

The Commission's preliminary view is that the proposed rule amendments should promote efficiency, competition, and capital formation. These amendments should provide eligible broker-dealers an opportunity to increase operational efficiency by having their supervisory risk assessment and the computation of certain capital charges more closely aligned to the sophisticated methods the firms already use to manage their business risk and capital, while at the same time requiring sufficient net capital. The incorporation of mathematical risk management techniques into the calculation of net capital charges should enable such a broker-dealer to reallocate capital from the broker-dealer to affiliates that may receive a higher return than the broker-dealer. The proposed rule amendments should also allow broker-dealers to increase operational efficiency by adopting risk management practices which have become industry best practice. In addition, the proposed amendments should enhance the ability of U.S. securities firms to compete effectively in global securities markets.

We solicit comments on these matters with respect to the proposed rule amendments. Would the amendments have an adverse effect on competition that is neither necessary nor appropriate in furtherance of the purposes of the Exchange Act? Would the proposed amendments, if adopted, promote efficiency, competition, and capital formation? Commenters are requested to provide empirical data and other factual support for their views, if possible.

VII. Regulatory Flexibility Act Certification

The Commission hereby certifies, pursuant to 5 U.S.C. 605(b), that proposed amendments to Rules 15c3-1, 15c3-4, 17a-5, 17a-11, 17h-1T, and 17h-2T, if adopted, would not have a significant economic impact on a substantial number of small entities.

These provisions would be available only to broker-dealers that have tentative net capital of at least \$1 billion and net capital of at least \$500 million. According to March 2003 FOCUS reports, there are only 28 such firms, and, of these firms, none were small businesses.⁹³ Further, election to apply

for the alternative capital regime is voluntary. The proposed rules and rule amendments, therefore, should not have a significant impact on a substantial number of small entities.

We encourage written comments regarding this certification. We solicit comment on whether the proposed rule amendments could have an effect that we have not considered. We request that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of the impact.

VIII. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"⁹⁴ a rule is "major" if it has resulted, or is likely to result, in:

- An annual effect on the economy of \$100 million or more;
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effect on competition, investment or innovation.

We request comment on the potential impact of the proposed amendments on the economy on an annual basis. We request that commenters provide empirical data and other factual support for their views.

IX. Statutory Authority

The Commission proposes to amend Title 17, Chapter II of the Code of Federal Regulations pursuant to the Exchange Act (15 U.S.C. 78a *et seq.*) (particularly sections 15(c), 17(a), 23, 24(b), and 36 thereof (15 U.S.C. 78o(c), 78q(a), 78w, 78x(b), and 78mm)).

List of Subjects in 17 CFR Part 240

Broker-dealers, Reporting and recordkeeping requirements, Securities.

day of the preceding fiscal year (or in the time that it has been in business, if shorter); and (2) [i]s not affiliated with any person (other than a natural person) that is not a small business or small organization as defined in this section * * * (17 CFR 240.0-10(c)). Further, pursuant to § 240.0-10(i), "[f]or purposes of paragraph (c) of this section, a broker or dealer is affiliated with another person if [* * *] [s]uch broker or dealer introduces transactions in securities, other than registered investment company securities or interests or participations in insurance company separate accounts, to such other person or introduces accounts of customers or other brokers or dealers, other than accounts that hold only registered investment company securities or interests or participations in insurance company separate accounts, to such other person that carries such accounts on a fully disclosed basis." (17 CFR 240.0-10(i)).

⁹⁴ Pub. L. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

Text of Proposed Rule Amendments

For the reasons set forth in the preamble, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for Part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 79q, 79t, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, 7202, 7241, 7262, and 7263; and 18 U.S.C. 1350, unless otherwise noted.

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2. Remove the authority citations following §§ 240.15c3-1 and 240.17a-5.
3. Section 240.15c3-1 is amended by:
- a. Revising the undesignated section heading preceding paragraph (a)(7);
 - b. Adding text to paragraph (a)(7);
 - c. Revising the undesignated section heading preceding paragraph (c)(13);
 - d. Adding text to paragraph (c)(13);
- and
- e. Adding a sentence to the end of paragraph (c)(15).

The additions and revisions read as follows:

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

(a) * * *

Alternative Net Capital Computation for Broker-Dealers That Elect to be Supervised on a Consolidated Basis

(7) In accordance with Appendix E to this section (§ 240.15c3-1e), the Commission may approve, in whole or in part, an application or an amendment to an application by a broker or dealer, when calculating net capital, to use the market risk standards of Appendix E to calculate the market risk capital charge on some or all of its positions instead of the provisions of paragraph (c)(2)(vi) of this section, and to use the credit risk standards of Appendix E to calculate the credit risk capital charge on certain credit exposures arising from transactions in derivatives instruments instead of the provisions of paragraph (c)(2)(iv) of this section, subject to any conditions or limitations the Commission may require as necessary or appropriate in the public interest and consistent with the protection of investors. Such a broker or dealer must at all times maintain tentative net capital of not less than \$1 billion and net capital of not less than \$500 million.

(c) * * *

⁹³ Pursuant to 17 CFR 240.0-10, "the term *small business* or *small organization* shall: [* * *] (c) [w]hen used with reference to a broker or dealer, mean a broker or dealer that: (1) [h]ad total capital (net worth plus subordinated liabilities) of less than \$500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to § 240.17-5(d) or, if not required to file such statements, a broker or dealer that had total capital (net worth plus subordinated liabilities) of less than \$500,000 on the last business