



DIVISION OF
TRADING AND MARKETS

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

February 3, 2012

Peter J. Morgan III
Senior Vice President & Deputy General Counsel
Charles Schwab & Co., Inc.
211 Main Street
San Francisco, CA 94105

**Re: No-Action Request with Respect to the Possession and Control of Securities
Processed through the NSCC Alternative Investment Products Service**

Dear Mr. Morgan:

We have received your letter of February 3, 2012 ("Letter") on behalf of Charles Schwab & Co., Inc. ("Schwab") in which you request assurance that the Division of Trading & Markets ("Division") will not recommend enforcement action against Schwab with respect to Schwab's use of the National Securities Clearing Corporation's ("NSCC") Alternative Investment Products ("AIP") service to establish satisfactory control locations as required by SEC Rule 15c3-3(c)(7), for uncertificated securities of alternative investments participating in the AIP service ("Uncertificated Alternative Investment Securities").

As described in your Letter, the AIP service is intended to standardize the way the alternative investment industry communicates information between broker-dealers, fund managers, administrators, custodians and issuers of alternative investments such as hedge funds, funds of funds, private equity, non-traded real estate investment trusts (REITs) and limited partnerships. The AIP service offers a number of control improvements to the current manual, de-centralized and paper-based mechanisms that are used today for establishing a satisfactory control location for uncertificated securities of alternative investments.

Schwab wishes to be able to designate as good control locations entities that are members of the AIP service that also are responsible for maintaining ownership records of Uncertificated Alternative Investment Securities. Further, Schwab will obtain the requisite assurances from the entities serving as the control locations through AIP's electronic communications network (rather than through a paper letter from the control location) that such Uncertificated Alternative Investment Securities are registered in Schwab's name for the benefit of its customers and are not subject to a lien.

Based on the facts and representations Schwab has made to the Division in the Letter, the Division will not recommend enforcement action to the Commission if Schwab designates as a good control location for Uncertificated Alternative Investment Securities the AIP member that is responsible for maintaining ownership records of such securities, subject to the following conditions:

1. The entity is an AIP Member and is bound by the rules and regulations of the NSCC, as such rules and regulations have been approved by the Commission from time to time;
2. The applicable alternative investment product has been approved by NSCC as eligible for processing through the AIP service;
3. Schwab will carry the Uncertificated Alternative Investment Securities "long" in customers' accounts;
4. Schwab will reflect Uncertificated Alternative Investment Securities separately in securities records or ledgers maintained pursuant to SEC Rule 17a-3 under the Exchange Act;
5. When accepting custody of an Uncertificated Alternative Investment Security, Schwab is not aware of any substantial problems of an operational nature which the AIP service, the AIP Member or the issuer of the Uncertificated Alternative Investment Securities may be experiencing and which may endanger the interests of the customer;
6. Schwab will obtain and record an electronic communication from the applicable AIP member, as denoted by the "broker-controlled" designation made in accordance with the NSCC's rules, that the securities are not subject to any right, charge, security interest, lien, or claim of any kind in favor of the securities issuer or the AIP member;
7. Schwab will continually monitor the AIP service for any changes to the "broker-controlled" designation with respect to Uncertificated Alternative Investment Securities held at Schwab and maintain a process reasonably designed to provide for the timely removal of Uncertificated Alternative Investment Securities from the customer's brokerage account when the designation has been correctly changed to "customer-controlled;"
8. The Uncertificated Alternative Investment Securities are registered with the Commission pursuant to the Securities Act or not required to be registered; and
9. Schwab will maintain in a separate file a current list of all investments of which securities will be carried on its books and records subject to the terms and conditions set forth above. The list will contain the name of the contact person, telephone number, and address for each issuer of such securities.

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You should understand that this is a staff position with respect to enforcement only, and does not purport to state any legal conclusions on this matter. The Division's position is confined to the facts and representations as stated herein. Any material change in circumstances may warrant a different conclusion and should be brought immediately to the Division's attention.

