



ABA SECURITIES ASSOCIATION

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Sarah A. Miller
General Counsel

June 18, 2007

Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F. Street, N.E.
Washington, D.C. 20549-1090

Re: Amendments to Financial Responsibility Rules for Broker-Dealers;
Release No. 34-55431; File No. S7-08-07; 72 Fed. Reg. 12862 (March 19,
2007).

Dear Ms. Morris:

The ABA Securities Association¹ ("ABASA") appreciates the opportunity to comment on the Securities and Exchange Commission's ("Commission") proposed amendments to the broker-dealer financial responsibility rules. Under Rule 15c3-3, broker-dealers must maintain segregated customer funds in such a manner that those assets are protected in case of broker-dealer insolvency. Although the proposal would not directly affect the activities of the banking industry, it would impose unnecessary limitations on the activities of ABASA's member institutions to operate efficiently with both affiliated and unaffiliated financial institutions. In addition, the proposal fails to recognize the significant supervisory oversight of the banking regulators, particularly their responsibilities under the prompt corrective action provision of the Federal Deposit Insurance Corporation Improvement Act (FDICIA).²

Banks Where Special Reserve Deposits May Be Held

Of particular concern to our members is the Commission's proposal to limit where and to what extent a broker-dealer may place cash deposits at affiliated and unaffiliated banks for purposes of meeting customer and proprietary account of another broker-dealer ("PAB account") reserve

¹ ABASA is a separately chartered affiliate of the American Bankers Association (ABA) representing those holding company members of the ABA actively engaged in capital markets, investment banking and broker-dealer activities.

² Section 38 of FDICIA and implementing regulations: FDIC, 12 CFR 325.105; Office of the Comptroller of Currency, 12 CFR 6; and Federal Reserve Board, 12CFR 208.40.

requirements. The proposal would outright exclude cash deposits at affiliated banks to meet these reserve requirements. In addition, the proposal would require broker-dealers to exclude the cash deposits at unaffiliated banks to the extent the deposit exceeds: (1) 50 percent of the broker-dealer's excess net capital; or (2) 10 percent of the bank's equity capital. As a basis for this amendment, the proposal *hypothesizes* that:

[T]o the extent a broker-dealer deposits cash in a reserve bank account, there is a risk the cash could be lost or inaccessible for a period if the bank experiences financial difficulties. ... This risk may be heightened when the deposit is held at an affiliated bank in that the broker-dealer may not exercise due diligence with the same degree of impartiality when assessing the soundness of an affiliate bank as it would with a non-affiliate bank.³

Without historical evidence to support the need for these limitations, the proposal ignores both the banking regulators' close scrutiny of transactions with affiliates as well as the significant changes in banking law since the enactment of the FDICIA. FDICIA added yet another layer of protection to an already extensive supervisory framework, by requiring the federal banking agencies to initiate prompt corrective action to address declines in a bank's capital.⁴ Under FDICIA, bank regulators must categorize banks by their capital levels: (1) well-capitalized; (2) adequately capitalized; (3) undercapitalized; (4) significantly undercapitalized; or (5) critically undercapitalized. These categories allow the regulators to assess the institution's capital adequacy and determine whether prompt corrective action is necessary, such as restricting the bank from paying capital distributions and management fees, requiring the bank to submit a capital restoration plan, restricting the growth of bank assets, prohibiting entering into material transactions and making any material change in accounting methods. In their quarterly call reports filed with the banking regulators and published on the FDIC's website for public access, an insured depository institution must report its capital ratio along with other important financial information. In addition, under the rules of the federal banking regulators, a bank must provide notice to its primary regulator within "15 calendar days following the date that any material event has occurred that would cause the bank to be placed in a lower capital category."⁵

In addition to the protections mentioned above, Section 23B of the Federal Reserve Act restricts transactions between affiliates and insured

³ SEC Proposal, 72 Fed. Reg. 12862, 12864.

⁴ 12 U.S.C. §1831o.

