

## Subscription-Way Transactions

### FINRA Provides Limited Relief Regarding Requirement to Promptly Transmit Funds in Connection With Sales of Securities on a Subscription-Way Basis for the Purpose of Completing Suitability Reviews Under Identified Conditions

#### Executive Summary

FINRA is providing limited relief regarding the requirement to promptly transmit customer funds received in connection with sales of securities on a subscription-way basis for the purpose of completing suitability reviews. Pursuant to the limited relief, a firm may hold a customer check payable to an issuer or an appropriate third-party payee acting on behalf of the issuer (e.g., a transfer agent or custodian) (hereinafter collectively referred to as “issuer”) for up to seven business days from the date that an office of supervisory jurisdiction (OSJ) receives a complete and correct application package for the purchase of securities on a subscription-way basis provided that all conditions set forth herein are present.

Questions regarding this *Notice* should be directed to:

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- ▶ James S. Wrona, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8270;
- ▶ Jeanette Wingler, Assistant General Counsel, OGC, at (202) 728-8013; and
- ▶ Susan DeMando Scott, Associate Vice President, Risk Oversight and Operational Regulation, at (240) 386-4620.

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#### Notice Type

- ▶ Guidance

#### Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Senior Management

#### Key Topics

- ▶ Investment Company Securities
- ▶ Principal Review
- ▶ Sales Practices
- ▶ Suitability
- ▶ Supervision

#### Referenced Rules & Notices

- ▶ FINRA Rule 2111
- ▶ FINRA Rule 2150
- ▶ FINRA Rule 3110
- ▶ NASD Rule 2830
- ▶ SEA Rule 15c3-3

## Background and Discussion

### SEC No-Action Letter

Recently, the staff of the Securities and Exchange Commission's (SEC) Division of Trading and Markets (SEC staff) issued a no-action letter<sup>1</sup> providing relief from the requirement to promptly transmit customer funds received in connection with sales of securities on a subscription-way basis.<sup>2</sup> If the no-action letter's conditions are met, a firm is permitted to hold a customer check payable to an issuer for up to seven business days from the date that the firm's OSJ receives a complete and correct application package in order for a principal to complete a suitability review of each sale of a recommended subscription-way security.

Prior to the issuance of the no-action letter, a firm was required to send a check a registered representative received in connection with the sale of securities on a subscription-way basis to the issuer of such securities by noon local time on the business day following receipt regardless of the location at which the check was received.<sup>3</sup> In providing no-action relief, SEC staff considered that a firm's obligation to supervise customer subscription-way transactions under FINRA Rules 2111 and 3110 to ensure, among other things, that the recommended transactions were suitable may conflict with the firm's obligation to promptly transmit funds to issuers under SEA Rule 15c3-3.<sup>4</sup>

### FINRA Relief

To alleviate any potential conflict between the relief provided by SEC staff in the no-action letter and FINRA rules, FINRA is providing limited relief, as described below, to firms from the requirements of FINRA Rule 2150(a) and NASD Rule 2830(m) regarding the obligation to promptly transmit customer funds to an issuer in connection with sales of securities on a subscription-way basis.<sup>5</sup> FINRA Rule 2150(a) generally prohibits firms from making improper use of customer funds. NASD Rule 2830(m) requires firms that engage in direct retail transactions for investment company shares to transmit payments received from customers for such shares to the appropriate third-party payee (*e.g.*, the investment company or its agent) by: (i) the end of the third business day following a receipt of a customer's order to purchase such shares; or (ii) the end of one business day following receipt of a customer's payment for such shares, whichever is the later date.

Without violating either FINRA Rule 2150(a) or NASD Rule 2830(m), a firm may hold a customer check payable to an issuer for up to seven business days from the date that an OSJ receives a complete and correct application package for the sale of securities on a subscription-way basis provided that all seven conditions delineated below are present.<sup>6</sup>

1. The reason that the firm is holding the application for the securities and a customer's non-negotiated check payable to a third party is to allow completion of principal review of the transaction pursuant to FINRA Rules 2111 and 3110.
2. The associated person who recommended the purchase of the securities makes reasonable efforts to safeguard the check and, after receiving information necessary to prepare a complete and correct application package, promptly prepares and forwards the complete and correct copy of the application package to an OSJ.
3. The firm has policies and procedures in place that are reasonably designed to ensure compliance with condition number 2 above.
4. A principal reviews and makes a determination of whether to approve or reject the purchase of the securities in accordance with the provisions of FINRA Rules 2111 and 3110.
5. The firm holds the application and check no longer than seven business days from the date an OSJ receives a complete and correct copy of the application package.
6. The firm maintains a copy of each such check and creates a record of the date the check was received from the customer and the date the check was transmitted to the issuer or returned to the customer.
7. The firm creates a record of the date when the OSJ receives a complete and correct copy of the application package.
8. If any of these seven conditions are not present, FINRA's limited relief will not apply and it will enforce FINRA Rule 2150(a) and NASD Rule 2830(m), as appropriate.