Sincerely,



Michael A. Macchiaroli
Associate Director

Office Of Corporate Counsel
211 Main Street, San Francisco, CA 94105-1905
Tel (415) 667-7000 Fax (415) 667-0170

February 3, 2012

Michael A. Macchiaroli, Esq.
Associate Director
Division of Trading and Markets
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

**Re: Control of Securities Processed through the NSCC Alternative Investment
Products Service Pursuant to Rule 15c3-3 under the Securities Exchange
Act of 1934**

Dear Mr. Macchiaroli:

Charles Schwab & Co., Inc. ("Schwab") requests the Division of Trading and Markets ("Division") to advise it that, on the basis of the facts stated herein, it will not recommend that the Securities and Exchange Commission ("Commission") take enforcement action against Schwab if it uses the facilities and structure of the National Securities Clearing Corporation's ("NSCC") Alternative Investment Products ("AIP") service¹ to establish a satisfactory control location as required by SEC Rule 15c3-3(c)(7) for uncertificated securities of participating alternative investments. For the reasons discussed below, Schwab believes that the controls and processes that will be provided under the AIP service model will not just provide for an adequate protection of customer securities for satisfactory control locations, but will represent a significant improvement over the way broker-dealers currently establish control locations for uncertificated alternative investments.

Developed and offered by the NSCC, the AIP service is intended to standardize the way the alternative investment industry communicates information between broker-dealers, fund managers, administrators, custodians and issuers of alternative investments such as hedge funds, funds of funds, private equity, non-traded real estate investment trusts (REITs) and limited partnerships. The AIP service offers a number of control improvements to the current manual, de-centralized and paper-based mechanisms that are used today for establishing a satisfactory control location for uncertificated securities of alternative investments.

¹ See, Securities Exchange Act Release No. 57813 (May 12, 2008), 73 FR 28539 (May 16, 2008)(SR-NSCC-2007-12).

I.

Regulatory Background

A. Possession and Control of Uncertificated Securities

Broker-dealers that hold securities for the accounts of customers are required to maintain the physical possession or control of all customer fully-paid and excess margin securities under SEC Rule 15c3-3(b). The possession or control requirement means that broker-dealers must have securities in physical possession or at one of the several "control locations" identified by SEC Rule 15c3-3(c). Because uncertificated securities generally cannot be physically held in a broker-dealer's possession, the broker must establish that the uncertificated securities are lodged in a "satisfactory control location." Under the rule, satisfactory control locations include registered securities clearing agencies, U.S. banks, and, with the approval of the Commission, certain foreign financial institutions and "such other locations as the Commission shall upon application from a broker or dealer find and designate to be adequate for the protection of customer securities."²

The Division has permitted registered broker-dealers to designate certain entities as satisfactory control locations for uncertificated securities where such entities are obligated to create and maintain the ownership records with respect to such uncertificated securities. Specifically, in a No-Action letter issued by the Division in 1986, the staff permitted a registered broker-dealer to carry on its books and records limited partnership units that were uncertificated and registered pursuant to the Securities Act of 1933 (the "Securities Act") while designating the general partner as a good control location for purposes of SEC Rule 15c3-3 under the Securities Exchange Act of 1934 (the "Exchange Act").³ The Division extended the same treatment to Schwab in 1997, authorizing us to carry unregistered limited partnership units on our books and records while designating the general partner as a good control location.⁴ In 1999, the Division granted this authorization to Schwab with respect to our carrying of unregistered limited liability company units on our books and records while designating the manager as a good control location.⁵ Over the years, this authority has been extended to REIT shares,⁶ Cayman Islands domiciled corporate entities,⁷ units of Delaware business trusts,⁸ and uncertificated notes.⁹

² SEC Rule 15c3-3(c)(7).

³ Wayne Hummer & Co., SEC No-Action Letter, 1986 WL 65387 (S.E.C.) (publicly avail. Apr. 8, 1986).

⁴ Letter from Marc J. Hertzberg, Division of Market Regulation, to Brandon Becker, Wilmer, Cutler & Pickering (July 30, 1997).

⁵ Letter from Mark M. Attar, Division of Market Regulation, SEC, to Brandon Becker, Wilmer, Cutler & Pickering (Sept. 17, 1999).

⁶ Letter from Bonnie L. Gauch, Division of Market Regulation, SEC, to Michael K. Rafter, Holland & Knight, LLP (Jan. 5, 2000).

