NASD

Notice To Members

SPECIAL

National Association of Securities Dealers, Inc. October 11, 1989 — Supplement

Number 89 - 69

Suggested Routing:*

✓Senior Management	✓Internal Audit	__Operations	__Syndicate
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__Government Securities	__Municipal	__Registration	__Trading
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Subject: SEC Proposes Significant Amendments to the Net Capital Rule; Last Date for Comments: December 18, 1989

EXECUTIVE SUMMARY

On September 15, 1989, the Securities and Exchange Commission issued Release No. 34-27249 containing proposed amendments to Rule 15c3-1 (the "Net Capital Rule"). The proposal would raise the minimum net capital requirement of certain registered broker-dealers. The change would be implemented over a four-year period. In addition, the proposal would standardize the "haircut" deductions for equity securities, and there would be changes to the computation of aggregate indebtedness. The SEC's comment period expires December 18, 1989. The text of the proposed amendments follows this notice.

SUMMARY OF PROPOSED CHANGES

I. MINIMUM NET CAPITAL

A. Clearing and Carrying Firms

For firms that clear and carry customer accounts, the commission is proposing a minimum net capital requirement of $250,000. However, carrying firms that do not hold customer funds or securities (i.e., those that are exempt from SEC Rule 15c3-3 by virtue of paragraph (k)(2)(i)) would have a requirement of $100,000.

B. Introducing Firms

The proposed amendments would create three classes of introducing firms, each with a different minimum requirement.

- Firms that routinely receive customer funds and securities for transmittal to the clearing firm would have a $100,000 minimum requirement.
- Firms that occasionally receive customer funds and securities for transmittal to the clearing firm would have a $50,000 minimum requirement.
- Firms that never receive customer funds or securities would retain the current $5,000 minimum requirement. (These firms need to take the utmost care in advising their customers not to send funds or securities to them.)

However, in addition to the above dollar minimums, introducing firms would be required to maintain net capital of one-quarter of one percent (.0025) of the customer debit balances that they introduce.

One other change is being proposed for introducing broker-dealers. The proposal would permit introducing broker-dealers with a capital requirement of at least $50,000 to participate in firm-commitment underwritings as a selling dealer only, never as a statutory underwriter. The present prohibition against $5,000 introducing firms participating in a firm-commitment underwriting in any capacity will continue.

C. Over-the-Counter Market Makers

The minimum requirement would change from the current $25,000 to $100,000 for firms that compute under the basic method. However, market-maker firms that clear and carry customer accounts and are fully subject to the provisions of Rule 15c3-3 would have a $250,000 requirement. Another change proposed would raise the requirement for each security priced at $5 or less per share to $1,000 from $500. (The current capital requirement of $2,500 per share for securities priced over $5 remains unchanged). The present ceiling of $100,000 net capital for market makers would increase to $1 million.

D. Broker-Dealers That Transact Business in Mutual Fund Shares

The current $2,500 minimum net capital requirement will change to $25,000 except that mutual fund firms that do not handle customer funds or securities and are not direct wire-order firms would have a $5,000 requirement.

E. Broker-Dealers That Trade Solely for Their Own Accounts

These firms no longer will be permitted to elect the alternative method. They must use the basic method of the greater of $100,000 (an increase from $25,000) or 6 2/3 percent of aggregate indebtedness.

F. All Other Broker-Dealers

A $5,000 minimum category will be maintained for firms that do not handle customer funds and securities, such as firms that sell direct participation programs (DPPs) in real estate syndications or firms that engage exclusively in mergers and acquisitions. As noted in Section B above, certain fully introducing firms can qualify as $5,000 firms. These firms now are permitted to participate in underwritings on a "best-efforts" basis that uses an independent escrow agent. The commission is requesting comments on whether it is appropriate to permit best-efforts underwriting firms to remain in this $5,000 category.

Because firms in the $5,000 category would be prohibited from receiving customer funds or securities, should they do so, they would immediately be required to maintain the next higher level of net capital.

NOTE: Under the proposal, only a broker-dealer that carries customer accounts, holds customer funds or securities, and is subject to the full provisions of Rule 15c3-3 can elect the alternative method. All other broker-dealers must compute their net capital under the basic method and be subject to the aggregate indebtedness ratio.

Analysis of Changes to Minimum Net Capital Requirements

Class of Broker-Dealer	Present Requirement	Proposed Requirement
1.(a) Firms that carry customer accounts and fully compute under Rule 15c3-3		
Basic Method	Greater of $25,000 or 6 2/3% of aggregate indebtedness (AI)	Greater of $250,000 or 6 2/3% of AI
Alternative Method	Greater of $100,000 or 2% of Rule 15c3-3 Reserve Formula debits	Greater of $250,000 or 2% of Rule 15c3-3 Reserve Formula debits (See Note on previous page.)
	(In addition, if also a market maker, there is a requirement based on the number of markets made. See Class 3 on next page.)	
(b) Firms that carry customer accounts, receive but do not hold customer funds or securities, and operate under the paragraph (k)(2)(i) exemption of Rule 15c3-3	Greater of $25,000 or 6 2/3% of AI	Greater of $100,000 or 6 2/3% of AI
2. Firms that introduce accounts on a fully disclosed basis to another broker-dealer	Greater of $5,000 or 6 2/3% of AI	(a) Greater of $100,000 or 6 2/3% of AI plus 1/4 of 1% of customer debits introduced, if firm routinely receives customer funds or securities; or (b) Greater of $50,000 or 6 2/3% of AI plus 1/4 of 1% of customer debits introduced, if firm occasionally receives customer funds or securities; or (c) Greater of $5,000 or 6 2/3% of AI plus 1/4 of 1% of customer debits introduced, if firm never receives customer funds or securities

Class of Broker-Dealer	Present Requirement	Proposed Requirement
3. Over-the-counter market makers		
Basic Method	Greater of $25,000 or 6 2/3% of AI	Greater of $100,000 or 6 2/3% of AI
Alternative Method	Greater of $100,000 or 2% of Reserve Formula debits	Firms that do not carry customer accounts will no longer be able to elect the alternative method (See 1(a) above for firms that do carry customer accounts.)
	or	or
	$2,500 for each security in which a market is made ($500 per security if the price is $5 or less per share	Same, except the requirement will be $1,000 per security at $5 or less per share
	with	with
	a maximum requirement of $100,000)	a maximum requirement of $1 million
4. Firms transacting a business solely in mutual fund shares	Greater of $2,500 or 6 2/3% of AI	Greater of $25,000 or 6 2/3% of AI
		with
		Greater of $5,000 or 6 2/3% of AI for firms that do not handle any customer funds or securities and are not direct wire order firms
5. Broker-dealers that trade solely for their own accounts (Also see Class 3 above.)		
Basic Method	Greater of $25,000 or 6 2/3% of AI	Greater of $100,000 or 6 2/3% of AI
Alternative Method	Greater of $100,000 or 2% of aggregate debits in the Reserve Formula	The alternative method will not be available to these broker-dealers.

Class of Broker-Dealer	Present Requirement	Proposed Requirement
6. Other broker-dealers		
(a) Firms that deal only in direct participation programs (DPPs)	Greater of $5,000 or 6 2/3% of AI	Same
(b) Firms that do not take customer orders, hold customer funds or securities, or execute customer trades, yet register with the commission because of the nature of their activities (e.g., mergers and acquisitions)	Greater of $5,000 or 6 2/3% of AI	Same

The commission proposes to phase in these new requirements over a four-year period as follows:

		Minimum Net Capital Required By			
Class of Broker-Dealer	**Current Requirement**	**12-31-90**	**12-31-91**	**12-31-92**	**12-31-93**
1(a) Basic	$25,000	$81,250	$137,500	$193,750	$250,000
1(a) Alternative	100,000	137,500	175,000	212,500	250,000
1(b), 3, and 5	25,000	43,750	62,500	81,250	100,000
2	5,000 or	28,750	52,500	76,250	100,000
	5,000	16,250	27,500	38,750	50,000
4	2,500 or	8,125	13,750	19,375	25,000
	2,500	3,125	3,750	4,375	5,000

II. OTHER PROPOSED AMENDMENTS

A. Securities Haircuts

1. Equity Securities: Presently there are two methods of calculating haircuts depending on whether a firm computes under the basic or alternative method. The commission proposes to eliminate the dual methodologies and establish one standardized method for firms with $100,000 or more of net capital. It would be 15 percent of the market value of the greater of the long or short position and 15 percent of the lesser to the extent it exceeds 25 percent of the greater position.

However, firms with less than $100,000 would apply the present basic method haircuts until their net capital reached $100,000 or more. It is 30 percent of the market value of the greater of the long or short positions and 15 percent of the lesser to the extent it exceeds 25 percent of the market value of the greater.

Finally, the proposed amendments would adopt the alternative method for computing concentration charges. For equities, that would be 15 percent, effective immediately and not after 11 business days as in the basic method.

2. Zero Coupon and Stripped Securities: Presently, based upon an interim interpretation, these types of instruments that include only principal or interest incur the securities haircuts depending on the maturity of the security. The commission notes in its release that the haircuts for debt instruments ". . . were drafted to reflect the price volatilities of securities that include both principal and interest and thus do not contemplate the risk inherent in stripped securities." Therefore, under the proposal, these zero-coupon securities (other than those issued by the Treasury) would be subject to the 15 percent haircut being proposed for equity securities.

B. Aggregate Indebtedness

In light of the proposed increases in the minimum net capital requirements, the commission has identified two items of aggregate indebtedness (AI) for which the current 6 2/3 percent charge may not be appropriate. Accordingly, it proposes to reduce the AI impact for the following two items:

1. Mutual Funds Payable Offset by Fails to Deliver

When a broker-dealer owes money to a mutual fund in connection with a purchase of shares of the fund that is offset by a receivable from another broker-dealer (fail to deliver) related to that transaction, the commission is proposing a change. Rather than the entire amount of the liability being subject to the 6 2/3 percent charge as is the case under the current rule, the commission is proposing that the AI requirement be only one percent of the liability amount.

2. Stock Loan and Stock Borrowed

Currently, when a broker-dealer borrows stock for money and in turn lends out those securities for money to another broker-dealer, no offset is permitted, and the entire payable amount is included in aggregate indebtedness and subject to the 6 2/3 percent calculation. The release notes that given ". . . the matched nature of those related payables and receivables, the commission does not believe that risk merits a charge of 6 2/3 percent on the dollar amount of the liability." Accordingly, the commission is proposing that when a security loan liability is related to a corresponding security borrowed asset, the AI requirement is only one percent of the liability amount.

C. Contractual Charges

With the increase in the capital requirements, the commission proposes to permit the use of that additional capital to offset the initial haircut related to a firm-commitment underwriting or any subsequent contractual commitment haircuts on positions associated with that underwriting. The proposed amendment would not require a broker-dealer that meets this $250,000 minimum to apply the contractual commitment haircut charge in certain circumstances in which that haircut would be $150,000 or less. The current open contractual commitment charge of 30 percent haircuts for securities not listed for trading on a national securities exchange or not designated as NASDAQ National Market will remain unchanged.

NASD members that wish to comment on the proposed rule change should do so by December

18, 1989. Comment letters in triplicate should be sent to:

Johnathan G. Katz,
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549

Comment letters should refer to File No. S7-28-89. All comment letters received will be made available for public inspection and copying in the commission's Public Reference Room, 450 Fifth Street, NW, Washington, DC 20549.

Members are requested to send copies of their comment letters to:

Lynn Nellius, Corporate Secretary
National Association of
Securities Dealers, Inc.
1735 K Street, NW
Washington, DC 20006-1506

Questions concerning this notice may be directed to Walter Robertson, NASD Associate Director, Financial Responsibility, at (202) 728-8236 or Samuel Luque, Associate Director, Financial Responsibility at (202) 728-8472.

Proposed Rules

Federal Register
Vol. 54, No. 189
Monday, October 2, 1989

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34-27249; File No. S7-28-89]

RIN 3235-AD79

Net Capital Rule

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule amendments.

SUMMARY: The Securities and Exchange Commission proposes to amend its net capital rule under the Securities Exchange Act. The proposal would raise the absolute minimum net capital required of certain registered broker-dealers. Broker-dealers that hold customer funds or securities would 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 would need to maintain at least $100,000. Broker-dealers that introduce customer accounts would be required to maintain $50,000 or $100,000, depending on whether they occasionally or routinely receive customer funds and securities. In addition, market makers would be required to maintain greater net capital in proportion to the number of securities in which they make markets. The minimum net capital requirement of certain mutual fund brokers and dealers would also be increased to $25,000. A residual $5,000 minimum requirement would apply to those broker-dealers who do not receive customer funds or securities. This latter class also would include so-called direct participation firms. The raising of minimum capital levels for firms would be implemented over a period of four years. Additionally, deductions for equity securities positions ("haircuts") would be standardized under the proposal. Finally, some changes would be made to the computation of aggregate indebtedness.

DATE: Comments must be received on or before December 18, 1989.

ADDRESSES: Persons wishing to submit written comments should file three copies thereof with Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549. Reference should be made to File No. S7-28-89. Copies of the submission and of all written comments will be available for public inspection at the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549.

