



DIVISION OF
MARKET REGULATION

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

December 20, 1991

Edward Kwalwasser, Esquire
Executive Vice President
New York Stock Exchange, Inc.
20 Broad Street
New York, New York 10005

John E. Pinto, Jr.
Executive Vice President
Compliance
National Association of
Securities Dealers, Inc.
1735 K Street, N. W.
Washington, D.C. 20036

Dear Messrs. Kwalwasser and Pinto:

We understand that certain of your member broker-dealers act as "finders" or "conduits" as a part of their securities loaned and borrowed businesses. We have been asked whether a broker-dealer may conduct a finder or conduit business as described hereinafter without violating the Commission's customer protection rule, Rule 15c3-3 under the Securities Exchange Act of 1934 (17 C.F.R. § 240.15c3-3).

We understand that, generally, each of the broker-dealers that desires relief from Rule 15c3-3 operates its finder business as follows: The broker-dealer acts as a "finder" or "conduit" whereby it borrows securities from one party that it then lends to another party. A separate clearing account is established at the Depository Trust Company ("DTC") to process the broker-dealer's securities loaned and borrowed finder business separately from the broker-dealer's customer related borrows and loans.

Separate internal DTC box account numbers are used to identify securities that are used in the broker-dealer's finder business (as opposed to any customer related borrows and loans). 1/ Additionally, the broker-dealer uses separate internal securities borrow and loan account numbers to reflect the broker-dealer's

1/ It should be noted that a conduit box may not be considered to be a control location.

finder business. The broker-dealer has a separate "loan" account that serves as the subsidiary ledger for each person to or from whom the broker-dealer has loaned or borrowed securities. All suspense items also have their own account numbers.

Intra company loans between the broker-dealer's customer and conduit businesses are made only when there is an excess of customer securities available to be loaned to the broker-dealer's conduit business and the securities transferred to the conduit business are loaned immediately. No customer excess securities available to be loaned may be loaned to and accumulated in the broker-dealer's conduit accounts to or for potential securities loans. The customer securities to be loaned first must be delivered to the broker-dealer's conduit business, from the customer business, before such securities can be loaned out through the broker-dealer's conduit business. Once delivered to the broker-dealer's conduit business from the customer business, those securities can no longer be treated as if in possession or control.

Broker-dealers engaged in conduit businesses as part of their proprietary securities loaned and borrowed businesses establish management accountability for the performance of the proprietary conduit businesses' processing, recordkeeping, reconciliation, and maintenance functions separate from those of the broker-dealers' customer securities loaned and borrowed businesses. These broker-dealers also utilize independent review by control personnel to ensure the separation of the broker-dealers' conduit businesses from their conventional securities loaned and borrowed businesses and to monitor the balancing of the matched book systems.

Subparagraph (b)(1) of Rule 15c3-3 provides that a broker-dealer promptly must obtain and thereafter maintain the physical possession or control of all fully-paid and excess margin customer securities. Subparagraph (d) of that rule requires that certain action be taken within prescribed periods if the broker-dealer does not have the requisite number of customer securities by class and issue in its possession or control.

Two problems typically arise under Rule 15c3-3 in connection with a broker-dealer's securities borrowed and loaned transactions. The first problem occurs when a broker-dealer has a possession or control deficit and borrowed securities that the broker-dealer delivered out on a securities loan are returned. The broker-dealer must freeze the amount of returned securities needed to eliminate the deficiency and maintain such securities in its possession or control, and may not return the borrowed securities to the original lender in whole or in part.

The second problem arises if a broker-dealer that has lent out securities subsequently discovers that it has a deficiency in the amount of securities of which it is required to maintain possession or control. Under such circumstances, the broker-dealer must effect a recall of the securities loaned sufficient to cure the possession or control deficiency within five business days, even if the loan clearly was related to a borrowing of securities.

Based on the above circumstances, the Division of Market Regulation will raise no question nor recommend any action to the Commission if a broker-dealer that conducts its "finder" (or "conduit") business as described above does not freeze the securities in the conduit account when returned or does not recall securities loaned in the conduit account, even if the broker-dealer has a deficiency in its possession or control requirements (except as to paragraph two below), under the following conditions:

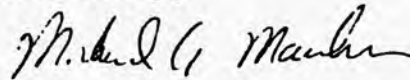
1. The broker-dealer may not commingle customer securities with those in the conduit account, except as described below.
2. Intra company stock loans and borrows are permissible between the broker-dealers' conduit book and customer book, if securities records reflect these intra company borrows and loans and related movements between the customer and conduit businesses. These intra company loans and borrows may not be used by a broker-dealer to circumvent or gain any advantage in connection with its possession or control of customer securities requirements or reserve formula requirements under Rule 15c3-3. Where a broker-dealer has made an intra company stock loan from its customer loan book to its conduit loan book and a possession or control deficiency arises, recall of the customer securities loaned to the conduit business is required within the time parameters specified in Rule 15c3-3(d)(1).
3. Securities loaned from the conduit book to the customer book may not be returned to the conduit book if such return would create or increase a deficit.
4. After recall by the customer book to the conduit book is made, if a conduit securities loan is returned ("received in") the broker-dealer first must satisfy the customer recall even though the securities returned to the account originally were borrowed from a broker-dealer or institution and reloaned. If there is a

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prior recall to the conduit box from another stock
lender, that recall may be satisfied before the
customer book recall.

The position expressed herein is a staff position with
respect to enforcement only and does not purport to express any
legal conclusion on this matter. If you have any questions
concerning this matter, please contact K. Susan Grafton, at (202)
272-7458, or the undersigned, at (202) 272-2904.

Sincerely,



Michael A. Macchiaroli
Assistant Director