



DIVISION OF
TRADING AND MARKETS

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

March 8, 2018

Michael Lyons
Chief Financial Officer
National Financial Services LLC
200 Seaport Boulevard
Boston, MA 02210

Re: Cash in a Customer Reserve Account under Rule 15c3-3(e)(5)

Dear Mr. Lyons:

In your letter dated March 7, 2018,¹ on behalf of National Financial Services LLC (“NFS”), you request assurances that the staff of the Division of Trading and Markets (“Division”) of the Securities and Exchange Commission (“Commission”) will not recommend enforcement action to the Commission pursuant to Rule 15c3-3 under the Securities Exchange Act of 1934 (“Exchange Act”)² if NFS, when calculating the 15% bank equity capital limitation under paragraph (e)(5) of the rule, excludes intra-day cash balances arising from maturing qualified securities and unwinding reverse repurchase transactions in qualified securities (“Permitted Investments”) in its special reserve bank account for the exclusive benefit of customers (“Reserve Account”) at The Bank of New York Mellon (“BNY”). You are not seeking this relief with respect to any other Reserve Account maintained now or in the future by NFS.

I. Background

Based on the representations in your letter, I understand the following to be pertinent to your request for relief. Rule 15c3-3 requires a broker-dealer that holds customer securities and cash (a “carrying broker-dealer”) to maintain cash or qualified securities on deposit in a Reserve Account at a bank in an amount computed in accordance with a formula in Exhibit A to the rule.³ The rule defines the term “qualified security” to mean a security issued by the United States or a security in respect of which the principal and interest are guaranteed by the United States

¹ We have attached a copy of your letter. Each defined term in our response has the same meaning as defined in the letter, unless we note otherwise.

² 17 CFR 240.15c3-3(e)(5).

³ 17 CFR 240.15c3-3(e).

(“qualified securities”).⁴ In determining whether a carrying broker-dealer maintains the minimum required amount on deposit in its Reserve Account(s), the firm must exclude: (i) cash deposited with an affiliated bank; and (ii) cash deposited with a non-affiliated bank to the extent that the amount of the deposit exceeds 15% of the bank’s equity capital as reported by the bank in its most recent Call Report (the “15% limitation”).⁵ The 15% limitation applies to cash deposits only (*i.e.*, it does not apply to the value of qualified securities deposited in a Reserve Account).

The Commission adopted the 15% limitation in 2013 with the objective of avoiding the situation where a carrying broker-dealer’s Reserve Account cash deposit constitutes a substantial portion of the bank’s total deposits.⁶ More particularly, the 15% limitation is designed to address the potential impairment of the bank’s ability to quickly return the cash in the Reserve Account to the broker-dealer.⁷

NFS operates as a carrying broker-dealer registered with the Commission. As a carrying broker-dealer, NFS is subject to Rule 15c3-3 and, accordingly, it maintains a Reserve Account at a bank. The majority of the required deposit amount in NFS’s Reserve Account arises from free credit balances held in retail customer accounts. NFS meets its Reserve Account requirement by depositing qualified securities into the Reserve Account. The bank holding the Reserve Account currently provides U.S. government securities clearance services that facilitates NFS’s use of qualified securities to meet its Reserve Account deposit requirement. A large proportion of the qualified securities in NFS’s Reserve Account are obtained through overnight and term reverse repurchase transactions cleared and settled in the account. The use of overnight (as opposed to term) reverse repurchase transactions is designed to maintain liquidity in the Reserve Account to address the potential risk that NFS could experience an unexpectedly large number of contemporaneous customer withdrawals of free credit balances. NFS’s use of overnight reverse repurchase transactions to address the risk of this type of liquidity stress event is designed to comport with regulatory guidance.⁸

The daily settlement of Permitted Investments in NFS’s Reserve Account results in an intra-day cash deposit into the Reserve Account of approximately \$20 billion.⁹ On a daily basis, this intra-day cash balance is primarily attributable to the close-out and re-establishment of overnight reverse repurchase transactions. NFS believes this daily intra-day cash balance in the Reserve Account appropriately addresses the liquidity risk arising from the total amount of free credit balances it holds for customers. Based on the amount of equity capital maintained by the bank that currently holds NFS’s Reserve Account, the intra-day cash deposit does not implicate the 15% limitation. However, this bank is exiting the business of providing U.S. government

⁴ 17 CFR 240.15c3-3(a)(6).

⁵ 17 CFR 240.15c3-3(e)(5).

⁶ See *Financial Responsibility Rules for Broker-Dealers*, Exchange Act Release No. 70072 (July 30, 2013), 78 FR 51824, 51834 (Aug. 21, 2013).

