient capital to stand behind that commitment. That commitment is no less important in the market for securities priced below $5 per share.

Based on these reasons, the NYSE, the NASD and the SIA supported the proposal. In fact, the SIA stated that the proposal did not go far enough. Specifically, the SIA argued that it is inappropriate to distinguish between securities priced above $5 per share from those that are priced below $5 per share in determining capital requirements. The Commission preliminarily agrees with the recommendation of the SIA and believes that a further amendment to the net capital rule is warranted.

Therefore, the Commission, in a separate release, is proposing for comment an amendment that would raise the requirement to $2,500 per security, regardless of the price of the security.

C. Introducing Firms

(i) Introduction

An introducing broker-dealer is one that has a contractual arrangement with another firm, known as the carrying or clearing firm, under which the carrying firm agrees to perform certain services for the introducing firm. Usually, the introducing firm submits its customer accounts and customer orders to the carrying firm, which executes the orders and carries the account. The carrying firm's duties include the proper disposition of the customer funds and securities after trade date, the custody of customer securities and funds, and the recordkeeping associated with carrying customer accounts.[16]

The practices regarding the handing of customer funds and securities vary among different introducing and clearing dealers. In many cases, the customer gives funds and securities directly to the introducing firm, which in turn is obligated to forward them to the clearing firm. In other cases, the customer sends funds and securities directly to the clearing firm.[17]

The receipt of customer funds or securities by inadequately capitalized introducing firms is a major concern of both the Commission and SIPC. Recognizing this concern, the proposing release would have created three tiers of introducing firm minimum net capital requirements, based on the frequency with which the introducing firm handles customer property. Firms that routinely handle customer funds or securities would have been required to maintain $100,000 in net capital. Brokers that occasionally handle funds and securities would have been required to maintain $50,000 in minimum net capital. Firms that never receive funds or securities would remain in a $5,000 category.

The Commission has decided to take a two-step approach to the minimum net capital requirements applicable to introducing firms. First, the Commission is abandoning the three-tier distinction that was based on the occasional versus routine receipt of securities in favor of a two-tier system which would have a $50,000 minimum for firms that receive any securities, and a $5,000 minimum for those that do not. The second phase of the Commission's action with respect to introducing firms will be the additional proposal of an amendment raising the $5,000 minimum to $25,000. Discussed more fully below are the specifics of the Commission's action and the reasons for the increases.

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[13] See the October 1987 Market Break, a Report by the Division of Market Regulation of the U.S. Securities and Exchange Commission, February 1988, (the "Market Break Report") pp. 5–11, 12 and 15.

[14] See File No. SR–NASD–88–1, Securities Exchange Act Release No. 25791 (June 9, 1988).

[15] See Report of the Special Committee of the Regulatory Review Task Force on the Quality of Markets, NASD publication, 1988, p. 15.

[16] A fully disclosed introducing arrangement should be distinguished from an omnibus clearing arrangement where the clearing firm maintains one account for all the customer transactions of the introducing firm. In an omnibus relationship, the clearing firm does not know the identity of the customers of the introducing firm. In a fully-disclosed clearing arrangement, the clearing firm knows the names, addresses, securities positions and other relevant data as to each customer. For the purposes of the net capital rule, broker-dealers that introduce accounts on an omnibus basis are considered clearing firms.

[17] Under paragraph (a)(2) of the net capital rule, introducing firms are prohibited from holding funds or securities for customers. They are required to promptly forward all funds and securities they receive to their carrying firm. In addition to these requirements, in order to take advantage of the $5,000 minimum, fully disclosed introducing firms must have a clearing agreement that states that for purposes of SIPA and the financial responsibility rules, the introduced customer accounts are the responsibility of the carrying firm. See Letter from Richard G. Ketchum, Director, Division of Market Regulation of David Marcus, New York Stock Exchange, January 14, 1985, ("Ketchum Letter"). Despite this requirement, SIPC exposure can result from the failure of an introducing firm in possession of customer property.

(ii) Need For Increases

The net capital rule requires introducing brokers to promptly forward all customer funds and securities to the clearing broker-dealer. Even when this requirement is complied with, as the commentators pointed out, many customers make checks payable or endorse securities directly to the introducing firm. SIPC has expressed its concern to the Commission regarding "* * * situations where the SIPC member involved in the customer protection proceeding is a broker-dealer exempt from the provisions of SEC Rule 15c3–3, and subject to less than the full net capital requirements of SEC Rule 15c3–1." SIPC reported in August 1991, that since January 1986, twenty introducing firms have become the subject of SIPC proceedings. In those proceedings, SIPC has paid $8,226,330 to satisfy customer claims and $3,405,365 for administrative expenses. SIPC has also informed the Commission that in one of these customer protection proceedings the trustee has received and is reviewing claims for customer protection of approximately $6 million.

Although the firms that are the subjects of these proceedings were prohibited from holding customer property, they were nevertheless in a position where they were able to obtain access to customer assets through a variety of schemes. Some of the SIPC proceedings involved firms that obtained customers' funds by soliciting those funds directly from the customers for investment in a "certificate of deposit" or other instruments issued by the broker-dealer. Some SIPC proceedings involve introducing firms that misappropriated funds by instructing clearing firms to place customer funds into accounts controlled by the introducing firm. Other cases involve introducing firms that failed to transmit customer monies entrusted for investment; in these cases, introducing firms converted the customer funds by forging the endorsement on the checks given to them by customers.

In one case, for example, principals of a firm converted $4.3 million of checks written by at least 129 customers made payable to the firm. Those funds were entrusted to the firm for purchase of certificates of deposit and mutual funds. Instead of investing them as instructed by the customer, the principals of the firm diverted the funds for their personal use. Although the firm misappropriated $4.3 million of customer property, SIPC reimbursed customers for only $2.9 million. For the most part, most of the shortfall was due to claims that exceeded the limitations on SIPC advances.[18]

Two recent Commission proceedings further illustrate the Commission's concerns. In the first, the broker misappropriated over $1.1 million of customer funds that were intended to be invested in securities. In the second, a particularly egregious case, a broker-dealer in Florida solicited money from investors by advertising, among other places, in local church flyers. Customers alleged they were purchasing certificates of deposit from the broker-dealer to be held by the broker-dealer. However, the owner of the broker dealer converted the funds, and after his scheme was discovered, committed suicide. It appears that the amount of stolen funds could reach $4 million. The case is further complicated by the fact that SIPC may not reimburse the customers on the grounds that the investments in question may be characterized as a loan to the broker-dealer.

Investors who give funds and securities to broker-dealers do so with some degree of assurance that their property is safe when entrusted with an entity registered with and regulated by the Commission. However, many investors are not able to ascertain the difference between a registered broker-dealer that is well capitalized and one that is not, and under what circumstances SIPC coverage is provided.

A second element of concern for the customers of introducing firms involves the customer's relationship with the clearing firm. Customers can be stranded if the introducing firm fails or closes temporarily due to a capital violation. Generally, the clearing firm will not accept orders directly from the customers because the clearing firm will consider the customers as those of the introducing firm. As a result, customers may be unable to liquidate their securities positions or open new positions until their accounts are transferred to another broker-dealer. Although higher minimums will not eliminate this risk, the increased standards will increase the likelihood that the firm can quickly find a purchaser for its assets and avoid an NASD supervised self-liquidation.

Aside from the impact on customers, there is a risk of sudden losses to clearing firms when introducing firms fail. For example, during periods of market decline, customer accounts may become unsecured due to sharp drops in the value of securities in margin accounts or because of changes in the value of customer short option positions. If a customer fails to meet margin calls made by the clearing firm or fails to pay the settlement amount for securities it has purchased, the introducing firm, because most clearing arrangements place liability on the introducing firm for deficits in introduced accounts, will bear the loss from the default. If the introducing firm does not have adequate resources to pay the clearing firm, the clearing firm incurs the loss.[19]

Two examples are illustrative. During the October 1987 market break, Haas Securities Corporation, a fully disclosed introducing broker-dealer and a market maker in eleven securities, ceased operations. As a result of unsecured customer accounts introduced by Haas, its clearing firm incurred a reduction in its net capital between $15 and $20 million.[20] More recently, an introducing broker was involved in a manipulation scheme wherein three registered representatives at the introducing firm attempted to corner the market in a particular security by placing large amounts of unauthorized purchases of the security in a number of customer accounts. As a result of the manipulation, the security rose in value, but trading in the security was suspended after the scheme was discovered and never resumed. The security served as margin for debits owned by customers of the registered representatives and became worthless when trading was suspended. As a result of this occurrence, the clearing firm incurred losses in excess of $20 million. The introducing firm could not cover losses of this magnitude. At the time of the manipulation, the clearing firm was owned by another broker-dealer. Mainly as a result of the losses incurred through the manipulation, the clearing firm was acquired by another broker-dealer and then eventually

[18] Under section 9 of SIPA, when the amount of customer property present in a failed firm is insufficient to meet the claims of customers, SIPC must make advances to customers to cover the shortfall in each customer's claim. Those advances are limited to a total of $500,000 of cash and securities per customer, with a $100,000 limitation on claims for cash.

[19] In imposing sanctions on an introducing firm for failing to disclose to its carrying firm material facts as to the creditworthiness of one of its customers, the Commission recognized the potential credit exposure of clearing firms and stated: "It is true that [the introducing firm] had a contractual obligation to indemnify [the clearing broker] for losses. However, considering [the introducing firm's] small net capital * * * there was a substantial likelihood that the clearing brokers would themselves have to bear all or part of any potential losses." In re Boylan, Securities Exchange Act Release No. 18378 at 45 n.33 (January 14, 1982).

[20] See Market Break Report at pg. 5–11.

liquidated. Before the liquidation, the clearing firm cleared for 154 introducing brokers.