## Endnotes

1. See [letter](#) from Mark M. Attar, Senior Special Counsel, Division of Trading and Markets, SEC, to Christopher M. Salter, Allen & Overy LLP, counsel to NYLIFE Securities LLC (March 12, 2015) (no-action letter). The conditions for relief set forth in the no-action letter are comparable to the conditions set forth in the SEC's exemptive relief for sales of deferred variable annuities. See Securities Exchange Act of 1934 (SEA) Release No. 56376, 72 FR 52400 (Sept. 13, 2007). See also SEA Release No. 59772 (April 15, 2009), 74 FR 18419, at 18422 n.37 (April 22, 2009) (Order Approving File No. SR-FINRA-2008-019) (stating in SEC order approving rule amendments that the exemptive order continues to apply, notwithstanding the new starting point for the principal review period under FINRA Rule 2330).
2. As described in the no-action letter, sales of securities on a subscription-way basis commonly involve a registered representative meeting with a current or potential customer, discussing a security or securities, which may or may not be recommended by the registered representative, assisting the customer in completing an application for the purchase of securities, and obtaining a check payable to the issuer or an appropriate third-party payee acting on behalf of the issuer (*e.g.*, a transfer agent or custodian) from the customer. As noted above, for purposes of brevity in this limited relief, both the issuer of the relevant securities and any third-party payee acting on behalf of the issuer are referred to herein as the "issuer." Following these interactions, the registered representative typically forwards the application package to an OSJ where it is reviewed by a supervisor before being sent to the issuer.
3. The SEC has interpreted the term "promptly transmit" for purposes of SEA Rules 15c3-1 and 15c3-3 to mean that "such transmission or delivery is made no later than noon of the next business day after receipt of such funds or securities." See SEA Release No. 31511 (Nov. 24, 1992), 57 FR 56973 at n.11 (Dec. 2, 1992), and 17 CFR 240.15c3-1(c)(9). Further, the SEC staff has stated that a firm "receives" customer funds when a registered representative receives a check from a customer. See [Interpretation of Financial Responsibility Rules, Rule 15c3-3 \(Exhibit A-Item 1\)/18](#).
4. The SEC has previously noted that "many broker-dealers are subject to lower net capital requirements under SEA Rule 15c3-1 and are exempt from the requirement to establish and fund a customer reserve account under SEA Rule 15c3-3 because they do not carry customer funds or securities." See SEA Release No. 56376 (Sept. 7, 2007), 72 FR 52400 (Sept. 13, 2007) (Order Granting Exemption to Broker-Dealers from Requirements in SEA Rules 15c3-1 and 15c3-3 to Promptly Transmit Customer Checks). Although some of these firms receive checks from customers made payable to third parties, the SEC also has stated that "a broker-dealer is not deemed to be carrying customer funds if it 'promptly transmits' the checks to the third parties." *Id.*
5. FINRA emphasizes that firms are not required to collect and hold checks or funds prior to principal review and approval. A firm may elect to wait until after a principal approves the transaction to collect the check or funds for the purchase of a security.

FINRA also notes the no-action letter's observation regarding the requirements of Rule 22c-1(a) under the Investment Company Act of 1940 for broker-dealers subject to the rule. Rule 22c-1(a) prohibits any registered investment company (RIC) issuing any redeemable security, any person designated in the RIC's prospectus as authorized to consummate transactions in the security, and *any principal underwriter of or dealer in the security* from selling and redeeming the security except at a price based on the security's current net asset value next computed after receipt of an order to purchase or redeem. The no-action letter comments that "[a] broker-dealer subject to the requirements of Rule 22c-1(a) that relies on the time periods set forth in this letter to transmit an order to purchase redeemable shares issued by a RIC would have to ensure that the price of the shares is based on the net asset value next computed after receipt of the order (*i.e.*, the completed and correct application and check) in accordance with the rule." No-action letter at n.13.

6. To promote operational efficiency, FINRA notes that the conditions required for the relief for sales of securities on a subscription-way basis are consistent with the conditions required for the relief FINRA has previously provided for transmissions of payments for deferred variable annuities. [Regulatory Notice 10-05](#) (Jan. 2010).