sifma
Invested in America

October 14, 2014

Michael A. Macchiaroli
Associate Director
Division of Trading and Markets
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-7010

Re: Request for further relief from the prior written consent requirement for Sweep Programs

Dear Mr. Macchiaroli:

The Securities Industry and Financial Markets Association (**"SIFMA"**)[1] submits this letter on behalf of its members to respectfully request further relief from the recently imposed requirement under the Financial Responsibility Rules (collectively, the **"Rules"**)[2] that a broker-dealer obtain prior written consent from a customer before placing customer funds into a sweep program (the **"Rule"**).[3] The Rules define sweep program (**"Sweep Program"**) as a service that provides the customer the option to automatically transfer free credit balances in a securities account into either a money market mutual fund or an FDIC-insured bank account.[4]

I. BACKGROUND

On February 26, 2014, SIFMA successfully requested and obtained from the SEC staff a no-action letter (the **"NAL"**) providing relief from the requirement to obtain prior written

[1] 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. For more information, visit www.sifma.org.

[2] The recent amendments to the Rules became effective on March 3, 2014. *Order Providing Broker-Dealers a Temporary Exemption from the Requirements of Certain New Amendments to the Financial Responsibility Rules for Broker-Dealers under the Securities Exchange Act of 1934*, Exchange Act Release No. 70701 (Oct. 17, 2013), 78 F.R. 62930 (Oct. 22, 2013).

[3] 17 C.F.R. §240.15c3-3(j)(2)(ii)(A).

[4] 17 C.F.R. §240.15c3-3(a)(17).

affirmative consent from a customer to participate in a Sweep Program.[5] In essence, the NAL requires firms to:

(i) Obtain and document verbal consent prior to initiating a sweep;
(ii) Provide prior notification of the general terms and conditions of products available through the Sweep Program, and state that the broker-dealer may change the products available under the Sweep Program;
(iii) Establish a process to obtain written consent within 90 calendar days of account opening; and
(iv) If written consent is not obtained within 90 calendar days, then the firm must stop including free credit balances in the Sweep Program.

SIFMA and its members greatly appreciate your and your staff's efforts in working with us to obtain the current NAL. The relief has proven helpful and beneficial to firms and customers alike. The NAL and its relief, however, are scheduled to sunset on March 3, 2015.

Accordingly, we believe now is an appropriate time to address whether a more permanent solution is achievable in order to avoid a significant expenditure of time, money and resources by many of our member firms, and to ensure that customers' free credit balances can be put to work for them in a more timely manner, as discussed below.

II. DISCUSSION

A. New account opening and documentation practices.

The opening of a new securities account at a broker-dealer can occur in a variety of ways including, among others, in-person, by telephone, or online via the Internet. When a customer opens an account online via the Internet, it is generally not an issue to obtain the customer's prior written consent to a Sweep Program, given that the customer's computer keystroke responses confirming that he has read and understood the relevant disclosures can readily be used to create the records that satisfy the Rule.

The difficulty in obtaining prior written consent, however, comes when a customer opens an account in-person or by telephone. First, any new account opening typically requires a fairly significant amount of documentation and information. Generally speaking, such documentation may request without limitation: (i) basic personal information (name, address, employer, etc.); (ii) financial information (income, net worth, investment objectives, etc.); (iii) Social Security number; (iv) two forms of identification (including a photo ID); (v) account application and agreement, including numerous disclosures; (vi) Form W-9 (or W-8), and (vii) an opening deposit. As a result, new account applications can be fairly lengthy packages, in certain cases 50 pages or more. Moreover, new account documentation may require the

[5] Letter dated Feb. 26, 2014 from Randall W. Roy, Assistant Director, SEC to Thomas F. Price, Operations, Technology & BCP, SIFMA re: *Certain Amendments to Rule 15c3-3*, available at: http://www.sec.gov/divisions/marketreg/mr-noaction/2014/sifma-022614-15c3.pdf.

signatures of, and responses from, multiple persons who will share ownership or access to the account, and who may not be present at account opening, thereby further delaying the process.

When a customer calls or visits a firm's offices to open an account, the firm's financial advisor (**"FA"**) generally explains the new account opening process to the customer. The FA will also collect from the customer certain personal and financial profile information for contemporaneous or later entry into the firm's electronic systems. It is also common for the customer to provide a deposit at account opening, whether by check, by wire transfer, by 'journaling' money from an existing account to the new account, or by other means. During this process, the customer may express his or her preference that any free credit balances in the newly established account be transferred to a product in the firm's Sweep Program.

