

SECURITIES AND EXCHANGE COMMISSION WASHINGTON. D.C. 20549

DIVISION OF

July 1, 1986 RECEIVED

Thomas R. Cassella Director Office of Financial Responsibility National Association of Securities Dealers, Inc. 1735 K Street, N.W. Washington, D.C. 20006

MASD SURVEILLANCE

Dear Mr. Cassella:

You have received many inquiries from bank affiliates engaging in securities activities that have been required to register with the Commission as broker-dealers under Section 15(a) of the Securities Exchange Act of 1934 (the "Act") pursuant to the provisions of Rule 3b-9 thereunder (17 CFR \$240.3b-9) and are seeking membership in the National Association of Securities Dealers, Inc. These inquiries have been primarily related to the requirements and obligations imposed by the Commission's financial responsibility rules, specifically the Uniform Net Capital Rule and the Customer Protection Rule, Rules 15c3-1 and 15c3-3, respectively (17 CFR \$240.15c3-1 and 15c3-3).

We understand the pertinent facts to be generally as follows: the Bank Affiliated Broker-Dealers ("BABDs") intend to introduce all accounts of customers to non-affiliated clearing broker-dealers ("CBD") who will carry such accounts on a fully disclosed basis. Accordingly, the CBD will establish, maintain and preserve all the books and records pertaining to the accounts of the BABD's customers that are required by Rules 17a-3 and 17a-4 under the Act (17 CFR 240.17a-3 and 17a-4). The CBD, pursuant to its clearing agreement made with the BABD, will establish an account at an affiliated bank of the BABD.

Q: What are the requirements and obligations under Rules 15c3-1 and 15c3-3 of a BABD with authority from its customer(s) to give instructions to transfer funds from his (their) account(s) to the CBD's account and with authority from the CBD to give instructions to transfer funds from its account to the accounts of customers for the settlement of securities transactions when these accounts are at affiliated banks of the BABD?

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A: Generally, a BABD can direct transfers of funds from the CBD's and its customers' accounts at its affiliated banks, for the settlement of securities transactions, only if it operates under the provisions of subparagraph (a) (1) of Rule 15c3-1. Pursuant thereto, the BABD would be required at all times to have and maintain net capital of not less than \$25,000.

In addition, a BABD directing transfers of funds from its customers' accounts at affiliated banks will not qualify for an exemption from the provisions of Rule 15c3-3 pursuant to subparagraph (k)(2)(B).

The Division of Market Regulation, however, will raise no question nor recommend any enforcement action to the Commission if a BABD that may direct transfers of funds from its customers' and the CBD's accounts, as described above, operates under the provisions of subparagraph (a) (2) of Rule 15c3-1 with net capital of not less than \$5,000. The BABD may also operate under the exemption set forth in paragraph (k) (2) (B) of Rule 15c3-3. This applies however only if:

- (a) the BABD obtains and preserves as part of its records a written authorization from its CBD and its customers authorizing them to direct transfers of funds from their accounts at affiliated banks;
- b) the BABD will have access to the CBD's and its customers' accounts at the bank solely for the purpose of settling the balance owing from any trades the customers have made; and
- (c) the BABD enters into a written agreement with its affiliated bank in which the affiliated bank agrees to be responsible to the customers or the CBD for any loss of funds resulting from misappropriations, conversions or errors made by the BABD in connection with the settlement of any securities transactions.
- 2 Q: Can the BABD be authorized to draw checks from the CBD's account at an affiliated bank for the settlement of securities transactions in addition to doing business in the manner specified in question number

1, and still operate as a \$5,000 broker-dealer and qualify for the exemption provided by subparagraph (k)(2)(B) of Rule 15c3-3?

