



DIVISION OF
TRADING AND MARKETS

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

December 21, 2012

Ira Hammerman
General Counsel
Securities Industry and Financial Markets Association (“SIFMA”)
1101 New York Avenue, NW, 8th Floor
Washington, D.C. 20005

Re: Regulatory Issues Related to the Current Lack of Access to the Physical Securities
Located at the Vault of the Depository Trust & Clearing Corporation (“DTC”)

Dear Mr. Hammerman:

This responds to your letter dated December 21, 2012, wherein you request that the staff of the Division of Trading and Markets (“Division”) provide you with regulatory relief arising from the inability of customers and broker-dealers to access certain physical securities certificates that were held in DTC’s vault at 55 Water Street (the “vault”). We understand that the securities in question were registered directly in the name of the owner rather than in street name. We understand that due to Hurricane Sandy and the flooding of the building at 55 Water Street, the physical certificates located in the vault are inaccessible and may remain so for some period of time. While we understand that DTC maintains electronic records and images of all of the physical certificates in its vault, and those electronic records are fully intact, SIFMA members face certain issues related to Securities Exchange Act of 1934 Rule 15c3-3¹ (the “customer protection rule”) and Rule 15c3-1² (the “net capital rule”) and have requested the relief described below as a result of DTC’s inability to access the physical certificates in the vault.

I. Requested Relief

In your memorandum, you requested that the Division confirm that DTC will continue to be considered a “good control location” under Rule 15c3-3(c)(1) for the physical security certificates that had been held in the vault at the time the vault flooded due to Hurricane Sandy. All unsold customer securities not acknowledged as received by DTCC would be included as a credit item in the Formula for Determination of Reserve Requirements for Brokers and Dealers under Rule 15c3-3a (“reserve formula”). To the extent there is a debit allocating to securities not acknowledged as received by DTC, a broker-dealer would have to take a capital charge for the debit and exclude such debit from the reserve formula.

¹ 17 CFR 240.15c3-3.

² 17 CFR 240.15c3-1.

Further, you requested for purposes of Rule 15c3-3, that in the event of a fail to receive, a buying broker may rely upon a selling broker's written representation that such fail allocates to securities acknowledged as received by DTC. You have also requested that for purposes of Rule 15c3-3 a buying broker-dealer may treat the time periods for requiring buy-ins under such rule as tolled until the Recommencement Date.³

Further, you note that the requested relief would obviate the need for extensions under Rule 15c3-3(n) that were requested for physical certificates located in the vault. Upon the Recommencement Date for a physical certificate, any broker-dealer continuing to need relief under section (n) of Rule 15c3-3 would be required to file an extension as required by the Rule.

You have requested that with respect to the three business day aging criteria for fails to deliver,⁴ a broker-dealer be permitted to disregard the three business day aging requirement but reduce such debits by the excess of the contract price of the fail to deliver contract over the market price of the underlying security and the applicable haircut on the security under Rule 15c3-1(c)(2)(vi). You have also requested that, with respect to fails to deliver allocating to customer securities acknowledged as received by DTC that are older than 30 calendar days, a broker-dealer be permitted to treat such items as a debit in the reserve formula but reduce such debit by the excess of contract price of the fail to deliver contract over the market value of the underlying security and the applicable haircut on the security under Rule 15c3-1(c)(2)(vi).

Finally, you have requested that with respect to Rule 15c3-1(c)(2)(ix), a broker-dealer be permitted to deduct the excess of the contract price of the fail to deliver contract over the market value of the underlying security .

All obligations under Rule 15c3-3 and Rule 15c3-1 with respect to a physical certificate presently inaccessible in the vault would resume upon the Recommencement Date.

II. Response

Based on your representations and the facts presented, the Division will not recommend enforcement action to the Commission with respect to physical certificates presently inaccessible in the vault if:

³ The Recommencement Date is the time at which a particular certificate become accessible and is the earlier of (1) five business days after the date the particular physical certificate(s) in the vault or documentation with equivalent effect becomes available (when a member is notified through DTC's systems that the security is in transfer to a requested destination) and (2) five business days after DTC has notified members that it has full access to all the physical certificates in the vault and has resumed standard processing operations.

⁴ See SEC Division of Trading & Markets Staff Interpretation /081 (Rule 15c3-3, Exhibit A - Item 12) (May 1995) (available at <http://www.finra.org/web/groups/industry/@ip/@reg/@rules/documents/interpretationsfor/p037772.pdf>) ("Interpretation /081").

