UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
TRADING AND MARKETS

October 22, 2020

Ms. Kris Dailey
Vice President, Office of Financial and Operational Risk Policy
Financial Industry Regulatory Authority
One World Financial Center
200 Liberty Street
New York, NY 10281

Re: Broker-Dealers Borrowing Fully Paid and Excess Margin Securities from Customers

Dear Ms. Dailey:

I. Introduction

Your staff has brought to our attention that a number of broker-dealers are operating programs in which they borrow fully paid and excess margin securities from their customers ("FPL Programs"). As discussed below, the staff of the Division of Trading and Markets ("Division staff") believes that some of these programs do not comply with the requirements of the broker-dealer customer protection rule ("Rule 15c3-3").[1] The staff also believes it would be appropriate to provide a limited amount of time for broker-dealers to come into compliance with Rule 15c3-3 which would allow them to adjust or wind down such FPL Programs in an orderly manner. Consequently, the Division staff will not recommend enforcement action to the Commission if a broker-dealer operating a FPL Program that does not comply with Rule 15c3-3 for the reasons discussed below comes into compliance with the rule as soon as practicable but no later than six months from the date of this letter: April 22, 2021.

II. Background

In 1982, the Securities and Exchange Commission ("Commission") amended Rule 15c3-3 to add paragraph (b)(3), which sets forth requirements for borrowing

[1] 17 CFR 240.15c3-3.

fully paid and excess margin securities from customers.[2] The paragraph, in pertinent part, requires a broker-dealer borrowing fully paid or excess margin securities from a customer to enter into a written agreement with the customer that, among other things, specifies that the broker-dealer must undertake to: (1) provide the lender collateral that fully secures the loan consisting of cash, U.S. Treasury bills or notes, an irrevocable letter of credit issued by a bank, or such other collateral as the Commission designates as permissible; (2) mark the loan to market not less than daily and provide additional collateral as necessary to fully collateralize the loan; and (3) notify the lender that the provisions of SIPA may not protect the lender and that, therefore, the collateral delivered to the lender may constitute the only source of satisfaction of the broker-dealer's obligation to return the securities. In the adopting release for these requirements, the Commission stated that the rule will "compel the firm to turn over the collateral physically to the lender."[3]

Your staff has informed Division Staff that some broker-dealers operating FPL Programs have not turned over the collateral physically to the lender and therefore retain control over the collateral that is used to secure their borrowings of fully paid and excess margin securities. For example, the collateral may be deposited into the lender's securities account at the broker-dealer or an omnibus account at a bank in the name of the broker-dealer. In either case, during the term of the loan, the collateral must be accessed through the broker-dealer and the broker-dealer has the operational ability to transfer or liquidate the collateral. The written agreement underlying such a program gives the broker-dealer control over the collateral. As the Commission has stated, paragraph (b)(3) of Rule 15c3-3 "compel[s] the firm to turn over the collateral physically to the lender."[4]

III. Temporary Position

The Division staff will not recommend enforcement action to the Commission pursuant to the requirement in paragraph (b)(3) of Rule 15c3-3 that a broker-dealer provide collateral that fully secures the loan, provided that:

1) The broker-dealer is operating a FPL Program that was in existence prior to the date of this letter;

2) The broker-dealer operating the FPL Program remains in compliance with all other aspects of Rule 15c3-3(b)(3); and

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[2] *See Net Capital Requirements for Brokers and Dealers*, Securities Exchange Act of 1934 ("Exchange Act") Release No. 18737 (May 13, 1982), 47 FR 21759 (May 20, 1982).

[3] *See Net Capital Requirements for Brokers and Dealers*, 47 FR at 21768.

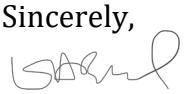
[4] *Id.*

3) The broker-dealer comes into compliance with paragraph (b)(3) of Rule 15c3-3 as soon as practicable but no later than six months from the date of this letter: April 22, 2021.

This Division staff position is based on the facts you have presented. Any different facts and circumstances from those set forth in this letter may require a different response. This letter, furthermore, expresses the Division staff's position regarding enforcement action only and does not purport to express any legal conclusions on the question presented. The Division 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 at any time.

If you have any questions regarding this letter, please call Mike Macchiaroli at 202-551-5525.

Sincerely,



Elizabeth Baird
Deputy Director