Indeed, many clearing firms require introducing firms to maintain net capital in excess of that required by the net capital rule (in addition to a clearing deposit) before they will transact business with an introducing firm. One firm will not clear for an introducing broker-dealer unless the firm has at least $150,000 in net capital. However, because industry practice is not uniform, weaknesses tend to develop. Assuming that risk-conscious clearing firms require their introducing firms to maintain the greatest amount of capital, the Commission is concerned that clearing firms that are not as sensitive to risk will tend to have a higher concentration of poorly capitalized introducing firms. The failure of one large introducing firm could weaken such a clearing firm, with a ripple effect that could expose other firms that clear through the same broker-dealer. If such a firm fails, not only will customers of that firm suffer, but a large number of market makers in lower priced securities might fail with it, resulting in significantly reduced liquidity in the markets for their securities.

(iii) Interpretation of Introducing Accounts on a Fully Disclosed Basis

There is a general misunderstanding among customers of securities firms as to the relationship between a clearing firm and an introducing firm and the responsibilities of each firm as to the customers' assets. Even in instances where those responsibilities are clearly outlined, customers are generally unable to distinguish an introducing firm from a full service broker-dealer that is authorized to maintain custody of their investment property. Customers are often not aware that their funds and securities are located at the clearing firm (rather than at the introducing firm). When an introducing firm fails, Commission staff members frequently receive inquiries from the introducing firm's customers regarding the whereabouts of their funds and securities.

The Division has interpreted the net capital rule and Rule 15c3–3 to require that, for the purposes of the Commission's financial responsibility rules and SIPC, the introducing firm's customers should be treated as customers of the clearing firm.[21] The Division has also interpreted revised paragraphs (a)(2)(i) and (a)(2)(iv) of the net capital rule to require an introducing firm, in order to fall under the terms of paragraph (a)(2)(iv), to have in place a clearing agreement with a registered broker-dealer that states, for the purposes of SIPA and the Commission's financial responsibility rules, customers are customers of the clearing, and not the introducing, firm. Furthermore, the clearing firm must issue account statements directly to customers. Each statement must contain the name and telephone number of a responsible individual at the clearing firm whom a customer can contact with inquiries regarding the customer's account. Finally, the account statement must disclose that customer funds or securities are located at the clearing broker-dealer, and not the introducing firm.

An introducing firm without such an arrangement will not be considered, for the purposes of the Commission's financial responsibility rules, to be a firm that "introduce[s] transactions and accounts of customers to another registered broker or dealer that carries such accounts on a fully disclosed basis." Absent such an arrangement, the introducing firm would be required to comply with the greater minimum net capital requirements required of a clearing firm.[22]

(iv) Industry Response and Commission Action

When the amendments were proposed, the Commission was sensitive to the potential impact of the increases. Accordingly, the Commission solicited comments from the introducing firm community on their potential impact.

Approximately 100 small broker-dealers objected to the proposals, arguing that the increases would either eliminate smaller firms, or prevent small broker-dealers from entering the industry. Other commentators objected to the size of the increases or the asserted lack of any need for them. As an alternative, a number of firms suggested that the Commission could accomplish its regulatory goals more fairly by drafting a net capital rule that would call for incremental increases for different types of business activity. For example, if a firm transacted a margin business, its minimum net capital requirement would increase by a pre-established factor. However, this approach would require the net capital rule to make dozens of distinctions that would further complicate the regulatory process. It is important for the net capital rule to be based on readily identifiable minimum classification requirements. Therefore this suggestion does not provide a workable alternative to the base requirement approach currently in place.

It appears that the primary objection to the proposed increases concerned the costs associated with raising additional capital and the impact on competition in the industry. To assess the cost of the proposed rules, using the NASD Data, the Division examined the capitalization of the industry to determine how many firms would need to raise additional funds. The Division also estimated the approximate costs of raising the additional capital.

The NASD Data does not distinguish between introducing brokers that receive funds and securities and those that do not. The assumption was made that all firms receive customer property to assess the maximum impact of the recommended amendments. Under this assumption, the calculations demonstrate that 919 introducing brokers (out of 2,301) would need total additional capital of $25 million to comply with the new $50,000 standard, or an average of $27,180 per firm. Based on an eight percent spread of cost of capital,[23] the new standards would cost each broker an average of approximately $2,174 per year. The Commission believes this is a slight insurance premium in light of the benefits that would be derived from the increase.

To assess the impact of the proposal on the industry, introducing firm revenue data was examined. Out of a total $4.96 billion in annual revenues generated by NASD member introducing firms, only $304 million is accounted for by firms with less than $50,000 in net capital. In other words, the amendments would at most affect the 919 firms that account for 6.1 percent of the total introducing firm revenues.

Thus, the data suggests the impact of the increases will not be dramatic. Notwithstanding, the Commission believes certain refinements to the original proposal are warranted. For example, a number of commentators, including the NASD, objected to the Commission's classification of minimum net capital levels based on the distinction between occasional and routine receipt of customer funds and securities.[24] The NASD suggested a reconsideration of the $100,000 category which would apply to those introducing

[21] See Ketchum Letter, *supra* note 17.

[22] Additionally, in order to take advantage of the revised $5,000 minimum net capital requirement, introducing firms will be required to notify their customers that the firm is prohibited from receiving funds (other than checks made out to third parties) or securities.

[23] For a discussion of the cost of capital, see section 2(B) (iii) *supra*.

[24] The NASD, the self-regulatory organization charged with overseeing the bulk of introducing firms, generally endorsed the new requirements.

firms that routinely receive customer funds or securities. Such introducing brokers would have the same capital requirement as broker-dealers that receive funds and securities pursuant to the provisions of paragraph (k)(2)(i) of Rule 15c3–3. As the NASD pointed out, introducing firms could, without changing their capital requirement, clear accounts under the (k)(2)(i) method. To prevent this, the NASD recommended the establishment of two classifications of introducing firms: A $50,000 minimum for firms that receive securities and a $25,000 minimum level for those that do not.

The Commission believes that the NASD's approach represents a reasonable compromise between the Commission's and the commentators' concern regarding the impact of the amendments on introducing firms. Accordingly, the three tier approach that would distinguish between occasional and routine receipt of funds and securities is not being adopted and will be supplanted by the approach recommended by the NASD.

Therefore, the Commission is adopting the proposal that would increase the minimum net capital requirement of introducing firms that receive securities to $50,000. The Commission is also adopting, on a temporary basis, the proposed $5,000 minimum requirement. Under the approach adopted by the Commission, an introducing broker-dealer that receives customer checks made payable to itself would be subject to a $250,000 minimum net capital requirement. An introducing broker-dealer that receives securities as well as customer checks made payable to its clearing firm or other appropriate third party (*e.g.*, escrow agent) that it promptly forwards to such third party would be subject to a minimum net capital requirement of $50,000. An introducing broker-dealer that receives no securities and only receives customer checks made payable to appropriate third parties would be subject to a $5,000 minimum net capital requirement.[25]

In a separate release, the Commission is proposing for comment the additional amendment that would raise the net capital requirements of this second tier of introducing firms to $25,000. The Commission considers the increased requirements to be more reasonably related to the level of capital needed to maintain successfully a securities business.

In addition to raising the base minimum capital requirements, the Commission's original proposal would have required an introducing firm to maintain additional net capital equal to one quarter of one percent of the customer debit balances introduced to its clearing firm. This requirement was designed to further address the situation where clearing firms have their capital endangered by the failure or financial difficulty of an introducing firm. The commentators, including the NASD, pointed out that the requirement would be difficult to calculate, and therefore difficult to enforce. Moreover, it would add very little to the capital requirements of most introducing firms. Based on these comments, the Commission has decided not to adopt this proposal.

The final component of the original proposal with regard to introducing firms was an amendment that would allow firms to participate in underwritings in which other members of the dealer group have firm commitments (an activity not allowed the current $5,000 broker-dealer) so long as the introducing firm is not the statutory underwriter, but a marketing agent with no commitment to purchase any of the securities. The rule amendments make it clear that this is a dealer activity (that would ordinarily subject the firm to a minimum requirement of $100,000), but permit introducing firms that maintain minimum net capital of at least $50,000 to engage in this activity.

In conclusion, the Commission believes it is appropriate to raise the minimum net capital requirements for introducing firms in the amounts indicated. The Commission believes the increases are justified because of the large amounts of customer assets handled by introducing firms, and the impact such firms' failures can have on customers and the SIPC fund. Permitting undercapitalized introducing firms to handle, even for a short period of time, the assets of investors has proven to be a regulatory problem that the Commission believes will be alleviated by requiring a greater cushion of net capital to insulate customers from loss. Finally, the Commission notes that it is taking today's action at the request of the NASD, which is the primary supervisory entity for the majority of the firms affected by the increases, and SIPC, which serves as the investor's last resort for recovery in broker-dealer failures.

D. Other Broker-Dealers

This section of the release will address the minimum net capital treatment for all other categories of broker-dealers not specifically referred to above.

(i) Mutual Fund Firms

Under the Commission's proposal, the minimum net capital requirement applicable to broker-dealers that limit their activities to transactions in shares of registered investment companies, and which receive customer funds or securities, would increase from $2,500 to $25,000. For those mutual fund firms that do not handle any customer funds or securities, and are not direct wire order firms, a $5,000 minimum was proposed. The Commission is adopting these amendments.

The firms that commented on the increase from the current $2,500 minimum to $25,000 were generally opposed to it. These firms feared that increasing minimum capital requirements would eliminate firms and stifle competition in the mutual fund industry. However, the Commission considers a capital requirement of $2,500 to be far too small for a firm that handles funds and securities. Moreover, the NASD Data does not indicate that the proposed increases would have a dramatic effect on competition. The Division has calculated that of a total 409 NASD mutual fund firms, 195 firms would require a total of $3 million or an average of $15,325 each to meet the $25,000 level. These firms generated revenues of $15.6 million, which represented only 1.2 percent of the total $1.31 billion in revenues produced by all NASD member mutual fund firms during the last year.