- (1) A broker-dealer continues to treat the vault as a “good control location” under Rule 15c3-3(c)(1) for the customer securities held there which have been acknowledged as received by DTC. All unsold customer securities not acknowledged as received by DTC must be included as a credit item in the reserve formula. To the extent there is a debit allocating to securities not acknowledged as received by DTC, a broker-dealer must take a capital charge for the debit and exclude such debit from the reserve formula.
- (2) A buying broker-dealer treats the time periods for requiring buy-ins under Rule 15c3-3 as tolled. In the event that there is a fail to receive, a buying broker-dealer may rely upon a selling broker-dealer’s written representation that such fail allocates to customer securities acknowledged as received by DTC.
- (3) With respect to the three business day aging criteria for fails to deliver,⁵ a broker-dealer may disregard the three business day aging requirement, but must reduce such debits by (i) the excess of the contract price of the fail to deliver contract over the market value of the underlying security, and (ii) the applicable haircut on the security under Rule 15c3-1(c)(2)(vi). All other requirements of Interpretation /081 must continue to be met.
- (4) With respect to fails to deliver allocating to customer securities acknowledged as received by DTC that are older than 30 calendar days,⁶ a broker-dealer continues to treat such fails as a debit in the reserve formula but reduces such debits by (i) the excess of the contract price of the fail to deliver contract over the market value of the underlying security, and (ii) the applicable haircut on the security under Rule 15c3-1(c)(2)(vi).
- (5) With respect to Rule 15c3-1(c)(2)(ix), a broker-dealer need only deduct the excess of the contract price of the fail to deliver contract over the market value of the underlying security.

The relief provided herein shall expire upon the Recommencement Date.

Any broker-dealer utilizing the foregoing relief must (i) promptly notify its designated examining authority (“DEA”); (ii) maintain a record for examination indicating the fail to deliver items allocating to securities acknowledged as received by DTC or allocating to fail to receive items for which the broker-dealer has a written representation from the broker-dealer failing to deliver (including any written representation so received); and (iii) upon request, deliver to its DEA a list of the its securities acknowledged as received by DTC.

You should be aware that this is a staff position with respect to enforcement only and does not purport to express any legal conclusions regarding the application of the federal securities laws. Moreover, this position is based on the facts you have presented and the

⁵ See Interpretation /081, supra note 4.

⁶ See 17 CFR 240.15c3-3a (Item 12).

December 21, 2012
Page 4 of 4

representations you have made, and any different facts or conditions may require a different response. This position is subject to modification or revocation if at any time the Commission or Division determines that such action is necessary or appropriate in furtherance of the purposes of the federal securities laws.

Sincerely,

A handwritten signature in cursive script, appearing to read "Michael Macchiaroli".

Michael A. Macchiaroli
Associate Director



December 21, 2012

John Ramsay, Deputy Director
Michael A. Macchiaroli, Associate Director
Division of Trading and Markets
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Grace B. Vogel
Executive Vice President, Member Regulation
Financial Industry Regulatory Authority
One Liberty Plaza
165 Broadway, 27th Floor
New York, NY 10006

Re: Regulatory Issues Related to the Lack of Access to the Physical Securities Located at the Vault of the Depository Trust Corporation (“DTC”)

Dear Mr. Ramsay, Mr. Macchiaroli, and Ms. Vogel:

The Securities Industry and Financial Markets Association (“SIFMA”)¹ submits this letter to set forth various regulatory issues and accompanying requests for regulatory relief and interpretive guidance from the Securities and Exchange Commission (“SEC”) and the Financial Industry Regulatory Authority (“FINRA”) arising from the inability of customers and broker dealers to access to securities held in physical form in the name of the owner located in the vault of the Depository Trust & Clearing Corporation (“DTC”) at 55 Water Street (the “vault”). We greatly appreciate your ongoing concern in communicating with us regarding the relief requested in this letter commencing shortly after Hurricane Sandy struck the week of October 29, 2012. Until the storm, DTC operated the vault and custody service at 55 Water Street designed to hold such securities (hereafter “physical certificates” and “Custody Service”). The U.S. securities industry is highly reliant on this Custody Service, which holds physical certificates, to effect transactions and conduct securities operations. As a result of the hurricane and flooding of the building at 55 Water Street, the physical certificates located in DTC’s vault are inaccessible and may remain so for some period of time. DTC has announced that it maintains electronic

¹ The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA’s mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.

