

PROPOSED AMENDMENT
TO RULE 325(a)

CONTENTS

Summary Memorandum

Proposed Amendment to Rule 325(a)

EXHIBIT A

SEC 17a-8 Letter

EXHIBIT B

THE New York Stock
Exchange

Summary Memorandum

PROPOSED AMENDMENT TO RULE 325(a)

DEBT/EQUITY CAPITAL REQUIREMENTS FOR MEMBER CORPORATIONS

The Issue

To determine whether the Board of Directors should revise the Exchange's net capital rule with respect to debt/equity requirements for member corporations prior to the implementation of a new uniform net capital rule by the SEC.

Background

The current debt/equity requirements of Exchange Rule 325(a) for member corporations whose stock is not freely transferable dates back to 1953, when member partnerships were first permitted to incorporate. Requirements for corporations whose stock is freely transferable were adopted in March 1970, along with other Constitution and Rule amendments permitting member corporations to issue their stock to the public.¹

¹ Rule 325(a) currently provides that:

In no case shall less than 25% of the net worth of a member corporation be attributable to capital stock. If a member corporation has any freely transferable security outstanding, at least 30% of its net worth must be attributable to capital stock if the corporation is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934; if a corporation is required to file such reports, then at least 50% of its net worth must be attributable to capital stock and at least 25% of its net worth must be attributable to voting common stock.

Member corporations issue freely transferable securities either because they want to go public or because they want to make a private placement. In the first instance, member corporations have generally found that underwriters require a substantially greater equity than the 50% required by the present rule. Private placements have been made primarily to corporations whose managements are highly sophisticated in financial matters. In effect, experience to date has indicated that it is unnecessary to maintain a 50% equity requirement for member corporations with freely transferable securities.

On October 30, 1972, the Exchange circulated a proposal to revise debt/equity requirements which, among other things, would have replaced the existing fixed percentage requirements with a schedule of percentage requirements descending from a maximum of 35% equity. In response, the Securities and Exchange Commission suggested that a fixed 30% equity requirement for all firms would be appropriate. However, the Exchange deferred further consideration of proposed changes pending adoption by the SEC of a proposed uniform net capital rule.

Recent Developments

In the staff's view, the recently announced consolidation of the business of two member corporations--Hayden Stone Inc. and Shearson, Hammill & Co. Incorporated--makes it impossible for the Exchange to await the implementation of an SEC uniform net capital rule.

The consolidation provides, in effect, that Hayden Stone will acquire Shearson, Hammill and change its name to Shearson Hayden Stone, Inc. Because of the relatively weak financial condition of Shearson, Hammill, Hayden Stone is gradually acquiring

branches and operating sections of Shearson, Hammill prior to the intended consummation date of September 1, 1974.

A proposed acquisition of \$50 million of aggregate indebtedness by Hayden Stone will have to be supported by a capital infusion. This infusion would be accomplished by the "switch" of an institutional subordinated loan of \$5 million from Shearson, Hammill to Hayden Stone. Although the ultimately proposed capitalization of Shearson Hayden Stone, Inc. would be in compliance with the existing 50/50 debt-equity requirement for a public member corporation, this initial \$5 million institutional subordination would cause the ratio of equity to net worth to fall below 50% during the proposed transition period. In addition, since Hayden Stone's debt-equity ratio is now close to 50/50, any presently unforeseen difficulties during or after the consolidation could well bring the new corporation's equity below the required 50%.

Discussion

In view of both the earlier determination that a 50% equity requirement is unnecessary and the potential problems which retention of that requirement might create with regard to the Shearson Hayden Stone situation, the staff has prepared proposed revisions of Rule 325(a). These revisions would combine existing features of the Exchange rule with the 30% equity requirement most recently proposed by the SEC for all broker-dealers who would be subject to an SEC uniform net capital rule; however, the proposed changes to Rule 325(a) would permit member corporations presently complying with a 25% equity requirement to continue to do so until the adoption of such a rule by the Commission.

The proposed amendment would not subject member partnerships to debt-equity requirements, but it would change the requirements applicable to member corporations as follows:

1. Those with no freely transferable security outstanding---no change, 25% equity requirement.
2. Those with a freely transferable security outstanding:
 - a) but not required (being narrowly held) to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934---no change, 30% equity requirement;
 - b) and required as publicly owned to file reports under Section 13 or 15(d) of the Securities Exchange Act of 1934---reduce the equity requirement from 50% to 30%.

RECOMMENDATION

The staff recommends that the Board of Directors adopt the proposed amendment to Rule 325(a) subject to receipt of a no objection letter from the SEC. The proposed amendment is shown in Exhibit A. Attached as Exhibit B is a copy of a letter sent to the SEC, pursuant to SEC Rule 17a-8, on July 19, 1974, requesting prompt consideration of the proposal so that, if the Board accepts the staff recommendation, the amendment can be implemented without delay.