(ii) Best Efforts Underwriters

Under the current rule, firms that participate, as a broker or dealer, in underwritings on a "best efforts" basis and that promptly forward all customer funds and securities to an issuer or an independent escrow agent designated for the underwriting are required to maintain minimum net capital of only $5,000. In effect, these firms are treated as introducing firms. Currently, broker-dealers that sell direct participation programs in real estate syndications also many avail themselves of this standard, so long as any funds or securities are promptly forwarded to an issuer or escrow agent. The original proposal did not propose an increase in minimum capital requirements for these firms; rather it added a provision which prohibited these firms from receiving

[25] It should be noted that the $5,000 standard adopted today differs from the previous $5,000 requirement. Under the new rule, introducing firms will be prohibited from receiving customer securities and funds (other than checks payable to third parties). It will be necessary for these firms to develop procedures to insure that they do not receive customer securities or checks made payable to themselves.

any customer funds or securities. This aspect of the proposal is being adopted.

(iii) Miscellaneous Brokers

The original release did not propose any increases applicable to the residual category of broker dealers that would include broker-dealers that are tangentially related to the securities business, such as firms that act as finders for potential merger and acquisition opportunities on behalf of their clients. Such firms do not take customer orders, hold customer funds or securities or execute customer trades, yet must register as broker-dealers with the Commission because they accept compensation based upon a percentage of securities transactions. Firms with this low required minimum will be those that cannot be classified in any of the categories enumerated above. This category also would include floor brokers on the national securities exchanges.

(iv) Further Proposals

As to each of the categories of firms described in paragraphs (i) through (iii) above, in a separate release, the Commission is proposing for comment an increase in the minimum net capital requirements to $10,000.

E. Phase-In Schedule

Because of the burden that the amendment may have on the industry, the proposal contained a provision that would have staggered the increases over a period of four years. Some commentators suggested that the phase-in schedule was unnecessary. Others suggested that the time period should be reduced, although others recommended an increase in time. The Commission has decided to adopt a modified phase-in period of one year, commencing six months from the effective date. The Commission considers this to be a fair period of time within which additional capital could be acquired, particularly since the proposal has been outstanding since 1989. The timing of the increases is summarized below:

i. *Firms That Carry Customer Accounts (Aggregate Indebtedness Standard)*
  a. Current Rule: $25,000
  b. By 6/30/93: $100,000
  c. By 12/31/93: $175,000
  d. By 6/30/94: $250,000

ii. *Firms That Elect The Alternative Standard*
  a. Current Rule: $100,000
  b. By 6/30/93: $150,000
  c. By 12/31/93: $200,000
  d. By 6/30/94: $250,000

iii. *Clearing Firms That Do Not Generally Maintain Custody of Customer Funds or Securities*
  a. Current Rule: $25,000
  b. By 6/31/93: $50,000
  c. By 12/31/93: $75,000
  d. By 6/30/94: $100,000

iv. *Mutual Fund Dealers That Receive Customer Funds*
  a. Current Rule: $2,500
  b. By 6/30/93: $10,000
  c. By 12/31/93: $17,500
  d. By 6/30/94: $25,000

v. *Mutual Fund Dealers That Do Not Receive Customer Funds*
  a. Current Rule: $2,500
  b. By 6/30/93: $3,300
  c. By 12/31/93: $4,100
  d. By 6/30/94: $5,000

vi. *Introducing Firms That Receive Customer Securities*
  a. Current Rule: $5,000
  b. By 6/30/93: $20,000
  c. By 12/31/93: $35,000
  d. By 6/30/94: $50,000

The Commission's original proposal, in addition to addressing the minimum net capital standards discussed above, also contained proposed rule amendments with respect to equity haircuts and certain aggregate indebtedness charges. The following sections of this release will address these topics.

III. Election of the Alternative Standard

The Commission proposed to make the alternative available only to firms that clear and carry customer transactions. That would have altered the present rule which allows trading firms and introducing firms to elect the alternative method of calculating net capital. After careful consideration, the Commission has determined to make the alternative standard available to all firms.

The Commission believes the amendment that would have prevented the election of the alternative standard by firms that do not carry customer accounts is not appropriate for several reasons. First, a firm could easily render the prohibition ineffective by accepting one customer account. Secondly, under the amendments as adopted, a firm must maintain at least $250,000 in order to compute under the alternative.[26] The Commission believes that the $250,000 capital requirement will provide sufficient cushion to compensate for the additional capital that would have been required for those firms under the aggregate indebtedness standard. Indeed, a firm will have to have more than approximately $3.8 million in aggregate indebtedness before its net capital requirement would exceed the $250,000 minimum. Finally, the Commission's concern with respect to leverage that can be attained by trading firms was addressed by the Commission's recent adoption of a new early warning level under paragraph (e) of the net capital rule based on 25 percent of haircuts. That early warning level change will address some of the Commission's concerns and constrain firms with large trading positions from removing capital from the broker-dealer in the event of financial distress.

IV. Equity Securities Haircuts

A. General

The net capital rule provides two separate methods for calculating haircuts related to a broker-dealer's equity securities positions. The method used by a broker-dealer depends on the election the broker-dealer makes with respect to its net capital requirement. A firm calculating its net capital requirement under the basic method incurs a haircut equal to 30 percent of the market value of the greater of its long or short positions, plus 15 percent of the lesser positions, but only to the extent that those positions exceed 25 percent of the market value of the greater of the long or short positions. In effect, the first 25 percent of the lesser position incurs no haircut.[27]

Under the current rule, a broker-dealer electing the alternative method of computing net capital incurs a 15 percent haircut on its long equity securities positions. That haircut is increased by 30 percent of the broker-dealer's short equity positions, but only to the extent those short positions exceed 25 percent of the long positions.[28]

The basis for the distinction between long and short positions is, for haircut purposes, no longer valid. The distinctions based upon the method chosen are, the Commission believes, even less significant when the increases to the minimum requirements are taken into account. The premise underlying the alternative method of calculating haircuts was that long positions have to be financed by an outside entity that will demand more margin than the 15 percent haircut. Short positions, by contrast, are self-financing.

Broker-dealers are not necessarily constrained by the ability to finance their long positions by a bank or another broker-dealer. For example, broker-dealers are able to receive cash collateral in excess of the market value

[26] The rule amendments also require a broker-dealer to notify its designated examining authority of its election to select the alternative standard; the rule previously required the broker-dealer to notify the appropriate Regional Office of the Commission.

[27] For example: Position: Long, $1,000,000; Short, $500,000. Haircut: Long, $300,000; Short, $37,500 (15% of $250,000); Total, $337,500.

[28] For example: Position: Long, $1,000,000; Short, $500,000. Haircut: Long, $150,000; Short, $75,500 (30% of $250,000); Total, $225,000.

of the long position by lending the security to another broker-dealer. Moreover, except for situations such as tender offers, the long position would seem to be no less volatile or damaging to the broker-dealer than the short position.

One commentator expressed the view that, given the volatility of the equity markets, all haircuts should remain at 30 percent. However, the Commission believes that a 15 percent haircut provides an adequate safeguard and is adopting the proposal. Thus, under the amended rule, all broker-dealers will incur a deduction of 15 percent on the market value of the greater of the long or short equity position, and a deduction of 15 percent on the market value of the lesser position, but only to the extent this lesser position exceeds 25 percent of the greater position.[29]

In addition to standardizing the deduction for equity securities positions under the net capital rule, the proposal would have required broker-dealers to apply the equity securities haircut (15 percent), rather than the lower, government securities haircut (6 percent), to their positions in interest and principal only instruments. In response to this proposal, the Public Securities Association submitted data suggesting that a lower haircut should be applied. The Commission is not adopting this amendment, and will await a further recommendation by the Commission staff in this regard.

B. Undue Concentration Charge

Paragraphs (c)(2)(vi)(M) and (f)(iii) currently include extra deductions for securities positions that are large relative to a firm's net capital. These "undue concentration charges" currently vary slightly depending on the firm's election of either the basic or alternative method. The Commission's proposal would eliminate this difference, and standardize the deduction, so that all concentration charges would be calculated according to the method previously set forth in paragraph (f) of the rule. There were no comments on this aspect of the proposal; therefore, the Commission is adopting this amendment as proposed.[30]

C. Contractual Commitments

The Commission's proposal, although it would standardize equity securities haircuts at 15 percent, would have nonetheless required a 30 percent charge for the contractual commitment haircut in certain securities. The Commission is adopting this amendment as proposed. Therefore, the contractual commitment haircut applicable to equity securities shall remain at 30 percent unless the class and issue of the securities are listed on a national securities exchange or are designated as NASDAQ National Market System Securities.

V. Aggregate Indebtedness

The aggregate indebtedness test has been included in the net capital rule since its adoption in 1942. The term aggregate indebtedness includes all of the liabilities and/or obligations (actual or otherwise) of a broker-dealer. The test applies to broker-dealers computing net capital under the basic method and limits the leverage that they are able to attain. The rule however, specifically excludes from aggregate indebtedness certain prescribed liabilities. In the two classes of liabilities described below, the Commission believes the 6⅔ percent aggregate indebtedness charge is not appropriate, particularly in light of the increases in the minimum requirements. Therefore, the Commission's proposal would have reduced the 6⅔ percent charge to one percent in the two areas discussed below. Both of these amendments are being adopted as proposed.