⁷ *Id.*

⁸ See, e.g., FINRA Regulatory Notice 15-33 (Guidance on Liquidity Risk Management Practices).

⁹ This amount may increase, or decrease, over time depending on portfolio activity and customer deposits.

securities clearance services. NFS has identified BNY as a bank that provides comparable U.S. government securities clearance services. Consequently, NFS is planning to move its Reserve Account to BNY.

BNY is a New York state-chartered bank and a member of the Federal Reserve System, and is subject to regulation, supervision, and examination by the Federal Reserve, the Federal Deposit Insurance Corporation, and the New York State Department of Financial Services.¹⁰ It is the largest banking subsidiary of its parent corporation, The Bank of New York Mellon Corporation (“BNY Mellon”). BNY Mellon – as one of the eight U.S. banking institutions that have been designated systemically important – is subject to heightened capital and liquidity requirements and a resolution process that explicitly requires planning to ensure the continuity of critical services even in the event of a default. The long-term senior debt of BNY Mellon and BNY is rated in one of the three highest rating categories by at least four credit rating agencies that are registered with the Commission as Nationally Recognized Statistical Rating Organizations.¹¹ As of December 31, 2016, BNY Mellon and BNY were “well capitalized” based on the capital ratios and rules applicable to them.¹² BNY Mellon, through its subsidiaries such as BNY, provides global and U.S. government securities clearance services and settles securities transactions in over 100 markets.¹³ In this regard, BNY Mellon services approximately \$1.5 trillion, or approximately 86%, of the \$1.8 trillion tri-party repurchase agreement market in the U.S.¹⁴

If NFS moves its Reserve Account to BNY, it intends to continue to meet its Rule 15c3-3 deposit requirement using qualified securities. Further, it will continue to obtain a large proportion of these securities by entering into overnight reverse repurchase transactions. Moreover, it will continue to manage its liquidity risk by entering into Permitted Investments that – when unwound each day – will result in an intra-day cash deposit in its Reserve Account of approximately \$20 billion.

NFS anticipates that BNY’s clearance process for settling Permitted Investments in its Reserve Account will be similar to the process used by its current bank. In particular, the approximately \$20 billion in Permitted Investments will be unwound each morning. This will result in an intra-day cash deposit in the Reserve Account of approximately \$20 billion. Throughout the morning and early afternoon, NFS will close out and re-establish Permitted Investments. This will reduce the approximately \$20 billion cash balance in the account arising from the unwinding of Permitted Investments and replace those positions with qualified securities which satisfy the 15% limitation. As a result, the intra-day cash balance in the Reserve Account will typically be eliminated by 3:30 p.m. each business day.

¹⁰ BNY 2016 Annual Report, p.85, *available at*: https://www.bnymellon.com/_global-assets/pdf/investor-relations/annual-report-2016.pdf.

¹¹ BNY 2016 Annual Report, p.49.

¹² BNY 2016 Annual Report, p.77.

¹³ BNY 2016 Annual Report, p.23.

¹⁴ BNY 2016 Annual Report, p.23.

Based on the amount of equity capital reported by BNY in its most recent Call Report, a \$20 billion intra-day cash deposit into a Reserve Account held at BNY would exceed the 15% limitation in Rule 15c3-3. Consequently, NFS is seeking relief from the 15% limitation, but solely with respect to intra-day cash balances arising from unwinding Permitted Investments in a Reserve Account held at BNY. NFS believes the relief would be appropriate because: (i) the cash balance is intra-day and primarily relates to the close-out and re-establishment of overnight reverse repurchase transactions; (ii) the intra-day cash balance is a tool designed to manage liquidity risk; (iii) BNY is well-capitalized; and (iv) BNY is subject to stringent regulatory and prudential requirements. NFS also notes that BNY provides a broad suite of U.S. government securities settlement services that will greatly facilitate NFS's use of qualified securities to meet its Reserve Account deposit requirement. Finally, NFS has established a Reserve Account at one or more other banks and procedures so that in the unlikely event that the intra-day cash balance in the Reserve Account at BNY is not eliminated by 3:30 p.m. New York time, NFS will transfer a sufficient amount of the remaining cash balance to a Reserve Account at another bank by 6:00 p.m. New York time on that same business day in order to reduce the cash balance in the Reserve Account at BNY to an amount that complies with the 15% limitation in Rule 15c3-3.