FOR FURTHER INFORMATION CONTACT: Michael A. Macchiaroli, (202) 272-2904, Michael P. Jamroz, (202) 272-2372, or David I. A. Abramovitz (202) 272-2398, Division of Market Regulation, 450 Fifth Street, NW., Washington, DC 20549.

SUPPLEMENTAL INFORMATION:

I. Introduction

The primary purpose of the net capital rule (Securities Exchange Act Rule 15c3-1; 17 CFR 240.15c3-1) is to protect customers and creditors of registered broker-dealers from monetary losses and delays that can occur when a registered broker-dealer fails. The rule requires registered broker-dealers to maintain sufficient liquid assets to enable firms that fall below the minimum net capital requirements to liquidate in an orderly fashion without the need for a formal proceeding. In doing so, the rule enhances investor confidence in the financial integrity of securities firms. Similarly, the rule promotes transactions between broker-dealers, lenders, and creditors, on one hand, and the counterparty broker-dealers on the other, because those entities are more likely to consider a broker-dealer credit-worthy if it must comply with a liquidity-based capital adequacy standard. Presently, the net capital rule generally requires a registered broker-dealer's net capital to exceed the greater of $25,000 or 6⅔ percent of its aggregate indebtedness ("aggregate indebtedness method" or "basic method") if the broker-dealer does not elect the alternative method.[1] If it elects the alternative method under paragraph (f), the broker-dealer's net capital must exceed the greater of $100,000 or 2 percent of its aggregate debit items as computed in accordance with the Formula for Determination of Reserve Requirement for Brokers and Dealers contained in Securities Exchange Act Rule 15c3-3.[2]

If the broker-dealer does not carry customer accounts and limits its business to certain specified activities, it need maintain only $5,000, rather than the $25,000 which would otherwise be required under the aggregate indebtedness method.[3] If the broker-dealer makes markets in securities, it must maintain the greater of its requirement under the aggregate indebtedness method or $2,500 for each security priced over $5 in which it makes a market plus $500 for each security priced at $5 or less in which it makes a market.[4] Unless required to do so because of the level of its aggregate indebtedness, regardless of how many securities in which it makes a market, a market maker is not currently required to maintain net capital greater than $100,000 to support its market making activities.

If the broker-dealer elects the alternative method, as opposed to the basic method as noted above, its minimum net capital will be $100,000 rather than $25,000, but it will generally incur smaller haircuts on the market value of its equity securities positions than those broker-dealers that elect the aggregate indebtedness method.[5]

[1] *See* Securities Exchange Act Rule 15c3-1(a); 17 CFR 240.15c3-1(a).

[2] *See* Securities Exchange Act Rule 15c3-3a; 17 CFR 240.15c3-3a.

[3] *See* Securities Exchange Act Rule 15c3-1(a)(2); 17 CFR 240.15c3-1(a)(2).

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

[5] Securities Exchange Act Rule 15c3-1(c)(2)(vi)(J) sets forth the deduction for equity securities positions and other securities positions that are not otherwise specifically provided for in Rule 15c3-1. That deduction is "30 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, there shall be a percentage deduction on such excess equal to 15 percent of the market value of such excess." Securities Exchange Act Rule 15c3-1(f)(3)(ii) sets forth the deduction incurred by broker-dealers that elect the alternative method for securities that would otherwise incur a deduction under subparagraph (c)(2)(vi)(J). Subparagraph (f)(3)(ii) requires the electing broker-dealer to deduct 15 percent of the market value of long positions and 30 percent of the market value of short positions but only to the extent those short positions exceed 25 percent of the long positions.

II. Minimum Net Capital

While the idea of a net capital standard dates back to at least 1934, federal requirements as to a minimum amount of net capital were first introduced in 1965. In that year, principally in response to the Report of the Special Study of Securities Markets ("Special Study"),[6] the Commission's net capital rule was amended to require firms to maintain certain minimum capital amounts.[7]

The Special Study recommended minimum capital requirements as an essential qualification for broker-dealers entering the securities business. It based its recommendation on several factors: First, firms handling customer funds and securities should have sufficient capital so that they are not dependent upon customer assets to make up the principal working capital of the firm. Second, firms should have adequate capital, resources, and equipment so that the securities markets function smoothly and efficiently and market participants have the resulting confidence to carry out business responsibly. Finally, if the liability of a broker-dealer to its customers from violations of state and federal law is to be a deterrent to improper conduct, a firm should be required to maintain a reasonable financial stake in its business.

The Commission is mindful of the argument that increased minimum capital requirements restrict free entry to the broker-dealer business. However, while capital barriers were not initially imposed after the enactment of the Securities Exchange Act, both Congress and the Commission later recognized the need to restrict under-capitalized firms from entry into the securities business. In the 1971 Committee Staff Study for a Special Subcommittee of the House Committee on Interstate and Foreign Commerce, Congress suggested that attention be directed to the need to increase the minimum net capital requirements of broker-dealers, "particularly those just entering the securities industry." [8] In 1971, the Commission issued its Study of Unsafe and Unsound Practices ("Practices Study") [9] in response to the paperwork crisis of the late 1960's, in which many firms experienced debilitating back-office failures due to the then heavy volume of securities transactions. In the Practices Study, the Commission specifically addressed the issue of ease of entry. Appendix F to the Practices Study contained a description of actions taken by the Commission against certain broker-dealers. In that Appendix, the Commission noted that the principals of many of those firms, which were able to remain in business for periods ranging from only eight months to three years and eight months, had little or no background in the securities industry. The previous activities of some included such unlikely fields as advertising, insurance, automobile financing, personnel relations, engineering, and selling soft drinks.[10]

The Commission was concerned then, as it is today, that undercapitalized new entrants to the business would cause harm to customers and potentially be a financial drain on the insurance-type fund maintained by the Securities Investor Protection Corporation ("SIPC"). SIPC, through the Commission, may draw up to $1 billion on the U.S. Treasury.[11] The Practices Study concluded that:

> [t]o permit unprepared, irresponsible parties to enter the broker-dealer business without the restraining influence of adequate entry standards would be tantamount to the subsidization of incompetent and irresponsible individuals by SIPC and the United States Treasury.[12]

In response, the Commission adopted the current $25,000 net capital minimum requirement for broker-dealers transacting a general securities business.[13] The absolute minimum capital requirements of $5,000, $25,000 and $100,000 have remained since the Uniform Net Capital Rule was adopted over fourteen years ago.[14] Both the relative value of the dollar and the nature of the securities industry have changed markedly since that time. Indeed, the dollar is now worth less than 50 percent of its 1976 value, making these minimum requirements less than half of what they were in absolute terms.[15] The complexity of markets and the activities that broker-dealers are engaged in also have dramatically increased in the last decade. Proprietary trading by both institutions and by the broker-dealers themselves has greatly expanded. The penny stock markets have become much more active.

Broker-dealers have also expanded the variety of their activities. The last fifteen years have seen firms engaging in not only a greater volume of transactions but in transactions involving more complex products, such as interest rate swaps, foreign currencies, mortgages, mortgage-backed securities, and over-the-counter ("OTC") options. The holdings of customer funds and securities also have increased greatly over the years; the Commission estimates that this figure has risen perhaps as much as ten-fold since the early 1970s. Finally, while the Commission notes that on a statistical basis price volatility has been relatively low in the last year, during the period from October 1988 through April 1989 there were 73 separate days in which the Standard and Poor's 500 Stock Index experienced intra-day price movements of more than two percent.

The business of buying and selling securities, moreover, is one in which success, both to the firms and to the investing public, is strongly dependent upon confidence, continuity, and commitment. The Commission is concerned over the potential effects of broker-dealer firm failures on their counterparties, clearing agencies, and

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[6] *See* Report of Special Study of Securities Markets of the Securities and Exchange Commission, 88th Cong., 1st Sess., H.R. No. 95, April 3, 1963.

[7] *See* note 14, *infra*.

[8] Review of SEC Records of the Demise of Selected Broker-Dealers, Staff Study for the Special Subcommittee on Investigations of the Committee on Interstate and Foreign Commerce, House of Representatives, 92nd Cong., 1st Sess., pg. 33 (July 1971).

[9] Study of Unsafe and Unsound Practices of Brokers and Dealers, Report and Recommendations of the Securities and Exchange Commission. H.R. Doc. No. 231, 92d Cong., 1st Sess. 13 (1971).

[10] *See* Practices Study at p. 164.

[11] Under the Securities Investor Protection Act of 1970 ("SIPA"), SIPC maintains a fund consisting primarily of assessments received from its member broker-dealers. From that fund SIPC makes advances to customers, as defined in SIPA, of failed broker-dealers. In the event the SIPC fund should prove inadequate, SIPC may, through the Commission, borrow up to $1 billion from the U.S. Government. *See* Securities Investor Protection Act of 1970, Sec. 4(h).

[12] *Id.*

[13] Securities Exchange Act Release No. 9633, June 14, 1972, (37 FR 11970, June 16, 1972).

[14] The absolute minimum of $25,000 under the basic method was adopted in 1972 (*See* footnote 12). The $100,000 absolute minimum under the alternative method was adopted in 1975 (Securities Exchange Act Release No. 11497 (June 26, 1975), 40 FR 29795, (July 26, 1975)). The $5,000 minimum currently applicable to most broker-dealers that do not hold customer funds and securities was adopted in 1965. At that time, the $5,000 minimum was applicable to all broker-dealers except those that limited their activities to transactions in shares of registered investment companies and federally insured savings and loan associations. (*See* Securities Exchange Act Release No. 7611, May 26, 1965, 30 FR 7276, June 2, 1965.)

[15] The Consumer Price Index (CPI) in February 1976 was an adjusted 55.8 (based on a 1982–84 base year) and 121.6 in February 1989. This is an increase of 117.9 percent. *See* Department of Labor, Bureau of Labor Statistics, CPI. The Commission requests comment on whether the minimum net capital requirements should be regularly adjusted to take into account the effect of inflation. In this connection, should capital levels in the future automatically be adjusted or indexed to the rate of inflation? Commentators favoring indexing of minimum capital requirements should also indicate what measure they believe should be used by the Commission to index capital requirements and how often they believe adjustments based on the rate of inflation should be made.

the financial system in general. Given the increasingly large customer and proprietary positions maintained by even relatively small broker-dealers, the potential exists for a single firm failure to trigger substantial exposure to a number of broker-dealers and banks. The risks of such a chain reaction underline the importance of minimum capital requirements set at levels which may substantially reduce the likelihood of such failures.

Thus, increasing the minimum capital requirements would ensure that those who do wish to establish a broker-dealer entity do so with that amount of capital necessary to maintain adequately a solvent venture. The increased minimum capital requirement would encourage potential entrants to exhibit a serious commitment to a business whose customer and capital nature demands such a commitment. Most importantly, as discussed earlier, raising minimum capital requirements would protect the investing public and the SIPC fund by requiring a greater pool of liquid assets from which customer claims may be satisfied.

The Commission's most serious concern is with the current amount of capital required of clearing firms. As discussed more fully below, firms with capital of only $25,000 can clear for a number of other securities firms and can hold customer funds and securities amounting to millions of dollars. When such firms experience financial difficulty, there are significant costs imposed on customers and on regulators (which ultimately are borne by the securities industry or by taxpayers) even if the firms do not ultimately have to be liquidated under SIPA. Customers can be frozen in their positions for weeks or months and administrative costs to monitor troubled firms and/or to administer liquidations can be high. The Commission believes that the potential costs to investors, to the SIPC fund, and to the self-regulatory organizations, in the event firms self-liquidate with a very limited cash cushion are inappropriately high when weighed against the potential costs to broker-dealers of increased minimum net capital requirements.

Furthermore, the Commission's proposal to raise the minimum capital requirements of broker-dealers has drawn preliminary support from some of the self-regulatory organizations responsible for monitoring the activities of those firms and from one industry association. The National Association of Securities Dealers' ("NASD's") Capital and Margin Committee and the NASD's Advisory Council have expressed their belief that adopting higher minimum capital standards is a matter of some urgency.[16] Furthermore, both the Securities Industry Association ("SIA")[17] and the New York Stock Exchange ("NYSE")[18] had previously endorsed the reconsideration and the increasing of the minimum net capital requirements.

A. *Clearing Firms*—For purposes of Rule 15c3–1, a clearing firm is a broker-dealer that takes orders from customers, processes their trades and maintains custody of customer funds and securities. Clearing firms are frequently engaged in other lines of business such as securities lending, proprietary trading, and futures trading. A firm may also process trades and maintain custody of funds and securities of investors who give their orders to introducing firms. The clearing firm's duties, as outlined in the clearing agreement, include the proper disposition of the customer monies and securities after trade date, the holding of customer securities and funds as appropriate, and the handling of the paperwork associated with carrying customer accounts. These services involve such high fixed costs that, if they were incurred by the typical introducing firm, it would be prohibitively expensive for such a firm to enter the securities business. Such costs include the computer costs necessary to generate various customer statements and account records, as well as the personnel costs of maintaining back-office operations such as cashiering and margin departments. For its services, the clearing firm usually charges the introducing broker-dealer a fee based on a percentage of the retail securities commission revenue received by the introducing firm.

