

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38956; File No. SR-CSE-97-09]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Cincinnati Stock Exchange, Inc., Relating to Net Capital Requirements

August 21, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934¹ ("Exchange Act" or "Act"), notice is hereby given that on July 29, 1997, the Cincinnati Stock Exchange, Incorporated ("CSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the CSE. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange hereby proposes to amend Exchange Article II, Section 5.1 and Exchange Rule 11.9(a) to increase the net capital requirements for members and Designated Dealers.

The text of the proposed rule change is available at the Office of the Secretary, CSE and at the Commission.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the CSE included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The CSE has prepared summaries, set forth in sections A, B, and C below, of the most significant parts of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(1) *Purpose.* The Exchange is proposing to increase its net capital requirements for member firms. The CSE notes that several smaller, introducing broker-dealers have recently encountered financial trouble, endangering the investing public. In this increasingly volatile and uncertain marketplace, the Exchange believes that

increased net capital levels are justified. Specifically, the proposed rule change would increase the net capital requirement for Exchange specialists, called Designated Dealers, to \$500,000 from the current requirement of \$100,000, and the net capital requirement for other members to \$250,000 from the current requirement of \$25,000.

The Exchange Act, as amended, and Commission Rules require specialists to undertake certain responsibilities and obligations in return for the privilege of trading for their own accounts. These include a requirement to maintain adequate minimum capital levels, as set forth in exchange rules, and a responsibility to engage in a course of dealings for the specialist's own account to assist in the maintenance of a fair and orderly market. Specialists are thus required to provide liquidity and depth in times of market stress or volatility. Minimum net capital requirements are intended to help ensure that specialists have the financial resources necessary to perform this function.

Prior to 1984, the CSE's net capital rules required a Designated Dealer to maintain at least \$500,000 in net capital.² The Exchange has subsequently amended the net capital requirement from time to time, as market conditions have warranted. Exchange Rule 11.9(a) currently requires Designated Dealers to maintain net capital of at least the greater of \$100,000 or the amount required under Commission Rule 15c3-1. When implemented in 1989, the \$100,000 minimum was determined by the Exchange to be a level of capital sufficient to ensure that the Exchange's Designated Dealers would possess sufficient financial resources to enable them to provide liquidity and depth in times of market stress.³ Subsequent growth in the United States' capital markets generally, and in the CSE's market in particular have outstripped this requirement. Record price and volume levels have created a need for greater capital levels on the CSE. These greater levels of capital will help to ensure that Designated Dealers are adequately prepared to provide depth and liquidity to the Exchange's markets in times of market stress or volatility. The Exchange believes that the previous net capital requirement for Designated Dealers of at least the greater of \$500,000 or the amount required under Commission Rule 15c3-1 will better

protect the integrity and quality of the Exchange's markets, and therefore the investors whose orders are executed on the Exchange.

Article II, Section 5.1 of the CSE By-Laws imposes a minimum net capital level on non-specialist Exchange members equal to the greater of the net capital level required by Commission Rule 15c3-1 or \$25,000. The proposed rule change would increase that requirement from \$25,000 to 250,000. Members would, of course, still be subject to any higher net capital requirements imposed by Commission Rule 15c3-1. Commission Rule 15c3-1 distinguishes minimum net capital levels among dealer firms that trade for their own account and between brokerage firms that carry accounts and those that introduce customers to other firms. The Exchange believes, however, that a higher, uniform minimum requirement is appropriate because each of these types of firms may pose a risk to the financial integrity of the Exchange, as well as to the investing public generally, if permitted to operate with inadequate capitalization.

Commission Rule 15c3-1 currently requires minimum net capital of \$100,000 for any broker or dealer that effects more than 10 transactions in any one calendar year for its own investment account.⁴ CSE members that trade for their own accounts on the Exchange often effect more than 10 trades per day. Because proprietary trading places member firm capital directly at risk, the Exchange believes the higher net capital requirement of \$250,000 is appropriate for member firms that trade for their proprietary accounts on the Exchange.

Commission Rule 15c3-1 currently imposes a similar \$250,000 minimum net capital requirement for any broker-dealer that carries customer accounts.⁵ The proposed rule change would bring the CSE's net capital requirement for brokerage firms that carry accounts in line with the Commission's requirements.

The Exchange also believes that a uniform net capital requirement should apply to introducing brokerage firms. The CSE notes that the Commission examined this issue in revising Commission Rule 15c3-1 in 1992. The Commission noted in proposing to raise the minimum net capital level for introducing brokers under Commission Rule 15c3-1 that customers are placed at risk by brokers that do not receive or hold customer funds or securities because such brokers have indirect

² See Securities Exchange Act Rel. No. 20766 (Mar. 20, 1984), 49 FR 11274 (Mar. 26, 1984).