- A: It is the opinion of the Division that a BABD may write checks drawn on an account set up by a CBD to pay customers of the BABD and still qualify for the \$5,000 category and the (k)(2)(B) exemption, if:
 - (a) the check is made payable to the order of the BABD's customer;
 - (b) the bank account is in the name of the CBD;
 - (c) there is a written contract between the CBD and the BABD which explicitly states that the BABD is authorized to draw on the account only as agent for the CBD; and
 - (d) the CBD does not debit free credit balances or other credit balances by the amount of checks drawn on such account until the checks clear.
- 3 Q: What are the requirements and obligations under Rules 15c3-1 and 15c3-3 of a BABD when, in addition to doing business in the manner specified in question number 1, its affiliated bank has a Trust Department which places its securities orders with the BABD to be settled on an DVP/RPV basis by the CBD?
 - A: The BABD, as long as it complies with the terms and conditions stated in response to question number 1 above, can operate under the provisions of subparagraph (a)(2) of Rule 15c3-1 as a \$5,000 brokerdealer and under the (k)(2)(B) exemption to Rule 15c3-3.
- 4 Q: What are the requirements and obligations under Rules 15c3-1 and 15c3-3 of a BABD that is engaged both in general securities activities as an introducing broker-dealer doing business in the manner specified in question number 1, and in the selling of registered investment company shares on a wire order basis?
 - A: The BABD, as long as it complies with the terms and conditions stated in response to question number 1 above, can operate under the provisions of subparagraph (a)(2) of Rule 15c3-1 as a \$5,000 broker-dealer.

However, with respect to Rule I3c3-3, the BABD will be required to comply with the terms and conditions of the exemption set forth in subparagraph (k)(2)(A) of Rule 15c3-3 as to its sales of shares of investment companies. The BABD will also be responsible for establishing, maintaining and preserving all the books and records that are required by rules 17a-3 and 17a-4 regarding the wire order sales of shares of registered investment companies.

- 5 Q: What are the requirements and obligations under Rules 15c3-1 and 15c3-3 of a BABD that is doing business in the manner specified in question number 1 and that solicits, in any way, the receipt of securities so it can deliver the securities directly to the customers or the CBD, as appropriate, for the settlement of securities transactions?
 - A: A BABD that solicits the receipt of securities to deliver them to the appropriate party is required to operate pursuant to subparagraph (a)(1) of Rule 15c3-1 by having and maintaining net capital of not less than \$25,000 at all times.

With respect to Rule 15c3-3, the Division of Market Regulation will raise no question nor recommend any enforcement action to the Commission if the BABD operates pursuant to the provision of subparagraph (k)(2)(B) of Rule 15c3-3, if the BABD promptly transmits all customers' securities received to the appropriate party. The term "promptly transmit" means by noon of the next business day in which the securities are received. The BABD must also make appropriate records under Rule 17a-3 relating to the receipt and delivery of securities.

- 6 Q: What are the requirements and obligations under Rules 15c3-1 and 15c3-3 of a BABD that solicits the receipt of customers' funds as well as securities so it can deliver the funds and securities directly to the customer or the CBD, as appropriate?
 - A: A BABD that solicits the receipt of customers' funds and securities to deliver the funds and securities directly to the appropriate parties is required to operate pursuant to subparagraph (a)(1) of Rule 15c3-1. Under the provisions of subparagraph (a)(1) of Rule 15c3-1 the BABD would be required at all times to have and maintain net capital of not less than \$25,000.

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With respect to Rule 15c3-3, the BABD will be considered a fully computing broker-dealer and must comply with all the provisions of Rule 15c3-3. The BABD will also be responsible for establishing, maintaining and preserving the appropriate books and records that are required by Rules 17a-3 and 17a-4.

- 7 Q: Are cash deposits held at an affiliated bank in a bank account on behalf of the BABD, "allowable assets" for the BABD's net capital calculation pursuant to the provisions of subparagraph (c)(2)(iv) of Rule 15c3-1?
 - A: Pursuant to subparagraph (c)(2)(iv) of Rule 15c3-1, cash deposits held in a bank account with a parent or affiliated bank on behalf of the BABD will only have net capital value to the extent that the deposits represent normal day to day operating balances.

The Division's opinions herein are necessarily confined to the facts as stated; any material change therein may warrant a different result and should be brought to the Division's attention.

If you have any questions, please contact us.

Sincerely,

Michael A. Macchiaroli

Assistant Director