If a broker-dealer carrying customer funds and securities fails, there is potential for significant harm to be suffered by its customers. Furthermore, the risks that clearing firms, particularly those with small amounts of capital, pose to customer accounts can be greatly exacerbated by the fact that there are no limits on the amount of customer funds and securities that can be held.

SIPC's experience with liquidations demonstrates this latter point. In many cases, the SIPC trustee has had to use SIPC advances[19] at least in part to pay off customers' claims of securities and cash in amounts many times in excess of the firm's required net capital. For example, in one case, in which the firm's required net capital before it failed was only $119,000, the SIPC trustee paid out to customers from SIPC advances over $6,000,000 and from the debtor's estate over $25,000,000 in customer funds and securities. In another case, in which the firm's required net capital was less than $120,000, the SIPC trustee paid out to customers almost $14,000,000 in cash and securities; more than half this amount was paid out of SIPC advances.

These SIPC liquidations reflect common risk exposures of many operating clearing firms. At the request of the Commission staff, the NASD randomly sampled NASD clearing firms having capital of less than $130,000. Of the 84 firms in this sample, 21 were found to be holding more than $1 million in securities. The Commission believes that SIPC liquidation experience and the random sampling demonstrate that a significant percentage of broker-dealers that clear and carry funds and securities and that do not maintain significant excess net capital control substantial customer assets that are potentially at risk.

In order to evaluate the risks entailed in maintaining those low minimum capital requirements, the Commission also has evaluated instances of liquidations which did not require intervention by SIPC. While there were only eight SIPC liquidations in 1987 and 1988,[20] there were more than twice as many self-liquidations under the auspices of the NASD Washington headquarters staff. In 1987 and 1988, there were 18 such self-liquidations in which the NASD oversaw the distribution of over $250,000,000 in customer property involving relatively undercapitalized firms. These cases provide examples of potential exposure to the SIPC fund. Of the many cases of firm self-liquidation that the NASD has had to supervise because of lack of substantial net capital, two are

[16] *See* Letter from John E. Pinto, Executive Vice President, Compliance, NASD, to Michael Macchiaroli, Assistant Director, Division of Market Regulation, SEC, dated May 31, 1989.

[17] *See* Comment letter to John Wheeler, Secretary, SEC, from Michael Minikes, Chairman, Capital Committee, SIA, dated July 26, 1985, concerning Concept Release, File No. S7–3–85, p. 8.

[18] *See* Comment letter to John Wheeler, Secretary, SEC, dated July 31, 1985, from James Buck, Secretary, NYSE, concerning Concept Release, File No. S7–3–85, pp. 3–4.

[19] Under Section 9 of SIPA, SIPC makes advances to customers of a broker-dealer that is the subject of a SIPC proceeding. SIPC makes those advances from the SIPC fund. The SIPC fund had been established through assessment of SIPC member broker-dealers. (*See* Section 4 of SIPA).

[20] In this regard, the number of SIPC customer protection proceedings commenced in 1987 and 1988 is the lowest for any two-year period in SIPC's history. And the SIPC fund is at its highest level ever. *See* SIPC Annual Report 1988. P3.

particularly noteworthy. One firm held $70 million of customer securities, although it had only $61,000 of net capital. The other firm held $8 million of customer securities and only $42,000 of net capital. Fortunately, because the NASD was aware of the problems suffered by the above firms before they failed, the NASD was able to have the firms move customer accounts to other clearing firms and thereby avoid SIPC liquidations.

When the NASD monitors a firm self-liquidation, it commits from two to 25 of its staff personnel to the process of supervising the firm. In addition to the NASD personnel, employees of the firm being liquidated are retained in order to do the work associated with transferring the accounts. Those employees, along with the costs associated with maintaining the premises, and transferring and shipping securities, must be paid from whatever capital remains in the broker-dealer. Self-liquidations may take from three weeks to several months, depending on the condition of the records of the broker-dealer and whether the NASD is readily able to locate other broker-dealers willing to take the customer accounts.

Self-liquidation costs to the self-regulatory authorities are difficult to measure since most of the incremental expenses other than employees' compensation time is mainly for per diem expenses of employees on travel status and for telecommunication expenses. On average, however, the NASD has advised the Commission staff that even the smallest liquidation requires two to three NASD employees on premises for a minimum of two weeks. The largest recent liquidation required a staff of about 25 NASD employees for about 10 weeks on premises, with fewer people thereafter. The recorded average cost for the NASD including salaries is about $2,000 per week per employee.

Beyond administrative costs, customers are usually unable to access their accounts when their broker-dealer is placed in a SIPC liquidation or a self-liquidation. Although every attempt is made to transfer accounts to a solvent broker as rapidly as possible, that goal is not always achievable, either because of the type of accounts, the poor condition of the broker-dealer's records, or the lack of adequate margin in customer accounts.

While requiring additional amounts of net capital to be maintained will not prevent firms from failing or otherwise leaving the securities business, the additional capital provides a fund from which the expenses associated with the liquidation can be paid. If that fund is not adequate, either the NASD or SIPC must fund the administration of the liquidation. If the remaining capital in the firm is low and the NASD supervises the liquidation, the NASD will not have the means to pay the employees of the broker-dealer to perform the clerical tasks associated with the distribution of property to customers. Accordingly, the NASD would have to use its own employees to perform these tasks and would incur substantial additional expenses. If the amount of remaining capital is small and the amount of customer property to be distributed is very large, SIPC would likely have to administer the liquidation. The initiation of a SIPC proceeding would result in increased administrative expenses.

More importantly, customers are adversely impacted from a SIPC liquidation because their funds and securities remain frozen until their property can be transferred to another broker-dealer or returned to them. Finally, to the extent their claims exceed their pro rata share of customer property, customers must rely on SIPC advances. Section 4 of SIPA limits SIPC advances to satisfy the claims of each customer up to a maximum of $500,000 for cash and securities, with a limit of $100,000 for cash claims.

Failures of clearing firms also present risk to the system as a whole by putting a financial strain on clearing agencies. Clearing agencies or corporations act as the central location for matching security transactions of members. This facilitates determination of minimum quantities of particular securities to be received or delivered. Generally, the clearing corporation nets each broker-dealer's settling purchases and sales in each security to arrive at a daily net settlement obligation for each broker-dealer. Broker-dealers then settle those net obligations with the clearing corporation. The clearing corporation guarantees the settlement obligations of each broker-dealer's counter trading party.

Losses to clearing firms from market disruptions such as the October market break can have the serious effect of causing losses to the related clearing corporations. While a single clearing firm failure probably would not put the entire system at risk, a combination of such failures could conceivably bring down a clearing system. If a clearing agency itself were to fail, the risk of a precipitous disaster to other financial service entities would be enormous.

Based on these observations, the Commission preliminarily has concluded that broker-dealers who are responsible for customer funds and securities impose substantial actual and potential risks on customers, other broker-dealers and the financial system and therefore should have a required minimum net capital higher than other classes of broker-dealers covered under the Rule. The amount of capital these customer firms maintain demonstrates their level of commitment to the business. Accordingly, the Commission believes that the minimum level of net capital for this class of broker-dealers should be raised to $250,000.

Because of the increased assurance of stability which would be provided by the proposed minimum capital level, the Commission proposes that the haircut associated with positions in firm commitment underwritings, or the contractual commitment haircut, be relaxed for a portion of a firm's increased capital requirement.[21] The proposed amendment would not require a broker-dealer who meets the $250,000 minimum to apply the contractual commitment haircut charge in certain circumstances in which that haircut would be $150,000 or less.

In addition, because the Commission believes that capital requirements should be based largely on the risks created by firms in their securities activities, the Commission believes that it is appropriate to distinguish between those firms that hold funds and securities for other persons and those that do not hold funds or securities yet carry customer accounts. Because firms that do not hold funds and securities impose a lower level of risk, the Commission believes that lower minimum requirements for such firms are justified. The Commission therefore proposes for comment a minimum capital requirement of $100,000 for firms that are exempt from Rule 15c3-3 by virtue of paragraph (k)(2)(i). Firms that fall within the paragraph (k)(2)(i) exemption must effectuate all customer securities transactions through a Special Bank Account for the Exclusive Benefit of Customers. Such broker-dealers cannot carry margin accounts, must promptly forward all customer funds and deliver all securities received in connection with their activities as broker-dealers and cannot otherwise hold for, or owe money or securities to, customers.

[21] A contractual commitment haircut is a percentage deduction from net worth which must be taken by a broker-dealer that has open contractual commitments. Currently, the net capital rule requires that the appropriate haircut be applied to these positions reduced by any unrealized profits that the broker-dealer may have in these commitments. *See* Rule 15c3-1(c)(2)(viii) (17 CFR 240.15c3-1(c)(2)(viii)).

B. *Introducing Firms*—An introducing broker-dealer is one that has a contractual arrangement with another firm, the carrying or clearing firm, in which the carrying firm agrees to perform certain services for the introducing firm. Generally, the introducing firm submits its customer accounts and customer orders to the carrying firm, which executes the orders and carries the accounts. The carrying firm's duties include the proper disposition of the customer monies and securities after trade date, the holding of customer securities and funds and the recordkeeping associated with carrying customer accounts.

The Commission believes that introducing firms create risks for investors, clearing firms, and other firms with which they deal, and thus that there is ample justification for an increase in their minimum capital requirements. Even though the failure of an introducing firm does not normally result in a SIPC liquidation, it may result in substantial costs to the firms that carry the customer accounts for the introducing firm. In addition, customers may be unable to trade for some period of time until they can find another introducing or clearing firm to which they can transfer their accounts. Finally, because many introducing firms do in fact handle customer funds and securities for short periods of time, there is SIPC exposure from their activities. As a result, the Commission believes that increased minimums for introducing firms are risk-justified.

As the Market Break Report pointed out,[22] introducing broker-dealers pose risks to the investing public as well as to other broker-dealers. First, those broker-dealers do, in fact, receive customer funds and securities, although the funds and securities must be promptly forwarded to firms that carry the customer accounts.

There is an obvious risk for the customer if the introducing firm fails while in possession of customer funds and securities. There have been several recent cases where an introducing firm failed and, because the firm was declared to have "customers" under SIPA, there was exposure and payout for the SIPC fund. Such "customers" are created, as mentioned above, when the introducing firm does not promptly forward the customer funds to the clearing firm and the introducing firm fails.

Second, if an introducing firm fails, or even ceases doing business temporarily, its customers are often stranded. The carrying firms associated with introducing firms often will not accept orders from customers because the carrying firm may regard the customers as those of the introducing firm. As a result, customers may be unable to liquidate securities positions or open new positions with the proceeds of sales until their accounts are transferred to other broker-dealers.

Finally, introducing broker-dealers can cause significant losses to carrying firms, exposing the customers and creditors of those firms to loss. During periods of market decline, customer accounts may become unsecured due to a precipitous drop in the value of the securities in margin accounts or because of changes in value of customer short options positions. If the account has been introduced, the introducing firm generally is obligated to the carrying firm for deficits in the introduced customer accounts. If the introducing broker-dealer does not have adequate resources to reimburse the carrying firm, the carrying firm may suffer significant losses.[23]

Because of the loss exposure from introducing firms, many clearing firms will not clear for introducing firms without substantial capital or substantial deposits, which serve as collateral for unsecured customer debits.[24] At the request of the Commission staff, the NASD conducted an informal survey of the firms that clear introduced accounts. The NASD survey indicates that the practices varied greatly among the clearing firms that were contacted. For example, the following arrangements for introducing firms were included in the surveyed clearing arrangements: A requirement of $150,000 minimum net capital and a deposit if the firm has trading accounts; minimum deposit of $5,000, but could go as high as $300,000 for market makers; clearing deposits between $50,000 and $100,000 determined by credit committee; a requirement of 110 percent of the introducing firms' highest inventory position.

The Commission believes that, while the NASD survey is informal and includes only a small number of clearing firms, it demonstrates that many firms have imposed capital and deposit requirements to protect themselves from the risk of failure of undercapitalized introducing firms. At the same time, because the standards are not uniform, weaknesses in the system tend to develop. Assuming that clearing firms that are more risk conscious require their introducing firms to maintain the greatest amount of capital, clearing firms that are not as sensitive to risk will tend to have a higher concentration of introducing firms that are poorly capitalized and engaging in riskier activities.

Accordingly, the Commission proposes to raise the minimum capital requirement for introducing firms based upon the activities that they engage in and the commensurate risks created. Thus, three classes of introducing firms would be created under the proposed amendments. Some introducing broker-dealers now routinely receive customer funds and securities for transmittal to the clearing firm. Those firms are responsible for the funds and securities until received by the clearing firm. Under the proposal, this class of introducing firm would be required to maintain net capital of at least $100,000. Introducing firms that occasionally receive customers' funds and securities would be required to maintain at least $50,000. This covers instances of customers inappropriately sending funds or securities to the introducing firm.

While the Commission preliminarily believes that the net capital minimums

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[22] *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"). Approximately 55 firms that introduced customer transactions on a fully disclosed basis to a clearing broker-dealer ceased operations because of violations of the net capital rule caused by losses directly related to the October 1987 market break. Most of the losses resulted from defaults by customers that failed to make payment to the clearing broker-dealers for which the introducing broker-dealers were contractually liable. At least eleven of the fifty-five introducing firms made markets in OTC securities.

