

Broker-Dealers Can Hold Customers' Initial Checks

SECURITIES TRANSACTIONS AND COMPLIANCE | SECURITIES AND DERIVATIVE LITIGATION | LIFE, ANNUITY, AND RETIREMENT SOLUTIONS | DECEMBER 22, 2016



Thomas C. Lauerman

A recent SEC no-action letter gives broker-dealers more time to perform suitability and other reviews when opening certain customer accounts.

The firms requesting the letter were affiliated with three different insurance company complexes and were engaged in retail sales of mutual funds, variable annuity and variable life insurance contracts, Section 529 plans, and other securities. The firms sometimes served as "introducing" brokers, who would open accounts for their customers with the firms' "clearing" brokers.

Although, in order to fund the account, a customer might give an introducing broker a check made out to the clearing broker, the introducing firms did not want to be deemed to be carrying customer funds for purposes of broker-dealer net capital requirements. This meant that, under longstanding SEC interpretations, the checks had to be forwarded to the clearing broker by noon on the next business day following receipt.

This, however, did not allow enough time for the introducing firms' process of forwarding the relevant account opening documentation to their "offices of supervisory jurisdiction" (OSJs) to correct any inaccuracies or omissions and determine that regulatory requirements (such as suitability, "know your customer," and anti-money laundering) were satisfied, before opening the account and forwarding the check to the clearing broker.

Accordingly, under the no-action letter, the introducing broker need not forward the check to its clearing broker until noon on the day after a registered principal of the introducing broker approves opening the account, provided that: (a) the principal's review is completed within seven business days after the introducing broker has a complete application at its OSJ and (b) certain other conditions are met.

This is very similar to relief the SEC previously granted where a broker-dealer delays delivery of an initial check the customer has made payable to the issuer of a security (rather than, as here, to a clearing broker) that the customer is purchasing on a "subscription way" basis. See "'Promptly Transmit' Redefined for Some Customer Checks," *Expect Focus* Vol. III, 2015.