II. Response

Based on the facts and representations set forth in your letter, and without necessarily agreeing with your conclusions and analysis, the Division will not recommend enforcement action to the Commission pursuant to Rule 15c3-3 if NFS excludes the intra-day cash balances arising from unwinding Permitted Investments in its Reserve Account at BNY in calculating the 15% limitation, provided that:

1. The intra-day cash balances arising from unwinding Permitted Investments are reinvested in Permitted Investments by 3:30 p.m. New York time the same day the cash balances arise;
2. In the unlikely event that cash balances remain in the Reserve Account at BNY after 3:30 p.m. New York time on the same day they arise, NFS will transfer a sufficient amount of the cash balances no later than 6:00 p.m. New York time out of the Reserve Account at BNY and to a Reserve Account at one or more other banks to comply with the 15% limitation in Rule 15c3-3 with respect to the Reserve Account maintained by BNY;
3. NFS establishes, maintains, and enforces written policies and procedures that are reasonably designed to comply with conditions #1 and #2 above; and
4. NFS maintains accurate books and records, including a daily itemized record of cash balances in the Reserve Account at BNY and any other bank, that evidence compliance with the conditions in this letter and that will be provided to the staff of the Commission or NFS's Designated Examining Authority ("DEA") upon request.

Mr. Michael Lyons
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In your letter, NFS undertakes to notify the Commission and its DEA immediately if the cash balances in the Reserve Account at BNY after 6:00 p.m. New York time exceed 15% of the equity capital of BNY.

This staff position is based on the facts you have presented and the representations you have made in your letter. Moreover, this staff position is strictly limited to the application of Rule 15c3-3 to the intra-day cash balances arising from the unwinding of Permitted Investments in the Reserve Account that NFS maintains at BNY. Any different facts and circumstances from those set forth in this letter may require a different response. This response, furthermore, expresses the Division's position regarding enforcement action only and does not purport to express any legal conclusions on the question presented. The staff expresses no view with respect to any other questions that the activities discussed above may raise, including the applicability of any other federal or state laws, or rules of a self-regulatory organization. This position is subject to modification or revocation as necessary or appropriate for the public interest or the protection of investors.

If you have any questions regarding this letter, please contact Sheila Dombal Swartz, Senior Special Counsel at (202) 551-5545, Randall W. Roy, Deputy Associate Director at (202) 551-5522, or me at (202) 551-5525.

Sincerely,



Michael A. Macchiaroli
Associate Director

National Financial Services, LLC
200 Seaport Blvd
Z2K
Boston, MA 02210



March 7, 2018

BY E-MAIL

Michael A. Macchiaroli
Associate Director
Division of Trading and Markets
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Cash in a Customer Reserve Account under Rule 15c3-3(e)(5)

Dear Mr. Macchiaroli:

On behalf of National Financial Services LLC ("NFS" or "Firm"),¹ I am writing to request assurances that the staff of the Division of Trading and Markets ("Division") of the Securities and Exchange Commission ("Commission") will not recommend enforcement action to the Commission pursuant to Rule 15c3-3 under the Securities Exchange Act of 1934 ("Exchange Act")² if NFS, when calculating the 15% bank equity capital limitation under paragraph (e)(5) of the rule, excludes intra-day cash balances arising from maturing qualified securities and unwinding reverse repurchase transactions in qualified securities ("Permitted Investments") in its special reserve bank account for the exclusive benefit of customers ("Reserve Account") at The Bank of New York Mellon ("BNY"). We are not seeking this relief with respect to any other Reserve Account maintained now or in the future by NFS.

Background

The Firm's request relates to the interpretation of Rule 15c3-3(e) with respect to cash deposits in the Firm's Reserve Account in light of necessary changes to the clearance and settlement of its government securities business. Rule 15c3-3 requires a broker-dealer that holds customer securities and cash (a "carrying broker-dealer") to maintain cash or qualified securities on deposit in a Reserve Account at a bank in an amount computed in accordance with a formula in Exhibit A to the rule.³ The rule defines the term "qualified security" to mean a security issued

¹ NFS, a Fidelity Investments company, is an SEC-registered clearing and carrying broker-dealer and Financial Regulatory Authority ("FINRA") member. As such, NFS acts as the custodian for cash and securities for (i) customers of affiliated retail introducing broker-dealer Fidelity Brokerage Services LLC (FBS); (ii) customers of unaffiliated introducing broker-dealers and investment advisers; and (iii) its direct institutional customers.

² 17 CFR 240.15c3-3(e)(5).