The losses sustained by these firms were a result of unsecured customer debits for which they were contractually liable and declines in the market value of proprietary inventory. Three of the 55 firms also suffered substantial trading losses related to their options market making business. *See* p. 5–9 of the Report.

Approximately forty percent of the introducing firms that ceased operations re-opened within a week after they closed. A number of firms forced to close because of unsecured customer debits were able to increase the r net capital and therefore re-open by entering into subordination agreements with their clearing brokers. The remaining firms were able to acquire additional capital sufficient to bring them into compliance with the Commission's rules.

[23] During the October 1987 market break, Haas Securities Corporation, a market maker in 11 securities and a member of the NYSE, ceased operations. Haas introduced customer transactions on a fully disclosed basis to L.F. Rothschild. As a result of unsecured customer accounts introduced by Haas, Rothschild incurred a reduction in net capital of between $15 and $20 million. *See* Market Break Report pg. 5–11.

[24] Under the net capital rule, a bona fide clearing deposit made by an introducing firm with a clearing firm is treated as asset readily convertible into cash and therefore part of the net capital of the introducing firm. *See* Rule 15c3–1(c)(2)(iv)(E).

should be increased substantially to reflect the risks entailed in the operation of many introducing broker-dealers, it is also cognizant of the importance of providing relatively free access to the securities industry when firms do not pose risks to their customers or the SIPC fund. Accordingly, introducing firms that never receive customer funds or securities and do not handle margin accounts would be allowed to remain in the $5,000 minimum net capital category. In order to avoid classification as a $50,000 broker-dealer, introducing broker-dealers who wish to remain in the $5,000 category would need to take the utmost care in advising their customers not to send funds or securities to the introducing firm. In addition to the requirement imposed on such introducing firms under the basic method, they would be required to maintain additional net capital of ¼ percent of the customer debit balances that they introduce.

Finally, the Commission proposes to increase the ability of introducing firms to participate in firm commitment underwritings. Under the current rule, broker-dealers that compute under the minimum required of introducing broker-dealers are prohibited from engaging in firm commitment underwritings. In light of the proposed higher minimum levels, introducing broker-dealers would be allowed to participate in firm commitment underwritings as long as they are only the selling dealer and not the statutory underwriter.[25]

The Commission requests comment on its proposed classes of introducing firms and the minimum levels associated with each class. Furthermore, the Commission requests comment regarding practices of firms that clear introduced accounts for setting financial responsibility standards for introducing firms. Specifically, the Commission requests comment on the effectiveness of standard-setting by the industry and whether higher minimum capital requirements are necessary.

C. *Over-the-Counter Market Makers*—In its Market Break Report, the Division of Market Regulation expressed its belief that the minimum amount of capital necessary for a broker-dealer to qualify as a market maker should be reviewed.[26] The Commission is also concerned about the limited amount of net capital the rule presently requires of a market maker. The market maker who maintains only the minimum amount of net capital required frequently is unable to assume even the smallest number of positions in the stocks in which it reportedly makes a market. Moreover, to the extent its net capital falls below the minimum amount required, such a firm is compelled to withdraw as market maker in at least some of its market making securities, an action which could impair the market in those securities. This has been a particular problem in the penny stock market, in which the failure of market making firms has resulted in the virtual elimination of a public market for many of the securities for which they made public markets. A sound marketplace requires that OTC market makers have the wherewithal to take positions in those securities in which they make markets.

The NASD has recommended that the capital requirements of certain market makers be increased. The NASD has recently approved rule amendments to its Small Order Execution System ("SOES") which require not only mandatory participation in the SOES for all market makers in certain securities, but also different maximum SOES order-size limits based upon the market characteristics of the securities.[27] Under mandatory SOES participation, market makers will be required to accept small orders received through the SOES system. Accordingly, the NASD Quality of Markets Committee has recommended that the Commission require an increase in capital to at least the amount required to support mandatory SOES positions.[28]

In response to the concerns noted above, the Commission proposes for comment two separate amendments. The first would increase the present ceiling of $100,000 net capital required of market makers to $1,000,000. The second would raise the requirement for each security priced at $5.00 or less per share to $1,000 from $500. Thus, for example, a firm making markets in 100 securities priced in excess of $5 and 50 securities priced below $5 would have a minimum net capital requirement of $300,000.

D. *Broker-Dealers That Transact a Business in Mutual Fund Shares*—The proposed amendments would also alter the capital requirements for broker-dealers that limit their activities to transactions in shares of registered investment companies. Currently, the minimum net capital requirement for this type of broker-dealer is the greater of $2,500 or 6⅔ percent of their aggregate indebtedness. This minimum requirement seems inappropriately low, however, considering that these firms receive money from customers and may also transact business directly with issuers. The Commission thus proposes for comment that the basic minimum requirement for mutual fund broker-dealers be raised to $25,000. However, for those mutual fund firms which do not handle any customer funds or securities and are not direct wire order firms, the Commission proposes a $5,000 minimum net capital requirement.

E. *Broker-dealers Who Trade Solely for Their Own Accounts*—Firms that trade solely for their own accounts ("trading firms") are currently required to maintain net capital of the greater of 6⅔ percent of their aggregate indebtedness or $25,000 under the basic method, or $100,000 under the alternative method. The Commission believes these firms should not be permitted to continue to compute under the alternative method.

The theory underlying the alternative method of calculating net capital is that, for large firms, customer debits will provide an approximate proxy of the amount of business and exposure of the firm. Because proprietary firms have no customer accounts, the alternative method does not limit leverage for those firms. This means that a firm with the $100,000 minimum capital required under the alternative method could have very large aggregate indebtedness and therefore very substantial leverage in its business, thereby increasing its assets substantially in relation to its net worth, without restriction except for the haircuts on its positions.

Yet, proprietary trading activities obviously are risky, and leverage exacerbates that risk. As pointed out in the October Market Break Report, several risk arbitrage firms lost an average of 41 percent of their combined net worth during the market break.[29] Moreover, such firms often have positions concentrated in a few stocks and may suffer substantial losses from arbitrage positions in a hostile takeover battle. Furthermore, the trading firms' business involves substantial risk to the extent that it consists of investing in large risk arbitrage or speculative positions with less diversification than that usually undertaken by larger firms.

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[25] In a firm commitment underwriting, the underwriters agree to buy the entire issue of a security from the issuing corporation at a specified price. The current net capital rule allows introducing broker-dealers to participate in underwritings only on a "best efforts" or "all or nothing" basis. The Commission proposes that as long as the firm is only a selling dealer, i.e., purchases the issue from the statutory underwriter and not the issuer in order to sell, it can participate in firm commitment underwritings.

[26] *See* Market Break Report at p. 5–15.

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

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

[29] *See* Market Break Report at p. 5–7.

While these firms do not deal directly with customers, they do expose other broker-dealers, clearing entities, and creditors to substantial risk.

The Commission believes that failure of a proprietary firm with the relatively small cushion provided by the alternative method could impose financial risk on those contra parties and, in turn, their customers. Accordingly, the Commission proposes for comment that trading firms no longer be permitted to elect the alternative method. The Commission further proposes for comment that the minimum net capital requirement for those firms be raised to $100,000. As a consequence of these proposed amendments, most of those firms would be required to increase their capital by the difference between their current $100,000 minimum and 6⅔ percent of their aggregate indebtedness.

F. *All Other Broker-Dealers*—As noted above, the Commission has preliminarily determined to maintain a $5,000 category for introducing brokers and dealers who do not handle customer funds or securities. In addition, under the current rule, broker-dealers that participate in underwritings on a "best efforts" basis and who promptly forward all customer funds to the issuer or a designated independent escrow agent, are required to maintain minimum capital of only $5,000. This firm category should include primarily firms that sell direct participation programs ("DPP") in real estate syndications. Because of the limited business conducted by DPP firms, the Commission is making no specific proposal for change in the minimum capital requirements. However, the proposed amendments would provide that any firm that maintains only the $5,000 level of capital would be prohibited from receiving customer funds or securities. If they do so, they would immediately be required to maintain the next higher level. The Commission believes that this new requirement would help to protect investors from having their cash and securities exposed while being handled by a broker-dealer with very limited capital. The Commission requests comments as to whether it is appropriate to permit best efforts underwriting firms to remain in the $5,000 residual category.

Finally, some firms do not take customer orders, hold customer funds or securities, or execute customer trades, yet register with the Commission because of the nature of their activities. An example of such a broker-dealer is a firm that identifies and locates potential merger or acquisition opportunities on behalf of a client, and thereby earns a percentage fee. For these miscellaneous types of broker-dealers, the Commission also proposes a $5,000 minimum net capital requirement.

For most firms that would be included in this category, this will not represent an increase in the required minimum net capital.[30] Some mutual fund dealers that would fall into this category will go to a $5,000 requirement from a $2,500 requirement under the existing rule. Like the DPP firms, however, the Commission proposes that these firms be prohibited from having any contact with customer funds or securities. In addition, other firms, such as floor brokers, which may avail themselves presently of the $5,000 requirement, will continue to be able to comply with that requirement.

G. *Phase-In Schedule*—Because of the impact of the increased minimum capital requirements on some broker-dealers, the Commission proposes 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. Thus, for example, if the increase was from $25,000 to $250,000, the minimum requirement one year after the effective date would be $81,250 (($225,000 × .25) + $25,000). The proposed timing of the increases is summarized below:

i. *Firms That Hold Customer Funds or Securities (Aggregate Indebtedness Method)*
  a. Current rule: $25,000
  b. By 12/31/90: $81,250
  c. By 12/31/91: $137,500
  d. By 12/31/92: $193,750
  e. By 12/31/93: $250,000

ii. *Firms That Hold Customer Funds or Securities (Alternative Method)*
  a. Current Rule: $100,000
  b. By 12/31/90: $137,500
  c. By 12/31/91: $175,000
  d. By 12/31/92: $212,500
  e. By 12/31/93: $250,000

iii. *Clearing Firms That Do Not Hold Customer Funds or Securities*
  a. Current Rule: $25,000
  b. By 12/31/90: $43,750
  c. By 12/31/91: $62,500
  d. By 12/31/92: $81,250
  e. By 12/31/93: $100,000

[30] To qualify presently for a $5,000 minimum net capital requirement under paragraph (a)(2) of Rule 15c3-1, in addition to not carrying customer accounts, the broker-dealer must limit itself to certain specified activities in paragraph (a)(2). The Division has issued no-action positions that make the $5,000 minimum requirement available to certain firms that do not handle customer funds or securities, but engage in activities not specified in paragraph (a)(2).

iv. *Introducing Firms That Routinely Receive Customer Funds or Securities*
  a. Current rule: $25,000
  b. By 12/31/90: $43,750
  c. By 12/31/91: $62,500
  d. By 12/31/92: $81,250
  e. By 12/31/93: $100,000

v. *Introducing Firms That Do Not Routinely Receive Customer Funds or Securities*
  a. Current rule: $5,000
  b. By 12/31/90: $16,250
  c. By 12/31/91: $27,500
  d. By 12/31/92: $38,750
  e. By 12/31/93: $50,000

vi. *Mutual Fund Dealers That Routinely Receive Customer Funds*
  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

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 Commission 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, given the size of some of the increases in minimums proposed, the Commission is interested in permitting, to the extent practicable, a smooth transition with minimal disruption for both firms and customers.

H. *Request for Comment*—The Commission requests comment on the minimum capital requirements set forth in the proposed amendments to the rule. In this connection, the Commission recognizes that the determination of the appropriate levels of minimum net capital necessarily requires consideration of the benefits of higher standards, as well as the impact of those standards on broker-dealers. In arriving at the proposed new minimum net capital requirements, the Commission, on the basis of available data and its regulatory experience, has attempted to balance the cost of raising additional capital (and the effect on those that will not be able to raise it) against the above described benefits of a prudent financial responsibility standard. The Commission, nevertheless, requests comment on alternative methods that might be used to establish minimum net capital requirements. More specifically, the Commission asks if a minimum absolute dollar amount requirement could be based on quantifiable measures of risk.

As discussed, the Commission is concerned with the large dollar amounts of customer fully-paid securities in the possession of broker-dealers with minimum capital. Some broker-dealers have access to several million dollars of fully-paid customer securities, but are required to maintain only $25,000 in net capital. This financial commitment does not appear commensurate with the resulting risk to SIPC or the investment community. The Commission requests comment as to whether this concern is best addressed by a larger minimum dollar requirement for broker-dealers that carry customer accounts or by requiring broker-dealers that carry customer accounts to regularly determine the dollar amount of customer fully-paid securities they have in their possession and take a charge against these amounts when computing their net capital requirement. The Commission also seeks comment regarding whether some combination of the above would be appropriate. Finally, the Commission requests comment as to whether it would be appropriate to have a smaller minimum dollar requirement (for example $100,000) for carrying firms that take a capital charge against customer fully-paid securities in their possession, and a larger minimum dollar requirement (for example $250,000) for firms that chose not to.

