AN ALERT FROM THE BDO FINANCIAL SERVICES PRACTICE

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FINANCIAL SERVICES

▶SUBJECT

SEC ADOPTS AMENDMENTS TO BROKER DEALER CUSTOMER PROTECTION, NET CAPITAL AND FINANCIAL REPORTING RULES

On July 30, the SEC adopted amendments to the broker-dealer customer protection rule (Rule 15c3-3), the net capital rule (Rule 15c3-1), the books and records rules (Rules 17a-3 and 17a-4) and the notification rule (Rule 17a-11). Concurrently with these amendments, the SEC adopted new reporting requirements aimed at enhancing oversight of broker-dealer custody practices and strengthening audit requirements. The following summary describes the key elements of the new rules and reporting requirements.

Amendments to the Customer Protection Rule

Background

The SEC's customer protection rules[1] are designed to preclude a firm that maintains custody of customer cash and securities (a carrying broker-dealer) from using those funds and securities for its own proprietary activities. To meet this objective, the rules require carrying broker-dealers to comply with two primary requirements. The first requirement is that a carrying broker-dealer must maintain physical possession or control over customers' fully paid and excess margin securities[2]. Physical possession or control means that the securities are held at a specified location (such as a bank or a clearing agency) and are free of liens or any other third-party interests. If the broker-dealer becomes insolvent, the segregated cash and securities should be readily available to be returned to the customers. In addition, if the failed broker-dealer is liquidated in a formal proceeding under the Securities Investor Protection Act of 1970 (SIPA), the securities and cash would be isolated and readily identifiable as customer property and, consequently, available to be distributed to customers ahead of other creditors.

The second requirement is that a carrying broker-dealer must maintain a reserve of cash or qualified securities in an account at a bank that is at least equal in value to the net cash owed to customers. To determine the required reserve amount, the broker-dealer adds up customer credit

1 Rules 15c3-3(a) – (o) of the Securities Exchange Act
2 Excess margin securities means those securities carried for the account of a customer having a market value in excess of 140 percent of the total of debit (owed) balances in the customers' account.

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▶SUMMARY OF NEW REQUIREMENTS

- The SEC has adopted amendments to customer protection and net capital requirements that are effective October 21, 2013.
- Effective Dec. 31, 2013, all broker-dealers will be required to file a new **Form Custody** on a quarterly basis along with their FOCUS reports.
- Effective June 1, 2014, all broker-dealers will be required to prepare and file either (1) a **compliance report** or (2) an **exemption report** along with the currently required annual audited financial statements and supplemental information. The compliance report must be examined, or the exemption report reviewed, by an independent accountant that is registered with the Public Company Accounting Oversight Board (PCAOB).
- Effective December 31, 2013. all broker-dealers that are SPIC members are required to file annual audited financial reports with SPIC.
- Effective June 1, 2014, audits of broker-dealer annual reports (covering the financial report and supplemental information) must be performed under PCAOB standards by an independent accountant that is registered with the PCAOB.

items (e.g., cash in customer securities accounts and cash obtained through the use of customer margin securities) and then subtracts from that amount customer debit items (e.g., margin loans). If credit items exceed debit items, the net amount must be on deposit in the customer reserve account in the form of cash and/or qualified securities. Generally, the reserve must be computed on a weekly basis. Funds must be added or may be withdrawn from the reserve account when a reserve calculation results in a higher or lower reserve requirement than the previous calculation.

Proprietary Accounts of Broker-Dealers

Broker-dealers are not within the definition of "customer" for purposes of the customer protection rule. Accordingly, a carrying broker-dealer that carries proprietary accounts of other broker-dealers (PAB accounts) is not restricted from using the securities and cash in these accounts for its own business purposes. The definition of "customer" in SIPA, however, is broader than the SEC's definition in the customer protection rules in that the SIPA definition does not exclude broker-dealers. Consequently, there is an increased risk that, in the event a carrying broker-dealer is liquidated under SIPA, the claims of SIPA customers (which include both customers and PAB account holders) will exceed the amount of customer property available and thereby expose the SIPC fund and, potentially, SIPA customers to losses.

