

Statement

Improving the Effectiveness of the Customer Protection Rule



Commissioner Jaime Lizárraga

July 12, 2023

Today's proposal to update the customer protection rule for carrying broker-dealers falls in the category of "there's always room for improvement." By increasing efficiency, liquidity, and competitiveness, these updates will improve the daily functioning of our capital markets, increase confidence, and protect investors.

The proposed updates address a potential mismatch in funds owed and funds held in a broker-dealer's reserve account. Under the current weekly reserve calculations, broker-dealers may receive large cash inflows prior to the next weekly reserve calculation. This means that the amount of net cash and securities held in the reserve account may not equal the net cash owed to investors for several days.

This potential mismatch creates a risk that if a broker-dealer failed during this period, it may be unable to return all of the cash and securities owed to investors. There's a significant downside to reaching this stage in that customer claims may not be satisfied in full.

As a result, the backstop fund established by Congress to protect investors when a brokerage firm fails, overseen by the Securities Investor Protection Corporation (SIPC), might be required to advance money to make investors whole. Given that the target amount for the SIPC fund is \$5 billion, a failure of a carrying broker-dealer with a large shortfall could potentially deplete the SIPC fund.

The amount of these potential shortfalls is not trivial. In 2022, following customer reserve calculations, certain broker-dealers were required to make additional deposits ranging between \$1.6 billion to over \$6 billion to replenish their reserve accounts.

Recent failures in the banking sector brought into sharper focus the need to review vulnerabilities in the existing customer asset protection framework for broker-dealers.

The Commission's review of this framework led to today's proposal. It is designed to strengthen existing protections for customer assets and to lower the risk that a failure at a broker-dealer would result in customers having no other choice than to seek remedies in a bankruptcy court.

The proposal requires broker-dealers that carry large amounts of customer cash and securities to perform their reserve computations daily rather than weekly. This would shorten any potential mismatch period during which the amounts reserved and owed exist.

It carries the benefit of protecting customer assets and increasing confidence in the securities markets.

It would also help mitigate risks to the SIPC fund by avoiding potential harm and losses in the event a broker-dealer is liquidated.

In the public comment period that will follow, it will be particularly useful to receive feedback, including relevant data, on whether all broker-dealers that hold customer assets should be required to calculate their reserves daily.

I support today's proposal and its goal of strengthening protection of customers' assets in the event of a broker-dealer's failure. The proposal was crafted with much care and thought by the Division of Trading and Markets, with essential contributions from several other Commission divisions and offices. Through their commitment to strong and effective oversight of our capital markets, the Commission's staff provides a valuable service to the public and to our country.