The Commission also requests comment on the costs imposed by the proposed amendments. While a precise estimate of the costs of the proposals is difficult, a rough estimate can be made based on the relative cost of capital. Persons who enter the broker-dealer business generally do so through partnerships or through corporations. In either case, the individual or individuals who establish the firm can deposit into the entity assets they have or cash they have borrowed. These assets are deemed to be capital of the broker-dealer. Indeed, as has happened before, a person may borrow $5,000 on a credit card and deposit the money as capital into a broker-dealer corporation and thus be in compliance with the net capital rule requirements for a $5,000 broker-dealer. In addition, a broker-dealer may, under the net capital rule, count as net capital monies borrowed from another person if subordinated in conformity with the net capital rule requirements.[31]

Once in the broker-dealer corporation, the funds 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. The Commission estimates the difference between the lending rate and the rate the broker-dealer could earn on the above investments to be approximately three to four percent annually before taxes. Assuming a $45,000 borrowing for an introducing firm which only occasionally receives customer funds and securities (and thereby would qualify for the proposed $50,000 introducing level), the cost of the additional capital (assuming a net cost of 4%) would be only $1,800 per year.

From recent financial filings with the NASD[32] compiled as of March 31, 1989, it was determined that 173 clearing firms would need, on average, an additional $123,000 to comply with the new $250,000 minimum requirement. Using the above assumptions on the cost of capital (a four percent spread), in order to comply with the new minimum net capital requirement, it would cost each of the 173 clearing firms on average approximately $5,000 per year or a total of $850,000. Additionally, of the 763 market maker firms, 63 have required capital of between $100,000 and $1,000,000 and thus may be affected by the new higher ceiling on additional capital required of market makers.

As to introducing firms, NASD data as of the same period does not distinguish between introducing firms that routinely handle funds and securities and those that do not. Assuming that every introducing firm handles customer property on a routine basis, the data indicate that 1428 introducing firms would need, on average, $65,702 each to comply with the new $100,000 minimum capital requirement. The total cost of raising this capital based on a 4 percent cost of capital assumption is $3.8 million or $2,600 per firm. Assuming every introducing firm only occasionally handles customer funds and securities and thus would have a $50,000 minimum requirement, it was determined that 1,063 firms would need to raise an average of $28,555. Making the same cost assumption as discussed above, the cost of raising their capital requirements would be $1.2 million or $1,100 per firm per year.

The Commission acknowledges that broker-dealers may incur costs other than the estimated 4 percent referred to above in obtaining additional capital. For example, if the borrowing is done personally, the owner of the firm will likely be required to encumber personal assets. However, even if the estimated cost of obtaining additional capital were 8 percent, the average annual cost for a clearing firm would be only $10,000. At the 8 percent level, an introducing firm would incur annual costs of either $5,200 or $2,200 per year, depending on the method by which the firm elects to do business.

The Commission preliminarily does not believe that the costs described above will have the effect of barring entry or making unprofitable any group of entrepreneurs who have a serious commitment to developing a brokerage firm. The Commission requests comment, however, on the specific costs to broker-dealers of its proposal. In this connection, the Commission asks for comment as to the amount of net capital in excess of the early warning levels[33] that firms would normally maintain as a business matter. Additionally, commentators are requested to provide information regarding their likely sources for obtaining additional capital, the cost of those funds, and the return on the investment they would likely obtain from the use of those funds.

The Commission also asks if particular firms will change their operations so they can operate under one of the lower minimum net capital categories permitted under the proposals. Commentators are further encouraged to provide information regarding their lines of business and related revenues and the need for the Commission to determine if additional classes of firms should be created to accommodate the needs of smaller broker-dealers.

The Commission also requests comment from those small broker-dealers that elect to carry customer accounts rather than to take advantage of the lower capital requirements that are currently in the rule for introducing firms. The Commission is particularly interested in receiving input from smaller carrying firms regarding the reasons they have elected to remain as carrying firms and be subject to the higher minimum requirements and how their business would be affected if they were to switch to introducing their customers to another firm. The

[31] *See* Appendix D to the net capital rule, Rule 15c3-1d.

[32] Under Securities Exchange Act Rule 17a-5 (17 CFR 240.17a-5), registered broker-dealers are required to file reports containing certain financial and operational information with both their designated examining authority and the Commission. These reports are filed on the Uniform Financial and Operational Combined Uniform Single Report (commonly known as the FOCUS report).

[33] *See* 17 CFR 240.17a-11.

Commission is specifically interested in receiving input from firms regarding the potential impact on revenues and expenses in the event these broker-dealers decided to conform to the limitations imposed under the provisions of the lower capital requirements (such as not handling in any way customer funds and securities).

Finally, the Commission requests comment from those firms that may not be able to raise additional funds. The Commission requests input on whether the alternatives proposed by the Commission with respect to maintaining low levels of minimum net capital are flexible enough to permit those firms to continue to remain in business—even if that means they will have to forego handling funds and securities—or whether those firms will have to cease doing business as registered broker-dealers. For those firms that would cease doing business because of the increase in minimums, the Commission asks what factors would be important in making that decision.

III. Securities Haircuts

A. *Equity Securities*—The current rule requires different levels of deductions as to equity securities and different computations of those deductions depending on the broker-dealer's election of either the basic or alternative methods.[34] Although the nation's equity securities markets experienced an extraordinary surge of volume and price volatility during October 1987, in most circumstances the deductions incurred for those securities appear adequate. However, the distinctions in the haircuts between the alternative and basic methods, given the proposed raising of the minimum requirements, do not seem appropriate.

Haircuts generally are designed to provide a cushion of capital against adverse fluctuations in the prices of securities. The net capital rule haircut has varied over the years. Generally, equity haircuts were settled some 25 years ago at 30 percent of the greater of the long or short position. The lesser position was deemed by the rule to be hedged by the greater position but only to the extent that it did not exceed 25 percent of the greater position. The theory, of course, is since market movements are responsible for a substantial percentage of price movements for individual stocks, diversified long positions (or diversified short positions) will to some degree move in the same direction.

In 1975, the Commission adopted the present rule and a new, alternative method for determining haircuts. In order to facilitate market-making, the Commission determined to allow firms electing the alternative method to take a 15 percent haircut on the long positions. The haircut on the short position, to the extent it exceeded in value 25 percent of the long position, was taken at 30 percent of the market value. Firms electing the alternative, however, were required to have a minimum net capital of $100,000, rather than the $25,000 minimum otherwise required. This additional cushion of capital was deemed necessary in the event the haircuts proved inadequate.

Given the Commission's experience with the haircuts under the alternative method and because the Commission is revisiting its minimum net capital levels generally, the Commission preliminarily believes that the haircuts for equity positions under the aggregate indebtedness method should be lowered. However, haircuts may be appropriately reduced only if the minimum levels of net capital are raised because the value of a particular security could easily move more than the lower haircut. Moreover, generally, except for tender offer situations, a long would seem to be no less volatile or risky than a short position, and thus should not be subject to a different haircut.

Under the proposed amendments, the calculation of haircuts for those under the alternative method and those on the aggregate indebtedness method would be standardized.[35] The haircuts for both long and short positions would be 15 percent of the market value. An additional 15 percent would be assessed on the market value of the lesser position to the extent it exceeded 25 percent of the greater position. The 15 percent deduction for long positions would be available to those firms which have more than $100,000 in net capital. Under the proposed amendments, the alternative method for computing concentration charges would be adopted.

The Commission invites comment on particular methods for determining haircuts on equity securities positions. The Commission further requests comment on whether the use of historical price volatility data, such as the Commission has used in the past for developing haircuts for debt securities, is an appropriate method for determining haircuts on equity securities.

B. *Zero Coupon and Stripped Securities*—The Commission also proposes to amend its securities deductions to exclude instruments that include only principal or interest. Under the current rule, for example, any security that is "* * * issued or guaranteed as to principal or interest by the United States or any agency thereof * * *" incurs a haircut of zero to six percent, depending upon the maturity of the security. These percentages, however, were drafted to reflect the price volatilities of securities that include both principal and interest and thus do not contemplate the risk inherent in "stripped" securities. Under the proposal, these zero-coupon securities (other than those issued by the Treasury) would be subject to the 15 percent haircut proposed for equity securities.

The Commission recognizes that, while stripped securities have different price volatilities for differing maturities than corresponding coupon bonds, there is a distinct benefit in creating a uniform haircut across all maturities. Preliminarily, the Commission believes that, given the relatively lower level of activity in coupon instruments as compared to Treasury instruments that contain principal and interest, a uniform haircut is more practical because it minimizes the complexity of the rule. If the Commission does not adopt a uniform haircut for coupon instruments, it is likely that a separate series of maturity categories will have to be created for those securities. The Commission requests comment as to the appropriate haircut for zero-coupon Treasury as well as other stripped instruments.

IV. Aggregate Indebtedness

The aggregate indebtedness test has been included in the net capital rule since its adoption in 1942. Generally, the term aggregate indebtedness includes all of the liabilities and/or obligations (contingent or otherwise) of the broker-dealer. By limiting the amount of indebtedness of registered broker-dealers to a percentage of net capital, the rule limits the leverage that broker-dealers that elect the basic method 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 may not be appropriate, particularly in light of

[34] *See* note 4, *supra*.

[35] Under the proposed amendments, the broker-dealer would notify only its designated examining authority, and not the Commission (as is currently the case), of its election to operate under the alternative method.

the proposed increases in the minimum requirements.

A. *Mutual Funds Payable Offset by Fails to Deliver*—The present 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. This payable arises out of a purchase by the broker-dealer directly from the fund of shares of the fund for another broker-dealer (presumably for its 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. Our experience indicates that, as a general rule, most of these fails to deliver are completed. The Commission believes that, to the extent that this class of fails to deliver is offset by a liability to the fund, a capital cushion of 6⅔ percent to cover the liability is unnecessary. Rather than the 6⅔ percent charge that results under the current rule, the Commission proposes that this requirement be lowered to one percent of the liability amount when an offset exists.

B. *Stock Loan and Stock Borrowed*—A stock loan payable is a liability arising from the receipt of cash collateral from a person who borrows securities from the broker-dealer. It is considered aggregate indebtedness even if the securities that were loaned were borrowed from another broker-dealer. 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. That collateral is deemed to be a liability on the books of the lending broker-dealer, since that broker-dealer owes money to the borrowing broker-dealer.

Much of the stock lent by one broker-dealer to another broker-dealer has been borrowed from yet a third broker-dealer or other person. That borrowing, if collateralized by cash, results in a receivable from the lending person. The borrowing broker-dealer has turned over cash to the lending entity which in turn was received from the second borrower of securities. In that situation, the firm has a stock loan payable versus a stock loan receivable analogous to a government securities repurchase book. Generally, excluding fraud, these are not risky positions. The major risk in such positions (normally characterized as a finder's book) is the liquidity risk. If a perception arises that a broker-dealer is in financial distress, stock borrowers will return stock to the lending broker-dealer for cash which cannot be as readily obtained from the persons to whom the failing broker-dealer has given cash. This run on a broker-dealer would likely impair its ability to function as a clearing agent.

Given the matched nature of those related payables and receivables, the Commission does not believe that risk merits a charge of 6⅔ percent on the dollar amount of the liability. The Commission believes, however, that a lower cushion (one percent) against the liquidity risk of a large finder's book is appropriate. The one percent number has previously been used by the Commission in the net capital rule in order to curtail leverage.[36] The Commission thus proposes that liabilities related to a corresponding securities borrowing incur only a 1 percent charge against net capital.

V. Technical Amendments

Because of the proposed amendments to the minimum net capital requirements and the equity securities haircuts, it became possible for the Commission to merge paragraph (f) with paragraph (a) of the rule. As a result, the proposed rule amendments include several technical changes to the rule. For example, all references to paragraph (f) would be deleted. Other examples include the proposed amendments to the concentration charges under paragraph (c)(2)(vi)(M) and the contractual commitment charge under paragraph (c)(2)(viii). The proposed amendments would also delete a provision from paragraph (c)(2)(ix) of Rule 15c3–1 that expired on January 1, 1983.

VI. Summary of Initial Regulatory Flexibility Analysis

The Commission has prepared an Initial Regulatory Flexibility Analysis ("Analysis") in accordance with 5 U.S.C. 603 regarding the proposed amendments. The Analysis notes that the objective of the proposed amendments is to further the purposes of the various financial responsibility rules which provide safeguards with respect to the financial responsibility and related practices of brokers and dealers. In sum, the Analysis states that the proposed amendments would subject smaller broker-dealers to higher capital requirements. A copy of the Analysis may be obtained by contacting David I.A. Abramovitz, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549, (202) 272–2398.

VII. 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 proposes to amend § 240.15c3–1, of Title 17 of the Code of Federal Regulations in the manner set forth below.

VIII. List of Subjects in 17 CFR Part 240

Reporting and recordkeeping requirements, Securities.

IX. Text of the Proposed Amendments

In accordance with the foregoing, 17 CFR part 240 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: Sec. 23, 48 Stat. 901, as amended; 15 U.S.C. 78w * * *. 240.15c3–1 is also issued under secs. 15(c)(3), 15 U.S.C. 78*o*(c)(3).