To address this disparity in treatment between customers and PAB account holders, the SEC has amended Rules 15c3-3 and 15c3-3a to require carrying broker-dealers to (1) perform a separate reserve computation for PAB accounts, (2) establish and fund a separate reserve account for the benefit of PAB account holders and (3) maintain physical possession and control of non-margin securities[3] carried for PAB accounts. A broker-dealer will be permitted to use PAB account securities for its own purposes *provided* that it provides written notice to the PAB account holder that it intends to do so and provides the PAB account holder with the opportunity to object to such use. If the broker-dealer complies with the notification requirements, the PAB account holder will not be required to deduct the value of the PAB account from its net capital under the net capital rule.

This amendment effectively codifies a no-action letter issued by the SEC staff in 1998 which provided that a broker-dealer is not required to take a capital deduction for cash held in a securities account of another broker-dealer provided that the other broker-dealer (1) performs a reserve computation for the PAB accounts, (2) establishes a separate reserve bank account and (3) maintains cash or qualified securities in the reserve account equal to the computed reserve requirement.

Reserve Accounts and PAB Accounts held at Banks

The customer protection rules relating to reserve accounts have been amended to reflect the new requirement for a PAB reserve account. Accordingly, a broker-dealer that maintains a customer reserve account and/or a PAB reserve account must obtain a written agreement from the bank where the accounts reside which provides that the cash and/or qualified securities will at no time be used as security for a loan to the broker or dealer and will not be subject to claims of any kind in favor of the bank. To further limit the risk of reserve funds becoming unavailable due to the bank's use of those funds, the SEC added Rule 15c3-3(e)(5), to (1) prohibit a broker-dealer from maintaining customer and PAB reserve funds in accounts at an affiliated bank and (2) limit the amount of cash that can be deposited in both types of reserve accounts at non-affiliated banks to 15 percent of the bank's equity capital (based on the bank's most recently filed Call Report or Thrift Financial Report).

Allocation of Customers' Fully Paid and Excess Margin Securities to Short Positions

Under the current customer protection rules, when the carrying broker-dealer as principal sells short a security to its own customer, the broker-dealer is not required to have possession or control of the security even though its customer has paid for the security in full. Rather, the broker-dealer must include the mark-to-market value of the security as a credit item in the reserve formula. The broker-dealer can use the cash paid by the customer to purchase the security to make any increased deposit requirement caused by the credit item. This permits the broker-dealer, in effect, to use the customer's assets for proprietary purposes. The result is contrary to the customer protection goals of Rule 15c3-3.

To address these concerns, the SEC adopted an amendment to the customer protection rules that requires a broker-dealer to obtain physical possession or control of a customer's fully paid and excess margin securities that allocate to a broker-dealer short position. The amendment gives the broker-dealer 30 calendar days from when the deficit in the security first arises before the possession and control requirement is triggered.

Treatment of Free Credit Balances

Free credit balances are funds payable by a broker-dealer to its customers on demand. They may arise from cash deposited by the customer to purchase securities, proceeds from the sale of securities or earnings from dividends and interest on securities. Broker-dealers may, among other things, pay interest to customers on their free credit balances or offer to routinely transfer (sweep) them into a money market fund or bank account. On occasion, broker-dealers may change the product to which a customer's free credit balances are swept- most frequently to or from a money market account, or to or from an interest-bearing bank account.

Free credit balances may expose broker-dealer customers to different levels of risk, depending on the type of account the funds are transferred to. For example, money market shares receive up to $500,000 in SIPC protection while bank deposits are only insured for up to $250,000 by the FDIC. On the other hand, money market shares may incur market losses. There also may be differences in the amount of interest earned from the two

3 Non-marginable securities are those that were 100% funded by the investor's own cash.

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products. To address the potential consequences of these differing risks, the SEC has added new paragraph (j)(1) to Rule 15c3-3 that requires broker-dealers to provide customers with sufficient opportunity to make an informed decision regarding the accounts in which their free credit balances reside.