records and images of all of the physical certificates in its vault and has commenced efforts to facilitate the issuance of replacement certificates, as described further in Section 1.²

SIFMA members still face the following regulatory-related issues as a result of DTC's inability to access the physical certificates in its vault:

1. Delivery time frames under the customer protection rule.
2. Capital charges for aged fails under the net capital rule.
3. ACATS of accounts that have "safekeeping positions."
4. Buy-ins under the Uniform Practice Code when there is a fail because of lack of access to physical certificates.³

In summary, SIFMA strongly believes that it is critical to the proper functioning of U.S. securities markets that regulatory relief and guidance with respect to the lack of availability of the physical certificates in the vault be issued rapidly to toll regulatory obligations relating to the physical certificates until they can reasonably be delivered and processed, and that such regulatory relief and guidance should apply retroactively to the time at which physical certificates became inaccessible. Markets and prices could be unnecessarily impacted through buy-ins caused by the temporary lack of availability of securities whose physical certificates happen to be located in the vault. As noted above, we greatly appreciate the concern the regulators have expressed regarding the impact of the storm and your efforts to mitigate unnecessary consequences such as those described herein. Each firm that takes advantage of this relief and interpretive guidance will notify their Regulatory Coordinator at FINRA and provide any information requested.

We request that the relief sought herein apply with respect to securities transactions whose settlement is dependent on the delivery of physical certificates that are located in the vault and therefore are currently inaccessible. For the purposes of this memo, we have defined the time at which a particular certificate becomes accessible as the earlier of (1) five business days after the date the particular physical certificate(s) in the vault or documentation with equivalent effect becomes available (when a member is notified through DTC's systems that the security is in transfer to a requested destination) and (2) five business days after DTC has notified members that it has full access to all the physical certificates in the vault and has resumed standard processing operations (the "Recommencement Date").

1. Delivery Time Frames and Other Issues under Rule 15c3-3; Issues under the Net Capital Rule (Rule 15c3-1 under the Exchange Act)..

² On November 20th DTC announced that it had come to an agreement with representatives of the Securities Transfer Association ("STA") on a protocol for the presentment of evidence of ownership in lieu of physical certificates which are inaccessible due to the impact of the storm on the Vault (see Section 1 below). For a description of DTC's Custody Service, *see generally*: <http://www.dtcc.com/products/asset/services/custody.php>.

³ As a result of separately held SIFMA discussions with the SEC regarding a request for relief with respect to the applicability of Reg SHO's locate requirement (Rule 203) and closeout requirement (Rule 204) to Continuous Net Settlement ("CNS") fails caused by the ongoing lack of availability of physical certificates in the Vault, the SEC recently issued an Order Granting Exemptions from Certain Rules of Regulation SHO Related to Hurricane Sandy, dated December 12, 2012 (Release No. 34-68419).

SIFMA requests that the SEC confirm that DTC will continue to be considered a “good control location” under Rule 15c3-3(c)(1) for the physical security certificates that had been held in the vault at the time the vault flooded due to Hurricane Sandy. All unsold customer securities not acknowledged as received by DTC would be included as a credit item in the Formula for Determination of Reserve Requirements for Brokers and Dealers under Rule 15c3-3a (“reserve formula”). To the extent there is a debit allocating to securities not acknowledged as received by DTC, a broker-dealer would have to take a capital charge for the debit and exclude such debit from the reserve formula.

In addition, we request that, for purposes of Rule 15c3-3, in the event of a fail to receive, a buying broker may rely upon a selling broker’s written representation that such fail allocates to securities acknowledged as received by DTC. We also request that for purposes of Rule 15c3-3 a buying broker-dealer may treat the time periods for requiring buy-ins under such rule as tolled until the Recommencement Date.

We believe that the requested relief should obviate the need for extensions under Rule 15c3-3(n) that were requested for physical certificates located in the vault. Upon the Recommencement Date for a physical certificate, any broker-dealer continuing to need relief under section (n) of Rule 15c3-3 would be required to file an extension as required by the Rule.

All obligations under Rule 15c3-3 and Rule 15c3-1 with respect to a physical certificate presently inaccessible in the vault would resume upon the Recommencement Date.

We request that with respect to the three business day aging criteria for fails to deliver,⁴ a broker-dealer be permitted to disregard the three business day aging requirement but reduce such debits by the excess of the contract price of the fail to deliver contract over the market price of the underlying security and the applicable haircut on the security under Rule 15c3-1(c)(2)(vi). In addition, we request that, with respect to fails to deliver allocating to customer securities acknowledged as received by DTC that are older than 30 calendar days, a broker-dealer be permitted to treat such items as a debit in the reserve formula but reduce such debit by the excess of contract price of the fail to deliver contract over the market value of the underlying security and the applicable haircut on the security under Rule 15c3-1(c)(2)(vi).