2. In § 240.15c3–1 by removing paragraph (f) and paragraphs (a)(8) and (a)(9), removing and reserving paragraph (c)(2)(vi)(I), adding paragraphs (c)(1)(xiv) and (c)(1)(xv) and revising paragraphs (a)(1), (a)(2), (a)(3), (a)(4), (a)(5), (c)(1)(xiii), (c)(2)(i)(C)(*1*), (c)(2)(iv)(B), (c)(2)(iv)(F)(*3*)(*i*)(*B*), (c)(2)(iv)(F)(*3*)(*i*)(*C*), (c)(2)(vi), (c)(2)(vi)(A)(*1*), (c)(2)(vi)(A)(*5*), (c)(2)(vi)(B)(*2*), (c)(2)(vi)(F)(*1*), (c)(2)(vi)(J), (c)(2)(vi)(M), (c)(2)(viii), (c)(2)(ix), (c)(2)(x)(A) (*2*) through (*4*), (c)(2)(x)(A)(*5*), (c)(9), and (c)(10).

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

(a) No broker or dealer shall maintain net capital less than the amounts required as to that broker or dealer under this paragraph.

Ratio Requirements

Aggregate Indebtedness Method

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

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[36] *See* Rule 15c3–1(f)(5)(iv).

Alternative Method

(ii) A broker or dealer who carries customer accounts and holds customer funds or securities may elect not to be subject to the limitations of paragraph (a)(1)(i) of this section. Such broker or dealer shall not permit his net capital to be less than 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, 17 CFR 240.15c3-3a). Such broker or dealer shall notify the Examining Authority for such broker or dealer. in writing, of his election to operate under this paragraph. Once a broker or dealer has notified its Examining Authority, he shall continue to operate under this paragraph unless a change is approved upon application to the Commission.

(A) In addition to the foregoing, a broker or dealer electing this alternative shall:

(*1*) make the computation required by 17 CFR 240.15c3-3(e) and set forth in Exhibit A, 17 CFR 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;

(*2*) include in Items 7 and 8 of Exhibit A, 17 CFR 240.15c3-3a, the market value of specified items therein more than 7 business days old;

(*3*) 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

(*4*) Deduct from net worth in computing net capital 1 percent of the contract value of all failed to deliver contracts or securities borrowed which were allocated to failed to receive contracts of the same issue and which thereby were excluded from Items 11 or 12 of Exhibit A, 17 CFR 240.15c3-3a.

Futures Commission Merchants

(iii) No broker or dealer registered as a futures commission merchant shall permit his net capital to be less than 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

Brokers or Dealers That Carry Customer Accounts

(2)(i) A broker or dealer that carries customer or broker or dealer accounts and holds funds or securities for those persons shall maintain net capital of not less than $250,000 (see paragraphs (a) and (b) of appendix (E) (17 CFR 240.15c3-1e) for temporary minimum requirements).

Brokers or Dealers That Carry Customer Accounts, But Do Not Generally Hold Customer Funds or Securities

(ii) A broker or dealer who is exempt from the provisions of 17 CFR 240.15c3-3 under the Securities Exchange Act of 1934 pursuant to paragraph (k)(2)(i) shall maintain net capital of not less than $100,000 (see paragraph (c) of appendix (E) (17 CFR 240.15c3-1e) for temporary minimum requirements).

Dealers, Underwriters and Arbitragers

(iii) A dealer shall maintain net capital of not less than $100,000 (see paragraph (c) of appendix (E) (17 CFR § 240.15c3-1e) for temporary minimum requirements) if he does not receive, directly or indirectly, funds or securities from, or owe money or securities to, customers and does not carry accounts of, or for, customers. For purposes of this section, the term "dealer" includes underwriters and any broker or dealer who endorses or writes options otherwise than on a registered national securities exchange or a facility of a registered national securities association.

Brokers Who Introduce Customers' Accounts and Routinely Receive Funds or Securities

(iv) A broker or dealer shall maintain net capital of not less than $100,000 (see paragraph (d) of appendix (E) (17 CFR 240.15c3-1e) for temporary minimum requirements) plus ¼ percent of debit balances in introduced customers' cash and margin accounts if it is exempt from the provisions of 17 CFR 240.15c3-3 under the Securities Exchange Act of 1934 pursuant to paragraph (k)(2)(ii) of this section.

(v) Those introducing brokers or dealers that receive, but do not promptly forward, customer funds and securities shall maintain the minimum net capital requirement as set forth in paragraph (a)(2)(i) of this section.

Brokers Who Introduce Customer Accounts But Do Not Routinely Receive Funds or Securities

(vi) An introducing broker or dealer that is exempt from the provisions of 17 CFR 240.15c3-3 under the Securities Exchange Act of 1934 pursuant to paragraph (k)(2)(ii) of this section but does not routinely receive customer funds or securities and effects ten or fewer transactions per year in securities for his own investment account with or through another registered broker or dealer shall maintain net capital of not less than $50,000 (see paragraph (e) of appendix (E) for temporary minimum requirements) plus ¼ percent of debit balances in introduced customers' cash and margin accounts.

(A) A broker or dealer operating under paragraph (a)(2)(iv) of this section and under this paragraph (a)(2)(vi) of this section may participate as a selling dealer in a firm commitment underwriting but may not enter into a contractual commitment with the issuer for the purchase of shares related to that underwriting.

(B) A broker or dealer operating under this paragraph may engage in the activities allowed under paragraphs (a)(2)(vii) and (a)(2)(ix) of this section.

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

(vii) A broker or dealer may maintain net capital of not less than $25,000 (see paragraph (f) of appendix (E) (17 CFR 240.15c3-1e) for temporary minimum requirements) if he meets all of the following conditions:

(A) His dealer transactions are limited 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 the issuer on other than on a subscription way basis, except that he may also effect ten or fewer transactions per year in other securities for his own investment account with or through another registered broker or dealer;

(B) He promptly transmits all funds and delivers all securities received in connection with his activities as a broker or dealer, and does not otherwise hold funds or securities for, or owe money or securities to, customers; and

(C) His transactions as broker are limited to one or more of the following;

(*1*) The sale and redemption of redeemable shares of registered investment companies or of interests or participation in an insurance company separate account whether or not registered as an investment company;

(*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 the account of a customer to obtain funds for immediate reinvestment in redeemable securities of registered investment companies; and

(*4*) The activities allowed under paragraph (a)(2)(ix) of this section.

Municipal Securities Brokers' Brokers

(viii) A municipal securities brokers' broker, as defined in subsection (A) of this paragraph (a)(2)(viii), may elect not to be subject to the limitations of paragraphs (c)(2)(ix) of this section, provided that such brokers' broker complies with the requirements set out in paragraphs (a)(2)(viii)(B), (C) and (D) of this section.

(A) The term municipal securities "brokers' broker" shall mean a municipal securities broker or dealer who acts exclusively as an undisclosed agent in the purchase or sale of municipal securities for a registered broker or dealer or registered municipal securities dealer, who has no "customers" as defined in paragraph (c)(6) of this section and who does not have or maintain any municipal securities in its proprietary or other accounts.

(B) In order to qualify to operate under this paragraph (a)(2)(viii), a brokers' broker shall at all times have and maintain net capital of not less than $150,000.

(C) For purposes of this paragraph (a)(2)(viii), a brokers' broker shall deduct from net worth 1 percent of the contract value of each municipal failed to deliver contract which is outstanding 21 business days or longer. Such deduction shall be increased by any excess of the contract price of the fail to deliver over the market value of the underlying security.

(D) For purposes of this paragraph (a)(2)(viii), a brokers' broker may exclude from its aggregate indebtedness computation indebtedness adequately collateralized by municipal securities outstanding for not more than one business day and offset by municipal securities failed to deliver of the same issue and quantity. In no event may a brokers' broker exclude any overnight bank loan attributable to the same municipal securities failed to deliver contract for more than one business day. A brokers' broker need not deduct from net worth the amount by which the market value of securities failed to receive outstanding longer than thirty (30) calendar days exceeds the contract value of those failed to receives as required by Rule 15c3–1(c)(2)(iv)(E).

Other Brokers or Dealers

(ix) A broker or dealer that does not receive, directly or indirectly, funds or securities from, or owe money or securities to, customers and does not carry accounts of, or for, customers and that engages in ten or fewer transactions in securities per year for his own account with or through another registered broker or dealer, shall maintain net capital of not less than $5,000. Those brokers or dealers that introduce cash accounts under this paragraph must maintain net capital of not less than the amounts required under this paragraph (a) plus ¼ percent of debit balances in introduced customers' cash and margin accounts.

Consolidated Minimum Requirements

(3) A broker or dealer shall maintain net capital of not less than its 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), 17 CFR 240.15c3–1c.

Additional 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 he makes a market (unless a security in which he 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 he have net capital less than that otherwise required by the other provisions of paragraph (a) of this section, or be required to maintain net capital of more than $1,000,000 unless otherwise required by the other provisions of paragraph (a).

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

(5) A broker or dealer shall maintain net capital in addition to the amounts otherwise required under paragraph (a) of this section in an amount greater than 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; and

(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) * * *

Exclusions From Aggregate Indebtedness

(1) * * *

(xiii) Deferred tax liabilities;

(xiv) Eighty-five percent of amounts payable to a registered investment company related to fail to deliver receivables 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 a receivable related to securities of the same class and issue that are securities borrowed by the broker or dealer.

* * * * *

(2) * * *

(i) * * *

(C) * * *

(*1*) The aggregate amount resulting from applying to the amount of the deductions computed in accordance with paragraph (c)(2)(vi) and Appendices (A) and (B), 17 CFR 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.

* * * * *

Certain Unsecured and Partly Secured Receivables

(iv)(A) * * *

(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 220.4(b) 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 which 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 which are outstanding 5 business days or less, except deficits in cash accounts as defined in 12 CFR 220.4(c) 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 paragraphs (c)(2)(vi) or appendix A (17 CFR 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 (17 CFR 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 paragraphs (c)(2)(vi) of this section (less any deduction taken with respect to repurchase agreements with that party under subparagraph (F)(3)(i)(A)) 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)-(M) of this section (or the deductions prescribed for securities positions set forth in Appendix (A), 17 CFR 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.

Government Securities

(A)(*1*) In the case of a security consisting of principal and interest (except for stripped instruments issued by the United States Treasury) issued or guaranteed as to principal or interest by the United States or any agency thereof, the applicable percentages of the market value of the net long or short position in each of the categories specified below are:

* * * * *

(*5*) In the case of a Government securities dealer which reports to the Federal Reserve System, which transacts business directly with the Federal Reserve System, and which 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.

Municipals

(B) * * *

(*1*) * * *

(*2*) In the case of any municipal security (other than those specified in paragraph (c)(2)(vi)(B)(*1*)) consisting of principal and interest which is not traded flat or in default as to principal or interest, the applicable percentages of the market value of the greater of the long or short position in each of the categories specified below are:

* * * * *

Nonconvertible Debt Securities

(F)(*1*) In the case of nonconvertible debt securities consisting of principal and interest having a fixed interest rate and fixed maturity date and which are not traded flat or in default as to principal or interest and which are rated in one of the four highest rating categories by at least two of the nationally recognized statistical rating organizations, the applicable percentages of the market value of the greater of the long or short position in each of the categories specified below are:

* * * * *

(I) [Removed and reserved.]

All Other Securities

(J) In the case of all securities or evidences of indebtedness, except those described in Appendix (A), 17 CFR 240.15c3-1a which are not included in any of the percentage categories enumerated in paragraphs (c)(2)(vi) (A)-(H) of this section or (K)(ii) of this section, the deduction shall be 15 percent (30 percent if the broker's or dealer's net capital requirement as computed under paragraph (c)(2) of this section is less than $100,000) 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 which is convertible into or exchangeable for another security within a period of 90 days, subject to no condition 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 which has been called for redemption and which 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 "exempt securities" and redeemable securities of an investment company registered pursuant to the Investment Company Act of 1940), which are long or short in the proprietary or other accounts of a broker or dealer, including securities which are collateral to secured demand notes defined in appendix (D), 17 CFR 240.15c3-1d, and which have a market value of more than 10 percent of the "net capital" of a broker or dealer before the application of paragraphs (c)(2)(vi)(B)-(H) and appendix (A), 17 CFR 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), 17 CFR 240.15c3-1d, equal to 50 percent of the percentage deduction otherwise provided by this paragraph (c)(2)(vi) (B-I) or appendix (A), 17 CFR 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) and appendix (A), § 240.15c3-1a.

(*2*) In the case of securities underwritten, the deduction required by this paragraph (c)(2)(vi)(M) shall be applied after 11 business days.

(*3*) 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 on that portion of the securities position and secured demand note collateral in excess of 10 percent of the net capital before the application of paragraph (c)(2)(vi) and appendix A, 17 CFR 240.15c3-1a.

(4) 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.

(5) 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 net capital before the application of paragraph (c)(2)(vi) and appendix (A), 17 CFR 240.15c3-1a.

(6) 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% 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.

(7) Any specialist who is subject to a deduction required by this paragraph (c)(2)(vi)(M), respecting his specialty stock, who 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 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 subdivision, 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 who has open contractual commitments (other than those option positions subject to appendix (A), 17 CFR 240.15c3-1a), the respective deductions as specified in paragraph (c)(2)(vi) of this section or Appendix (B), 17 CFR 240.15c3-1b, from the market value (which shall be the market value whenever there is a market) on 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 need not deduct from net worth any amount computed under this paragraph that is less than $150,000.