The new rule establishes conditions that must be met in order for a broker-dealer to use or transfer free-credit balances in a customer's security account. The requirements are different depending on whether or not the broker-dealer has adopted a "sweep program" (a program that routinely sweeps the customer's free credit balances into a money market fund or bank account). Further, for an account opened on or after the effective date of the rule, a customer must give prior written affirmative consent before a broker-dealer can establish a sweep program for the free credit balances in that account. The other conditions that must be met for free credit balances in accounts (both new and existing) subject to a sweep program are:

- The broker-dealer must provide the customer with disclosures and notices regarding the sweep program required by each self-regulatory organization (SRO) of which the broker-dealer is a member.
- The broker-dealer must, as part of the customer's quarterly statement of account, provide the swept funds account balance and inform the customer that the swept funds can be liquidated on the customer's order and the proceeds returned to the securities account or remitted to the customer.
- The broker-dealer provides the customer with a written notice at least 30 calendar days before (1) making changes to the terms and conditions of the sweep program, (2) making changes to the terms and conditions of the products available through the sweep program or changing the products available and (3) changing the account into which the funds are swept from one product to another.

For free credit balances that are not part of a sweep program, the new rule specifies that a broker-dealer is permitted to invest or transfer to another account or institution free credit balances in a customer's account only upon a specific order, authorization or draft from the customer.

"Proprietary Accounts" under the Commodity Exchange Act

Broker-dealers who also are registered as futures commission merchants under the Commodity Exchange Act (CEA) carry both securities and commodities accounts for customers. Currently, the definition of free credit balances in Rule 15c3-3(a)(8) does not include funds carried in commodities accounts that are required to be segregated under CEA's rules. However, certain types of accounts (proprietary accounts) are excluded from the CEA's segregation requirements. This exclusion from the segregation requirements under the CEA has raised a question as to whether a broker-dealer must treat payables to customers in proprietary commodities accounts as "free credit balances" when performing a customer reserve computation. For this reason, the SEC has amended the definition of "free credit balance" to clarify that funds held in a commodities account meeting the definition of a "proprietary account" under CEA regulations are not to be included as free credit balances in the customer reserve formula.

Futures Positions in Securities Margin Accounts

Under SRO portfolio margin rules, a broker-dealer can combine securities and futures positions in a portfolio margin securities account to compute margin requirements based on the net market risk of all positions in the account. Until the passage of the Dodd-Frank Act, SIPA specifically excluded from protection futures contracts that are not also securities. The Dodd-Frank Act expanded SIPA protection to include futures and options on futures in portfolio margin securities accounts. Consequently, futures positions are now protected under SIPA. The SEC has adopted amendments to Rules 15c3-3(a)(8) and 15c3-3(a)(9) to complement the Dodd-Frank SIPA amendments and provide additional protection to customers that carry futures positions. The amendments expand the terms "free credit balance" and "other credit balances," for purposes of the customer reserve formula, to include funds carried in a securities account pursuant to a SRO portfolio margin rule approved by the SEC.

The SEC also has also amended Item 14 of the reserve formula in Rule 15c3-3a to permit a broker-dealer to include as a debit item the amount of customer margin required on deposit at a derivatives clearing organization related to futures positions carried in a portfolio margins account.

Documentation of Risk Management Procedures

The SEC has adopted new Rule 17a-3(a)(23) to require certain broker-dealers to make and keep current a record documenting the credit, market and liquidity risk management controls established and maintained by the broker-dealer to assist it in analyzing and managing the risks associated with its business activities. The documentation requirement applies only to broker-dealers that have more than $1 million in aggregate credit items as computed under the customer reserve formula of Rule 15c3-3 or $20 million in capital, including debt subordinated in accordance with Appendix D to Rule 15c3-1. The amendments do not require any changes to existing controls, procedures and policies, but rather require that the controls that are in place be adequately documented. The documentation must be retained until three years after termination of the use of the risk management controls documented therein.

