OPENING REMARKS OF
RICHARD C. BREEDEN, CHAIRMAN
U.S. SECURITIES AND EXCHANGE COMMISSION

AT
THE COMMISSION'S OPEN MEETING
TO CONSIDER THE ADOPTION OF AMENDMENTS
TO THE NET CAPITAL RULE

NOVEMBER 24, 1992

We return today to one of the core areas of SEC concern -- marketplace stability and the protection of trading markets and public customers from the adverse impact that could arise from failures of broker-dealers. The Commission's net capital rule under the Securities Exchange Act of 1934 establishes the minimum amounts of liquid assets that registered broker-dealers must maintain. These capital requirements -- together with the tough discipline of daily marking to market of positions -- play a vital role in promoting solvency among all types of broker-dealers.

When failures do occur -- which historically has not been a frequent event compared with the banking experience -- capital requirements provide the buffer to allow a firm to be closed without loss to the Securities Investor Protection Corporation ("SIPC"). Since SIPC was created in 1970, it has had to undertake relatively few liquidations of firms. The largest payout SIPC has ever made was $31.7 million, reflecting in part the success of the net capital rule. There have not been any losses to customers

within SIPC's coverage levels, and this protection for investors has been achieved at a very low cost.

It is essential that the Commission's net capital rule set forth minimum financial responsibility standards that require broker-dealers conducting a business with the investing public to maintain capital commensurate with the nature of their business activities. Investors doing business with a broker-dealer registered with, and regulated by, the Securities and Exchange Commission should be able to do so with the confidence that the broker-dealer is adequately capitalized so that the broker-dealer has sufficient assets on hand to pay the claims of its customers and creditors within a reasonable amount of time.

The Commission's net capital rule has proved to be an effective financial responsibility standard. In previous instances of brokerage failures, the net capital rule has generally enabled regulators to liquidate securities firms in an orderly fashion, without loss or undue delay to its customers or counterparties. However, even effective rules must be continuously reevaluated in light of changing business practices and marketplace realities.

The current net capital rule is, in general, the most stringent in the world. This is because the level of "haircuts" that every firm must take on the current market value of its securities positions is set at a very conservative level. The

current rule requires haircuts of 15% on a firm's aggregate long position in equity securities, plus 30% of any short positions that exceed one-quarter of the long position. Even for U.S. Treasury securities where the risk of default is zero, a broker-dealer is required to maintain 6% capital against a long position in a 30-year bond. In some firms the SEC's capital requirement results in literally billions of dollars in haircuts -- a sizeable investment in stability. Due to this conservatism, large U.S. broker-dealers were able to weather Black Monday in 1987 and other turbulent markets without serious losses. This gave our entire market the resilience to recover from such periods of stress.

The SEC remains absolutely committed to a strong net capital rule that will protect the systemic stability of our marketplace in the future as it has in the past. While the current haircut requirements have proven themselves in times of turmoil, we have also learned that there are areas where these rules can be improved. Today's proposals would bring haircuts on short positions into line with the percentages on long positions -- a step that should facilitate more efficient use of capital and avoid any disincentives to hedging positions.

In addition, today's proposals would raise -- in some cases significantly -- the minimum levels of absolute capital that different types of broker-dealers are required to maintain. This is particularly significant for firms that handle customer accounts

but do not have their own securities positions that would be subject to the haircut requirements.

In some cases the current minimum requirements were established as long ago as 1965, and have not been adjusted for either inflation or changing levels of risk as our market has become more complicated. Though our overall rule sets a high standard, the current minimum requirements are outdated and insufficient. The time has come to make adjustments so that customers, counterparties and the SIPC will not be exposed to undue risk that reasonable minimum capital levels would prevent.

Thus, under today's actions broker-dealers that clear and carry customer accounts would be required to maintain minimum capital of at least $250,000, up from either $25,000 or $100,000 today. Similarly, underwriters and marketmakers would be required to maintain a minimum of $100,000 in capital, up from $25,000.

Raising capital requirements will result in higher costs for some of the nation's 8,461 registered broker-dealers. However, it is also an investment in safety for America's investors. By phasing-in the new requirements over 18 months, even the smallest firms should have ample time to adjust to these new requirements.