

DATE: January 24, 2000

TO: Members and Member Organizations

FROM: Division of Regulatory Services

SUBJECT: Net Capital Requirements for  
Proprietary Day Trading of Broker-Dealers

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#### KEY ISSUES

- Securities and Exchange Commission ("SEC") Rule 15c3-1(a) - Net Capital Requirements for Brokers or Dealers requires broker-dealers to be in compliance with net capital requirements **at all times**. The SEC has interpreted "at all times" to include at all times during the business day.
- The term "day trading" means the purchasing and selling of the same security on the same day.
- Day trading can pose considerable risk to a broker-dealer's net capital.
- Based on SEC interpretations, broker-dealers employing accounting systems based on settlement date are expected to take material differences between trade date and settlement date accounting methods into consideration when computing net capital.
- Similarly, even if computing net capital on an end of the day basis, broker-dealers are required to take into account the effects of day trading on their intra-day net capital levels where such effect would be material.
- If intra-day haircuts for day trading reduce a broker-dealer's net capital below its required minimum at any time during the day, the broker-dealer would have been in violation of the SEC's net capital rule, regardless of whether net capital is sufficient based on positions existing at the beginning and/or end of the day. Such violations can result in serious disciplinary action.

- Members and members organizations that are capital computing are advised to monitor proprietary day trading and insure that net capital is sufficient to meet the haircut on day traded positions.

## DISCUSSION

The position of the SEC with respect to broker-dealer accounting was set forth in an April 23, 1986, letter to the AICPA and included in the NYSE Interpretation Handbook (No. 86-10, December, 1986).

The SEC has determined that broker-dealers which use a trade date basis of record keeping are in compliance with the AICPA Guide for Audits of Brokers and Dealers in Securities, while broker-dealers that use a settlement date basis of record keeping are only in compliance with the Guide if the difference between trade date and settlement date accounting is not material. Further, the SEC requires that where there is a material difference, the broker-dealer must take such difference into account in computing its net capital.

SEC Rule 15c3-1(a) - Net Capital Requirements for Brokers or Dealers - requires broker-dealers to be in compliance with net capital requirements **at all times**. This includes having sufficient net capital to effect intra-day activity, such as "day trading". The term "day trading" means the purchasing and selling of the same security on the same day.

While broker-dealers generally compute their net capital levels as compared to their requirements on an end of day basis, broker-dealers are required to take into account the effects of day trading on their intra-day net capital levels where such effect would be material. If after consideration of intra-day haircuts for day trading, a broker-dealer's net capital was below the minimum requirement at any time during the day, the broker-dealer would have been in violation of net capital requirements, regardless of whether net capital had been sufficient based upon open positions existing at the beginning and/or the end of the trading day (See NYSE Interpretation Handbook No. 99-8, August, 1999)

Unless the execution time of day trades and position balances are monitored and recorded by the broker-dealer throughout the day, any intra-day net capital computation must include a haircut equaling the sum of the haircuts on the greater of the purchase or sale transactions involving day trades on each individual security occurring on a single day. If execution times are monitored and recorded, and the broker-dealer is able to document it was not exposed to all day trades at the same time, only the highest haircut representing the largest open position at any one time need be deducted in computing an intra-day net capital level.

If the effect on capital of intra-day activity is not assessed by the broker-dealer, there is a risk that intra-day net capital may be insufficient resulting in the imposition of serious disciplinary sanctions for violation of net capital requirements.

Questions regarding net capital requirements for proprietary day trading may be directed to Robert Gardner (312) 786-7937 or Richard Lewandowski (312) 786-7183, in the Exchange's Department of Financial and Sales Practice Compliance.