DEPARTMENT OF REGULATORY DEVELOPMENT

PROPOSED AMENDMENT TO RULE 325 (a)

New language underlined.

Deleted language [bracketed]

CAPITAL REQUIREMENTS

General provisions

Rule 325 (a)

* * * *

[Not less than 25% of the Net Worth of a member corporation shall be attributable to capital stock, except that with respect to any member corporation which has outstanding any freely transferable security (1) which is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, not less than 30% of such corporation's net worth shall be attributable to capital stock, or (2) which is required to file reports under Section 13 or 15(d), not less than 50% of such corporation's net worth shall be attributable to capital stock and at least 25% of such corporation's net worth shall be attributable to voting common stock.]

No member corporation shall permit that part of its net worth not attributable to capital stock to exceed 70% of its net worth (75% in the case of member corporations having no freely transferable security outstanding) for a period in excess of 90 days, or for such longer period which the Exchange may upon application of the member corporation grant in the public interest or for the protection of investors. For a member corporation which has outstanding any freely transferable security and which is required to file reports under Section 13 or 15(d) of the Securities Exchange Act of 1934, at least 25% of such corporation's net worth shall be attributable to voting common stock.

THE New York Stock
Exchange

July 19, 1974

James E. Buck
Secretary

Mr. Lee A. Pickard
Director
Division of Market Regulation
Securities and Exchange Commission
500 North Capitol Street, N.W.
Washington, D.C. 20549

Dear Mr. Pickard:

At its meeting on July 11, the Board of Directors adopted amendments to Rule 325 along with a complementary revision of Rule 327. The Exchange would now like to further amend Rule 325 to more closely attune our capital rule to provisions of the proposed Securities and Exchange Commission uniform net capital rule for the transitional period. Pursuant to Rule 17a-8 under the Securities Exchange Act of 1934, we are submitting herewith three copies of a proposed amendment to Exchange Rule 325(a).

You will recall that on October 30, 1972 the Exchange circulated to its membership and other interested parties a proposal to revise debt-equity requirements which would have, among other things, replaced the fixed percentage requirements with a schedule of percentage requirements starting at an upper limit of 35% equity. At that time, the proposed changes were sent to the Commission pursuant to Rule 17a-8. The Commission indicated that a 30% equity requirement for all firms would be appropriate, but the Exchange deferred consideration of the proposal in view of the proposed uniform net capital rule.

The current debt-equity requirements of Rule 325(a) are as follows:

Not less than 25% of the Net Worth of a member corporation shall be attributable to capital stock, except that with respect to any member corporation which has outstanding any freely transferable security (1) which is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, not less than 30% of such corporation's net worth shall be attributable to capital stock, or (2) which is required to file reports under Section 13 or 15(d), not less than 50% of such corporation's net worth shall be attributable to capital stock and at least 25% of such corporation's net worth shall be attributable to voting common stock.

The requirements for corporations whose stock is freely transferable were first adopted in March, 1970 along with other Constitution and Rule amendments to permit member corporations to issue their stock to the public. The requirement for corporations whose stock is not freely transferable dates back to 1953, when member partnerships were first permitted to incorporate.

Experience has shown that it is not necessary to have different debt-equity requirements for corporations which have a freely transferable security outstanding and those which do not. Corporations issue freely transferable securities either because they want to go public or because they want to make a private placement. In the first case, corporations have generally found that underwriters require a substantially greater equity than the 50% required under Rule 325(a). Private placements have been mostly to corporations whose managements are highly sophisticated in financial matters. Thus, it is not necessary to require higher equity requirements for corporations with freely transferable securities.

This proposal to amend Rule 325(a) represents a combination of the Commission's debt-equity requirements in its most recent proposal of a uniform net capital rule and the debt-equity requirements in Rule 325(a) in such a way that those member organizations which are currently complying with a 25% equity requirement may continue to do so until adoption of a uniform net capital rule. The Commission's most recent proposal of a uniform net capital rule would impose a 30% equity requirement upon all broker/dealers subject thereto. The proposed amendment to Rule 325(a) would not subject member partnerships to debt-equity requirements. The amended requirements applicable to member corporations would be:

1. Those with no freely transferable security outstanding---25% equity requirement, no change.
2. Those with a freely transferable security outstanding:
 - a) but not required (being narrowly held) to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934---30% equity requirement, no change;
 - b) and required as publicly owned to file reports under Section 13 or 15(d) of the Securities Exchange Act of 1934---30% equity requirement, a reduction from 50% to 30%.

We would appreciate receiving your comments as soon as possible.

Any questions you may have regarding this matter may be directed to Mr. George Beliakow, telephone (212) 623-7713.

Very truly yours,

James E. Buck