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Amendments to the Net Capital Rule

Background

The net capital rule, SEC Rule 15c3-1, establishes uniform net capital standards for SEC-registered broker-dealers . With few exceptions, all SEC-registered broker-dealers must comply with this liquidity standard. The primary purpose of this rule is to ensure that registered broker-dealers maintain at all times sufficient liquid assets to (1) promptly satisfy their liabilities - the claims of customers, creditors, and other broker-dealers and (2) to provide a cushion of liquid assets in excess of liabilities to cover potential market, credit and other risks if they should be required to liquidate. The rule achieves its purpose by prescribing a liquidity test that requires a broker-dealer to maintain the greater of a specified minimum dollar amount or specified percentage of net capital in relation to either aggregate indebtedness (generally all liabilities of the broker-dealer) or customer-related receivables (money owed to the broker-dealer by customers) as computed by the reserve requirements of Rule 15c3-3.

Changes to the net capital rule are are summarized below

Expense Sharing Agreements

New rules have been adopted with respect to the net capital rule that address the concern that some broker-dealers may be excluding from their calculations of net worth certain liabilities that have been incurred through an expense sharing agreement, under the premise that a third party (usually a parent or affiliate) has assumed responsibility for these obligations. In some cases, however, the third party does not have the resources – independent of the broker-dealer's revenues and assets – to assume these liabilities. Thus, the third party is dependent on the resources of the broker-dealer to pay the expenses and debts. The SEC views the exclusion of these liabilities from the broker-dealer's net worth calculation as potentially misrepresenting the firm's actual financial condition, and hampering the ability of regulators to monitor the firm's financial condition. To address this concern, Rule 15c3-1 has been amended to add new paragraph (c)(2)(i)(F) that will require a broker-dealer, in calculating net capital, to take into account any liabilities that are assumed by a third party if the broker-dealer cannot demonstrate that the third party has the resources – independent of the broker-dealer's income and assets – to pay the liabilities. A broker-dealer can demonstrate the adequacy of the third party's financial resources by maintaining records such as the third party's most recent (i.e., as of a date within the previous 12 months) audited financial statements, tax returns or regulatory filings containing financial reports.

Short-term Capital Contributions

In response to concerns that broker-dealers may be receiving capital contributions from investors that are subsequently withdrawn after a short period of time (often less than a year), Rule 15c3-1 has been amended to add new paragraph (c)(2)(i)(G) to require treatment as a liability (1) any capital that is contributed under an agreement giving the investor the option to withdraw it and (2) any capital contribution that is intended to be withdrawn within one year of its contribution. In addition, the amendment provides that capital withdrawn within one year of contribution is deemed to have been intended to be withdrawn within one year unless the broker-dealer receives permission in writing for the withdrawal from its designated examining authority (DEA).

Fidelity Bonding Requirements

Under SRO rules, certain broker-dealers that do business with the public or that are required to become members of the Securities Investor Protection Corporation (SIPC) must comply with mandatory fidelity bonding requirements. SRO rules typically permit a broker-dealer to have a deductible provision included in the bond; however, such rules provide that the deductible may not exceed certain amounts. Several SRO rules provide that the broker-dealer must deduct this excess amount from its net worth when calculating net capital; however, the SEC's net capital rule does not specifically reference the SRO deductible requirements as a charge to net worth. Therefore, a broker-dealer would not be required to account for the deduction required by an SRO rule in computing net capital or in the net capital computation reflected on the broker-dealer's Financial and Operational Combined Uniform Single Reports (FOCUS reports). To address this inconsistency, Rule 15c3-1 has been amended to require a broker-dealer to deduct, with regard to fidelity bonding requirements, the amount specified by the broker-dealer's DEA relating to its fidelity bond coverage.