A. Mutual Fund Payables

Currently, the net capital rule requires a broker-dealer that owes money to a mutual fund in connection with a purchase of shares of that fund to include that amount in aggregate indebtedness even if offset by a receivable from another broker-dealer related to that transaction.[31]

Currently, the net capital rule requires a charge of 6⅔ percent on these mutual fund payables. The Commission's proposal would lower this deduction to one percent of the liability amount when an offset from the mutual fund exists. Other than the request for clarification discussed in the following paragraph, the Commission received no comments on this amendment, and is adopting it as proposed.

A number of commentators wrote to the Commission requesting clarification in the method of computation. Specifically, the commentators questioned why the proposed rule amendment contained an 85 percent aggregate indebtedness exclusion when the narrative description of the rule change in the proposing release described a one percent aggregate indebtedness charge. The answer is that 6⅔ percent of .15 (remaining after .85 is deducted from one) gives the same result as one percent of one. The method chosen for reducing the charge was designed for consistency with the present status of the rule.

B. Stock Loan Payables

A stock loan payable is a liability arising from the receipt of cash collateral from a person who borrows securities from the broker-dealer. The payable is considered aggregate indebtedness even if the securities that were loaned were borrowed from another broker-dealer.[32] The current rule requires a 6⅔ percent charge on these items. As with mutual fund receivables, the Commission's proposal would reduce this charge to one percent.

Given the matched nature of these related payables and receivables, the Commission does not believe that the risk merits a charge of 6⅔ percent on the dollar amount of the liability; therefore, the Commission is adopting the amendment as proposed.

VI. Technical Amendments

Because of the amendments to the minimum net capital requirements and equity securities haircuts, the Commission is merging paragraph (f) into paragraph (a) of the rule. As a result, the rule amendments include several technical changes to the rule.

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[29] As proposed, this lowered haircut would have been available to firms only when they crossed the $100,000 net capital threshold. However, the NASD suggested that this would be difficult to monitor. Based on this recommendation the Commission is not adopting this amendment. The contractual commitment haircut will remain at 30 percent for initial public offerings. Similarly, the haircut assessed for receivables arising in conjunction with subordinated loans will remain at 30 percent.

[30] A broker-dealer is also required to deduct the portion of a long equity securities position that it holds that is large in relation to the trading volume for that security. This is generally referred to as the "blockage test".

[31] This payable arises out of a purchase of shares by the broker-dealer directly from the fund for another broker-dealer (presumably for the other broker-dealer's customer). The first broker-dealer owes money to the fund secured by the investment company shares. The second broker-dealer owes money to the first broker-dealer. The debt on the first broker-dealer's books is offset by a receivable from the second broker-dealer, classified generally as a fail to deliver. That receivable is also secured by the mutual fund shares, since delivery of the shares will not occur until payment of the obligation by the second broker-dealer.

[32] When one broker-dealer lends securities to another broker-dealer, the lending broker-dealer generally receives cash collateral in excess of the value of the securities lent. For financial statement purposes, the lending broker-dealer accounts for the cash collateral as a liability, since that broker-dealer must repay the funds to the borrowing broker-dealer upon return of the securities.

Much of the stock lent by broker-dealers to other broker-dealers is borrowed from a third broker-dealer or other person. If a broker-dealer borrows stock through a stock loan transaction collateralized by cash, the borrowing broker-dealer accounts for the collateral in its financial statements as a receivable from the lending person.

For example, all references to paragraph (f) are deleted and new references to appropriate rule sections are substituted. Other examples include the amendments to the concentration charges under paragraph (c)(2)(vi)(M) and the contractual commitment charge under paragraph (c)(2)(viii). The amendments also delete a provision from paragraph (c)(2)(ix) of Rule 15c3-1 that expired on January 1, 1983.

VII. Summary of Final Regulatory Flexibility Analysis

The Commission has prepared a Final Regulatory Flexibility Analysis ("Analysis") in accordance with 5 U.S.C. 603 regarding the amendments. The Analysis notes that the objective of the amendments is to further the purposes of the various financial responsibility rules that provide safeguards with respect to the financial responsibility and related practices of brokers-dealers. The Analysis states that the Commission did not receive any comments concerning the Initial Regulatory Flexibility Analysis. A copy of the Analysis may be obtained by contacting Roger G. Coffin, Division of Market Regulation, Securities and Exchange Commission, Washington, DC 20549, (202) 272-7375.

VIII. Statutory Analysis

Pursuant to the Securities Exchange Act of 1934 and particularly sections 15(c)(3), 17 and 23 thereof, 15 U.S.C. 78o(c)(3), 78q and 78w, the Commission is adopting amendments to § 240.15c3-1 of title 17 of the Code of Federal Regulations in the manner set forth below.

IX. List of Subjects in 17 CFR Part 240

Reporting and recordkeeping requirements, Securities.

X. Text of the Amendments

In accordance with the foregoing, title 17, chapter II, part 240 of the Code of Federal Regulations is amended as follows:

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

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

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78i, 78j, 78*l*, 78m, 78n, 78o, 78p, 78s, 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 removing paragraph (f), removing the word "and" from paragraph (c)(1)(xii), removing and reserving paragraphs (a)(3), (a)(5) and (c)(2)(vi)(I), adding paragraphs (c)(1)(xiv) and (c)(1)(xv) and revising paragraphs (a) introductory text, (a)(1), (a)(2), (a)(4), (a)(6)(i), (a)(7)(i), (a)(9), (c)(1)(xiii), (c)(2)(i)(C)(1), (c)(2)(iv)(B), (c)(2)(iv)(F)(*3*)(*1*)(*B*) and (*C*), (c)(2)(vi) introductory text, (c)(2)(vi)(A)(*5*), (c)(2)(vi)(J) and (M), (c)(2)(viii), (c)(2)(ix), (c)(2)(x)(A)(*2*) through (*5*), (c)(9), and (c)(10) to read as follows:

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

(a) Every broker or dealer shall at all times have and maintain net capital no less than the greater of the highest minimum requirement applicable to its ratio requirement under paragraph (a)(1) of this section, or to any of its activities under paragraph (a)(2) of this section. Each broker or dealer also shall comply with the supplemental requirements of paragraphs (a)(4) and (a)(9) of this section, to the extent either paragraph is applicable to its activities. In addition, a broker or dealer shall maintain net capital of not less than its own net capital requirement plus the sum of each broker's or dealer's subsidiary or affiliate minimum net capital requirements, which is consolidated pursuant to Appendix C, § 240.15c3-1c.

Ratio Requirements

Aggregate Indebtedness Standard

(1)(i) No broker or dealer, other than one that elects the provisions of paragraph (a)(1)(ii) of this section, shall permit its aggregate indebtedness to all other persons to exceed 1500 percent of its net capital (or 800 percent of its net capital for 12 months after commencing business as a broker or dealer).

Alternative Standard

(ii) A broker or dealer may elect not to be subject to the Aggregate Indebtedness Standard of paragraph (a)(1)(i) of this section. That broker or dealer shall not permit its net capital to be less than the greater of $250,000 or 2 percent of aggregate debit items computed in accordance with the Formula for Determination of Reserve Requirements for Brokers and Dealers (Exhibit A to Rule 15c3-3, § 240.15c3-3a). Such broker or dealer shall notify its Examining Authority, in writing, of its election to operate under this paragraph (a)(1)(ii). Once a broker or dealer has notified its Examining Authority, it shall continue to operate under this paragraph unless a change is approved upon application to the Commission. A broker or dealer that elects this standard and is not exempt from Rule 15c3-3 shall:

(A) Make the computation required by § 240.15c3-3(e) and set forth in Exhibit A, § 240.15c3-3a, on a weekly basis and, in lieu of the 1 percent reduction of certain debit items required by Note E (3) in the computation of its Exhibit A requirement, reduce aggregate debit items in such computation by 3 percent;

(B) Include in Items 7 and 8 of Exhibit A, § 240.15c3-3a, the market value of items specified therein more than 7 business days old;

(C) Exclude credit balances in accounts representing amounts payable for securities not yet received from the issuer or its agent which securities are specified in paragraphs (c)(2)(vi) (A) and (E) of this section and any related debit items from the Exhibit A requirement for 3 business days; and

(D) Deduct from net worth in computing net capital 1 percent of the contract value of all failed to deliver contracts or securities borrowed that were allocated to failed to receive contracts of the same issue and which thereby were excluded from Items 11 or 12 of Exhibit A, § 240.15c3-3a.

Futures Commission Merchants

(iii) No broker or dealer registered as a futures commission merchant shall permit its net capital to be less than the greater of its requirement under paragraph (a)(1) (i) or (ii) of this section, or 4 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers on or subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the customer's account).

Minimum Requirements

See Appendix E (§ 240.15c3-1E) for temporary minimum requirements.

Brokers or Dealers That Carry Customer Accounts

(2)(i) A broker or dealer (other than one described in paragraphs (a)(2)(ii) or (a)(8) of this section) shall maintain net capital of not less than $250,000 if it carries customer or broker or dealer accounts and receives or holds funds or securities for those persons. A broker or dealer shall be deemed to receive funds, or to carry customer or broker or dealer accounts and to receive funds from those persons if, in connection with its activities as a broker or dealer, it receives checks, drafts, or other evidences of indebtedness made payable to itself or persons other than the requisite registered broker or dealer carrying the account of a customer, escrow agent, issuer, underwriter, sponsor, or other distributor of securities. A broker or dealer shall be deemed to hold securities for, or to carry customer or broker or dealer accounts, and hold securities of, those persons if it does not promptly forward or promptly deliver all of the securities of customers or of other brokers or dealers received by the firm in connection with its activities as a broker or dealer. A broker or dealer, without complying with this paragraph (a)(2)(i), may receive securities only if its activities conform with the provisions of paragraphs (a)(2) (iv) or (v) of this section, and may receive funds only in connection with the activities described in paragraph (a)(2)(v) of this section.

(ii) A broker or dealer that is exempt from the provisions of § 240.15c3–3 pursuant to paragraph (k)(2)(i) thereof shall maintain net capital of not less than $100,000.

