american securities association

America's Voice for Main Street's Investors

September 11, 2023

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Ms. Countryman,

The American Securities Association[1] (ASA) appreciates this opportunity to submit comments in response to the Securities and Exchange Commission's (SEC) proposed amendments to Rule 15c3-3 (the Customer Protection Rule) to require certain broker-dealers to compute their customer and broker-dealer reserve deposit requirements on a daily basis, rather than weekly (Proposal).

I. General Feedback

Before the agency proceeds to a final rule, it should learn more about how firms operate in this space. Engaging with affected industry participants – such as the ASA – will help the Commission achieve a result that is both desirable and protects an otherwise well-functioning market.

Perhaps most important, the SEC should consider the unintended and practical consequences of some components of its proposal as discussed below, so that it can make adjustments to achieve maximum effectiveness while minimizing unintended disruptions.

The SEC has failed to appropriately weigh the costs of this change versus any potential benefits that could derive from the proposal. These costs include hiring and training staff, negative impacts on liquidity, implementing new systems to perform the daily calculation, and that many inputs used in the reserve calculation are not currently available on a daily basis. All of this will increase the costs to investors buying and selling securities, a reality not reflected in the proposing release.

II. External Sweep Programs

[1] The ASA is a trade association that represents the retail and institutional capital markets interests of regional financial services firms who provide Main Street businesses with access to capital and advise hardworking Americans how to create and preserve wealth. The ASA's mission is to promote trust and confidence among investors, facilitate capital formation, and support efficient and competitively balanced capital markets. This advances financial independence, stimulates job creation, and increases prosperity. The ASA has a geographically diverse membership base that spans the Heartland, Southwest, Southeast, Atlantic, and Pacific Northwest regions of the United States.

The Proposal does not adequately acknowledge how firms currently utilize external sweep programs through either a bank sweep program governed under FDIC or money market funds. Many firms off balance sheet external sweep offerings represent the majority of client cash holdings and may represent over 80% of these balances. These arrangements already address many of the desired outcomes of the proposed daily computations. By pushing customer funds off the broker-dealer's balance sheet at regular intervals, these programs contribute to protecting customer assets. Broker-dealers often immediately sweep customer funds to segregated accounts. Under this process, the 'mismatch' problem the Proposal seeks to remedy does not exist, and it is unclear how a daily calculation requirement would benefit the customers of these firms.

External sweep programs have deadlines for purchases & redemptions that are generally earlier than other industry processing deadlines (including banking wire transfer). This disparity creates a window of time where a free credit may be received but cannot be immediately swept. In those cases, funds are generally sent to the sweep program early the following business day as many external sweep programs have 2 to 3 batches each business day. An exception to this operation occurs when those funds are needed to satisfy an offsetting receivable from that same customer on that following business day (i.e. - the client has purchased securities that settle the following business day).

Therefore, to the extent a client has elected to participate in a sweep program (and the funds aren't otherwise needed to satisfy a customer receivable the following day), any overnight free credit balance will sweep to the product elected by the client, achieving the desired protection sooner than including free credits pre-designated for transfer to a sweep program (per client's standing election to participate in a sweep program) in the calculation.

ASA urges the SEC to consider that widely-used sweep programs already address the objectives being sought by the Proposal.

III. Implications of Daily Computation

While we recognize that there are potential benefits to more frequent computations, we raise concerns about the potential impact on liquidity, particularly in cases involving transitory free credits. A daily reserve computation will increase the likelihood of undue liquidity stress in situations where a free credit balance is transitory.

For purpose of clarity, 'transitory' is intended to mean free credits that (a) are included in the computation, (b) will be needed to fund a known activity on the first following day, and (c) will be included in the deposit due the morning of the second following day (despite the fact the free credits have already been used for another, client-directed purpose).

A few examples of those transitory scenarios are:

- Free credits that will be needed next day to fund an ACH or Wire distribution request received after banking cutoff times;
- Free credits received after the cutoff time that will be needed next day to fund transfer to a Sweep Program the client has elected under J(2)(ii);

- Free credits that will be needed next day to fulfill a client's specific order or authorization to facilitate transfer to another institution or account that is not carried by the broker or dealer, including transfers facilitated under J(2)(i);
- Free credits that will be needed next day to facilitate a client's standing instruction for a periodic distribution; and
- Trades that settle the next business day.

The above scenarios can occur under the current weekly reserve computation, but the impact is muted since many of the scenarios are resolved during the period between computations. As part of their liquidity management plan, some firms have procedures in place to identify large transitory credits occurring on the date of the computation that will create a significant deposit requirement, and they act to mitigate the impact of the large credit to the extent they can.