³ 17 CFR 240.15c3-3(e).

by the United States or a security in respect of which the principal and interest are guaranteed by the United States (“qualified securities”).⁴ In determining whether a carrying broker-dealer maintains the minimum required amount on deposit in its Reserve Account(s), the firm must exclude: (i) cash deposited with an affiliated bank; and (ii) cash deposited with a non-affiliated bank to the extent that the amount of the deposit exceeds 15% of the bank’s equity capital as reported by the bank in its most recent Call Report (the “15% limitation”).⁵ The 15% limitation applies to cash deposits only (*i.e.*, it does not apply to the value of qualified securities deposited in a Reserve Account).

The Commission adopted the 15% limitation in 2013 with the objective of avoiding the situation where a carrying broker-dealer’s Reserve Account cash deposit constitutes a substantial portion of the bank’s total deposits.⁶ More particularly, the 15% limitation is designed to address the potential impairment of the bank’s ability to quickly return the cash in the Reserve Account to the broker-dealer.⁷

NFS operates as a carrying broker-dealer registered with the Commission. As a carrying broker-dealer, NFS is subject to Rule 15c3-3 and, accordingly, it maintains a Reserve Account at a bank. The majority of the required deposit amount in NFS’s Reserve Account arises from free credit balances held in retail customer accounts. NFS meets its Reserve Account requirement by depositing qualified securities into the Reserve Account. The bank holding the Reserve Account currently provides U.S. government securities clearance services that facilitates NFS’s use of qualified securities to meet its Reserve Account deposit requirement. A large proportion of the qualified securities in NFS’s Reserve Account are obtained through overnight and term reverse repurchase transactions cleared and settled in the account. The use of overnight (as opposed to term) reverse repurchase transactions is designed to maintain liquidity in the Reserve Account to address the potential risk that NFS could experience an unexpectedly large number of contemporaneous customer withdrawals of free credit balances. NFS’s use of overnight reverse repurchase transactions to address the risk of this type of liquidity stress event is designed to comport with regulatory guidance.⁸

⁴ 17 CFR 240.15c3-3(a)(6).

⁵ 17 CFR 240.15c3-3(e)(5).

⁶ See *Financial Responsibility Rules for Broker-Dealers*, Exchange Act Release No. 70072 (July 30, 2013), 78 FR 51824, 51834 (Aug. 21, 2013).

⁷ *Id.*

⁸ See, *e.g.*, FINRA Regulatory Notice 15-33 (Guidance on Liquidity Risk Management Practices). As a result, a minimum of twenty-five percent (25%) of the portfolio in the Reserve Account is invested overnight which is effected through overnight and reverse repo activity. There are additional maturity bucket limits to ensure orderly maturity. Currently, Permitted Investments activity is managed to ensure that daily settlement activity, both during the day and at the close of business, stays below the 15% limitation.

NFS currently has a deposit obligation in its Reserve Account of approximately \$45.9 billion, of which the daily settlement of Permitted Investments in NFS's Reserve Account results in an intra-day cash deposit into the Reserve Account of approximately \$20 billion.⁹ On a daily basis, this intra-day cash balance is primarily attributable to the close-out and re-establishment of overnight reverse repurchase transactions. NFS believes this daily intra-day cash balance in the Reserve Account appropriately addresses the liquidity risk arising from the total amount of free credit balances it holds for customers. Based on the amount of equity capital maintained by the bank that currently holds NFS's Reserve Account, the intra-day cash deposit does not implicate the 15% limitation. However, this bank is exiting the business of providing U.S. government securities clearance services. NFS has identified BNY as a bank that provides comparable U.S. government securities clearance services. Consequently, NFS is planning to move its Reserve Account to BNY.

BNY is a New York state-chartered bank and a member of the Federal Reserve System, and is subject to regulation, supervision, and examination by the Federal Reserve, the Federal Deposit Insurance Corporation, and the New York State Department of Financial Services.¹⁰ It is the largest banking subsidiary of its parent corporation, The Bank of New York Mellon Corporation ("BNY Mellon"). BNY Mellon – as one of the eight U.S. banking institutions that have been designated systemically important – is subject to heightened capital and liquidity requirements and a resolution process that explicitly requires planning to ensure the continuity of critical services even in the event of a default. The long-term senior debt of BNY Mellon and BNY is rated in one of the three highest rating categories by at least four credit rating agencies that are registered with the Commission as Nationally Recognized Statistical Rating Organizations.¹¹ As of December 31, 2016, BNY Mellon and BNY were "well capitalized" based on the capital ratios and rules applicable to them.¹² BNY Mellon, through its subsidiaries such as BNY, provides global and U.S. government securities clearance services and settles securities transactions in over 100 markets.¹³ In this regard, BNY Mellon services approximately \$1.5 trillion, or approximately 86%, of the \$1.8 trillion tri-party repurchase agreement market in the U.S.¹⁴

If NFS moves its Reserve Account to BNY, it intends to continue to meet its Rule 15c3-3 deposit requirement using qualified securities. Further, it will continue to obtain a large proportion of these securities by entering into overnight reverse repurchase transactions.