Dealers

(iii) A dealer shall maintain net capital of not less than $100,000. For the purposes of this section, the term "dealer" includes:

(A) Any broker or dealer that endorses or writes options otherwise than on a registered national securities exchange or a facility of a registered national securities association; and

(B) Any broker or dealer that effects more than ten transactions in any one calendar year for its own investment account. This section shall not apply to those persons engaging in activities described in paragraphs (a)(2)(v), (a)(2)(vi) or (a)(8) of this section, or to those persons whose underwriting activities are limited solely to acting as underwriters in best efforts or all or none underwritings in conformity with paragraph (b)(2) of § 240.15c2–4, so long as those persons engage in no other dealer activities.

Brokers or Dealers That Introduce Customer Accounts And Receive Securities

(iv) A broker or dealer shall maintain net capital of not less than $50,000 if it introduces transactions and accounts of customers or other brokers or dealers to another registered broker or dealer that carries such accounts on a fully disclosed basis, and if the broker or dealer receives but does not hold customer or other broker or dealer securities. A broker or dealer operating under this paragraph (a)(2)(iv) of this section may participate in a firm commitment underwriting without being subject to the provisions of paragraph (a)(2)(iii) of this section, but may not enter into a commitment for the purchase of shares related to that underwriting.

Brokers or Dealers Engaged in the Sale of Redeemable Shares of Registered Investment Companies and Certain Other Share Accounts

(v) A broker or dealer shall maintain net capital of not less than $25,000 if it acts as a broker or dealer with respect to the purchase, sale and redemption of redeemable shares of registered investment companies or of interests or participations in an insurance company separate account directly from or to the issuer on other than a subscription way basis. A broker or dealer operating under this section may sell securities for the account of a customer to obtain funds for the immediate reinvestment in redeemable securities of registered investment companies. A broker or dealer operating under this paragraph (a)(2)(v) must promptly transmit all funds and promptly deliver all securities received in connection with its activities as a broker or dealer, and may not otherwise hold funds or securities for, or owe money or securities to, customers.

Other Brokers or Dealers

(vi) A broker or dealer that does not receive, directly or indirectly, or hold funds or securities for, or owe funds or securities to, customers and does not carry accounts of, or for, customers and does not engage in any of the activities described in paragraphs (a)(2) (i) through (v) of this section shall maintain net capital of not less than $5,000. A broker or dealer operating under this paragraph may engage in the following dealer activities without being subject to the requirements of paragraph (a)(2)(iii) of this section:

(A) In the case of a buy order, prior to executing such customer's order, it purchases as principal the same number of shares or purchases shares to accumulate the number of shares necessary to complete the order, which shall be cleared through another registered broker or dealer or

(B) In the case of a sell order, prior to executing such customer's order, it sells as principal the same number of shares or a portion thereof, which shall be cleared through another registered broker or dealer.

(3) [Reserved].

Capital Requirements for Market Makers

(4) A broker or dealer engaged in activities as a market maker as defined in paragraph (c)(8) of this section shall maintain net capital in an amount not less than $2,500 for each security in which it makes a market (unless a security in which it makes a market has a market value of $5 or less, in which event the amount of net capital shall be not less than $1,000 for each such security) based on the average number of such markets made by such broker or dealer during the 30 days immediately preceding the computation date. Under no circumstances shall it have net capital less than that required by the provisions of paragraph (a) of this section, or be required to maintain net capital of more than $1,000,000 unless required by paragraph (a) of this section.

(5) [Reserved].

Market Makers, Specialists and Certain Other Dealers

(6)(i) A dealer who meets the conditions of paragraph (a)(6)(ii) of this section may elect to operate under this paragraph (a)(6) and thereby not apply, except to the extent required by this paragraph (a)(6), the provisions of paragraphs (c)(2)(vi) or Appendix A (§ 240.15c3–1a) of this section to market maker and specialist transactions and, in lieu thereof, apply thereto the provisions of paragraph (a)(6)(iii) of this section.

* * * * *

Self-Clearing Options Specialists

(7)(i) A dealer who meets the conditions of paragraph (a)(7)(ii) of this section may elect to operate under this paragraph (a)(7) and thereby not apply, except to the extent required by this paragraph (a)(7), the provisions of paragraphs (c)(2)(vi), (c)(2)(x), and (c)(2)(xi) of this section or Appendix A (§ 240.15c3–1a) to this section and, in lieu thereof, apply the provisions of paragraph (a)(7)(iii) of this section.

* * * * *

Certain Additional Capital Requirements for Brokers or Dealers Engaging in Reverse Repurchase Agreements

(9) A broker or dealer shall maintain net capital in addition to the amounts required under paragraph (a) of this section in an amount equal to 10 percent of:

(i) The excess of the market value of United States Treasury Bills, Bonds and Notes subject to reverse repurchase agreements with any one party over 105 percent of the contract prices (including accrued interest) for reverse repurchase agreements with that party;

(ii) The excess of the market value of securities issued or guaranteed as to principal or interest by an agency of the United States or mortgage related securities as defined in section 3(a)(41) of the Act subject to reverse repurchase agreements with any one party over 110 percent of the contract prices (including accrued interest) for reverse repurchase agreements with that party; and

(iii) The excess of the market value of other securities subject to reverse repurchase agreements with any one party over 120 percent of the contract prices (including accrued interest) for reverse repurchase agreements with that party.

* * * * *

(c) * * *

(1) * * *

Exclusions From Aggregate Indebtedness

(xiii) Deferred tax liabilities;

(xiv) Eighty-five percent of amounts payable to a registered investment company related to fail to deliver receivables of the same quantity arising out of purchases of shares of those registered investment companies; and

(xv) Eighty-five percent of amounts payable against securities loaned for which the broker or dealer has receivables related to securities of the same class and issue and quantity that are securities borrowed by the broker or dealer.

Net Capital

(2) * * *

(i) * * *

(C) * * *

(*1*) The aggregate amount resulting from applying to the amount of the deductions computed in accordance with paragraph (c)(2)(vi) of this section and Appendices A and B, § 240.15c3–1a and 240.15c3–1b, the appropriate Federal and State tax rate(s) applicable to any unrealized gain on the asset on which the deduction was computed;

* * * * *

(iv)(A) * * *

Certain Unsecured and Partly Secured Receivables

(B) All unsecured advances and loans; deficits in customers' and non-customers' unsecured and partly secured notes; deficits in special omnibus accounts maintained in compliance with the requirements of 12 CFR 220.10 of Regulation T under the Securities Exchange Act of 1934, or similar accounts carried on behalf of another broker or dealer, after application of calls for margin, marks to the market or other required deposits that are outstanding 5 business days or less; deficits in customers' and non-customers' unsecured and partly secured accounts after application of calls for margin, marks to the market or other required deposits that are outstanding 5 business days or less, except deficits in cash accounts as defined in 12 CFR 220.8 of Regulation T under the Securities Exchange Act of 1934 for which not more than one extension respecting a specified securities transaction has been requested and granted, and deducting for securities carried in any of such accounts the percentages specified in paragraph (c)(2)(vi) of this section or Appendix A (§ 240.15c3–1a); the market value of stock loaned in excess of the value of any collateral received therefor; receivables arising out of free shipments of securities (other than mutual fund redemptions) in excess of $5,000 per shipment and all free shipments (other than mutual fund redemptions) outstanding more than 7 business days, and mutual fund redemptions outstanding more than 16 business days; any collateral deficiencies in secured demand notes as defined in Appendix D (§ 240.15c3–1d);

* * * * *

(F) * * *

(*3*)(*i*)(*A*) * * *

(*B*) The excess of the aggregate repurchase agreement deficits with any one party over 25 percent of the broker or dealer's net capital before the application of paragraph (c)(2)(vi) of this section (less any deduction taken with respect to repurchase agreements with that party under paragraph (c)(2)(iv)(F)(*3*)(*i*)(*A*) of this section) or, if greater;

(*C*) The excess of the aggregate repurchase agreement deficits over 300 percent of the broker's or dealer's net capital before the application of paragraph (c)(2)(vi) of this section.

* * * * *

Securities Haircuts

(vi) Deducting the percentages specified in paragraphs (c)(2)(vi) (A) through (M) of this section (or the deductions prescribed for securities positions set forth in Appendix A (§ 240.15c3–1a) of the market value of all securities, money market instruments or options in the proprietary or other accounts of the broker or dealer.

(A) (*4*) * * *

(*5*) In the case of a Government securities dealer that reports to the Federal Reserve System, that transacts business directly with the Federal Reserve System, and that maintains at all times a minimum net capital of at least $50,000,000, before application of the deductions provided for in paragraph (c)(2)(vi) of this section, the deduction for a security issued or guaranteed as to principal or interest by the United States or any agency thereof shall be 75 percent of the deduction otherwise computed under paragraph (c)(2)(vi)(A) of this section.

* * * * *

(I) [Reserved].

All Other Securities

(J) In the case of all securities or evidences of indebtedness, except those described in Appendix A, § 240.15c3–1a, which are not included in any of the percentage categories enumerated in paragraphs (c)(2)(vi) (A) through (H) of this section or paragraph (c)(2)(vi)(K)(ii) of this section, the deduction shall be 15 percent of the market value of the greater of the long or short positions and to the extent the market value of the lesser of the long or short positions exceeds 25 percent of the market value of the greater of the long or short positions, the percentage deduction on such excess shall be 15 percent of the market value of such excess. No deduction need be made in the case of:

(1) A security that is convertible into or exchangeable for another security within a period of 90 days, subject to no conditions other than the payment of money, and the other securities into which such security is convertible or for which it is exchangeable, are short in the accounts of such broker or dealer; or

(2) A security that has been called for redemption and that is redeemable within 90 days.

