

**MEMO# 20962**

March 16, 2007

## **SEC Proposal Relating to Net Capital and Customer Protection Rules**

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TO: MONEY MARKET FUNDS ADVISORY COMMITTEE No. 5-07  
INST. MONEY MARKET FUNDS ADVISORY COMMITTEE No. 6-07  
SEC RULES MEMBERS No. 36-07 RE: SEC PROPOSAL RELATING TO NET CAPITAL AND  
CUSTOMER PROTECTION RULES

The Securities and Exchange Commission has proposed amendments to its financial responsibility rules, including the net capital (Rule 15c3-1) and customer protection (Rule 15c3-3) rules for broker-dealers under the Securities Exchange Act of 1934. [\[1\]](#) The most significant aspects of the proposal impacting investment companies are summarized below.

### **Amendments to Net Capital Rule**

The Commission is proposing several amendments to the net capital rule, [\[2\]](#) including an amendment that would reduce the “haircut” broker-dealers apply under Rule 15c3-1 for money market funds from two percent to one percent when computing net capital. The Release notes that the Commission adopted a two percent haircut requirement for money market funds before the Commission adopted certain amendments to Rule 2a-7 under the Investment Company Act of 1940. These amendments strengthened the risk limiting investment restrictions for money market funds. According to the Release, the Commission is proposing to reduce the haircut for money market funds based on these enhancements, as well as the historical stability of money market funds as investments.

The Commission requests comment on all aspects of the amendment, including whether it

is appropriate to reduce the haircut to one percent or, alternatively, to zero percent.

## **Amendments to Customer Protection Rule**

The Commission is proposing several changes to the customer protection rule, [3] including an amendment that would expand the definition of “qualified securities” [4] to include certain money market funds. Under the proposed amendment, the definition of “qualified security” would be amended to include an unaffiliated money market fund that: (i) is described in Rule 2a-7 of the Investment Company Act; (ii) invests solely in securities issued by the United States or guaranteed by the United States as to interest and principal; (iii) agrees to redeem fund shares in cash no later than the business day following a redemption request by a shareholder; and (iv) has an amount of net assets equal to at least ten times the value of the shares deposited by the broker-dealer in its customer reserve account.

The Commission requests comment on, among other things, whether these types of money market funds are appropriate for the customer reserve account in terms of liquidity and safety. The Commission also requests comment on whether the ten percent net asset limitation would be an adequate safeguard in terms of ensuring a broker-dealer could quickly redeem its shares.

Jane G. Heinrichs  
Associate Counsel

### **endnotes**

[1] SEC Release No. 34-55431 (March 9, 2007) (“Release”). The proposal can be found on the SEC’s website at <http://sec.gov/rules/proposed/2007/34-55431.pdf>. Comments on the proposal are due to the SEC no later than May 18, 2007.

[2] Under Rule 15c3-1, broker-dealers are required to maintain, at all times, a minimum amount of net capital. The rule generally defines “net capital” as a broker-dealers net worth (assets minus liabilities), plus certain subordinated liabilities, less certain assets that are not readily convertible into cash (e.g., fixed assets), and less a percentage (haircut) of certain other liquid assets (e.g., securities).

[3] Rule 15c3-3 governs a broker-dealer’s acceptance, custody and use of a customer’s securities. In general, under the rule, a broker-dealer must segregate customer funds and fully paid and excess margin securities held by the firm in a separate special reserve bank account. The intent of the rule is to require a broker-dealer to hold customer assets in a manner that enables their prompt return in the event of the broker-dealer’s insolvency.

[4] Under the rule, only cash or “qualified securities” may be deposited in a special reserve account. A “qualified security” is a security issued by the United States or guaranteed by the United States with respect to principal and interest.

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