Securities Lending and Borrowing and Repurchase/Reverse Repurchase Transactions

Amendments have been adopted in response to concerns about stock lending activities between broker-dealers. The rules address concerns that broker-dealers with principal liability in a stock loan transaction may purport to be acting in an agency capacity and, consequently, not taking appropriate capital charges. As amended, Rule 15c3-1 clarifies that broker-dealers providing securities lending and borrowing settlement services are deemed, for purposes of the rule, to be acting as principal and are subject to applicable capital deductions. Under the amendment, these deductions can be avoided if (a) the broker or dealer fully discloses the identity of each party to the other, and (b) each party expressly agrees in writing that the obligations of the broker or dealer are guaranteed by the other party.

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Rule 17a-11 (Notification Provisions for Brokers and Dealers) was also amended to require a broker-dealer to notify the SEC whenever the total amount of money payable against all securities loaned or subject to a repurchase agreement, or the total contract value of all securities borrowed or subject to a reverse repurchase agreement, exceeds 2,500 percent of tentative net capital. [4]

Temporary Restrictions on Capital Withdrawals

The current net capital rules allow the SEC to temporarily restrict a broker-dealer from withdrawing capital or making loans or advances to stockholders, insiders and affiliates under certain circumstances. These rules have been amended to expand the conditions under which the SEC may limit such withdrawals. The rules now allow the SEC to restrict, for a period of up to 20 business days, any withdrawal by the broker or dealer of equity capital or unsecured loan or advance to a stockholder, partner, sole proprietor, member, employee or affiliate as the SEC deems necessary or appropriate in the public interest if, based on the information available, the SEC concludes that such withdrawal, advance or loan may be detrimental to the financial integrity of the broker or dealer.

Broker-Dealer Insolvency Rules

Rule 15c3-1 has been amended to require a broker-dealer to cease conducting a securities business if certain insolvency events were to occur. The definition of insolvency includes, among other things, a broker-dealer's placement in a voluntary or involuntary bankruptcy or similar proceeding; the appointment of a trustee, receiver or similar official; a general assignment by the broker-dealer for the benefit of its creditors; an admission of insolvency; or the inability to make computations necessary to establish compliance with the SEC's net capital rules.

Financial Reporting Rules Amendments

In June 2011, the SEC proposed certain amendments to annual reporting, audit and notification requirements for broker-dealers. After considering the comments received on the proposed rules, the SEC released final rules on July 30, 2013.

New Reports to be Filed with Annual Reports

Under the amendments to the reporting and audit requirements, broker-dealers must, among other things, file with the SEC annual reports consisting of a financial report and either a *compliance* report or an *exemption* report that are prepared by the broker-dealer, as well as a report prepared by an independent public accountant covering the financial report and the compliance report or the exemption report. [5] *The filing of a compliance or exemption report and the related report of the independent public accountant are new requirements.*

The financial report must contain the same types of financial statements that were required to be filed prior to these amendments (a statement of financial condition, a statement of income, a statement of cash flows, and certain other financial statements). In addition, the financial report must contain the applicable supporting schedules that were required to be filed prior to these amendments (a computation of net capital under Rule 15c3-1, a computation of the reserve requirements under Rule 15c3-3 and information relating to the possession or control requirements under Rule 15c3-3). A broker-dealer that did not claim exemption from Rule 15c3-3 throughout the most recent fiscal year must file the compliance report, and a broker-dealer that did claim exemption from Rule 15c3-3 throughout the most recent fiscal year (generally, a "non-carrying broker-dealer") must file the exemption report. Under the amendments, a broker-dealer is considered to be exempt if the broker-dealer claimed an exemption from Rule 15c3-3 in its FOCUS Reports. A broker-dealer that did not claim an exemption from Rule 15c3-3 at any time during the most recent fiscal year or claimed an exemption for only part of the fiscal year must file the compliance report.