⁹ Data as of December 31, 2017. This amount may increase, or decrease, over time depending on portfolio activity and customer deposits.

¹⁰ BNY 2016 Annual Report, p.85, *available at*: https://www.bnymellon.com/_global-assets/pdf/investor-relations/annual-report-2016.pdf.

¹¹ BNY 2016 Annual Report, p.49.

¹² BNY 2016 Annual Report, p.77.

¹³ BNY 2016 Annual Report, p.23.

¹⁴ BNY 2016 Annual Report, p.23.

Michael A. Macchiaroli

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Moreover, it will continue to manage its liquidity risk by entering into Permitted Investments that – when unwound each day – will result in an intra-day cash deposit in its Reserve Account of approximately \$20 billion.

NFS anticipates that BNY's clearance process for settling Permitted Investments in its Reserve Account will be similar to the process used by its current bank. In particular, the approximately \$20 billion in Permitted Investments will be unwound each morning. This will result in an intra-day cash deposit in the Reserve Account of approximately \$20 billion. Throughout the morning and early afternoon, NFS will close out and re-establish Permitted Investments. This will reduce the approximately \$20 billion cash balance in the account arising from the unwinding of Permitted Investments and replacing those positions with qualified securities which satisfy the 15% limitation. As a result, the intra-day cash balance in the Reserve Account will typically be eliminated by 3:30 p.m. each business day.

Based on the amount of equity capital reported by BNY in its most recent Call Report, a \$20 billion intra-day cash deposit into a Reserve Account held at BNY would exceed the 15% limitation in Rule 15c3-3. Consequently, NFS is seeking relief from the 15% limitation, but solely with respect to intra-day cash balances arising from unwinding Permitted Investments in a Reserve Account held at BNY. NFS believes the relief would be appropriate because: (i) the cash balance is intra-day and primarily relates to the close-out and re-establishment of overnight reverse repurchase transactions; (ii) the intra-day cash balance is a tool designed to manage liquidity risk; (iii) BNY is well-capitalized; and (iv) BNY is subject to stringent regulatory and prudential requirements. NFS also notes that BNY provides a broad suite of U.S. government securities settlement services that will greatly facilitate NFS's use of qualified securities to meet its Reserve Account deposit requirement. Finally, NFS has established a Reserve Account at one or more other banks and procedures so that in the unlikely event that the intra-day cash balance in the Reserve Account at BNY is not eliminated by 3:30 p.m. New York time, NFS will transfer a sufficient amount of the remaining cash balance to a Reserve Account at another bank by 6:00 p.m. New York time on that same business day in order to reduce the cash balance in the Reserve Account at BNY to an amount that complies with the 15% limitation in Rule 15c3-3.

Request for Relief

Based on the facts and representations set forth in this letter, we are requesting that the Division will not recommend enforcement action to the Commission pursuant to Rule 15c3-3 if NFS excludes the intra-day cash balances arising from unwinding Permitted Investments in its Reserve Account at BNY in calculating the 15% limitation, provided that:

1. The intra-day cash balances arising from unwinding Permitted Investments are reinvested in Permitted Investments by 3:30 p.m. New York time the same day the cash balances arise;
2. In the unlikely event that cash balances remain in the Reserve Account at BNY after 3:30 p.m. New York time on the same day they arise, NFS will transfer a sufficient amount of the cash balances no later than 6:00 p.m. New York time out of the Reserve Account at

BNY and to a Reserve Account at one or more other banks to comply with the 15% limitation in Rule 15c3-3 with respect to the Reserve Account maintained by BNY;

3. NFS establishes, maintains, and enforces written policies and procedures that are reasonably designed to comply with conditions #1 and #2 above; and
4. NFS maintains accurate books and records, including a daily itemized record of cash balances in the Reserve Account at BNY and any other bank, that evidence compliance with the conditions in this letter and that will be provided to the staff of the Commission or NFS's Designated Examining Authority ("DEA") upon request.

NFS also will undertake to notify the Commission and its DEA immediately if the cash balances in the Reserve Account at BNY after 6:00 p.m. New York time exceed 15% of the equity capital of BNY.

We appreciate your consideration of this request. Please contact me at (201) 915-7437 if you have any questions.

Sincerely,



Michael Lyons
Chief Financial Officer