



DIVISION OF
MARKET REGULATION

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

February 23, 2000

Mr. Raymond J. Hennessy
Vice President
New York Stock Exchange, Inc.
20-Broad Street
New York, New York 10005

Ms. Susan DeMando
Vice President
NASD Regulation
1735 K Street, NW
Washington, DC 20006

Re: Net Capital Treatment of Temporary Capital Contributions

Dear Mr. Hennessy and Ms. DeMando:

This letter is in response to comments that the Division of Market Regulation ("Division") has received concerning the net capital treatment under Rule 15c3-1¹ under the Securities Exchange Act of 1934 ("Exchange Act") of capital contributions that are received by a broker-dealer from an individual investor and withdrawn within one year of the contributions.

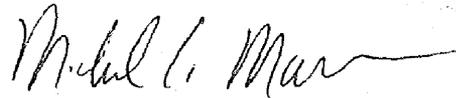
In conversations with the Division's staff, you identified several instances where a broker-dealer received capital contributions from an individual investor that were subsequently withdrawn after a short period of time, often less than one year from the date of the contributions. The firm included the capital contributions in its net capital computation. The individual investor actively traded the firm's proprietary trading account, within certain limits based on that individual investor's capital contributions. In addition, pursuant to an agreement with the firm, the individual investor could withdraw not only the profits generated through the individual investor's trading, but also the individual investor's capital contributions. You request guidance on whether an individual investor's capital contribution, if withdrawn within one year of the date of contribution, should be included as net capital or, for net capital purposes, should be re-characterized as a liability.

¹ 17 C.F.R. § 240.15c3-1 (1999).

The Securities and Exchange Commission ("Commission") has for some time emphasized that capital contributions to a broker-dealer must not be temporary.² The Commission has stated that an affiliate's infusion of funds into a broker-dealer and subsequent withdrawal after a short time can be viewed as a loan and considered a liability of the broker-dealer.³ In addition, this liability may not be included in the firm's net capital absent a proper subordination in accordance with Appendix D of Rule 15c3-1.

It is the view of the Division that, for net capital purposes, if an individual investor contributes capital to a broker-dealer with an understanding that the contribution can be withdrawn at the option of the individual investor, the contribution may not be included in the firm's net capital computation and must be re-characterized as a liability. Any withdrawal of capital as to that investor within a period of one year, other than a withdrawal described in paragraph (e)(4)(iii) of Rule 15c3-1,⁴ shall be presumed to have been contemplated at the time of the contribution.

Sincerely,



Michael A. Macchiaroli
Associate Director

² See *Study of Unsafe and Unsound Practices of Brokers and Dealers, Report and Recommendations of the Securities and Exchange Commission*, H.R. DOC. NO. 92-231 (1971).

³ Exchange Act Release No. 28927 (Feb. 28, 1991), 56 FR 9124 (March 5, 1991). See also Letter from Nelson Kibler, Assistant Director, Division of Market Regulation to John Pinto, National Association of Securities Dealers, Inc. (Sept. 8, 1980).

⁴ Paragraph (e)(4)(iii) of Rule 15c3-1 permits a broker-dealer to make required tax payments and pay reasonable compensation to partners without the restrictions of paragraphs (e)(1) and (e)(2) of the Rule and without considering them to be part of the calculation of withdrawals, advances and loans under those paragraphs.