Generally, these balances will be swept off the balance sheet to an external third-party bank or deployed at customer direction meeting the funding requirement that results from the Special Reserve Account (SRA) calculation, resulting in broker dealers covering the deficiency with their own capital/liquidity and leaving the industry exposed to liquidity risk driven by the 15c3-3 rule. More frequent calculations will likely increase the probability of material liquidity concerns. Furthermore, the expected increase in volatility may result in banks that currently accept SRA deposits to exit the space resulting in reduced ability for the industry to manage counterparty exposure.

The liquidity risk stems from the requirement that the firm meet the SRA funding requirement without recognition that the free credits were used for another client directed purpose. Since those 'transitory' customer free credits are no longer available to fund the SRA deposit, the firm must substitute its own capital/liquidity to make the required SRA deposit. The SEC should recognize that the substitution of firm capital/liquidity to meet the SRA funding requirement when transitory free credits are used for alternate client-directed purposes effectively imposes an additional capital buffer, which we do not believe was intended under the rule.

It is virtually impossible to accurately forecast the amount of transitory customer free credits that will be in the SRA calculation and funded using firm capital/liquidity on a day-to-day basis. However, it is reasonable to expect the day-over-day change in those transitory customer free credits to be highly volatile. The volatile and unpredictable amount of transitory free credits included in the SRA calculation and funded with firm capital/liquidity presents a significant challenge to another important aspect of customer protection: Liquidity Risk Management[2].

To put it differently, current Rule 15c3-3 is taking a snapshot of customer free credits at a point in time without factoring in an adjustment for known activities that will use those customer free credits on the next business day. As context, if a firm receives a large wire transfer after the cutoff time established for the sweep option the client selected, it must include those free credits in the SRA deposit even though that same money will be needed for transfer to the client's elected sweep option. In doing so, the firm must then contribute its own capital/liquidity to fund

[2] See FINRA Notice to Members 23-11 highlighting generally the importance of liquidity risk management, available at: https://www.finra.org/rules-guidance/notices/23-11.

the second use of the capital (the SRA funding requirement). In extreme situations, the firm may be forced to reject a single large wire – or a series of smaller wires due to their aggregate value – that are received after the cutoff time for the client's selected sweep option.

Though the risk that a firm will have to commit its own capital to meet the SRA funding requirement currently exists, that is limited to once per week under the current rule. With a shift to a daily computation, the undue liquidity stress from transitory free credits is guaranteed unless the rule includes some provision which allows free credits that are known to be transitory to be excluded from the computation. As a result, we recommend that the SEC provide relief for these situations under the final proposal. Additionally, the SEC must allow firms to account for challenges arising from significant liquidity events, as the timing of these events can substantially affect reserve computations and liquidity needs.

IV. Clearing Broker Dealers

Clearing broker-dealers currently manage reserve requirements weekly, which has been effective for the industry and never resulted in any problems. We believe the SEC may be underestimating the adjustments required for daily computations and inadvertently creating an uneven playing field between broker-dealers and banks. The proposed amendments hold broker-dealers to a higher standard compared to banks, without concrete evidence of systemic failures in the broker-dealer sector.

Further, we caution that the substitution of firm liquidity/capital for transitory credits that are no longer available at the time of deposit could result in comingling firm & customer assets and/or constitutes a misuse of the SRA based upon the stated purpose of the account under 15c3-3(f) since the transitory credits have been used for an alternate purpose, requiring (a) the broker/dealer to substitute with firm liquidity/capital, and (b) the SRA to be titled "Special Custody Account for the Exclusive Benefit of Customers of [broker/dealer]", identified as such to the bank by the broker dealer, and confirmed in writing by the bank (15c3-3(f)).

The SEC is required by law to consider the impact this rule change will have on competition amongst broker-dealers. Specifically, any rule change cannot result in a competitive advantage for large Wall Street banks with broker-dealer affiliates vis-a-vis standalone broker-dealers not affiliated with banks. Again, these disproportionate consequences on the broker-dealer industry were not fully considered as part of the proposal.

V. Weekly PAB Computation and Optional Daily Computations

For firms performing both customer reserve and Proprietary Account of Broker-Dealer (PAB) computations, we recommend exempting the PAB computation from daily requirements. This adjustment would align with the goal of protecting customer reserves while mitigating stress on firms' resources.

Moreover, the SEC should consider allowing optional daily computations under specific circumstances, such as early bond market closures, bank holidays, and days with low industry-wide activity. This flexibility could improve operational efficiency and mitigate the burden on firms during unusual market conditions.