If the customer is on the telephone, it is not possible to concurrently obtain their written consent to a Sweep Program, so the firm obtains their oral consent. If the customer is in-person, most firms likewise obtain the customer's oral consent to the Sweep Program at that time and thereafter, obtain the customer's written consent when they return their fully executed application package.

With respect to in-person account openings, the SEC staff recently asked us whether firms could comply with the new Rule by having their new customers sign a separate, one-page "*Consent to Sweep Program*" form at account opening. The vast majority of firms have not undertaken to develop or implement such a form. Due to the fairly voluminous nature of the account opening documentation, a number of our member firms report that they generally treat the application as a single, collective package, which is most easily and reliably managed and tracked as such. These same firms anticipate that it would be an expensive, time-consuming, labor-intensive, and manual process to separately administer, track, supervise, and ensure system-wide compliance with such a stand-alone, additional form.

Where the customer has provided a deposit at account opening, which as discussed is common, the profile information collected by the FA is generally sufficient for the firm to perform the required regulatory checks to open the customer's account prior to accepting and placing the customer's money to work for them through the firm's Sweep Program. Next, depending on the operational capabilities of the firm or the branch office, and on whether the customer is in-person or on the telephone, the FA prints the new account application and associated forms and hands it to the customer to review, or mails, e-mails, or faxes the new account application and forms to the customer to review and return accompanied with their signature. In order to give the customer adequate time to review the new account application forms before signing them in-person, the FA may allow the customer to take the forms home to avoid pressures associated with reviewing the forms too quickly.

Each firm may follow one of a variety of processes to ensure that all new account application forms are signed and returned in a timely manner. For example, the FA of a customer with an outstanding account opening packet may begin to receive reminders from the firm after one week, with reminders escalating until 30 days at which point activity in the account may be restricted. If no documents are returned within 60-90 days, the account may be frozen. FAs thus have a strong interest in facilitating the timely execution and return of their

customers' new account forms, and are thereby incentivized to follow-up with their customers by telephone, email, mail, or otherwise, until the package is fully executed and returned.

B. Supporting data re: new account openings and Sweep Programs.

The SEC staff also requested that we furnish supporting data and information about our member firms' new account opening processes and the operational challenges they face in complying with the new Rule. Accordingly, we recently surveyed our members in order to collect information that we hope the staff will find helpful. The following discusses the aggregate survey responses of our members:

Survey Respondents

Twenty-one SIFMA member firms who open customer accounts with Sweep Program features responded to SIFMA's Financial Responsibility Rule – Sweep Program Survey (the **"Survey"**). These firms reported that collectively, they open, on average, approximately **6,372,000** customer accounts with Sweep Program features per year. The responding firms range in size and model from firms that open approximately **1,500,000** accounts per year to firms that open approximately **120** accounts per year.

Account Opening Mechanism

With respect to the means by which firms open new customer accounts (e.g., whether in-person, by telephone, internet, mail, etc.), a number of firms indicated that they were unable to quantify the various categories with specificity. Thirteen firms, however, reported that they opened **90% or more** of their customer accounts either **in-person** or **by telephone**, which, on a yearly basis, represents approximately **4,374,000** accounts per year. Thus, absent relief, the Rule has the potential to impact a significant number of customers.

Funding Prior to Return of All Account Opening Documents

A fundamental challenge of complying with the new Rule is that virtually all Sweep Programs are, by operation, automatic. Typically, free credit balances are automatically transferred (i.e., "swept") from the new securities account into either a money market mutual fund or an FDIC-insured bank account. The issue arises when the firm receives and deposits the customer's opening deposit (i.e., the account is "funded") before the firm receives the customer's executed account opening documents (including the written consent to the Sweep Program).

As discussed above, the funding of customer accounts prior to receiving all signed account opening documentation is a fairly common occurrence. Of the 6,372,000 customer accounts with Sweep Program features opened annually by our twenty-one Survey respondents, over one-third, approximately **2,267,000** accounts, were funded prior to receiving all of the executed account opening documents from the customer.

Industry Use of the Current NAL Relief

Twelve of the Survey respondents currently rely on the NAL relief to comply with the new Rule. **Seven** of the Survey respondents have undertaken to implement a system/technology measure to suppress the sweep function until the customer's written consent is obtained. Of the nine firms not currently relying on the NAL relief, **six** stated that their decision not to rely on the NAL relief may change if the NAL relief is made permanent.

