

**SECURITIES AND EXCHANGE COMMISSION**  
**(Release No. 34-56376)**

**September 7, 2007**

**ORDER GRANTING A CONDITIONAL EXEMPTION TO BROKER-DEALERS  
FROM REQUIREMENTS IN RULES 15c3-1 AND 15c3-3 UNDER THE  
SECURITIES EXCHANGE ACT OF 1934 TO PROMPTLY TRANSMIT  
CUSTOMER CHECKS FOR THE PURCHASE OF DEFERRED VARIABLE  
ANNUITY CONTRACTS**

I. Background

The Securities and Exchange Commission (the “Commission”) today approved new National Association of Securities Dealers (“NASD”)<sup>1</sup> Rule 2821.<sup>2</sup> NASD Rule 2821 sets forth recommendation requirements (including a suitability obligation), principal review and approval requirements, and supervisory and training requirements with respect to transactions in deferred variable annuities.

According to the NASD, it designed the rule to address significant and persistent sales-practice problems in sales of deferred variable annuities. One component of Rule 2821 is a requirement that registered principals perform a comprehensive and rigorous review of the transactions. Specifically, Rule 2821(c) states, in part, that: “Prior to transmitting a customer’s application for a deferred variable annuity to the issuing insurance company for processing, but no later than seven business days after the customer signs the application, a registered principal shall review and determine whether he or she approves of the purchase or exchange of the deferred variable annuity.”

---

<sup>1</sup> On July 26, 2007, the Commission approved a proposed rule change filed by NASD to amend NASD’s Certificate of Incorporation to reflect its name change to Financial Industry Regulatory Authority, Inc., or FINRA, in connection with the consolidation of the member firm regulatory functions of NASD and NYSE Regulation, Inc. See Exchange Act Release No. 56146 (July 26, 2007), 72 FR 42190 (Aug. 1, 2007).

<sup>2</sup> See Exchange Act Release No. 56375 (Sep. 7, 2007).

Many broker-dealers are subject to lower net capital requirements under Securities Exchange Act of 1934 (“Exchange Act”) Rule 15c3-1<sup>3</sup> and are exempt from the requirement to establish and fund a customer reserve account under Rule 15c3-3<sup>4</sup> because they do not carry customer funds or securities. Some of these broker-dealers receive checks from customers that are made out to third parties. Pursuant to Rules 15c3-1 and 15c3-3, a broker-dealer is not deemed to be carrying customer funds if it “promptly transmits” the checks to the third parties.<sup>5</sup> For purposes of Rules 15c3-1 and 15c3-3, the term “promptly transmit” means when “such transmission or delivery is made no later than noon of the next business day after the receipt of such funds or securities.”<sup>6</sup>

According to the NASD, a broker-dealer may need to hold customer checks for more than one business day in order to comply with Rule 2821.

## II. Discussion

The Commission has decided to exempt broker-dealers from any additional requirements of Rules 15c3-1 or 15c3-3 due solely to a failure to promptly transmit a check made payable to an insurance company for the purchase of a deferred variable

---

<sup>3</sup> 17 CFR 240.15c3-1. The purpose of Rule 15c3-1 is to ensure that a broker or dealer at all times has sufficient liquid assets to promptly satisfy the claims of customers if the broker or dealer goes out of business.

<sup>4</sup> 17 CFR 240.15c3-3. The purpose of Rule 15c3-3 is to protect customers by assuring that broker-dealers do not use customers’ funds or securities to fund the broker-dealer’s operations. Among other things, Rule 15c3-3 requires that a broker-dealer make a periodic computation of the amount of money it is holding that constitutes customer funds or funds obtained from the use of customer securities. If this amount exceeds the amount of money customers owe the firm, the broker-dealer must deposit the excess in a special reserve bank account for the exclusive benefit of the firm’s customers.

<sup>5</sup> When it amended the net capital rule in 1992, the Commission stated that a broker-dealer shall not be deemed to receive funds from customers if it receives checks made payable to certain entities other than itself (such as another broker-dealer or an escrow agent) and promptly transmits such funds. Exchange Act Release No. 31511 (Nov. 24, 1992), 57 FR 56973 (Dec. 2, 1992).

<sup>6</sup> See Exchange Act Release No. 31511 (Nov. 24, 1992), note 11, and 17 CFR 240.15c3-1(c)(9).

annuity product by noon of the business day following the date the broker-dealer receives the check from the customer, provided:

- (i) the transaction is subject to the principal review requirements of NASD Rule 2821 and a registered principal has reviewed and determined whether he or she approves of the purchase or exchange of the deferred variable annuity within seven business days in accordance with that rule;
- (ii) the broker-dealer promptly transmits the check no later than noon of the business day following the date a registered principal reviews and determines whether he or she approves of the purchase or exchange of the deferred variable annuity; and
- (iii) the broker-dealer maintains a copy of each such check and creates a record of the date the check was received from the customer and the date the check was transmitted to the insurance company if approved, or returned to the customer if rejected.