³ See Securities Exchange Act Rel. No. 27458 (Nov. 21, 1989), 54 FR 49376 (Nov. 30, 1989).

⁴ 17 CFR 240.15c3-1.

⁵ 17 CFR 240.15c3-1.

¹ 15 U.S.C. 78s(b)(1).

access to customer funds and securities, and can direct the movement of such assets by placing orders with clearing firms.⁶ Customers are often unaware of or unable to distinguish between introducing and clearing firms, and tend to rely heavily upon the representations of brokers at introducing firms. A higher net capital requirement will help ensure the financial integrity of such introducing firms and thereby help to protect investors.

Similarly, better capitalized introducing firms are less likely to become insolvent. In the event that such a firm does become insolvent, customers will be better protected by higher minimum net capital requirements. The failure of an introducing firm can strand an investor, who may be unable to place orders directly with a clearing firm because the clearing firm regards the investor as the customer of the introducing firm. Such a customer would be unable either to liquidate or open new positions until the introducing firm is wound up or the customer opens a new account with a different broker. Higher net capital levels would likely result in a quicker, easier sale of the introducing firm and would help to minimize the impact of such a failure on the investing public.

Finally, the Exchange believes that raising the minimum net capital level for members will further the antifraud provisions of the federal securities laws. Members have access to customer securities and funds either directly, as in the case of a clearing firm, or indirectly, as in the case of an introducing firm that places orders with a clearing firm on behalf of its customers. In either case, member firms are presented with an opportunity to convert customer assets for personal or other inappropriate use. Higher net capital levels will help ensure adequate firm resources to address such problems. In addition, higher net capital levels may create a disincentive toward such activity by ensuring sufficient operating capital. That is, a firm with sufficient net capital may be less likely to attempt to convert customer funds for the firm's use.

(2) *Basis.* The proposed rule change is consistent with Section 6(b) of the Act in general, and furthers the objectives of Section 6(b)(5) in particular in that it is designed to promote just and equitable principles of trade and to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the

public interest. Specifically, the proposed rule change will help ensure greater financial stability of the Exchange's members by requiring those members to maintain higher capital levels. In the event of adverse market movements, these capital reserves will help protect members and their customers by helping to ensure that funds are available to cover securities positions.

B. Self-Regulatory Organization's Statement on Burden on Competition

The CSE does not believe that the proposed rule change will impose any inappropriate burden on competition.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others

No comments were solicited in connection with the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve such proposed rule change; or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such

filings will also be available for inspection and copying at the principal office of the CSE. All submissions should refer to File No. SR-CSE-97-09 and should be submitted by September 19, 1997.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁷

Margaret H. McFarland,
Deputy Secretary.

[FR Doc. 97-23011 Filed 8-28-97; 8:45 am]

BILLING CODE 8010-01-M

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38964; File No. SR-DTC-97-05]

Self-Regulatory Organizations; The Depository Trust Company; Order Approving a Proposed Rule Change Relating to the Establishment of Procedures to Distinguish Repurchase Transactions and Other Financing Transactions From Securities Pledges

August 22, 1997.

On May 14, 1997, The Depository Trust Company ("DTC") filed with the Securities and Exchange Commission ("Commission") a proposed rule change (File No. SR-DTC-97-05) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").¹ Notice of the proposal was published in the **Federal Register** on July 15, 1997.² The Commission received no comment letters in response to the filing. On August 7, 1997, DTC amended the proposed rule change.³ For the reasons discussed below, the Commission is approving the proposed rule change.

I. Description

The rule change amends DTC's Collateral Loan Program ("CLP") procedures⁴ to enable DTC's participants to distinguish repurchase transactions ("repos") and other types of financing transactions from pledges of securities. The CLP's current procedures do not differentiate between a securities transaction that involves the transfer of the entire interest in securities (*i.e.*, as in a repo transaction) from a securities transaction that involves the transfer of

⁷ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 38820 (July 7, 1997), 62 FR 37947.

³ The amendment was technical in nature and therefore did not require republication of the notice.

⁴ A copy of DTC's procedures for repo accounts is attached as Exhibit 2 to DTC's proposed rule change, which is available for inspection and copying at the Commission's Public Reference Room or through DTC.

⁶ Securities Exchange Act Rel. No. 31512 (Nov. 24, 1991), 57 FR 57027 (Dec. 2, 1992).