



September 11, 2023

Submitted by SEC Webform (<https://www.sec.gov/rules/submitcomments.html>)

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

RE: File No. S7-11-23: Daily Computation of Customer and Broker-Dealer Reserve Requirements under the Broker-Dealer Customer Protection Rule

Dear Ms. Countryman:

On behalf of the North American Securities Administrators Association, Inc. (“NASAA”),¹ I am writing in response to U.S. Securities and Exchange Commission (the “Commission”) Release No. 34-97877, *Daily Computation of Customer and Broker-Dealer Reserve Requirements under the Broker-Dealer Customer Protection Rule* (the “Proposal”),² in which the Commission proposes to require carrying broker-dealers with average total credits³ of \$250 million or more to perform customer and PAB reserve account computations and make required deposits daily.⁴

NASAA supports the Commission’s goal to reduce the risk caused by mismatches between the net amounts owed by large carrying broker-dealers to their customers and PAB account holders, and the amounts on deposit in those reserve accounts.⁵ Such a mismatch could cause significant shortfalls in the amounts available in reserve accounts which could lead to delayed satisfaction of account holder claims or substantial losses if an affected carrying broker-dealer fails

¹ Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA’s membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Guam, Mexico, Puerto Rico, the U.S. Virgin Islands, and Guam. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

² The Proposal is available at <https://www.sec.gov/files/rules/proposed/2023/34-97877.pdf>.

³ The average total credits to be determined by the carrying broker-dealers twelve most recently filed month-end FOCUS Reports. Proposal at 27.

⁴ *Id.* at 5, 26.

⁵ *Id.* at 6.

and needs to be liquidated.⁶ We understand the impetus of this Proposal is to prevent systemic ripples from a large carrying broker-dealer's failure and to protect the Securities Investor Protection Corporation ("SIPC") Fund.⁷ We agree these risks can and should be addressed, and that a strengthened broker-dealer customer protection rule is the first line of defense against such risks. We offer two suggested revisions for the Commission's consideration below.

I. The Commission Should Define the Daily Computation Threshold as a Formula That Can Be Adjusted Periodically Without the Need for Further Rulemaking.

The Proposal explains that the proposed \$250 million daily computation threshold ("\$250 Million Threshold") is based on analyses of Financial and Operational Combined Uniform Single Reports ("FOCUS reports") submitted by carrying broker-dealers during 2022.⁸ From that data, the Commission has determined that "the largest average mismatches occurred for broker-dealers over the \$250 Million Threshold,"⁹ and that "carrying broker-dealers with average total credits above the proposed \$250 Million Threshold are more likely to experience larger mismatches and the dollar amounts underlying those mismatches are significantly larger."¹⁰

NASAA agrees with the logic of the Commission's approach and supports the Commission's aim to "provide a balanced demarcation between carrying broker-dealers with large amounts of total credits relative to smaller carrying broker dealers" in order to address the most likely segment of risk while considering which firms are "more likely to better absorb any potential increase in compliance costs."¹¹

However, because the proposed threshold is based on analyses that follow from a narrow set of FOCUS reports, it is possible that the threshold could become stale if the data changes materially. One remedy would be to require all carrying broker-dealers to compute reserve requirements daily,¹² but we recognize the Commission's implicit concern that extending the requirement to all carrying broker-dealers might be unnecessarily burdensome. On the other hand, it appears from the fact that 1) the Proposal was approved unanimously, and 2) the Commissioners' accompanying statements, that there is a potential consensus to support a reasonable "balanced demarcation."

⁶ *Id.* at 6.

⁷ *Id.* at 24.

⁸ *See id.* at 48-56.

⁹ *Id.* at 54.

¹⁰ *Id.* at 60.

¹¹ *Id.* at 28.

¹² *See id.* at 35, Request for Comment 6 ("Should Rule 15c3-3 be modified to require all carrying broker-dealers to perform daily customer and PAB reserve computations? If so, explain why. If not, explain why not.").

Should such a consensus be reached following the public comment period, NASAA asks the Commission to consider making that consensus evergreen by crafting the threshold not simply as a number, but instead as the result of a formula that can be recalculated periodically.¹³ Doing so would better ensure that the systemic risk mitigation aims of the Proposal are periodically re-evaluated and refreshed if necessary. It would also ease the Commission's future burdens given the significant effort required to engage in rulemaking.

II. The Commission Should Add a Probationary Period for Carrying Broker-Dealers That Drop to Weekly Reserve Account Computations.

The Proposal would allow a carrying broker-dealer that is required to perform daily reserve account computations to drop to weekly computations 60 days after notifying its designated examining authority that its total credits has fallen below \$250 million.¹⁴ However, if such a firm's total credits subsequently rose above \$250 million, it would not be required to return to daily computations for six months.¹⁵ The Commission's reasoning for the six-month return period is that the firm may need to add resources to again perform daily computations.¹⁶ Taken together, the two periods present an ironic circumstance under which a firm could shed its daily computation obligation quickly but be allowed to return to that obligation slowly.

While the Commission assumes such a situation would be infrequent,¹⁷ it stands to reason that a firm that drops to weekly computations shortly after falling below \$250 million in total credits may very well re-cross the threshold if it attracts new investors or firms that need reserve account services. Indeed, as the Commission notes, "[t]he number of affected carrying broker-dealers may vary month to month since a 12-month rolling average is used for the proposed \$250 Million Threshold."¹⁸ If such a set of circumstances occurred, for a period of six months the firm at issue would present the risk that the Commission is trying to address in the Proposal.

NASAA, therefore, suggests that the Proposal should be revised so that a firm that drops to weekly computations would enter into a probationary period – of perhaps six months – during which time the firm would be required to return to daily computations immediately if its total

¹³ As the Commission knows, some rules allow the Commission to make periodic adjustments. *See, e.g.*, 17 C.F.R. § 240.31(a)(12) [transaction fees under Section 31 of the Securities Exchange Act of 1934] and 17 C.F.R. § 275.205-3(e) [exemption from the compensation prohibition of Section 205(a)(1) of the Investment Advisers Act of 1940].

¹⁴ Proposal at 30.

¹⁵ *Id.*

¹⁶ *Id.* at 29.

¹⁷ *Id.* at 31.

¹⁸ *Id.* at 51.

credits re-crossed the threshold.¹⁹ If a firm drops to weekly computations due to variable market or business conditions, a probationary period would allow both regulators and the firm a more stable opportunity to determine whether the firm is likely to stay below the threshold over the long term, and the Commission would avoid the troublesome scenario in which a firm might hover above and below the threshold based on minor or cyclical changes to its business prospects.

III. Conclusion

For the reasons expressed above, NASAA supports the Proposal, encourages the Commission to consider industry feedback carefully, and asks the Commission to consider whether our suggestions would improve the final rule. Should you have any questions about this letter, please contact either the undersigned or NASAA's General Counsel, Vince Martinez, at (202) 737-0900.

Sincerely,



Andrew Hartnett
NASAA President and
Deputy Commissioner
Iowa Insurance Division

¹⁹ See *id.* at 35, Request for Comment 8 (“*If a carrying broker-dealer falls below the \$250 Million Threshold, reverts to a weekly computation after providing the 60-day prior notice, and subsequently exceeds the \$250 Million Threshold again, should the six-month period to begin performing the daily customer and PAB reserve computations be modified?*”). Presumably firms and industry trade associations will comment on this aspect of the Proposal; namely, whether the 60-day and six-month periods are appropriate. That commentary may in turn help the Commission to decide whether NASAA’s suggestion is helpful.