* * * * *

Undue Concentration

(M)(*1*) In the case of money market instruments, or securities of a single class or series of an issuer, including any option written, endorsed or held to purchase or sell securities of such a single class or series of an issuer (other than "exempted securities" and redeemable securities of an investment company registered pursuant to the Investment Company Act of 1940), and securities underwritten (in which case the deduction provided for herein shall be applied after 11 business days), which are long or short in the proprietary or other accounts of a broker or dealer, including securities that are collateral to secured demand notes defined in Appendix D, § 240.15c3–1d, and that have a market value of more than 10 percent of the "net capital" of a broker or dealer before the application of paragraph (c)(2)(vi) of this section or Appendix A, § 240.15c3–1a, there shall be an additional deduction from net worth and/or the Collateral Value for securities collateralizing a secured demand note defined in Appendix D, § 240.15c3–1d, equal to 50 percent of the percentage deduction otherwise provided by this paragraph (c)(2)(vi) of this section or Appendix A, § 240.15c3–1a, on that portion of the securities position in excess of 10 percent of the "net capital" of the broker or dealer before the application of paragraph (c)(2)(vi) of this section and Appendix A, § 240.15c3–1a. In the case of securities described in paragraph (c)(2)(vi)(J), the additional deduction required by this paragraph (c)(2)(vi)(M) shall be 15 percent.

(*2*) This paragraph (c)(2)(vi)(M) shall apply notwithstanding any long or short position exemption provided for in paragraph (c)(2)(vi)(J) of this section (except for long or short position exemptions arising out of the first proviso to paragraph (c)(2)(vi)(J)) and the deduction on any such exempted position shall be 15 percent of that portion of the securities position in excess of 10 percent of the broker or dealer's net capital before the application of paragraph (c)(2)(vi) of this section and Appendix A, § 240.15c3–1a.

(*3*) This paragraph (c)(2)(vi)(M) shall be applied to an issue of equity securities only on the market value of such securities in excess of $10,000 or the market value of 500 shares, whichever is greater, or $25,000 in the case of a debt security.

(*4*) This paragraph (c)(2)(vi)(M) will be applied to an issue of municipal securities having the same security provisions, date of issue, interest rate, day, month and year of maturity only if such securities have a market value in excess of $500,000 in bonds ($5,000,000 in notes) or 10 percent of tentative net capital, whichever is greater, and are held in position longer than 20 business days from the date the securities are received by the syndicate manager from the issuer.

(*5*) Any specialist that is subject to a deduction required by this paragraph (c)(2)(vi)(M), respecting its specialty stock, that can demonstrate to the satisfaction of the Examining Authority for such broker or dealer that there is sufficient liquidity for such specialist's specialty stock and that such deduction need not be applied in the public interest for the protection of investors, may upon a proper showing to such Examining Authority have such undue concentration deduction appropriately decreased, but in no case shall the deduction prescribed in paragraph (c)(2)(vi)(J) of this section above be reduced. Each such Examining Authority shall make and preserve for a period of not less than 3 years a record of each application granted pursuant to this paragraph (c)(2)(vi)(M)(5), which shall contain a summary of the justification for the granting of the application.

* * * * *

Open Contractual Commitments

(viii) Deducting, in the case of a broker or dealer that has open contractual commitments (other than those option positions subject to Appendix A, § 240.15c3–1a), the respective deductions as specified in paragraph (c)(2)(vi) of this section or Appendix B, § 240.15c3–1b, from the value (which shall be the market value whenever there is a market) of each net long and each net short position contemplated by any open contractual commitment in the proprietary or other accounts of the broker or dealer.

(A) The deduction for contractual commitments in those securities that are treated in paragraph (c)(2)(vi)(J) of this section shall be 30 percent unless the class and issue of the securities subject to the open contractual commitment deduction are listed for trading on a national securities exchange or are designated as NASDAQ National Market System Securities.

(B) A broker or dealer that maintains in excess of $250,000 of net capital may add back to net worth up to $150,000 of any deduction computed under this paragraph (c)(2)(viii)(B).

(C) The deduction with respect to any single commitment shall be reduced by the unrealized profit in such commitment, in an amount not greater than the deduction provided for by this paragraph (or increased by the unrealized loss), in such commitment, and in no event shall an unrealized profit on any closed transactions operate to increase net capital.

(ix) Deducting from the contract value of each failed to deliver contract that is outstanding five business days or longer (21 business days or longer in the case of municipal securities) the percentages of the market value of the underlying security that would be required by application of the deduction required by paragraph (c)(2)(vi) of this section. Such deduction, however, shall be increased by any excess of the contract price of the failed to deliver contract over the market value of the underlying security or reduced by any excess of the market value of the underlying security over the contract value of the failed to deliver contract, but not to exceed the amount of such deduction. The designated examining authority for the broker or dealer may, upon application of the broker or dealer, extend for a period up to 5 business days, any period herein specified when it is satisfied that the extension is warranted. The designated examining authority upon expiration of the extension may extend for one additional period of up to 5 business days, any period herein specified when it is satisfied that the extension is warranted.

(x)(A) * * *

(*2*) In the case of a bona fide hedged position as defined in this paragraph (c)(2)(x)(C) involving a long position in a security, other than an option, and a short position in a call option, the deduction shall be 15 percent (or such other percentage required by paragraphs (c)(2)(vi) (A) through (K) of this section) of the market value of the long position reduced by any excess of the market value of the long position over the exercise value of the short option position. In no event shall such reduction operate to increase net capital.

(*3*) In the case of a bona fide hedged position as defined in this paragraph (c)(2)(x)(C) involving a short position in a security, other than an option, and a long position in a call option, the deduction shall be the lesser of 15 percent of the market value of the short position or the amount by which the exercise value of the long option position exceeds the market value of the short position; however, if the exercise value of the long option position does not exceed the market value of the short position, no deduction shall be applied.

(*4*) In the case of a bona fide hedged position as defined in this paragraph (c)(2)(x)(C) involving a short position in a security other than an option, and a short position in a put option, the deduction shall be 15 percent (or such other percentage required by paragraphs (c)(2)(vi) (A) through (K) of this section) of the market value of the short security position reduced by any excess of the exercise value of the short option position over the market value of the short security position. No such reduction shall operate to increase net capital.

(*5*) In the case of a bona fide hedged position as defined in this paragraph (c)(2)(x)(C) involving a long position in a security, other than an option, and a long position in a put option, the deduction shall be the lesser of 15 percent of the market value of such long security position or the amount by which the market value of such long security position exceeds the exercise value of the long option position. If the market value of the long security position does not exceed the exercise value of the long option position, no deduction shall be applied.

* * * * *

Promptly Transmit and Deliver

(9) A broker or dealer is deemed to "promptly transmit" all funds and to "promptly deliver" all securities within the meaning of paragraphs (a)(2)(i) and (a)(2)(v) of this section where such transmission or delivery is made no later than noon of the next business day after the receipt of such funds or securities; provided, however, that such prompt transmission or delivery shall not be required to be effected prior to the settlement date for such transaction.

Promptly Forward

(10) A broker or dealer is deemed to "promptly forward" funds or securities within the meaning of paragraph (a)(2)(i) of this section only when such forwarding occurs no later than noon of the next business day following receipt of such funds or securities.

* * * * *

3. § 240.15c3–1a is amended by revising paragraphs (c)(1) through (c)(5), (c)(7), (c)(9) and (c)(10) to read as follows:

§ 240.15c3–1a Options (Appendix A to 17 CFR 240.15c3–1).

* * * * *

(c) * * *

Uncovered Calls

(1) Where a broker or dealer is short a call, deducting, after the adjustment provided for in paragraph (b) of this Appendix A, 15 percent (or such other percentage required by paragraphs (c)(2)(vi) (A) through (K) of § 240.15c3–1) of the current market value of the security underlying such option reduced by any excess of the exercise value of the call over the current market value of the underlying security. In no event shall the deduction provided by this paragraph be less than $250 for each option contract for 100 shares.

Uncovered Puts

(2) Where a broker or dealer is short a put, deducting, after the adjustment provided for in paragraph (b) of this Appendix A, 15 percent (or such other percentage required by paragraphs (c)(2)(vi) (A) through (K) of § 240.15c3–1) of the current market value of the security underlying the option reduced by any excess of the market value of the underlying security over the exercise value of the put. In no event shall the deduction provided by this paragraph be less than $250 for each option contract for 100 shares.

Covered Calls

(3) Where a broker or dealer is short a call and long equivalent units of the underlying security, deducting, after the adjustments provided for in paragraph (b) of this Appendix A, 15 percent (or such other percentage required by paragraphs (c)(2)(vi) (A) through (K) of § 240.15c3–1) of the current market value of the underlying security reduced by any excess of the current market value of the underlying security over the exercise value of the call. No reduction under this paragraph shall have the effect of increasing net capital.

Covered Puts

(4) Where a broker or dealer is short a put and short equivalent units of the underlying security, deducting, after the adjustment provided for in paragraph (b) of this Appendix A, 15 percent (or such other percentage required by paragraphs (c)(2)(vi) (A) through (K) of § 240.15c3–1) of the current market value of the underlying security reduced by any excess of the exercise value of the put over the market value of the underlying security. No such reduction shall have the effect of increasing net capital.

Conversion Accounts

(5) Where a broker or dealer is long equivalent units of the underlying security, long an unlisted put written or endorsed by a broker or dealer and short an unlisted call in its proprietary or other accounts, deducting 5 percent (or 50 percent of such other percentage required by paragraphs (c)(2)(vi) (A) through (K) of § 240.15c3–1) of the current market value of the underlying security.