(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 which 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 which would be required by application of the deduction required by paragraph (c)(2)(vi). Such deduction, however, shall be increased by any excess of the contract price 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 fail, but not to exceed the amount of such deduction. The designated examining authority for the broker or dealer may, 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 up to 5 business days, any period herein specified when it 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) 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)-(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) 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 position as defined in this paragraph (c)(2)(x) 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)-(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) 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 paragraph (a)(2)(vii) 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.

* * * * *

Forward and Promptly Forward

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

* * * * *

3. By amending § 240.15c3–1a by revising paragraphs (c)(1)–(c)(5), (c)(7), (c)(9) and (c)(10) 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)–(K) of 17 CFR 240.15c3–1) of the current market value of the security underlying such option reduced by an 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 subparagraph 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)–(K) of 17 CFR 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 subparagraph 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)–(K) of 17 CFR 240.1c3–1) 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 subparagraph 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)–(K) of 17 CFR 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 his proprietary or other accounts, deducting 5 percent (or 50 percent of such other percentage required by paragraphs (c)(2)(vi) (A)–(K) of 17 CFR 240.15c3–1) of the current market value of the long 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)–(K) of 17 CFR 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 17 CFR 240.15c3–1.

* * * * *

Certain Security Positions With Offsetting Options

(9) Where a broker or dealer is long a security for which he 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 the 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. By amending § 240.15c3–1c by revising paragraph (b)(1), 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 dealer's net capital or the decrease of the broker's or dealer's minimum net capital requirement under paragraph (a) of 17 CFR 240.15c3–1, and an opinion of counsel described in paragraph (b)(2) has not been obtained, such benefits shall not be recognized in the broker's or dealer's computation required by this section.

* * * * *

5. By amending § 240.15c3–1d by revising paragraphs (b)(6)(iii), (b)(7), (b)(8), (b)(10)(ii)(b), (c)(2), (c)(5)(i), and (c)(5)(ii)(A) as follows:

§ 240.15c3–1d Satisfactory subordination agreements (Appendix D to 17 CFR 240.15c3–1).

* * * * *

(b)(6) * * *

(iii) The secured demand note agreement may also 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 17 CFR 240.15c3–1, net capital may not be less than the greater of 5 percent of aggregate debit items computed in accordance with 17 CFR 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). 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 17 CFR 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 which 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 or on or prior to the date on which the Payment Obligation in respect of such or on 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:

(i) 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 17 CFR 240.15c3-1 or, in the case of a broker or dealer operating pursuant to paragraph (a)(1)(ii) of 17 CFR 240.15c3-1, its net capital would be less than the greater of 5% of its aggregate debit items computed in accordance with 17 CFR 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), or

(ii) its net capital would be less than 120 percent of the minimum dollar amount required by paragraph (a)(1)(ii) of 17 CFR § 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) 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 Prepayment of such Payment Obligation (and to all Payments of Payment Obligations of such broker or dealer under any other subordination agreement(s) then outstanding which are scheduled to mature on or before such Payment Obligation) either:

(i) the aggregate indebtedness of the broker or dealer would exceed 1200% of its net capital, or in the case of a broker or dealer operating pursuant to paragraph (a)(1(ii)) of 17 CFR 240.15c3-1, its net capital would be less than the greater of 5 percent of aggregate debit items computed in accordance with 17 CFR 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 subject to the rules of a contract market, each such deduction not to exceed the amount of funds in the option customer's account), or

(ii) its net capital would be less than 120 percent of the minimum dollar amount required by 17 CFR 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 17 CFR 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 which has elected to operate under paragraph (a)(1)(ii) of 17 CFR 240.15c3-1, its net capital computed in accordance therewith is less than the greater of 2 percent of its aggregate debit items computed in accordance with 17 CFR 240.15c3-3a, or, if registered as a futures commission merchant, 4 percent of the funds required to be seqregated 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), 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 of 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 which are then due or mature within the following six months without reference to any projected profit or loss of the broker or dealer:

(i) 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 17 CFR 240.15c3-1, or, in the case of a broker or dealer operating pursuant to paragraph (a)(1)(ii) of 17 CFR 240.15c3-1, its net capital would be less than the greater of 5 percent of aggregate debit items computed in accordance with 17 CFR 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), or

(ii) less than 120 percent of the minimum dollar amount required by paragraph (a)(1)(ii) of 17 CFR 240.15c3-1.

* * * * *

Temporary and Revolving Subordination Agreements

(5)(i) For the purpose of enabling a broker of dealer to participate as an underwriter of securities or other extraordinary activities in compliance with the net capital requirements of 17 CFR 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 which 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 17 CFR 240.17a–11 under the Securities Exchange Act of 1934, 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 17 CFR 240.15c3–1, or

(B) in the case of a broker or dealer operating pursuant to paragraph (a)(1)(ii) of 17 CFR 240.15c3–1, its net capital is less than 5 percent of aggregate debits computed in accordance with 17 CFR 240.15c3–3a, or, if registered as a futures commission merchant, its net capital is 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), or is less than 120 percent of the minimum dollar amount required by paragraph (a) of this section, or

(C) the amount of its then outstanding subordination agreements exceeds the limits specified in paragraph (d) of 17 CFR 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 Payment Obligations under any other subordinated agreements then outstanding, the maturity or accelerated maturities of which are scheduled to fall due with 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

(*1*) 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 17 CFR 240.15c3–1, or in the case of a broker or dealer operating pursuant to paragraph (a)(1)(ii) of 17 CFR 240.15c3–1, its net capital is less than the greater of 6 percent of aggregate debits computed in accordance with 17 CFR 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); or

(*2*) less than 200 percent of the minimum dollar amount required by paragraph (a)(1)(ii) of this section or

* * * * *

6. By adding § 240.15c3–1e 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 Method

(a) A broker or dealer that falls within the provisions of paragraph (a)(2)(i), of Rule 15c3–1 and computes his required net capital under Rule 15c3–1(a)(1)(i) shall maintain net capital not less than the greater of the amount computed under that paragraph (a)(1)(i) or:

(1) $25,000 until December 31, 1990;
(2) $81,250 after January 1, 1991 but until December 31, 1991;
(3) $137,500 after January 1, 1992 but until December 31, 1992;
(4) $193,750 after January 1, 1993, but until December 31, 1993; and
(5) $250,000 after January 1, 1994.

Brokers or Dealers That Carry Customer Accounts

Alternative Method

(b) A broker or dealer that elects the provisions of Rule 15c3–1(a)(1)(ii) shall maintain net capital of not less than the greater of the amount computed under that paragraph (a)(1)(ii) or:

(1) $100,000 until December 31, 1990;
(2) $137,500 after January 1, 1991 but until December 31, 1991;
(3) $175,000 after January 1, 1992 but until December 31, 1992;
(4) $212,500 after January 1, 1993 but until December 31, 1993; and
(5) $250,000 after January 1, 1994.

Broker-Dealers That Carry Customer Accounts, But Do Not Generally Hold Customer Funds or Securities and Dealers, Underwriting and Arbitragers

(c) A broker or dealer that falls within the provisions of Rule 15c3–1(a)(2) (ii) or (iii) shall maintain net capital not less than the greater of the amount computed under Rule 15c3–1(a)(1)(i) or:

(1) $25,000 until December 31, 1990;
(2) $43,750 after January 1, 1991 but until December 31, 1991;
(3) $62,500 after January 1, 1992 but until December 31, 1992;
(4) $81,250 after January 1, 1993 but until December 31, 1993; and
(5) $100,000 after January 1, 1994.

Introducing Brokers That Routinely Receive Customer Funds or Securities

(d) An introducing broker that falls within the provisions of Rule 15c3–1(a)(2)(iv) shall maintain net capital of not less than the greater of the amount computed under Rule 15c3–1(a)(1)(i) or ¼ percent of debit balances in introduced customers' cash and margin accounts plus:

(1) $25,000 until December 31, 1990;
(2) $43,750 after January 1, 1992 but until December 31, 1991;
(3) $62,500 after January 1, 1992 but until December 31, 1992;
(4) $81,250 after January 1, 1993 but until December 31, 1993; and
(5) $100,000 after January 1, 1994.

Introducing Brokers That Do Not Routinely Receive Customer Funds or Securities

(e) An introducing broker that falls within the provisions of Rule 15c3–1(a)(2)(vi) shall maintain net capital of not less than the greater of the amount computed under Rule 15c3–1(a)(1)(i) or ¼ percent of debit balances in introducing customers' cash and margin accounts plus:

(1) $5,000 until December 31, 1990;
(2) $16,250 after January 1, 1991 but until December 31, 1991;
(3) $27,500 after January 2, 1992 but until December 31, 1992;
(4) $38,750 after January 1, 1993 but until December 31, 1993; and
(5) $50,000 after January 1, 1994.

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

(f) A broker or dealer that falls within the provisions of Rule 15c3–1(a)(2)(vii) shall maintain net capital of not less than the greater of the amount computed under Rule 15c3–1(a)(1)(i) or:

(1) $2,500 until December 31, 1990;
(2) $8,125 after January 1, 1991 but until December 31, 1991;
(3) $13,750 after January 2, 1992 but until December 31, 1992;
(4) $19,375 after January 1, 1993 but until December 31, 1993;
(5) $25,000 after January 1, 1994.

* * * * *

By the Commission.

Dated: September 15, 1989.

Jonathan G. Katz,
Secretary.

[FR Doc. 89-23022 Filed 9-29-89; 8:45 am]

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DEPARTMENT OF HEALTH AND HUMAN SERVICES

Food and Drug Administration

21 CFR Part 341

[Docket No. 89N-0411]

RIN 0905-AA06

Cold, Cough, Allergy, Bronchodilator, and Antiasthmatic Drug Products for Over-the-Counter Human Use; Proposed Amendment to the Monograph for OTC Antitussive Drug Products

AGENCY: Food and Drug Administration.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Food and Drug Administration (FDA) is proposing to amend the final monograph for over-the-counter (OTC) antitussive drug products to use only the term "lozenge" to describe a solid dosage form intended for dissolution in the mouth and to clarify that an oral antitussive drug product can be marketed in a lozenge dosage form. This proposal is part of the ongoing review of OTC drug products conducted by FDA.

DATES: Written comments by December 1, 1989; written comments on the agency's economic impact determination by January 30, 1990.

ADDRESS: Written comments to the Dockets Management Branch (HFA-305), Food and Drug Administration, Rm. 4-62, 5600 Fishers Lane, Rockville, MD 20857

FOR FURTHER INFORMATION CONTACT: William E. Gilbertson, Center for Drug Evaluation and Research (HFD-210), Food and Drug Administration, 5600 Fishers Lane, Rockville, MD 20857, 301-295-8000.

SUPPLEMENTARY INFORMATION: In the **Federal Register** of September 9, 1976 (41 FR 38312), FDA published an advance notice of proposed rulemaking for OTC cold, cough, allergy, bronchodilator, and antiasthmatic drug products. The Panel referred to solid topical dosage forms intended for dissolution in the mouth as either a troche or a lozenge. (See 41 FR 38312 at 38343 to 38353.)

In the **Federal Register** of October 19, 1983 (48 FDR 48576), FDA issued a notice of proposed rulemaking (tentative final monograph) for OTC antitussive drug products. One ingredient (menthol) was proposed as Category I in a lozenge dosage form. (See § 341.74(d)(2)(iii).) In response to a comment's request, the agency also included a "compressed tablet" dosage form for products containing menthol to be dissolved in the mouth. (See comment 20 at 48 FR 485786 at 48588 and proposed § 341.3(k) and § 341.74(d)(2)(iii) at 48 FR 48576, 48593 and 48594.)

In the **Federal Register** of August 12, 1987 (52 FR 30042), FDA issued a final monograph for OTC antitussive drug products (21 CFR part 341) that established conditions under which these products are generally recognized as safe and effective and not misbranded. The monograph provided for menthol to be used in a lozenge or compressed tablet dosage form. (See § 341.3(c) and § 341.74(d)(2)(iii) at 52 FR 30042, 30555 and 30056.)

Since the publication of the antitussive final monograph, the United States Pharmacopeial Convention, Inc., in a proposed revision of the United States Pharmacopeia (U.S.P.) (ref. 1), and in the recently published U.S.P. XXII (ref. 2), included a definition for lozenges as follows:

> Lozenges are solid preparations containing one or more medicaments, usually in a flavored, sweetened base which are intended to dissolve or disintegrate slowly in the mouth. They can be prepared by molding (gelatin and/or fused sucrose or sorbitol base) or by compression of sugar based tablets. Molded lozenges are sometimes referred to as pastilles while compressed lozenges are often referred to as troches. They are usually intended for treatment of local irritation or infections of the mouth or throat but may contain active ingredients intended for systemic absorption after swallowing.