Customer Impact

With respect to the **seven** Survey respondents that elected to develop and implement a system/technology measure to suppress the sweep function, and prevent the customer from participating in the Sweep Program until the firm has received the customer's written consent, the average yearly number of customer accounts impacted at these **seven** firms alone is approximately **839,000** accounts. The average total daily free credit balance in these accounts is approximately **$514,540,000.** Thus, to the customers' detriment, hundreds of millions of dollars sit idle and uninvested in hundreds of thousands of accounts, pending receipt of their written consent to the Sweep Program.

C. The Rule's costs are higher and more pervasive than originally contemplated.

The new Rule imposes a significantly greater scope and scale of costs and burdens that were neither identified nor addressed in the SEC's cost-benefit analysis of the Rule. These costs would be borne by both securities firms and investors alike. As discussed below, these costs also include potentially problematic conflict with other federal regulatory regimes, including ERISA requirements and Treasury regulations.

Costs to Broker-Dealers

In the Final Rule Release,[6] the SEC staff noted that broker-dealers would incur one-time and annual cost burdens to implement the new Rule. The staff estimated that these costs burdens may fall on all of the 189 broker-dealers that carry free credit balances, and that the new Rule may impact approximately 5% of all customer accounts per year.[7] Broker-dealers' cost burdens would include:

One-time cost to update electronic systems:	$10,659,600
One-time cost of outside counsel to implement system changes:	$3,780,000
Annual cost to process an affirmative consent for new customers:	$23,203,593[8]

[6] *Financial Responsibility Rules for Broker-Dealers*, Exchange Act Release No. 70072 (Jul. 30, 2013), 78 F.R. 51824 (Aug. 21, 2013).

[7] *Id.* at 51864 – 65.

[8] *Id.* at 51880.

Thus, by the staff's estimate, the cost of all broker-dealers that carry free credit balances to comply with the new Rule would be approximately $37.6 million in the first year and $23.2 million in every year thereafter.

The staff's estimate appears to contemplate that the only cost to firms would be that of generating and processing a new, up-front consent form, such as the *Consent to Sweep Program* form discussed above. As discussed, however, our members report that they generally have not undertaken to develop a separate, stand-alone form to obtain written customer consent to Sweep Programs at account opening, primarily because the account opening documents are already fairly voluminous and designed to be managed and tracked as a single package, and because it would require a costly, largely manual and labor-intensive process to collect, track, supervise, and ensure enterprise-wide compliance with an additional, stand-alone form at the point of account opening.

Regardless, even if firms endeavored to obtain the customer's written consent to the Sweep Program at account opening, there would likely be many instances where the firm is unable to obtain that written consent. Because of those situations, firms would also need to develop and implement a system/technology measure to suppress the automatic sweep function and embargo the customer's free credit balances until such time as the firm receives the customer's written consent to the Sweep Program. The SEC staff's estimate does not appear to contemplate or address this additional, likely substantial, cost of compliance for broker-dealers.

Costs to Customers

The costs of compliance with the new Rule will not be limited to expenditures by firms to develop and implement (i) new, up-front, written consent forms, and (ii) new system and technology measures to suppress the automatic sweep function, as discussed above. There will also be costs to customers. The SEC staff's estimate does not address these prospective costs.

As discussed above, customers typically provide a deposit at account opening, whether by check, wire transfer, or by other means. Absent relief from the new Rule, without the customer's prior written consent, the firm cannot immediately put these monies to work for the customer in the Sweep Program. Instead, the firm must allow the customer's free credit balances to sit idle and uninvested. Absent written consent, firms are effectively precluded from providing a valuable customer service, and from acting in the best interests of, and oftentimes in accordance with the express wishes of, the customer.

Potential Conflict with ERISA Requirements

As mentioned above, the SEC's cost-benefit analysis of the new Rule did not identify or address conflicts between the new Rule and other federal regulatory regimes, including ERISA and the Internal Revenue Code (**"Code"**) Section 4975 requirements. The new Rule requires that new customer deposits must remain in cash or free credit balances if the customer has not provided prior written consent to the Sweep Program. However, deviating from a customer's verbal direction and holding ERISA-governed "plan assets" in cash or as free credit balances may raise a number of issues under the prohibited transaction rules of both ERISA and the Code.

