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# SEC Adopts Amendments to Financial Responsibility Rules for Broker-Dealers

## FOR IMMEDIATE RELEASE

**2013-140**

*Washington D.C., July 31, 2013* — The Securities and Exchange Commission today announced the adoption of amendments to the net capital, customer protection, books and records, and notification rules for broker-dealers.

The amendments to the broker-dealer financial responsibility rules are designed to better protect a broker-dealer's customers and enhance the SEC's ability to monitor and prevent unsound business practices. The rule amendments were approved by a unanimous Commission vote.

"Investors need to feel confident that their money is safe when it's being held by their broker-dealers," said Mary Jo White, Chair of the SEC. "These measures will significantly bolster the protections that our rules already offer."

The rule amendments will become effective 60 days after their publication in the Federal Register.

# # #

## **FACT SHEET**

### **Adopting Amendments to the Financial Responsibility Rules for Broker-Dealers**

#### **Background**

##### *What Are Broker-Dealers?*

Broker-dealers are generally entities that engage in the business of carrying out securities transactions either for someone else's account or for their own account. Under the federal securities laws, most entities engaged in these activities (with the notable exception of certain commercial banks) must register with the SEC and be subject to Commission rules. Broker-dealers must be members of at least one self-regulatory organization (SRO) such as the Financial Industry Regulatory Authority or a national securities exchange.

##### *What Are Broker-Dealer Financial Responsibility Rules and How Do They Protect Customers?*

Broker-dealers must meet certain financial responsibility requirements under the Securities Exchange Act of 1934. These requirements help to protect customers from the consequences of the financial failure of a broker-dealer by requiring the safeguarding of customer securities and funds held by the broker-dealer.

These requirements include:

- **Net Capital Rule (Rule 15c3-1)** – Requires a broker-dealer to maintain more than a

dollar of highly liquid assets for each dollar of liabilities. If the broker-dealer fails, this rule helps to ensure that the broker-dealer has sufficient liquid assets to pay all liabilities to customers.

- **Customer Protection Rule (Rule 15c3-3)** – Broker-dealers sometime use their own funds to conduct trades and other transactions. When engaging in such “proprietary business activities,” this rule prohibits broker-dealers from using customer securities and cash to finance their own business. By segregating customer securities and cash from a firm’s proprietary business activities, the rule increases the likelihood that customer assets will be readily available to be returned to customers if a broker-dealer fails.
- **Books and Records Rules (Exchange Act Rules 17a-3 and 17a-4)** – Require a broker-dealer to make and maintain certain business records to assist the firm in accounting for its activities, and assist securities regulators in examining for compliance with the securities laws.
- **Notification Rule (Exchange Act Rule 17a-11)** – Requires a broker-dealer to give notice to the SEC and other securities regulators when certain events occur, such as the firm’s net capital falling below its required minimum.

These requirements are designed to protect customer assets held at broker-dealers. However, if a broker-dealer violates these requirements by, for example, misappropriating these assets, the securities and cash may not be available to be returned to customers.

In a situation where a broker-dealer misappropriates funds or converts securities from its customer, the Securities Investor Protection Corporation (SIPC) may step in and initiate a liquidation proceeding, which is the process that determines whether SIPC will pay the customers for any shortfalls in their accounts up to \$500,000 per customer (of which \$250,000 can be used to make up a cash shortfall.)

### *2007 Proposal*

In 2007, the Commission proposed a series of amendments to the broker-dealer financial responsibility rules and gave the public the opportunity to comment. Commenters were given an additional opportunity to weigh in when the Commission re-opened the comment period in 2012.

### **New Rules**

#### *Customer Protection Rule (Rule 15c-3-3)*

The key changes to the Customer Protection Rule will:

- Close a “gap” between the definition of “customer” in Rule 15c3-3 (which does not include broker-dealers) and the definition of “customer” under the Securities Investor Protection Act (which includes broker-dealers). It does this by requiring “carrying broker-dealers” that maintain customer securities and funds to maintain a new segregated reserve account for account holders that are broker-dealers.
- Place restrictions on cash bank deposits for purposes of the requirement to maintain a reserve to protect customer cash under Rule 15c3-3. The rule is amended to exclude cash deposits held at affiliated banks and limit cash held at non-affiliated banks to an amount no

greater than 15 percent of the bank's equity capital, as reported by the bank in its most recent call report.

- Establish customer disclosure, notice, and affirmative consent requirements (for new accounts) for programs where customer cash in a securities account is "swept" to a money market or bank deposit product.

### *Net Capital Rule (Rule 15c3-1)*

The key amendments to the Net Capital Rule will:

- Require a broker-dealer to adjust its net worth when calculating net capital by including any liabilities that are assumed by a third party if the broker-dealer cannot demonstrate that the third party has the resources – independent of the broker-dealer's income and assets – to pay the liabilities.
- Require a broker-dealer to treat as a liability any capital that is contributed under an agreement giving the investor the option to withdraw it. The rule also requires a broker-dealer to treat as a liability any capital contribution that is withdrawn within a year of its contribution unless the broker-dealer receives permission for the withdrawal in writing from its designated examining authority (DEA).
- Require broker-dealers to deduct from net capital (with regard to fidelity bonding requirements prescribed by a broker-dealer's SRO) the excess of any deductible amount over the amount permitted by SRO rules.
- Clarify that any broker-dealer that becomes "insolvent" as that term is now defined in Rule 15c3-1 is required to cease conducting a securities business. The companion amendment to Rule 17a-11 requires insolvent broker-dealers to provide notice to regulatory authorities.

### *Books and Records Rules (Rules 17a-3 and 17a-4)*

The amendments to Rules 17a-3 and 17a-4 will require large broker-dealers to document their market, credit, and liquidity risk management controls.

### *Notification Rule (Rule 17a-11)*

The amendments to Rule 17a-11 will establish new notification requirements for when a broker-dealer's repurchase and securities lending activities exceed a certain threshold. In lieu of the notification requirement, the final rule provides that a broker-dealer may report monthly its stock loan and repurchase activity to its DEA, in a form acceptable to its DEA.

### **What's Next**

The effective date for these amendments is 60 days after publication in the Federal Register.

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## **Related Materials**

- [SEC final rule amendments](#)