Finally, we request that with respect to Rule 15c3-1(c)(2)(ix), a broker-dealer be permitted to deduct the excess of the contract price of the fail to deliver contract over the market value of the underlying security .

All obligations under Rule 15c3-3 and Rule 15c3-1 with respect to a physical certificate presently inaccessible in the vault would resume upon the Recommencement Date.

We request that the above relief be issued in the form of a no action letter such that it is optional for members to avail themselves of the relief granted.

We are also seeking interpretive guidance and relief from FINRA with respect to Items 2 and 3 below:

⁴ See SEC Division of Trading & Markets Staff Interpretation /081 (Rule 15c3-3, Exhibit A - Item 12) (May 1995) (available at <http://www.finra.org/web/groups/industry/@ip/@reg/@rules/documents/interpretationsfor/p037772.pdf>) (“Interpretation /081”).

2. *ACATS of Customer Accounts (FINRA Rule 11870).*

FINRA Rule 11870 addresses “safekeeping positions” that are part of an ACAT. First, when an ACAT instruction is received by the carrying broker transferring the account, it must:

“Upon validation of an instruction to transfer securities account assets in whole or in specifically designated part, the carrying member must return the transfer instruction to the receiving member with an attachment indicating all securities positions, *safekeeping positions*, and money balances to be transferred as shown on the books of the carrying member. Except as hereinafter provided, the attachment must include a then-current market value for all assets so indicated. If a then-current market value for an asset cannot be determined (e.g., a limited partnership interest), the asset must be valued at original cost. However, delayed delivery assets (as defined in paragraph (j)(2) of this Rule), nontransferable assets, and assets in transfer to the customer, i.e., in possession of the transfer agent at the time of receipt of the transfer instruction by the carrying member for shipment, physically and directly to the customer, need not be valued, although the “delayed delivery,” “nontransferable,” or “in-transfer” status, respectively, of such assets must be indicated on the attachment.” (emphasis added)

A safekeeping position is defined as “any security held by a carrying member in the name of the customer. Safekeeping positions shall also include securities that are unendorsed or have a stock/bond power attached thereto.”

To the extent that a safekeeping position is not transferred, a fail contract must be set up in the transferring and in the receiving brokers’ fail files, designating that it relates to a safekeeping position. If DTC cannot by its system mark that a physical certificate is now held for the receiving broker, then under FINRA Rule 11870(f) it must be bought in within 10 or 30 days depending upon the type of security. Other steps, such as a deposit of funds at DTC may, as a matter of market practice, be required. See FINRA Rule 11870(f)(5) (“Open fail contracts established pursuant to the requirements of this Rule shall be marked-to-market regularly”).

Once again, we suggest that delivery requirements and associated requirements in connection with FINRA Rule 11870, including buy-in requirements, deposits of funds and any other applicable requirements, not be imposed with respect to the delivery of physical certificates located in DTC’s vault and that aging of the fails not begin until the Recommencement Date. As a practical matter, the industry has been reversing ACATs with respect to particular physical securities which are unavailable due to the storm until replacement certificates are available (see Section 1 above).

3. *Buy-ins under the FINRA Uniform Practice Code When There is a Fail Because of Lack of Access to Physical Certificates.*

Section (a) of FINRA Rule 11810 sets forth the time at which a receiving broker may commence a buy-in. “A securities contract that has not been completed by the seller according to its terms may be closed by the buyer not sooner than the third business day following the date delivery was due, in accordance with this Rule.” This Rule does not apply where other buy-in requirements apply, *i.e.*, those of a national securities exchange or a registered clearing agency.

SIFMA does not believe it is appropriate to have buy-in proceedings initiated when the location of the physical certificate is known and when DTC has clear records evidencing it. Instead, SIFMA suggests that the time for buy-in under this rule and under DTC/NSCC rules should be tolled until the Recommencement Date.

* * * * *

SIFMA greatly appreciates the Commission's and FINRA's consideration of this request for relief. If you have questions or need further information, please do not hesitate to contact me.

Sincerely,

A handwritten signature in black ink, appearing to read "Ira D. Hammerman". The signature is fluid and cursive, with a large initial "I" and "H".

Ira Hammerman
General Counsel