⁷ Letter from Joseph I. Levinson, Special Counsel, Division of Trading and Markets, SEC, to Mark D. Fitterman, Morgan, Lewis & Bockius LLP (June 9, 2009)

B. The Requirements of Satisfactory Control Locations

In each of the various No-Action Letters referenced above, the Division has conditioned its approval on the following conditions:

1. The securities are exempt from registration, or not required to be registered;
2. The broker-dealer carries the investment "long" in customers' accounts;
3. All securities positions of each securities issuer are reflected separately in securities records or ledgers maintained pursuant to Rule 17a-3 under the Exchange Act;
4. The broker-dealer is not aware of any substantial problems of an operational nature which the investment may be experiencing and which may endanger the interests of the customer;
5. The broker-dealer will obtain written assurances that the securities are not subject to any right, charge, security interest, lien, or claim of any kind in favor of the securities issuer or sponsor of the issuer (e.g., the general partner, managing member, trustee, etc.); and
6. The broker-dealer will maintain in a separate file a current list of all investments of which securities will be carried on its books and records subject to the terms and conditions set forth above. The list will contain the name of the contact person, telephone number, and address for each issuer of such securities.

C. Additional Requirements for Uncertificated Securities of Foreign Issuers

Uncertificated alternative investment securities are also issued from outside the United States. Under paragraphs (c)(4) and (c)(7) of SEC Rule 15c3-3, the Commission has determined that foreign securities held in the custody of foreign depositories, foreign clearing agencies, foreign custodian banks and foreign broker-dealers may be deemed to be held in satisfactory control locations for broker-dealers subject to SEC Rule 15c3-3.¹⁰ Where broker-dealers propose control locations that are not one of these designated central locations, the Commission has permitted broker-dealers to apply under SEC Rule 15c3-3(c)(7) for designation of other locations as satisfactory control locations. Under guidance from the Commission, once the application is complete, the foreign control location is accepted unless the broker-dealer is notified of its rejection within ninety days.¹¹ The approval of applications is generally

⁸ Letter from Joseph I. Levinson, Special Counsel, Division of Trading and Markets, SEC, to Mark D. Fitterman, Morgan, Lewis & Bockius LLP (June 9, 2009)

⁹ FOLIO[fn] Investments, Inc., SEC No-Action Letter, 2009 WL 58414 (Jan 6., 2009).

¹⁰ *See*, Securities Exchange Act Release No. 10429 (Oct. 12, 1973), 38 FR 29217 (Oct. 23, 1973) (hereinafter "Securities Exchange Release No. 10429").

¹¹ *Id.*

conditioned on the same requirements as provided for control locations of securities of U.S. issuers, except for two additional covenants. In addition to obtaining the written assurances described above, the broker-dealer must obtain:

1. Written assurance that the securities are registered on the books and records of the proposed control locations in the name of the carrying broker-dealer or its nominee as held solely for the customers of the carrying broker-dealer; and
2. Written assurance that that beneficial ownership of the securities is freely transferable without the payment of money or other value other than for safe custody or administration.

Other than these additional requirements, a broker-dealer would establish the designation of a good control location through the same processes and procedures as described for securities of U.S. issuers.

II.

Proposal to Use the AIP Service to Facilitate the Establishment of a Satisfactory Control Location

Similar to the no-action letters referenced above, Schwab wishes to designate as good control locations entities that are members of the AIP service that are responsible for maintaining ownership records of uncertificated securities for alternative investment products that are also participating in the AIP service (each such authorized record keeper hereinafter referred to as an "AIP Member"). Further, Schwab wishes to obtain the requisite assurances that such uncertificated securities of alternative investment issuers ("Uncertificated Alternative Investment Securities") are not subject to a lien through AIP's electronic communications network rather than through the collection of paper-based letters.

A. Entities that May Be Designated as Control Locations under the AIP Service

AIP membership criteria are set forth in the rules of the NSCC that have been approved by the Commission pursuant to SEC Rule 19b-4 under the Exchange Act ("AIP Members").¹² Under the NSCC's Rule 53, the following types of entities will be eligible to become control locations by being an AIP Member.¹³

¹² See, Securities Exchange Act Release No. 57813 (May 12, 2008), 73 FR 28539 (May 16, 2008)(SR-NSCC-2007-12).

¹³ *Id.* NSCC Rule 53 also permits U.S. registered broker-dealers and non-U.S. regulated broker-dealers to become AIP Members; however, Schwab acknowledges that a broker-dealer's authority to serve as a good control location for another broker-dealer would not derive from this request for No-Action, but rather from SEC Rule 15c3-3(c)(2) and applicable SEC and SRO guidance. Nothing in this letter is intended to contradict existing regulations pertaining to control locations under SEC Rule 15c3-3.

