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SEC Proposes Rules Requiring Daily Reserve Computation

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INTRODUCTION

Adopted in 1972, the SEC's customer protection rule, Rule 15c3-3 under the Securities Exchange Act of 1934 [17 C.F.R. §240.15c3-3], requires fully computing securities firms having custody over customer funds and securities to segregate customer funds and fully paid securities from the firm's own assets. The rule prescribes several prophylactic measures including requirements that firms perform reserve computations and, if necessary, make required deposits of cash and/or qualified securities in specified reserve bank accounts for customers and other broker dealers (generally introducing broker-dealers maintaining proprietary securities accounts at a clearing firm referred to as "PAB Accounts").

Currently, the rule requires these reserve computations weekly. Last week, the SEC proposed changes to Rule 15c3-3 to require certain covered firms, as described below, perform reserve computations daily [see Securities Exchange Act Release No. 97877 (July 12, 2023)]. Although more frequent computations may raise operating costs for covered firms, the proposal seeks to reduce risk to customers and PAB Accounts and, to a certain extent, to codify the practices of 11 large clearing and self-clearing firms that currently perform daily reserve computations as part of their customary risk-management practices.

The SEC estimated that the proposal, if adopted, would extend to 63 firms based on past FOCUS Report data.

COMMENT PERIOD

The SEC requested comments by a date that is the later of September 11, 2023 or within 30 days of the Federal Register publication date. Contact C. Dirk Peterson at dpeterson@mcintyrelf.com or (202) 659-3905 for more information regarding this SEC rule proposal.

PROPOSED CHANGES

The proposal is intended to reduce the financial risk to customers and PAB Accounts during weekly periods between computation and deposit requirements and account activity that may create substantial mismatches between the net amount of cash owed to customers and PAB Accounts and amounts actually deposited in the special reserve bank account. During the period between computations and deposits, customers and PAB Accounts may bear the risk of shortfalls in their accounts should a mismatch exist at the time a firm holding their accounts is subject to liquidation.

Hence, the SEC proposed to reduce the potential for account mismatches by requiring covered firms to perform daily rather than weekly reserve computations. The SEC's proposal contains the following highlights:

- The daily computation proposal extends to covered firms that have \$250 million or more “average total credits” owed to customers or PAB Accounts. The proposal defines the term “average total credits” as the average sum of total credits in the reserve computations based on a rolling 12-month FOCUS reporting period.
- Deposits would need to be made within one hour of the opening of banking business the day immediately following the computation.
- Upon triggering the \$250-million threshold initially and periodically on an ongoing basis, a covered firm would have up to six months to modify its operations to satisfy a daily computing regime. Conversely, should a covered firm fall below the threshold, it could revert back to weekly computations but only if it notified its designated examining authority in writing and observed a 60-day waiting period before transitioning back to a weekly computation regime.
- Firms would have the ability to continue to compute daily even if they are below or periodically drop below the \$250 million threshold. As the SEC noted, firms may wish to compute daily regardless because they could make more frequent withdrawals from the reserve account should customer and PAB Account debits exceed credits owed.
- The SEC also requested comment on whether a similar daily computation regime be extended to security-based swap dealers. Currently, the SEC is not seeking to amend rules in the swap context because, according to the SEC, virtually all integrated firms that would be covered by the proposed daily computation account for their security-based swap activities in their reserve computation and reserve bank account.

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