⁵ OCC Regulation, 12 CFR 6.3; FRB Regulation, 12 CFR 208.43; FDIC Regulation, 12 CFR 325.102; OTS Regulation, 12 CFR 565.3.

banks. Under Section 23B, any transaction that involves “the payment of money or the furnishing of services to an affiliate under contract, lease, or otherwise”⁶ must be made on an arm’s length basis.⁷ The banking regulators regularly examine depository institutions and their holding company affiliates for compliance with these requirements. With all of these overlapping protections in place, the Commission’s concern for broker-dealer deposits held at affiliated banks should be alleviated.

With respect to the cash deposits at unaffiliated banks, the proposal’s limitations are arbitrary and excessive reactions to the expressed concerns. The proposal would make it more expensive and cumbersome to administer the cash deposits than under the current rules and these costs would be passed down to the customers. Forcing broker-dealers to spread their deposits amongst multiple institutions not only prohibits them from obtaining the best return on the deposit, but imposes significant and ongoing administrative costs to manage, monitor, and reconcile numerous accounts.

The proposal gives little explanation for the rationale behind this limitation, except that cash deposits *may* become lost or inaccessible due to financial difficulties of the bank. It seems that the limitation was based on a 1988 Commission Staff letter to the New York Stock Exchange on the interpretation of Rules 15c3-3(e).⁸ However, at that time, the banking regulators were unable to take prompt corrective action to address the deterioration of bank capital. As mentioned above, FDICIA enactment in 1991 profoundly changed the regulation of banks. Surely this change has modified, if not eliminated, the rationale for the initial interpretation in 1988.

Recommended Requirements for Cash Deposits

As an alternative to the restrictive limitations on cash deposits at both affiliated and unaffiliated banks, the proposal should allow broker-dealers to make cash deposits at “well capitalized” or “adequately capitalized” banks after conducting appropriate due diligence on the institution. The banking industry is already subject to very similar rules governing third-party brokered deposits. Under Section 1831f of the Federal Deposit Insurance Act and its implementing regulations, “well-capitalized” institutions, and “adequately-capitalized” institutions if they receive FDIC permission, may receive brokered deposits (i.e., deposits placed in insured banks by third parties) subject to certain restrictions such as those on interest rates paid.⁹ The banking regulators are very experienced with these types of transactions and regularly examine for compliance with the rules.

⁶ 12 U.S.C. §371c-1(a)(2)(C).

⁷ 12 U.S.C. §371c-1(a)(1)(A).

⁸ See NYSE Interpretation Handbook No. 88-1 (February 1988).

⁹ 12 U.S.C. §1831f.

Cost/Benefit Analysis

Lastly, the cost/benefit analysis in Section V significantly underestimates the burden placed on broker-dealers to comply with the proposal. The estimate acknowledges only the initial costs of setting up these new accounts and ignores the continuous costs associated with the broker-dealer monitoring and reconciling, as well as opening and closing these accounts as needed. The proposal also fails to quantify the inherent inefficiency of forcing broker-dealers to set up numerous accounts to satisfy the restrictive broker-dealer net capital and bank equity capital requirements.

Definition of Qualified Securities

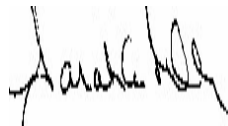
ABASA commends the Commission for expanding the definition of “qualified security” under Rule 15c3-3 to include certain money market funds. Nonetheless, for the same reasons mentioned above, money market funds should not be limited to those that are unaffiliated with the broker-dealer. Current broker-dealer and investment company regulations are adequate to allow an affiliated money market fund to meet the definition of qualified security. This amendment simply would add needless complexity to broker-dealer operations.

Conclusion

In conclusion, ABASA would strongly encourage the Commission not to place needless and potentially burdensome and costly limitations on the ability of broker-dealers to place cash deposits with affiliated and unaffiliated banks. In addition, while we support the expanded definition of “qualified security” to include money market funds, we do not believe that the expansion should be limited to unaffiliated mutual funds.

Should you wish to discuss this matter further, please do not hesitate to contact either the undersigned at 202-663-5325 or Phoebe Papageorgiou at 202-663-5053.

Sincerely yours,



Sarah A. Miller