Moreover, where a broker-dealer acting as or working with an IRS-approved custodian concludes that it cannot hold "plan assets" (including IRA assets) in cash or free credit balances, the only alternative may be to return the cash to the customer, which could trigger a taxable distribution from the plan or IRA and potentially expose the client to early withdrawal penalties of 10%. Furthermore, returning the cash to a plan may first require administrative action on the part of the plan, which may not be easily obtained in a timely manner.

Potential Conflict with Treasury Regulations

Yet another previously unidentified, potential conflict involves the interplay between the new Rule and certain Treasury Regulations. Specifically, Treasury Regulation § 1.408-2(e) allows nonbank custodians who meet certain requirements to handle fiduciary accounts such as qualified retirement plan custodial accounts, IRAs, and Roth IRAs, among others. A number of SIFMA's members function as nonbank custodians under this provision. Section 1.408-2(e)(5)(iv) requires that funds held in a fiduciary capacity by a nonbank custodian "will not be held uninvested or undistributed any longer than is reasonable for the proper management of the account." There is a substantial risk that a nonbank custodian's decision to allow new customer deposits to remain uninvested because the customer had given only oral – but not written – consent to a Sweep Program would *not* be deemed "reasonable" under the Treasury Regulations. Consequently, this potential conflict also represents a substantial risk to the continuing, Treasury-approved status of nonbank custodians and their ability to service fiduciary accounts.

III. REQUEST FOR FURTHER RELIEF

As discussed above, and generally speaking, current new account opening and documentation practices at securities firms make compliance with the new Rule exceedingly challenging. Many of our members would need to undertake significant time, money, and resource expenditures to make technology and system changes to comply with the new Rule. At the same time, many customers will continue to bear the costs of idle, uninvested, free credit balances, often against their express wishes. Finally, compliance with the new Rule raises significant, prospective conflicts with both ERISA requirements and Treasury Regulations.

Accordingly, SIFMA respectfully requests further relief from the Rule, as discussed below. We believe our proposal would adequately serve and protect the interests of customers, regulators, and securities firms alike. Under our proposal: (1) Customers would receive the benefit of oral disclosure and the choice to consent to the Sweep Program at account opening, and the assurance that their account opening deposits will be put to work for them without delay; (2) Regulators would fully satisfy their regulatory objectives of up-front disclosure, customer consent, and firm recordkeeping of compliance with these obligations; and (3) Firms would be spared the significant time, money, and resource expenditures to make technology and system changes necessary to comply with the new Rule.

Re-issue the current NAL without a sunset date.

We respectfully request that the SEC staff re-issue the current NAL without a sunset date. The staff would of course retain full discretion to withdraw or establish a new sunset date for the NAL in the future, if appropriate or necessary.

The current NAL relief generally works well within the context of our member firms' existing system and procedures. Our members can now avail themselves of the NAL relief, and best serve their clients, with fairly minimal burden and expense. Most of our member firms have not yet committed the time, money or resources to develop and implement the procedural, systemic, and automation fixes (e.g., Consent to Sweep Program form, suppress the sweep function, etc.), as discussed above, that would be necessary to comply with the new Rule. Our members caution that they would require significant lead-time to build-out these types of changes.

The current NAL relief also benefits customers because it allows firms to follow through on their customers' oral instructions and put their opening deposits to work for them immediately in the Sweep Program, while the firm awaits the customer's written consent. The current NAL relief also helps mitigate potential conflict with ERISA, the Code, and Treasury regulations, outlined above, insofar as it allows customers' deposits to remain invested through the Sweep Program for the first ninety days.

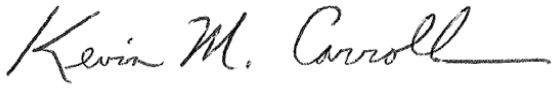
If the current NAL is allowed to sunset, and absent alternative relief, costs expand exponentially – costs to firms, costs to customers, costs of ERISA, Code and Treasury regulatory compliance, and yet, there would be no corresponding or additional benefit to either customers or to regulatory interests in return.

Before our members and their customers are subjected to these significant costs, we believe it is prudent and appropriate to first explore with the staff whether or not more lasting no-action or other relief is possible. Our member firms and their customers seek certainty and long-term stability on this important issue.

* * *

Again, we greatly appreciate your continued engagement with us on this important issue of cost and compliance for our members, and service and value for their clients. If you would like to further discuss this issue, or if we can provide further assistance, please contact the undersigned at 202.962.7382, kcarroll@sifma.org, or William Leahey at 212.313.1127, wleahey@sifma.org.

Sincerely yours,



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