The Compliance Report

The compliance report must contain statements as to whether (1) the broker-dealer has established and maintained internal control over compliance [6], (2) the internal control over compliance of the broker-dealer was effective during the most recent fiscal year, (3) the internal control over compliance was effective as of the end of the most recent fiscal year, (4) the broker-dealer was in compliance with Rule 15c3-1 (net capital requirements) and 15c3-3(e) (maintenance of a special reserve account for the exclusive benefit of customers) as of the end of the most recent fiscal year and (5) the information the broker-dealer used to state whether it was in compliance with these rules was derived from the books and records of the broker-dealer. Further, if applicable, the compliance report must contain a description of (1) each identified material weakness in the internal control over compliance during the most recent fiscal year, including those that were identified as of the end of the fiscal year and (2) any instance of noncompliance with Rule 15c3-1 or Rule 15c3-3(e) as of the end of the most recent fiscal year. A broker-dealer is not permitted to conclude that its internal control over compliance was effective if there were one or more material weaknesses.

4 For purposes of this leverage threshold, however, transactions involving government securities, as defined in Section 3(a)(42) of the Exchange Act, are excluded from this calculation.
5 The SEC has adopted rules requiring that annual reports be filed with SIPC if the broker-dealer is a member of SIPC.
6 Defined in the rules as internal controls that have the objective of providing the broker-dealer with reasonable assurance that noncompliance with the financial responsibility rules will be prevented or detected on a timely basis

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Definitions of Material Weakness and Deficiency

A *material weakness* is defined in the rules as a deficiency, or a combination of deficiencies, in the broker-dealer's internal control over compliance such that there is a reasonable possibility that noncompliance with Rule 15c3-1 or 15c3-3(e) will not be prevented or detected on a timely basis, or that noncompliance to a material extent with Rule 15c3-3 (excluding paragraph (e), Rule 17a-13) (Quarterly Security Counts) or any Account Statement Rule) will not be prevented or detected on a timely basis.

A *deficiency* in internal control over compliance exists when the design or operation of a control does not allow the management or employees of the broker-dealer to prevent or detect on a timely basis noncompliance with the financial responsibility rules in the normal course of performing their assigned functions.

The Exemption Report

Under the rules, an exemption report must contain the following statements made to the best knowledge and belief of the broker-dealer: (1) a statement that identifies the provisions in paragraph (k) of Rule 15c3-3 under which the broker-dealer claimed an exemption from Rule 15c3-3, (2) a statement that the broker-dealer met the identified exemption provisions in paragraph (k) throughout the most recent fiscal year without exception or that it met the identified exemption provisions throughout the most recent fiscal year except as described in the exemption report and (3) if applicable, a statement that identifies each exception during the most recent fiscal year in meeting the identified provisions in paragraph (k) and that briefly describes the nature of each exception and the approximate date(s) on which the exception existed.

Independent Auditor Requirements

Auditors' Reports

In addition to preparing and filing the financial report and the compliance report or exemption report, a broker-dealer must engage a PCAOB-registered independent public accountant to prepare a report based on an examination of the broker-dealer's financial report (including supporting schedules) in accordance with PCAOB standards.

A broker-dealer also must engage the PCAOB-registered independent public accountant to prepare a report based on an examination of certain statements in the broker-dealer's compliance report[7], or to prepare a report based on a review of the statement in the broker-dealer's exemption report. In each case, the examination or review must be conducted in accordance with PCAOB standards[8]. The broker-dealer must file these audit reports with the SEC along with the financial report and the compliance report or exemption report. These reports replace current provisions that required the filing of a "material inadequacy" report.