- A bank or trust company under supervision of federal or state banking authorities or a non-US bank subject to regulation in its home jurisdiction;
- An investment company registered under the Investment Company Act of 1940 or an issuer (structured as a fund or other pooled investment vehicle) that is not required to register thereunder;
- An investment adviser as defined under the Investment Advisers Act of 1940 regardless of whether it is registered under the Investment Advisors Act or is exempt from registration;
- A commodity pool operator or commodity trading advisor as defined in the Commodity Exchange Act regardless of whether the commodity pool operator or commodity trading advisor is registered pursuant to the Commodity Exchange Act or is exempt from registration thereunder;
- An insurance company regulated under state insurance law or a non-US insurance company subject to regulation by the appropriate insurance regulator in its home jurisdiction;
- An entity engaged under contract to provide administrative services to one or more alternative investment products that can be processed through the AIP service; or
- An entity that does not qualify as one of the above entities but that has demonstrated to the Board of Directors of NSCC that its business and capabilities are such that it could reasonably expect material benefit from direct access to the AIP service.

Before acceptance as an AIP Member, each applicant must submit an executed member's agreement to NSCC agreeing, among other things, that it will

- abide by the rules of NSCC, and be bound by all the provisions thereof, and agrees that the NSCC will have all the rights and remedies contemplated by the rules of NSCC;
- be bound by the rules of NSCC as to all matters and transactions occurring while the applicant was an AIP Member, notwithstanding that the applicant may subsequently cease to be an AIP Member;
- not submit, clear or settle through NSCC any contract or transaction unless the rules of NSCC are a part of the terms and conditions of such contract or transaction;
- pay to NSCC such charges as shall be established by NSCC by rule;
- not submit or confirm any transaction, charge, request, instruction or transmission through NSCC's services, nor otherwise utilize NSCC's

services, in contravention of any law, rule, regulation or statute applicable to the AIP Member;

- not submit any request, instruction, transaction or other transmission through NSCC's services for which it is not, directly or indirectly and whether acting on its own behalf or on behalf of any other entity, duly authorized;
- pay such fines as may be imposed in accordance with NSCC's rules for the failure of AIP Member, while an AIP Member, to comply therewith; and
- be bound by any amendment to the rules of NSCC with respect to any use of NSCC's services subsequent to the time such amendment takes effect, as fully as though such amendment were now a part of the rules of NSCC; provided, however that no such amendment shall affect an AIP Member's right to cease to be an AIP Member of NSCC, unless before such amendment becomes effective, the AIP Member is given an opportunity to give written notice to NSCC of the applicant's election that NSCC shall cease to act for AIP Member.

In order to make the respective obligations relating to possession and control clear and conspicuous, the following Sections II and III will be added to the NSCC's membership agreement:

SECTION II. Agreements Applicable to AIP Manufacturers for Establishing "Good Control Locations" under SEC Rule 15c3-3(c)(7).

In addition to the Agreements set forth in Section I hereto, to the extent the undersigned is an AIP Manufacturer and will be responsible for maintaining ownership records of uncertificated securities for an Eligible AIP Product, the undersigned further agrees that each time the undersigned designates an Eligible AIP Product as "broker-controlled" within NSCC's systems, the undersigned will be making continual and ongoing representations with respect to such Eligible AIP Product to such corresponding controlling AIP Distributor that is a broker-dealer registered with the U.S. Securities and Exchange Commission ("SEC"), that the undersigned is responsible and authorized for maintaining the ownership records of such Eligible AIP Product and that:

1. The Eligible AIP Product designated by the undersigned as "broker-controlled" is not subject to any right, charge, security interest, lien or claim of any kind in favor of the undersigned or any person claiming through the undersigned.
2. To the knowledge of the undersigned, there are no substantial problems of an operational nature which the undersigned is

experiencing or which may endanger the interest of investors in the Eligible AIP Product.

3. The Eligible AIP Product is registered with the SEC pursuant to the Securities Act of 1933, as amended, is exempt from such registration, or is not required to be so registered.
4. The Eligible AIP Product is registered on the books and records of the undersigned, or its designee, in the name of the controlling AIP Distributor, on behalf of its customers; and
5. In the case of an Eligible AIP Product issued outside the United States, the undersigned does not require the controlling AIP Distributor, or any of its customers, to pay any fees other than for safe custody or administration as a condition for the transfer of the Eligible AIP Product.

