

**MEMO# 1439**

October 11, 1989

## **SEC PROPOSES AMENDMENTS TO NET CAPITAL RULE**

October 11, 1989 TO: SEC RULES COMMITTEE NO. 61-89 BROKER/DEALER ADVISORY COMMITTEE NO. 47-89 RE: SEC PROPOSES AMENDMENTS TO NET CAPITAL RULE

The Securities and Exchange Commission has proposed amendments to the net capital rule under the Securities Exchange Act of 1934. A copy of the proposal is attached. Currently, the minimum net capital for broker-dealers that limit their activities to transactions in shares of registered investment companies is the greater of \$2,500 or 6 2/3 percent of their aggregate indebtedness. Under the proposal, the minimum net capital requirement of certain mutual fund brokers and dealers would be increased to \$25,000. However, for mutual fund firms which do not handle any customer funds or securities and are not direct wire order firms, the SEC has proposed a \$5,000 minimum net capital requirement. Because of the impact of the proposed increased minimum capital requirements on some broker-dealers, the SEC has proposed that the minimums be staggered over a period of four years from the effective date. Each year after the effective date, the minimum requirements for affected broker-dealers would increase by 25 percent of the increase. The timing of the increase for mutual fund dealers that routinely receive customer funds would be: a. current Rule: \$ 2,500 b. by 12/31/90: \$ 8,125 c. by 12/31/91: \$13,750 d. by 12/31/92: \$19,375 e. by 12/31/93: \$25,000 In order to qualify for the \$25,000 minimum net capital requirement, a broker or dealer must meet all of the following conditions: (A) Dealer transactions must be limited to the purchase, sale and redemption of redeemable shares of registered investment companies or interests or participations in insurance company separate accounts, although it may also effect ten or fewer transactions in other securities for its own account with or through another registered broker or dealer; (B) Transmittal of all funds must be done promptly and the broker or dealer must not otherwise hold funds or securities for, or owe money or securities to, customers; and (C) Transactions as a broker are limited to the following: (1) sales and redemptions of redeemable shares of registered investment companies or of interests or participations in insurance company separate accounts whether or not registered as investment companies; (2) the solicitation of share accounts for savings and loan associations insured by an instrumentality of the United States; (3) the sale of securities for a customer account for immediate reinvestment in redeemable shares of an investment company; and (4) ten or fewer transactions in securities per year for its own account with or through another registered broker or dealer. The SEC proposal also contains an exclusion from the aggregate indebtedness calculation for a broker-dealer whose indebtedness to a mutual fund in connection with a purchase of shares of that fund is offset by a receivable from another broker-dealer related to that transaction. The current rule requires that a broker-dealer must have a 6 2/3 percent cushion to cover its liability the broker-dealer has to the fund. The SEC believes that, to the

extent that this liability is offset by receivables from a second broker-dealer, the 6 2/3 percent cushion is unnecessary. Rather than the 6 2/3 percent charge that results under the current rule, the SEC proposes that this requirement be lowered to 1 percent of the liability amount when an offset receivable exists. The Commission specifically requests commentators to focus attention on the phase-in provisions and to indicate whether the proposed timing and method of phase-in are appropriate. In particular, the SEC is concerned that, given the significant level of risk present in the system, a four-year phase-in may be too long to achieve the maximum degree of customer and systemic protection contemplated by these proposals. On the other hand, the Commission recognizes the need for a smooth transition with minimum disruption for both firms and customers. The Commission also requests comment on alternative methods that might be used to establish minimum net capital requirements. More specifically, the Commission asks commentators to address whether a minimum absolute dollar amount requirement could be based on quantifiable measures of risk. The deadline for comments to the SEC is December 18, 1989. Therefore, please submit any comments to the undersigned by Friday, December 1, 1989.

Robert L. Bunnan, Jr. Assistant General Counsel Attachment

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