Based on the new U.S.P. definition, the agency has reconsidered its position stated in comment 20 of the notice of proposed rulemaking for OTC antitussive drug products (see above) and intends to adopt the new U.S.P. definition. Accordingly, the agency is proposing (1) to amend the final monograph for OTC antitussive drug products to use only the term lozenge to describe a solid dosage form to be dissolved in the mouth for a local effect, and (2) to delete the term "compressed tablet" from the final monograph in § 341.3(c) and § 341.74(d)(2)(iii). In addition, the definition in § 341.3(b) for an "oral antitussive drug" is being revised slightly to clarify that such drugs may also be formulated as lozenges. This revision is being made because the U.S.P. definition of lozenges provides for this dosage form to be dissolved in the mouth and to contain ingredients intended to have a systemic effect and because the agency is aware that antitussive drug products intended for systemic use are currently being marketed as lozenges (ref. 3). Thus, the revised definition in § 341.3(b) will be consistent with the new U.S.P. definition of lozenges.

The agency does not intend to finalize this amendment until the U.S.P. XXII becomes official in January 1990. In addition, the agency intends to use the term "lozenge" for solid dosage forms to be dissolved in the mouth in applicable rulemakings for other OTC drug categories, in future issues of the **Federal Register.** While the various types of lozenges such as compressed tablets, troches, or pastilles will not be described in final monographs, these terms may continue to be used in labeling. Accordingly, this proposed amendment, when finalized will not require any labeling revisions.

References

(1) "Pharmacopeial Forum," In-Process Revision, The United States Pharmacopeial Convention, Inc., 14:4390, 1988.

(2) "The United States Pharmacopeia XXII—The National Formulary XVII," The United States Pharmacopeial Convention, Inc., Rockville, MD, p. 1692, 1989.

(3) "Physicians' Desk Reference—For Nonprescription Drugs," 9th Ed., Medical Economics Co., Inc., Oradell, NJ, pp. 512, 515, 651, and 652, 1988.

The agency has examined the economic consequences of this proposed rulemaking in conjunction with other rules resulting from the OTC drug review. In a notice published in the **Federal Register** of February 8, 1983 (48 FR 5806), the agency announced the availability of an assessment of these economic impacts. The assessment determined that the combined impacts of all the rules resulting from the OTC drug review do not constitute a major rule according to the criteria established by Executive Order 12291. The agency therefore concludes that no one of these rules, including this proposed rule for OTC drug products, is a major rule.

The economic assessment also concluded that the overall OTC drug review was not likely to have a significant economic impact on a substantial number of small entities as defined in the Regulatory Flexibility Act (Pub. L. 96-354). That assessment included a discretionary Regulatory Flexibility Analysis in the event that an individual rule might impose an unusual or disproportionate impact on small entitites. However, this particular rulemaking for OTC drug products is not expected to pose such an impact on small businesses. Therefore, the agency certifies that this proposed rule, if implemented, will not have a significant economic impact on a substantial number of small entities.

The agency invites public comment regarding any substantial or significant economic impact that this rulemaking would have on OTC antitussive drug products. Comments regarding the impact of this rulemaking on OTC antitussive drug products should be accompanied by appropriate documentation.

The agency has determined under 21 CFR 25.24(c)(6) that this action is of a type that does not individually or cumulatively have a significant effect on the human environment. Therefore, neither an environmental assessment nor an environmental impact statement is required.

Interested persons may, on or before December 1, 1989, submit written comments to the Dockets Management Branch (address above). Written comments on the agency's economic impact determination may be submitted on or before January 30, 1990. Three copies of all comments are to be submitted, except that individuals may submit one copy. Comments are to be identified with the docket number found in brackets in the heading of this document and may be accompanied by a supporting memorandum or brief. Comments may be seen in the office above between 9 a.m. and 4 p.m., Monday through Friday.

List of Subjects in 21 CFR Part 341

Antitussive drug products, Labeling, Over-the-counter drugs.

Therefore, under the Federal Food, Drug, and Cosmetic Act and the Administrative Procedure Act, it is proposed that subchapter D of chapter I of title 21 of the Code of Federal Regulations be amended in part 341 as follows:

PART 341—COLD, COUGH, ALLERGY, BRONCHODILATOR, AND ANTIASTHMATIC DRUG PRODUCTS FOR OVER-THE-COUNTER HUMAN USE

1. The authority citation for 21 CFR part 341 continues to read as follows:

Authority: Secs. 201(p), 502, 505, 701, 52 Stat. 1041-1042 as amended, 1050-1053 as amended, 1055-1056 as amended by 70 Stat. 919 and 72 Stat. 948 (21 U.S.C. 321(p), 352, 355, 371); 5 U.S.C. 553; 21 CFR 5.10 and 5.11.

2. Section 341.3 is amended by revising paragraphs (b) and (c) to read as follows:

§ 341.3 Definitions.

* * * * *

(b) *Oral antitussive drug.* A drug that either is taken by mouth or is dissolved in the mouth in the form of a lozenge and acts systemically to relieve cough.

(c) *Topical antitussive drug.* A drug that relieves cough when inhaled after being applied topically to the throat or chest in the form of an ointment or from a steam vaporizer, or when dissolved in the mouth in the form of a lozenge for a local effect.

* * * * *

3. Section 341.74 is amended by revising paragraph (d)(2)(iii) to read as follows:

§ 341.74 Labeling of antitussive drug products.

* * * * *

(d) * * *

(2) * * *

(iii) *For products containing menthol identified in § 341.14(b)(2) in a lozenge.* The product contains 5 to 10 milligrams menthol. Adults and children 2 to under 12 years of age: Allow lozenge to dissolve slowly in the mouth. May be repeated every hour as needed or as directed by a doctor. Children under 2 years of age: consult a doctor.

* * * * *

Dated: September 12, 1989.

Ronald G. Chesemore,

Acting Associate Commissioner for Regulatory Affairs.

[FR Doc. 89-23137 Filed 9-29-89; 8:45 am]

BILLING CODE 4160-01-M

DEPARTMENT OF THE INTERIOR

Office of Surface Mining Reclamation and Enforcement

30 CFR Part 917

Kentucky Permanent Regulatory Program; Minor Field Revisions

AGENCY: Office of Surface Mining Reclamation and Enforcement (OSMRE), Interior.

ACTION: Proposed rule.

SUMMARY: OSMRE is announcing the receipt of a proposed amendment to the Kentucky permanent regulatory program (hereinafter referred to as the Kentucky program) under the Surface Mining Control and Reclamation Act of 1977 (SMCRA). The amendment concerns new permit revision procedures that will allow minor field revisions to be processed in the Department for Surface Mining Reclamation and Enforcement's (DSMRE) Regional Offices rather than in the central Office in Frankfort. The proposal contains a list of permit revisions defined as minor field revisions.

This notice sets forth the times and locations that the Kentucky program and the proposed amendment are available for public inspection, the comment period during which interested persons may submit written comments on the proposed amendment, and the procedures that will be followed regarding a public hearing, if one is requested.

DATES: Written comments must be received on or before 4:00 p.m. on November 1, 1989. If requested, a public hearing on the proposed amendment will be held at 10:00 a.m. on October 27, 1989. Requests to present oral testimony at the hearing must be received on or before 4:00 p.m. on October 17, 1989.

ADDRESSES: Written comments and requests for a hearing should be mailed or hand delivered to: Roger Calhoun, Acting Director, Lexington Field Office Office of Surface Mining Reclamation and Enforcement, 340 Legion Drive, Suite 28, Lexington, Kentucky 40504. Copies of the Kentucky program, the proposed amendment, and all written comments received in response to this notice will be available for review at the addresses listed below, Monday through Friday, 9:00 a.m. to 4:00 p.m., excluding holidays. Each requestor may receive, free of charge, one copy of the proposed amendment by contacting OSMRE's Lexington Field Office.

Office of Surface Mining Reclamation and Enforcement, Lexington Field

Office, 340 Legion Drive, Suite 28, Lexington, Kentucky 40504, Telephone: (606) 233-7327

Office of Surface Mining Reclamation and Enforcement, 1100 "L" Street, NW., Room 5131, Washington, DC 20240 Telephone: (202) 343-5492

Office of Surface Mining Reclamation and Enforcement, Eastern Field Operations, Ten Parkway Center, Pittsburgh, Pennsylvania 15220, Telephone: (412) 937-2828

Department for Surface Mining Reclamation and Enforcement, No. 2 Hudson Hollow Complex, Frankfort, Kentucky 40601, Telephone: (502) 564-6940

If a public hearing is held, its location will be: The Harley Hotel, 2143 North Broadway, Lexington, Kentucky 40505.

FOR FURTHER INFORMATION CONTACT: Roger Calhoun, Acting Director, Lexington Field Office, Telephone (606) 233-7327.

SUPPLEMENTARY INFORMATION:

I. Background

On May 18, 1982, the Secretary of the Interior conditionally approved the Kentucky program. Information pertinent to the general background, revisions, modifications, and amendments to the proposed permanent program submission, as well as the Secretary's findings, the disposition of comments and a detailed explanation of the conditions of approval can be found in the May 18, 1982, Federal Register (47 FR 21404-21435). Subsequent actions concerning the conditions of approval and program amendments are identified at 30 CFR 917.11, 917.15, 917.16, and 917.17.

II. Discussion of Amendment

By letter dated August 15, 1989, (Administrative Record No. KY-911), Kentucky submitted proposed regulations to revise Kentucky Administrative Regulations (KAR) at 405 KAR 8:010. The proposed amendment defines and establishes a new procedure for permit revisions that are minor field revisions by amending 405 KAR 8:010 section 20. The proposed amendment gives the Regional Offices of DSMRE the authority to process 27 types of minor field revisions as defined in the proposed amendment. The proposed regulations provide conditions for processing the various types of minor field revisions.

III. Public Comment Procedures

In accordance with the provisions of 30 CFR 732.17(h), OSMRE is now seeking comment on whether the amendment proposed by Kentucky satisfies the applicable program approval criteria of 30 CFR 732.15. If the amendment is deemed adequate, it will become part of the Kentucky program.

Written Comments

Written comments should be specific, pertain only to the issues proposed in this rulemaking, and include explanations in support of the commentor's recommendations. Comments received after the time indicated under "**DATES**" or at locations other than the Lexington Field Office will not necessarily be considered in the final rulemaking or included in the Administrative Record.

Public Hearing

Persons wishing to comment at the public hearing should contact the person listed under "**FOR FURTHER INFORMATION CONTACT**" by 4:00 p.m. on October 17, 1989. If no one requests an opportunity to comment at a public hearing, the hearing will not be held.

Filing of a written statement at the time of the hearing is requested as it will greatly assist the transcriber. Submission of written statements in advance of the hearing will allow OSMRE officials to prepare adequate responses and appropriate questions.

The public hearing will continue on the specified date until all persons scheduled to comment have been heard. Persons in the audience who have not been scheduled to comment, and who wish to do so, will be heard following those scheduled. The hearing will end after all persons scheduled to comment and persons present in the audience who wish to comment have been heard.

Public Meeting

If only one person requests an opportunity to comment at a hearing, a public meeting, rather than a public hearing, may be held. Persons wishing to meet with OSMRE representatives to discuss the proposed amendments may request a meeting at the OSMRE, Lexington Field Office listed under "**ADDRESSES**" by contacting the person listed under "**FOR FURTHER INFORMATION CONTACT.**" All such meetings will be open to the public and, if possible, notices of meetings will be posted in advance at the locations listed under "**ADDRESSES.**" A written summary of each meeting will be made a part of the Administrative Record.

VI. Procedural Determinations

1. Compliance With the National Environmental Policy Act

The Secretary has determined that, pursuant to section 702(d) of SMCRA, 30 U.S.C. 1292(d), no environmental impact statement need be prepared on this rulemaking.

2. Executive Order 12291 and the Regulatory Flexibility Act

On July 12, 1984, the Office of Management and Budget (OMB) granted OSMRE an exemption from sections 3, 4, 7 and 8 of Executive Order 12291 for actions directly related to approval or conditional approval of State regulatory programs. Therefore, this action is exempt from preparation of a Regulatory Impact Analysis and regulatory review by OMB.

The Department of the Interior has determined that this rule will not have a significant economic effect on a substantial number of small entities under the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*). This rule will not impose any new requirements; rather, it will ensure that existing requirements established by SMCRA and the Federal rules will be met by the State.

3. Paperwork Reduction Act

This rule does not contain information collection requirements which require approval by the Office of Management and Budget under 44 U.S.C. 3507.

List of Subjects in 30 CFR Part 917

Coal mining, Intergovernmental relations, Surface mining, Underground mining.

Dated: September 12, 1989.

Alfred E. Whitehouse,

Acting Assistant Director, Eastern Field Operations.

[FR Doc. 89-23144 Filed 9-29-89; 8:45 am]

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30 CFR Part 925

Missouri Permanent Regulatory Program

AGENCY: Office of Surface Mining Reclamation and Enforcement (OSM), Interior.

ACTION: Withdrawal of proposed amendment.

SUMMARY: OSM is announcing the withdrawal of a proposed amendment to the Missouri Permanent Regulation Program. The proposed amendment pertains to revegetation, permitting, and phase III liability release. Missouri is withdrawing this amendment because it intends to revise it and submit it as another formal amendment at a future date.

DATE: This withdrawal is effective October 2, 1989.