The undersigned understands and acknowledges that such controlling AIP Distributors may be relying on the above representations in order to establish custody in accordance with SEC Rule 15c3-3 and that failure to properly comply with these representations may require such AIP Distributor to remove the Eligible AIP Product from an investor's brokerage account.

SECTION III. Agreements Applicable to AIP Distributors for Establishing "Good Control Locations" under SEC Rule 15c3-3(c)(7).

In addition to the Agreements set forth in Section I hereto, if the undersigned is a broker-dealer registered with the SEC and will be relying on the "broker-controlled" designation within NSCC's system to establish a good control location in accordance with SEC Rule 15c3-3, then the undersigned further agrees that, with respect to each such Eligible AIP Product designated as "broker-controlled" within NSCC's systems, the undersigned will be continually, and on an ongoing basis, agreeing with respect to such Eligible AIP Product, as follows:

1. The AIP Distributor carries the Eligible AIP Product "long" in each respective customer account.
2. The AIP Distributor reflects all share positions of the Eligible AIP Product separately in its securities records or ledgers maintained pursuant to SEC Rule 17a-3.
3. The AIP Distributor maintains in a separate file a current list of all AIP Manufacturers of which Eligible AIP Products are carried on such AIP Distributor's books and records, including the name, telephone number and address of a contact person at

each AIP Manufacturer, which information shall be available to NSCC.

In addition, applicants for AIP membership will be subject to the customer identification program maintained by the NSCC that requires applicants for AIP membership to supply identifying information that includes (1) a written application, (2) an original IRS Form W9 or Form W8, as applicable, (3) a copy of the applicant's Certified Organizational Documents, and (4) an organizational chart of the applicant or written description of ownership of the applicant showing ownership percentages of 10% or higher.

An applicant for AIP membership must also demonstrate that it is able to satisfactorily communicate with the NSCC, fulfill anticipated commitments to and meet the operational requirements of the NSCC with necessary promptness and accuracy. Applicants for AIP membership must demonstrate an established business history of a minimum of six months or personnel with sufficient operational background and experience to ensure the ability of the firm to conduct such a business.

Beyond the increased controls that AIP membership process affords over and above today's process for establishing a control location, the NSCC's rules and regulations provide for a number of other tools and protections that will further SEC Rule 15c3-3's objective of assuring the control location is "adequate for the protection of customer securities." For example, none of the following benefits would be applicable to control locations established under existing guidelines, but would be present under the auspices of the NSCC's AIP service:

- AIP Members' books will be open for inspection by the NSCC;¹⁴
- AIP Members are obligated to promptly notify NSCC of material events of the sort that might constitute a danger to the interests of the customer;¹⁵
- AIP Members are obligated to fulfill any operational testing that NSCC may require;¹⁶ and
- The NSCC will maintain a central list, available to Commission inspection, of all AIP Members and participating alternative investments.¹⁷

Given the controls described above, Schwab believes that it would not only be adequate, but an improvement on existing processes, if Schwab could designate as good control locations those entities that are members of the AIP service that are responsible for maintaining ownership records of uncertificated securities for alternative investment products that are also participating in the AIP service.

¹⁴ NSCC Rule 2A, Section 1.E(k)

¹⁵ NSCC Rule 2B, Section B

¹⁶ NSCC Rule 2A, Section 1.C

¹⁷ NSCC Rule 3, Section 5

2. Investments Eligible for Processing through the AIP Service

In order for an Uncertificated Alternative Investment Security to be eligible for processing through the AIP service, an AIP Member must submit an application to the NSCC for consideration. Under the NSCC's rules, it may consider for inclusion within the AIP service securities issued by private pooled investment vehicles (including hedge funds and private equity funds, among others), interests in commodity pools, securities issued by funds of funds, real estate investment trust securities, managed futures, managed currency products and such other alternative investment products as NSCC deems eligible pursuant to its rules.

By submitting an alternative investment product to the NSCC for inclusion within the AIP service, the AIP Member must represent to the NSCC that the offer and sale of the alternative investment will comply with all applicable requirements under the federal securities laws and such other laws as may apply, whether state, federal or those of a jurisdiction outside the United States, for so long as the alternative investment product is processed through the NSCC. The AIP Member validates its authority as record keeper by operation of the NSCC's rules which provides includes a covenant that the AIP Member has the requisite authorization for any request, instruction or other transmission it submits through the AIP service.