The purpose of Rule 15c3-1 is to ensure that a broker or dealer at all times has sufficient liquid assets to promptly satisfy the claims of customers and other creditors if the broker or dealer goes out of business. One purpose of Rule 15c3-3 is to protect customers by assuring that broker-dealers do not use customers' funds or securities to fund the broker-dealer's operations. The reasons these rules require that a broker-dealer promptly forward checks is to reduce the risk that a broker-dealer or an associated person of a broker-dealer will convert or misuse customer funds or securities and to assure that the price of the security the customer purchases has not moved substantially from the date the customer decided to purchase that security.

In the Approval Order for Rule 2821 we stated,

“[Proposed Rule 2821] is designed to curb sales practice abuses in deferred variable annuities. Its recommendation requirements provide a specific framework for a broker-dealer’s suitability analysis of these securities. By setting forth factors that a broker-dealer must specifically consider in recommending deferred variable annuities and requiring the registered representative to obtain certain information from his or her customers, the proposed rule should improve communications between registered representatives and customers regarding these securities. The supervisory review component should foster a thorough analytical review of every deferred variable annuity transaction in a timeframe that will limit the possibility of unsuitable recommendations and transactions. The proposed rule as a whole is geared to protecting investors by requiring firms to implement more robust compliance cultures, and to give clear consideration of the suitability of these complex products.”

Further, we found that Rule 2821 is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. Consequently, we approved NASD’s proposed Rule 2821.

As we believe the NASD’s Rule 2821 to be in the public interest but a broker-dealer would be burdened with additional requirements under Exchange Act Rules 15c3-1 and 15c3-3 were it to comply with Rule 2821, we must balance the investor protections provided by Rules 15c3-1 and 15c3-3 with those provided by Rule 2821. For this reason, we have specifically tailored the above-described exemption.

First, the exemption is specifically limited to situations where a broker-dealer has failed to promptly transmit “a check made payable to an insurance company for the purchase of a deferred variable annuity product,” and “the transaction is subject to the principal review requirements of NASD Rule 2821 and a registered principal has reviewed and determined whether he or she approves of the purchase or exchange of the deferred variable annuity within seven business days in accordance with that rule.” In all

other situations where a check is received by a broker-dealer and is not promptly forwarded, the full provisions of both Rule 15c3-1 and 15c3-3 still apply.

Second, the exemption requires a broker-dealer to promptly transmit such checks no later than noon of the business day following the date a registered principal reviews and determines whether he or she approves of the purchase or exchange of the deferred variable annuity. This is designed to assure that the broker-dealer holds the customer's check no longer than is necessary to comply with Rule 2821.

Third, a broker-dealer must maintain a copy of each such check and create a record of the date the check was received from the customer and the date the check was transmitted to the insurance company if approved, or returned to the customer if rejected. This requirement will allow the broker-dealer's compliance and internal audit departments, as well as Commission, self-regulatory organization, and other examiners to verify that a broker-dealer is complying with the provisions of this exemption.

For the foregoing reasons, the Commission finds that granting the above-described exemption is necessary and appropriate in the public interest, and is consistent with the protection of investors.

### III. Conclusion

Accordingly, IT IS ORDERED, pursuant to Section 36 of the Exchange Act<sup>7</sup> that, a broker-dealer shall be exempt from any additional requirements of Rules 15c3-1 or 15c3-3 due solely to a failure to promptly transmit a check made payable to an insurance

---

<sup>7</sup> Section 36 of the Exchange Act authorizes the Commission, by rule, regulation, or order, to conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions from any provision or provisions of the Exchange Act or any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.

company for the purchase of a deferred variable annuity product by noon of the business day following the date the broker-dealer receives the check from the customer, provided:

- (i) the transaction is subject to the principal review requirements of NASD Rule 2821 and a registered principal has reviewed and determined whether he or she approves of the purchase or exchange of the deferred variable annuity within seven business days in accordance with that rule;
- (ii) the broker-dealer promptly transmits the check no later than noon of the business day following the date a registered principal reviews and determines whether he or she approves of the purchase or exchange of the deferred variable annuity; and
- (iii) the broker-dealer maintains a copy of each such check and creates a record of the date the check was received from the customer and the date the check was transmitted to the insurance company if approved, or returned to the customer if rejected.

By the Commission.

Nancy M. Morris  
Secretary