

JANUARY 2025

CARTANA'S FOCUS ON....

WHAT IS NET CAPITAL?



Net capital is fundamentally a measure of a firm's liquidity, which refers to the capacity to convert current assets and liabilities into net cash in the event of liquidation. According to Exchange Act Rule 15c3-1, commonly referred to as the Net Capital Rule, firms are required to maintain net capital at specified levels continually, in order to safeguard customers and creditors against monetary losses that may arise from firm failures. The minimum net capital requirements for broker-dealers are contingent upon the nature of the securities business undertaken and whether the firm carries customer accounts.

FINRA Minimum Net Capital Requirements

- Broker-dealers that carry customer accounts: \$250,000
- Broker-dealers that do not carry customer accounts: \$100,000
- Prime brokers: \$1,500,000
- Executing brokers within a prime broker relationship: \$1,000,000
- Introducing brokers: \$5,000

Should a firm opt not to be subjected to the Aggregate Indebtedness Standard, it remains imperative that its net capital consistently exceeds the higher of the specified minimum net capital amounts or 6.67% of its aggregate indebtedness. Aggregate indebtedness represents the calculation of a firm's liabilities, subject to particular adjustments. Newly established member firms face elevated requirements during their inaugural year of operations.

Typically, firms utilize the following equation to ascertain their allowable net capital:

Net Capital Equation
Net Worth
+ Net Income (Loss)

Owners Equity
+ Subordinated Debt

Total Available Capital
- Non-Allowable Assets
- Haircuts
=====
Net Capital

The allowable net capital is subsequently compared to the requisite minimum net capital to ascertain the excess net capital. The firm's Financial and Operations Principal (FINOP) is responsible for preparing these computations and monitoring net capital levels to ensure ongoing compliance with the Net Capital Rule and the financial stability of the broker-dealer. Should the levels diminish excessively, the firm must inject additional capital. This computation is also essential in determining whether the broker-dealer can participate in firm commitment offerings of securities, make larger purchases or distribute capital to shareholders. All computations must be retained within the firm's official books and records as a permanent record.

Furthermore, pursuant to Exchange Act Rule 17a-11, firms are obligated to notify the Financial Industry Regulatory Authority (FINRA) if their net capital falls below the prescribed minimum as stipulated by the Net Capital Rule. Failures to maintain adequate net capital or to inform regulatory agencies of insufficient net capital may result in significant regulatory sanctions, penalties, and potential suspension or disqualification from the industry.