3. Obtaining No-Lien Assurances through the AIP Service

Under the proposed AIP service, Schwab will obtain from the AIP Member the necessary representations for each designated security held at Schwab through the AIP service. These representations and assurances will be obtained by the AIP Member placing an electronic indicator in the records that reside within the AIP service.¹⁸ Schwab and other AIP Members would be able to determine, through the AIP service, whether the No-Lien Assurances have been provided by the AIP Member serving as the control location by reference to an indicator on a security profile that is included on a data file provided by the AIP Member through NSCC to Schwab, as AIP custodian. The files with these indicators would be provided to Schwab in a manner modeled after NSCC's existing Fund/SERV[®] service for registered funds, to allow the parties to distinguish customer-controlled versus broker-controlled assets.

The representations that the AIP Member serving as the control location would make to Schwab through the AIP service indicator would be reflected in NSCC's rules and procedures.¹⁹ Specifically, through the operation of the NSCC's rules, the designation by the AIP Member that the security is "broker-controlled" will carry with it the following representations to Schwab

¹⁸ The designation of an account as "customer-controlled" or "broker-controlled" would reside in several places within the AIP service. It would appear on the order record, which implies a first purchase of a participating alternative investment, allowing broker-dealers to label an account as "customer-controlled" or "broker-controlled." The designation would also reside on other account-specific records, such as: Position, Exchange, Activity/Distribution, and Account Maintenance/Registration. Throughout the lifetime of an account or position, there would be a clear designation of whether the account or position was customer-controlled or broker-controlled.

¹⁹ See, Securities Exchange Act Release No. 57813 (May 12, 2008), 73 FR 28539 (May 16, 2008)(SR-NSCC-2007-12).

- (i) the alternative investment products designated by as controlled by Schwab are not subject to any right, charge, security interest, lien or claim of any kind in favor of the AIP Member or any person claiming through the AIP Member;
- (ii) to the knowledge of the AIP Member, there are no substantial problems of an operational nature which the AIP Member is experiencing or which may endanger the interest of investors in the alternative investment products;
- (iii) the alternative investment products are registered with the SEC pursuant to the Securities Act , are exempt from such registration, or are not required to be so registered;
- (iv) the alternative investment products in the account are registered on the books and records of the AIP Member, or its designee, in the name of Schwab, on behalf of its customers; and
- (v) in the case of an alternative investment product issued outside the U.S., the AIP Member does not require Schwab, or any of its customers, to pay any fees other than for safe custody or administration as a condition for the transfer of the alternative investment products.

Because NSCC's rules will be amended to stipulate that these representations are made and continue each time the AIP Member designates Schwab as having control over the security, the representations cannot vary or be altered. The only choice for the AIP Member is a designation of either "broker-controlled" or "customer-controlled." In addition, Schwab will monitor the AIP service on a daily basis for any changes to the "broker-controlled" designation for any securities held at Schwab. If a security were to change from "broker-controlled" to "customer-controlled," Schwab will contact the AIP Member to confirm that the position was meant to be returned to the customer. If the security is not re-designated as "broker-controlled," Schwab will remove the position from the customer's brokerage account.

We believe this process also represents significant improvements from the manner in which the required assurances are obtained from control locations. Currently, broker-dealers generally comply with the required No-Lien Assurances required by the Division's guidance on control locations by obtaining a hard-copy of a letter from the issuer or its transfer agent or other record keeper, stating that the shares in the alternative investment are not subject to a lien in favor of the issuer, its transfer agent or record keeper or any person claiming through them. Each firm decides its own tolerances for determining and verifying the legitimacy and authority of the signatories to these letters. The AIP services offer the ability to automate this obligation into a standardized, centralized and controlled process. This not only assists the parties in establishing compliance with legal requirements, but it provides a better audit trail for the participants and their regulators to verify compliance after the fact.

In addition, by operation of the NSCC rules, Schwab will provide the following representation as to such positions:²⁰

- (i) Schwab carries the alternative investment products "long" in each respective customer's account;
- (ii) Schwab reflects all share positions of the alternative investment products separately in its securities records or ledgers maintained pursuant to SEC Rule 17a-3; and
- (iii) Schwab maintains in a separate file a current list of all AIP Members of which alternative investment products are carried on the Schwab's books and records, including the name, telephone number and address of a contact person at each AIP Member, which information shall be available from NSCC.