* * * * *

Long Over-the-Counter Options

(7) Where a broker or dealer is long an unlisted put or call endorsed or written by a broker or dealer, deducting 15 percent (or such other percentage required by paragraphs (c)(2)(vi) (A) through (K) of § 240.15c3–1) of the market value of the underlying security, not to exceed any value attributed to such option in paragraph (c)(2)(i) of § 240.15c3–1.

* * * * *

Certain Security Positions With Offsetting Options

(9) Where a broker or dealer is long a security for which it is also long a listed put (such broker or dealer may in addition be short a call), deducting, after the adjustments provided in paragraph (b) of this Appendix A, 15 percent of the market value of the long security position not to exceed the amount by which the market value of equivalent units of the long security position exceeds the exercise value of the put. If the exercise value of the put is equal to or exceeds the market value of equivalent units of the long security position, no percentage deduction shall be applied.

(10) Where a broker or dealer is short a security for which he is also long a listed call (such broker or dealer may in addition be short a put), deducting, after the adjustments provided in paragraph (b) of this Appendix A, 15 percent of the market value of the short security position not to exceed the amount by which the exercise value of the long call exceeds the market value of equivalent units of the short security position. If the exercise value of the call is less than or equal to the market value of equivalent units of the short security position no percentage deduction shall be applied.

* * * * *

4. § 240.15c3–1c is amended by revising paragraph (b)(1), to read as follows:

§ 240.15c3–1c Consolidated Computations of Net Capital and Aggregate Indebtedness for Certain Subsidiaries and Affiliates (Appendix C to 17 CFR 240.15c3–1).

* * * * *

Required Counsel Opinions

(b)(1) If the consolidation, provided for in paragraph (a) of this section, of any such subsidiary or affiliate results in the increase of the broker's or dealers's net capital and/or the decrease of the broker's or dealer's minimum net capital requirement under paragraph (a) of § 240.15c3–1 and an opinion of counsel described in paragraph (b)(2) of this section has not been obtained, such benefits shall not be recognized in the broker's or dealer's computation required by this section.

* * * * *

5. § 240.15c3–1d is amended by revising paragraphs (a)(2)(iii), (b)(6)(iii), (b)(7), (b)(8), (b)(10)(ii)(B), (c)(2), (c)(5)(i), and (c)(5)(ii)(A) to read as follows:

§ 240.15c3–1d Satisfactory Subordination Agreements (Appendix D to 17 CFR 240.15c3–1).

* * * * *

(a)(2) * * *

(iii) The term "Collateral Value" of any securities pledged to secure a secured demand note shall mean the market value of such securities after giving effect to the percentage deductions set forth in paragraph (c)(2)(vi) of § 240.15c3–1 except for paragraph (c)(2)(vi)(J). In lieu of the deduction under (c)(2)(vi)(J), the broker or dealer shall reduce the market value of the securities pledged to secure the secured demand note by 30 percent.

* * * * *

(b)(6) * * *

(iii) The secured demand note agreement also may provide that, in lieu of the procedures specified in the provisions required by paragraph (b)(6)(ii) of this section, the lender with the prior written consent of the broker or dealer and the Examining Authority for the broker or dealer may reduce the unpaid principal amount of the secured demand note. After giving effect to such reduction, the aggregate indebtedness of the broker or dealer may not exceed 1000 percent of its net capital or, in the case of a broker or dealer operating pursuant to paragraph (a)(1)(ii) of § 240.15c3–1, net capital may not be less than 5 percent of aggregate debit items computed in accordance with § 240.15c3–3a, or, if registered as a futures commission merchant, 7 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), if greater. No single secured demand note shall be permitted to be reduced by more than 15 percent of its original principal amount and after such reduction no excess collateral may be withdrawn. No Examining Authority shall consent to a reduction of the principal amount of a secured demand note if, after giving effect to such reduction, net capital would be less than 120 percent of the minimum dollar amount required by § 240.15c3–1.

Permissive Prepayments

(7) A broker or dealer at its option but not at the option of the lender may, if the subordination agreement so provides, make a Payment of all or any portion of the Payment Obligation thereunder prior to the scheduled maturity date of such Payment Obligation (hereinafter referred to as a "Prepayment"), but in no event may any Prepayment be made before the expiration of one year from the date such subordination agreement became effective. This restriction shall not apply to temporary subordination agreements that comply with the provisions of paragraph (c)(5) of this Appendix D. No Prepayment shall be made, if, after giving effect thereto (and to all Payments of Payment Obligations under any other subordinated agreements then outstanding the maturity or accelerated maturities of which are scheduled to fall due within six months after the date such Prepayment is to occur pursuant to this provision or on or prior to the date on which the Payment Obligation in respect of such Prepayment is scheduled to mature disregarding this provision, whichever date is earlier) without reference to any projected profit or loss of the broker or dealer, either aggregate indebtedness of the broker or dealer would exceed 1000 percent of its net capital or its net capital would be less than 120 percent of the minimum dollar amount required by § 240.15c3–1 or, in the case of a broker or dealer operating pursuant to paragraph (a)(1)(ii) of § 240.15c3–1, its net capital would be less than 5 percent of its aggregate debit items computed in accordance with § 240.15c3–3a, or if registered as a futures commission merchant, 7 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), if greater, or its net capital would be less than 120 percent of the minimum dollar amount required by paragraph (a)(1)(ii) of § 240.15c3–1. Notwithstanding the above, no Prepayment shall occur without the prior written approval of the Examining Authority for such broker or dealer.

Suspended Repayment

(8)(i) The Payment Obligation of the broker or dealer in respect of any subordination agreement shall be suspended and shall not mature if, after giving effect to Payment of such Payment Obligation (and to all Payments of Payment Obligations of such broker or dealer under any other subordination agreement(s) then outstanding that are scheduled to mature on or before such Payment Obligation) either (A) the aggregate indebtedness of the broker or dealer would exceed 1200 percent of its net capital, or in the case of a broker or dealer operating pursuant to paragraph (a)(1)(ii) of § 240.15c3–1, its net capital would be less than 5 percent of aggregate debit items computed in accordance with § 240.15c3–3a or, if registered as a futures commission merchant, 6 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers on or subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), if greater, or (B) its net capital would be less than 120 percent of the minimum dollar amount required by § 240.15c3–1 including paragraph (a)(1)(ii), if applicable. The subordination agreement may provide that if the Payment Obligation of the broker or dealer thereunder does not mature and is suspended as a result of the requirement of this paragraph (b)(8) for a period of not less than six months, the broker or dealer shall thereupon commence the rapid and orderly liquidation of its business, but the right of the lender to receive Payment, together with accrued interest or compensation, shall remain subordinate as required by the provisions of § 240.15c3–1 and § 240.15c3–1d.

* * * * *

(10)(ii) * * *

(B) The aggregate indebtedness of the broker or dealer exceeding 1500 percent of its net capital or, in the case of a broker or dealer that has elected to operate under paragraph (a)(1)(ii) of § 240.15c3–1, its net capital computed in accordance therewith is less than 2 percent of its aggregate debit items computed in accordance with § 240.15c3–3a or, if registered as a futures commission merchant, 4 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers on or subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), if greater, throughout a period of 15 consecutive business days, commencing on the day the broker or dealer first determines and notifies the Examining Authority for the broker or dealer, or the Examining Authority or the Commission first determines and notifies the broker or dealer of such fact;

* * * * *

(c) * * *

Notice of Maturity or Accelerated Maturity

(2) Every broker or dealer shall immediately notify the Examining Authority for such broker or dealer if, after giving effect to all Payments of Payment Obligations under subordination agreements then outstanding that are then due or mature within the following six months without reference to any projected profit or loss of the broker or dealer either the aggregate indebtedness of the broker or dealer would exceed 1200 percent of its net capital or its net capital would be less than 120 percent of the minimum

dollar amount required by § 240.15c3–1, or, in the case of a broker or dealer operating pursuant to paragraph (a)(1)(ii) of § 240.15c3–1, its net capital would be less than 5 percent of aggregate debit items computed in accordance with § 240.15c3–3a, or, if registered as a futures commission merchant, 6 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers on or subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), if greater, or less than 120 percent of the minimum dollar amount required by paragraph (a)(1)(ii) of § 240.15c3–1.

* * * * *

Temporary and Revolving Subordination Agreements

(5)(i) For the purpose of enabling a broker or dealer to participate as an underwriter of securities or other extraordinary activities in compliance with the net capital requirements of § 240.15c3–1, a broker or dealer shall be permitted, on no more than three occasions in any 12 month period, to enter into a subordination agreement on a temporary basis that has a stated term of no more than 45 days from the date such subordination agreement became effective. This temporary relief shall not apply to a broker or dealer if, at such time, it is subject to any of the reporting provisions of § 240 17a–11, irrespective of its compliance with such provisions or if immediately prior to entering into such subordination agreement, either:

(A) The aggregate indebtedness of the broker or dealer exceeds 1000 percent of its net capital or its net capital is less than 120 percent of the minimum dollar amount required by § 240.15c3–1, or

(B) In the case of a broker or dealer operating pursuant to paragraph (a)(1)(ii) of § 240.15c3–1, its net capital is less than 5 percent of aggregate debits computed in accordance with § 240.15c3–1, or, if registered as a futures commission merchant, less than 7 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers on or subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), if greater, or less than 120 percent of the minimum dollar amount required by paragraph (a)(1)(ii) of this section, or

(C) The amount of its then outstanding subordination agreements exceeds the limits specified in paragraph (d) of § 240.15c3–1. Such temporary subordination agreement shall be subject to all other provisions of this Appendix D.