Notification Requirements

The accountant must immediately notify the broker-dealer if the accountant determines during the course of preparing the accountant's reports that (a) the broker-dealer is not in compliance with the financial responsibility rules or (b) any material weakness exists in the broker-dealer's internal control over compliance with the financial responsibility rules. The broker-dealer, in turn, must file a notification with the SEC and its DEA within one business day if the accountant's notice concerns (1) an instance of noncompliance that would trigger notification under those rules or (2) the broker-dealer discovers or is notified by the accountant of the existence of any material weakness in the broker-dealer's internal control over compliance with the financial responsibility rules.[9]

Access to Accountant and Audit Documentation

To facilitate its oversight of broker-dealers and the regulatory examination process, the SEC has adopted rules that require a clearing broker-dealer[10] to provide a representation regarding its independent public accountant that the broker-dealer agrees to allow the SEC and the DEA to review the audit documentation associated with its annual reports, and to allow its independent public accountants to discuss findings related to the audit reports with the SEC and the DEA if requested. The representation must be included in the statement regarding identification of a broker-dealer's independent public accountant that broker-dealers must file each year with the SEC and their DEA (except that if the engagement is of a continuing nature, no further filing is required).

7 A carrying broker-dealer that is either registered as an investment advisor or maintains client assets of an affiliated investment advisor may satisfy the requirement under Investment Advisors Act Rule 206(4)-2 to file an internal control report relating to custody of those assets by filing the independent accountant's report based on an examination of the broker-dealer's compliance report.

8 The PCAOB has proposed an auditing standard for supplemental information accompanying audited financial statements, including supporting schedules broker-dealers must file as part of the financial report. In addition, the PCAOB has proposed specific attestation standards for examining compliance reports and reviewing exemption reports.

9 The notification process is generally the same as that in place before the amendments, except that the requirement to report "material inadequacies" has been replaced with the requirement to report any instances of "material noncompliance" with the financial responsibility rules and any material weakness in internal control over compliance with the financial responsibility rules"

10 For purposes of this requirement, a "clearing broker-dealer" is a broker-dealer that clears transactions or carries customer accounts.

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Reports to be Filed with SIPC

Currently, broker-dealers are required to file with their annual report a supplemental report on the status of their membership in SIPC, which is required to be "covered by an opinion of the independent public accountant" if the annual report of the broker-dealer is required to be audited. Among other things, the supplemental report needs to cover the SIPC annual general assessment reconciliation or exclusion from membership forms (i.e., Form SIPC-7 or Form SIPC-3, both of which are filed by the broker-dealer with SIPC). In addition, the rules require that the review by the accountant include certain minimum procedures. Under this provision, the supplemental report does not need to be filed if the SIPC Fund assessments are the minimum assessment provided for under SIPA.

Since the adoption of this rule, SIPC raised the annual assessment above the $150 minimum, which triggered the requirement for broker-dealers to file a supplemental report with the SEC, the broker-dealer's DEA and SIPC.

Because Forms SIPC-3 and SIPC-7 are used solely by SIPC for purposes of levying its assessments, the SEC has amended the filing requirements for the supplemental report that relates to these forms. The amendment requires that broker-dealers file the supplemental report with SIPC (rather than with the SEC). In addition, the SEC has proposed that SIPC adopt a rule prescribing the form of the supplemental reports. However, because there will be an interim period before a rule determined by SIPC becomes effective, broker-dealers must continue to file the supplemental report (using the existing format) with the SEC, the broker-dealer's DEA, and SIPC until SIPC adopts a rule prescribing its own form and the rule is approved by the SEC. The existing supplemental form will be in effect until the earlier of the SEC approving a rule adopted by SIPC or two years. If after two years, SIPC has not issued a rule covering the supplemental report, broker-dealers would no longer be required to file these reports.

Form Custody

The SEC has adopted a new form (Form Custody) that will elicit information about a broker-dealer's custodial activities. Form Custody must be filed on a quarterly basis along with the FOCUS report. The form contains information about whether the broker-dealer maintains custody of customer and non-customer assets and, if so, how the assets are maintained. It will not be subject to examination or review by the broker-dealer's independent accountant. The form is due within 17 *business* days of calendar quarter end (accordingly, the first Form Custody will be due by Jan. 27, 2014).

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