The procedures for obtaining control by use of the AIP service as described above takes into consideration prior SEC staff guidance relating to establishing control of uncertificated securities under SEC Rule 15c3-3, including control of certain alternative investment products. We believe the obligations imposed on AIP Members and Schwab in connection with the AIP service are consistent with this guidance.²¹ Furthermore, with respect to AIP Members that are responsible for maintaining ownership records of uncertificated securities for foreign-based alternative investment issuers participating in the AIP service, Schwab believes that the control location applications described in Securities Exchange Act Release No. 10429 are no longer necessary.

II.

Schwab's Request

We request that the Division advise Schwab that, on the basis of the facts stated herein, it will not recommend that the Commission take enforcement action against Schwab if it carries on its books and records, for the account of customers, Uncertificated Alternative Investment Securities and treats the corresponding AIP Members as good control locations for

²⁰ *Id.*

²¹ See, e.g., Letter from Joseph I. Levinson, Special Counsel, Division of Trading and Markets, SEC, to Mark D. Fitterman, Morgan, Lewis & Bockius LLP (June 9, 2009) (uncertificated interest of Delaware Business Trusts and Cayman Islands domiciled corporate entities); Letter from Sheila Dombal Swartz, Special Counsel, Division of Trading and Markets, SEC, to Michael J. Hogan, President and Chief Executive Officer, FOLIO[fn] Investments, Inc. (Jan. 6, 2009) (uncertificated registered notes); Letter from Bonnie L. Gauch, Division of Market Regulation, SEC, to Michael K. Rafter, Holland & Knight, LLP (Jan. 5, 2000) (uncertificated REIT shares); Letter from Mark M. Attar, Division of Market Regulation, SEC, to Brandon Becker, Wilmer, Cutler & Pickering (Sept. 17, 1999) (uncertificated LLC units); and Letter from Marc J. Hertzberg, Division of Market Regulation, to Brandon Becker, Wilmer, Cutler & Pickering (July 30, 1997) (uncertificated private limited partnership units).

purposes of Rule 15c3-3(c)(7) under Exchange Act, provided that Schwab establish and maintain a system reasonably designed to demonstrate compliance with the following conditions with regard to such control locations:

1. The entity has been accepted by NSCC as an AIP Member and is bound by the rules and regulations of the NSCC, as such rules and regulations have been approved by the Commission from time to time;
2. The applicable alternative investment product has been approved by NSCC as eligible for processing through the AIP service;
3. Schwab will carry the Uncertificated Alternative Investment Securities "long" in customers' accounts;
4. Schwab will reflect Uncertificated Alternative Investment Securities separately in securities records or ledgers maintained pursuant to SEC Rule 17a-3 under the Exchange Act;
5. When accepting custody of an Unregistered Alternative Investment Security, Schwab is not aware of any substantial problems of an operational nature which the AIP service, the AIP Member or the issuer of the Uncertificated Alternative Investment Securities may be experiencing and which may endanger the interests of the customer;
6. Schwab will obtain and record an electronic communication from the applicable AIP Member, as denoted by the "broker-controlled" designation made in accordance with the NSCC's rules, that the securities are not subject to any right, charge, security interest, lien, or claim of any kind in favor of the securities issuer or the AIP Member;
7. Schwab will continually monitor the AIP service for any changes to the "broker-controlled" designation with respect to Uncertificated Alternative Investment Securities held at Schwab and maintain a process reasonably designed to provide for the timely removal of Uncertificated Alternative Investment Securities from the customer's brokerage account when the designation has been correctly changed to "customer-controlled";
8. The Uncertificated Alternative Investment Securities are registered with the Commission pursuant to the Securities Act, exempt from registration, or not required to be registered; and
9. Schwab will maintain in a separate file a current list of all investments of which securities will be carried on its books and records subject to the terms and conditions set forth above. The list will contain the name of the contact person, telephone number, and address for each issuer of such securities.

* * * * *

Michael A. Macchiaroli, Esq.
February 3, 2012
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We hereby respectfully request that the Division advise us that it will not recommend that the Commission take enforcement action against Schwab if it treats the AIP Member responsible for maintaining the ownership records of an alternative investment product processed through the NSCC's AIP service as a good control location in the circumstances described herein. Please feel free to contact us if you have any questions or seek any additional information regarding this request.

Yours truly,

A handwritten signature in black ink, appearing to read "Peter J. Morgan III", with a long horizontal flourish extending to the right.

Peter J. Morgan III
Senior Vice President & Deputy General Counsel