(ii) * * *

(A) After giving effect thereto (and to all Payments of Payment Obligations under any other subordinated agreements then outstanding, the maturity or accelerated maturities of which are scheduled to fall due within six months after the date such prepayment is to occur pursuant to this provision or on or prior to the date on which the Payment Obligation in respect of such prepayment is scheduled to mature disregarding this provision, whichever date is earlier) without reference to any projected profit or loss of the broker or dealer, either aggregate indebtedness of the broker or dealer would exceed 900 percent of its net capital or its net capital would be less than 200 percent of the minimum dollar amount required by § 240.15c3–1 or, in the case of a broker or dealer operating pursuant to paragraph (a)(1)(ii) of § 240.15c3–1, its net capital would be less than 6 percent of aggregate debit items computed in accordance with § 240.15c3–3a, or, if registered as a futures commission merchant, 10 percent of the funds required to be segregated pursuant to the Commodity Exchange Act and the regulations thereunder (less the market value of commodity options purchased by option customers on or subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), if greater, or its net capital would be less than 200 percent of the minimum dollar amount required by paragraph (a)(1)(ii) of this section or

* * * * *

6. § 240.15c3–1e is added to read as follows:

§ 240.15c3–1e Temporary Minimum Requirements (Appendix E to 17 CFR 240.15c3–1e).

Brokers or Dealers That Carry Customer Accounts Aggregate Indebtedness Standard

(a) A broker or dealer that falls within the provisions of paragraph (a)(2)(i) of § 240.15c3–1 and computes its required net capital under § 240.15c3–1(a)(1)(i) shall maintain net capital not less than the greater of the amount computed under the paragraph (a)(1)(i) or:

(1) $25,000 until June 30, 1993;

(2) $100,000 on July 1, 1993, until December 31, 1993;

(3) $175,000 on January 1, 1994, until June 30, 1994; and

(4) $250,000 on July 1, 1994.

Brokers or Dealers That Elect the Alternative Standard

(b) A broker or dealer that elects the provisions of § 240.15c3–1(a)(1)(ii) shall maintain net capital of not less than the greater of the amount computed under the paragraph (a)(1)(ii) or:

(1) $100,000 until June 30, 1993;

(2) $150,000 on July 1, 1993, until December 31, 1993;

(3) $200,000 on January 1, 1994, until June 30, 1994; and

(4) $250,000 on July 1, 1994.

Broker or Dealers That are Exempt From Securities Exchange Act Rule 15c3–3 Under Paragraph (k)(2)(i) and Dealers

(c) A broker or dealer that falls within the provisions of § 240.15c3–1(a)(2) (ii) or (iii) and computes its required net capital under § 240.15c3–1(a)(1)(i) shall maintain net capital not less than the greater of the same computed under § 240.15c3–1(a)(1)(i) or:

(1) $25,000 until June 30, 1993;

(2) $50,000 on July 1, 1993, until December 31, 1993;

(3) $75,000 on January 1, 1994, until June 30, 1994; and

(4) $100,000 on July 1, 1994.

Brokers or Dealers That Introduce Customer Accounts and Receive Securities

(d) An introducing broker that falls within the provisions of § 240.15c3–1(a)(2)(iv) and computes its required net capital under § 240.15c3–1(a)(1)(i) shall maintain net capital of not less than the greater of the amount computed under § 240.15c3–1(a)(1)(i) or:

(1) $5,000 until June 30, 1993;

(2) $20,000 on July 1, 1993, until December 31, 1993;

(3) $35,000 on January 1, 1994, until June 30, 1994; and

(4) $50,000 on July 1, 1994.

Brokers or Dealers Engaged in the Sale of Redeemable Shares of Registered Investment Companies and Certain Other Share Accounts

(e) A broker or dealer that falls within the provisions of § 240.15c3–1(a)(2)(v) and computes its required net capital under § 240.15c3–1(a)(1)(i) shall maintain net capital of not less than the greater of the amount computed under § 240.15c3–1(a)(1)(i) or:

(1) $2,500 until June 30, 1993;

(2) $10,000 on July 1, 1993, until December 31, 1993;

(3) $17,500 on January 1, 1994, until June 30, 1994; and

(4) $25,000 on July 1, 1994.

Other Brokers or Dealers

(f) A broker or dealer that falls within the provisions of § 240.15c3–1(a)(2)(vi), computes its required net capital under § 240.15c3–1(a)(1)(i) and is not otherwise subject to a $5,000 minimum net capital requirement shall maintain net capital of not less than the greater of the amount computed under § 240.15c3–1(a)(1)(i) or:

(1) $2,500 until June 30, 1993;

(2) $3,300 on July 1, 1993, until December 31, 1993;

(3) $4,100 on January 1, 1994, until June 30, 1994; and

(4) $5,000 on July 1, 1994.

Dated: November 24, 1992.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 92–29031 Filed 12–1–92; 8:45 am]

BILLING CODE 8010–01–M

DEPARTMENT OF TRANSPORTATION

National Highway Traffic Safety Administration

Federal Highway Administration

23 CFR Part 1204

[NHTSA Docket No. 81–12; Notice 8]

Highway Safety Program Guideline No. 17, Pupil Transportation Safety

AGENCY: National Highway Traffic Safety Administration (NHTSA), Federal Highway Administration (FHWA), DOT.

ACTION: Final rule, technical amendment.

SUMMARY: This notice corrects an inconsistency between Highway Safety Program Guideline 17 and Federal motor vehicle safety standard No. 111, Rearview mirrors, which Guideline 17 incorporates by reference. This notice amends Guideline 17 to be consistent with today's amendment of Standard No. 111 by deleting unnecessary language that has the potential to be confusing. No new obligations or duties are imposed on any party as a result of this correction, since the correction merely removes obsolete provisions from the Guideline.

DATES: *EFFECTIVE DATE:* The amendment becomes effective December 2, 1993.

FOR FURTHER INFORMATION CONTACT: Mr. Ronald Engle, Chief, Safety Countermeasures Division, NTS–23, National Highway Traffic Safety Administration, 400 Seventh Street, SW., Washington, DC 20590 (202) 366–2717.

SUPPLEMENTARY INFORMATION:

On April 26, 1991, the National Highway Traffic Safety Administration (NHTSA) and the Federal Highway Administration (FHWA) published revisions to Highway Safety Program Guideline 17; Pupil Transportation Safety. (56 FR 19270) Guideline 17 contains recommendations to the States on various operational aspects of their school bus and pupil transportation safety programs, including school bus equipment such as mirror systems. (see § 1204.4(IV)(B)(1)(g)). As for mirror systems, Guideline 17 states that—

"All school buses should * * * (g) Have a system of mirrors that conforms to the school bus requirements of FMVSS No. 111, 49 CFR 571.111, and provides the seated driver a view to the rear along both sides of the bus and a view of the front bumper and the area in front of the bus. Mirrors should be positioned and adjusted such that when a rod, 30 inches long, is placed upright on the ground at any point along a traverse 1 foot forward of the forward-most point of a school bus, at least 7½ inches of the length of the rod should be visible to the driver, either by direct view or by the system of mirrors."

While Guideline 17 was being amended, NHTSA issued a proposal to determine whether to amend Federal motor vehicle safety standard No. 111, Rearview mirrors. (56 FR 20171, May 2, 1991). That NPRM proposed detailed test locations that would supersede the specific adjustment requirements in Guideline 17.

Elsewhere in today's **Federal Register**, the agency is publishing an amendment to FMVSS No. 111, Rearview Mirrors, with respect to the field-of-view around school buses. The notice amends the standard to require a bus driver to be able to see, either directly or through mirrors, certain specified areas in front of and along both sides of school buses. The amendment also specifies detailed performance requirements.

After reviewing Guideline 17's relationship with Standard No. 111, it is apparent that Guideline 17 should be amended to reference Standard No. 111, without any additional provisions. Accordingly, Guideline 17 is amended to state "All school buses should *** (g) Have a system of mirrors that conforms to the school bus requirements of FMVSS No. 111, 49 CFR 571.111." The additional provisions in Guideline 17 about the driver's view, mirror positioning and adjustment, and the 30" rod test are deleted from Guideline 17.

The agency notes that in amending Standard No. 111, Guideline 17 effectively was amended as well, since Guideline 17 incorporates Standard No. 111 by reference. Nevertheless, the existence of the additional provisions in Guideline 17 are being deleted because they are without legal effect and could be confusing given the amendment to Standard No. 111.

Based on the above considerations, the agency has decided to issue this conforming amendment to clarify this situation. This amendment imposes no duties or responsibilities on any party, nor does it alter existing obligations. Instead, this amendment will simply ensure that Guideline 17 has no extraneous language that could be misinterpreted as imposing guidelines that are not actually in effect. Accordingly, the agency finds for good cause that notice and opportunity for comment on this amendment are unnecessary.

List of Subjects in 23 CFR Part 1204

Grant programs, Highway safety.

In consideration of the foregoing, NHTSA and FHWA amend 23 CFR part 1204 as follows:

PART 1204—AMENDED

1. The authority citation for 23 CFR Part 1204 continues to read as follows:

Authority: 23 U.S.C. 402; delegations of authority at 49 CFR 1.48 and 1.50.

§ 1204.4 [Amended]

2. In § 1204.4, section (IV)(B)(1)(g) is revised to read as follows:

* * * * *

g. Have a system of mirrors that conforms to the school bus requirements of FMVSS No. 111, 49 CFR 571.111.

* * * * *

Issued on: November 24, 1992.

Marion C. Blakey,

Administrator.

Thomas D. Larson,

Administrator.

[FR Doc. 92–29052 Filed 12–1–92; 8:45 am]

BILLING CODE 4910–59–M

Coast Guard

33 CFR Part 165

[COTP St. Louis Regulation 92–09]

Safety Zone Regulation: Upper Mississippi River, Mile 90.0–103.02

AGENCY: Coast Guard, DOT.

ACTION: Temporary final rule.

SUMMARY: The Coast Guard is establishing a safety zone on the Upper Mississippi River, between Mile 90.0 and 103.0. This safety zone is needed to protect commercial traffic and private