VI. Debit Relief

We urge the SEC to adjust the debit penalty requirement from 3 percent to 1 percent, as the proposed threshold is overly broad. This modification would provide financial relief to firms while aligning with the needs of the computation schedule.

VII. Timely Risk Based Thresholds

The current proposal only uses size as a threshold to perform the calculation and does not address risk or liquidity factors which may be better predictors of a failing firm. Quickly identifying these factors could be effective in identifying those firms trending toward failure. The SEC can require those firms to perform a daily reserve calculation while not penalizing every firm over a predetermined size who likely have very healthy balance sheets. This is a sensible way to allow for different business models to compete while protecting customer assets.

Further, FINRA has proposed the concept of a daily liquidity risk management rule (Reg Notice 23-11) which outlines eight criteria for deteriorating liquidity and is reportable within two days. The SEC and FINRA should consider using these thresholds as the trigger for a daily reserve calculation.

VIII. Simplified Intra-Week Calculation

We acknowledge that certain firms should be required to perform a daily reserve calculation, but we also believe that the vast majority of firms should be permitted to use a simplified intra-week calculation to achieve similar results without causing undue hardship.

The current rule outlines a structure to implement the existing weekly calculation on a daily basis. If we studied the inputs for each firm, we would likely find that most firms have five to ten key balances that have a material impact on the required reserve deposit. A more simplified calculation would:

- Require firms to review their reserve deposits daily based on changes in key balances. As part of this simplified calculation, firms would be permitted to exclude cash balances moved to external third-party bank sweep or money market fund programs;
- Allow faster response time by firms as they would not be performing the complex calculation daily, rather adjusting the deposit for changes in key balances; and
- Provide relief for firms from having to develop infrastructure and hire regulatory associates to perform the current calculation on a daily basis.

We encourage the SEC to consider maintaining the existing weekly calculation and implementing a simplified intra-week calculation for the vast majority of firms as this would achieve a materially similar outcome with significantly faster response times by firms, and would be pleased to provide a supplemental submission outlining this approach

IX. Implementation Timeframe

We emphasize the importance of a reasonable implementation timeframe. Firms need adequate time to adjust their infrastructure, staffing, and technology to meet the proposed requirements.

As the SEC notes in its release, only parts of the securities industry are currently performing daily computations. Those firms have had the benefit of budgeting and addressing staffing over a period of time. They have also had the benefit of a self-directed runway with time to consider budgets and technology spends that ultimately have been phased-in over time. In industry calls, these firms have shared that it took them approximately 25,000 hours of staff and technology work and 1 ½ years to move from weekly to daily.

For firms that have yet to move to this standard, they will need adequate time to work with their Treasury, Operations, Legal, Compliance, Technology, and Human Resources functions (to name a few), and to update their infrastructure in a manner that is able to fulfil the requirements of any final proposal.

A number of our members have determined that the daily computational processes may extend over a 10-hour period. The time allocated by a firm to perform these computations typically commences with data acquisition and progresses through a series of calculations, validations, cross-references, and ultimately concluding with the finalization of fund transfers or deposits. During this 10-hour period, the undertaking involves the participation of numerous departments, as well as up to 50 different people, depending on firm size. This is a complicated process and not a task that can be effectively overseen by robotic process automation.

The same firms who will be required to move to a daily computation are also managing multiple other regulatory requirements such as preparation and filing of a monthly supplemental liquidity statement which started May 2022, sending information to the Consolidated Audit Trail, a move to the T+1 Settlement Cycle, implementation of new margin amendments under FINRA Rule 4210, a shortened TRACE reporting cycle for corporates, and a shortened reporting cycle for municipal securities, and potential adoption of a new daily liquidity risk management rule (Reg Notice 23-11), to name a few.

Unless the SEC provides adequate time to manage these new regulatory requirements together, firms will face an unmanageable clash of compliance requirements all converging at the same time. Considering the multitude of regulatory obligations firms currently manage, an implementation date beginning no sooner than January 2025 would allow for proper preparation and alignment. This proposal, along with the majority of the other regulatory proposals and recent changes are impacting the same subset of broker-dealers solely based on the size of a particular balance without regard to risk characteristics or other factors such as reserve cushion, excess net capital, borrowing capacity, etc.

X. Conclusion

We appreciate the SEC's receptiveness to industry feedback and urge careful consideration of our comments. The American Securities Association, represented by the firms with a significant stake in liquidity and retail client services, is committed to collaborating with the SEC to achieve the twin goals of market protection and efficient operations.

We remain available to engage in further discussions to ensure any final rule strikes the right balance and does not impair competition among broker-dealers.

Sincerely,

Christopher A. Iacovella

Christopher A. Iacovella
President & CEO
American Securities Association