UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

DIVISION OF
TRADING AND MARKETS

January 8, 2020

Mary Kay Scucci, PhD, CPA
Managing Director
Securities Industry and Financial Markets Association
120 Broadway, 35th Floor
New York, NY 10271-0080

Re: Treatment of Certain Investment Companies and Investment Funds under Note E(5) to Rule 15c3-3a

Dear Ms. Scucci,

In your letter dated January 8, 2020 on behalf of the Capital Steering Committee of the Securities Industry and Financial Markets Association ("SIFMA"), you request that the staff of the Division of Trading and Markets (the "Staff") not recommend enforcement action to the Securities and Exchange Commission (the "Commission") if a broker-dealer does not treat certain types of investment funds and investment companies as being under common control for the purposes of Note E(5) to Exhibit A of Rule 15c3-3 under the Securities Exchange Act of 1934 ("Exchange Act") notwithstanding that the entities share a common investment manager or have affiliated investment managers.

Pursuant to the reserve formula of Exhibit A to Rule 15c3-3, a broker-dealer enters the amount of debit balances in customers' cash and margin securities accounts on Line Item 10. However, Note E(5) to Line Item 10 generally requires the broker-dealer to reduce debit balances in margin accounts (other than omnibus accounts) by the amount by which any single customer's debit balance exceeds 25% (to the extent such amount is greater than $50,000) of the broker-dealer's tentative net capital (the "Note E(5) Reduction"). Note E(5) further provides that related accounts (e.g., accounts under common control) will be deemed to be a single customer's account for the purposes of Note E(5).

You state that the primary purpose of the Note E(5) Reduction is to protect customers' free credit balances carried by a broker-dealer against fraudulent debit balances as well as the credit risk arising from a large amount of debit balances relating to a single large customer. You also argue that there is no indication that the Commission – when adopting the Note E(5) Reduction in 1985 – contemplated that investment funds or investment companies, with different beneficial ownership, but that share a common investment manager or have affiliated investment managers

would need to be treated as being under common control.[1] Therefore, you believe that, for the purposes of the Note E(5) Reduction, a broker-dealer should not be required to treat an investment fund or investment company as being under common control with another investment fund or investment company notwithstanding that the entities share a common investment manager or have affiliated investment managers. In particular, you argue that this treatment should be accorded to:

1. An investment company that is registered under the Investment Company Act of 1940 ("1940 Act") that issues publicly-offered shares ("Publicly-offered Registered Investment Company" or "Publicly-offered RIC");
2. A private investment fund that is not registered under the 1940 Act because it is excluded from the definition of "investment company" by reason of Section 3(c)(1) or Section 3(c)(7) of the 1940 Act ("Private Investment Fund") or an investment company that is registered under the 1940 Act that is privately offered without registration under the Securities Act of 1933 (the "1933 Act") ("Privately-offered Registered Investment Company" or "Privately-offered RIC"),[2] and that (i) is not "narrowly held" as defined herein, or (ii) has no ownership in common with one or more other Private Investment Funds or other Privately-offered RICs that shares a common investment manager or has affiliated investment managers.

In your request, you argue that for the purposes of this letter a Private Investment Fund or Privately-offered RIC should not be deemed to be "narrowly held" if the fund or company has (i) at least ten investors and (ii) no single investor has more than a 10% ownership interest in the fund or company. You also request that the Commission permit a broker-dealer to rely on the determination that a Private Investment Fund or Privately-offered RIC is not narrowly held for up to twelve months. You argue that relying on a determination that was made within twelve months would be consistent with Financial Industry Regulatory Authority, Inc. ("FINRA") Rules 5130 and 5131(b).[3]

In addition, you argue that a Private Investment Fund or Privately-offered RIC with a small amount of debit balances should not be treated as being under common control with another customer for the purposes of the Note E(5) Reduction even if the fund or company is narrowly held or has ownership in common with one or more Private Investment Funds or Privately-offered RICs. Based upon your letter and our understanding from conversations with members of the SIFMA Capital Steering Committee, we understand that you believe this treatment would be appropriate because the risk is low that a Private Investment Fund or Privately-offered RIC with a small amount of debit balances would lead to the broker-dealer having debit balances that are concentrated across a group of investment funds and/or investment companies under common

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1 *See Customer Protection Rule*, Exchange Act Release No. 22499 (Oct. 3, 1985), 50 FR 41337 (Oct. 10, 1985) (adopting the Note E(5) Reduction).

2 You state that Privately-offered RICs are generally offered without registration under the 1933 Act in reliance on the exemption in Section 4(a)(2) of the 1933 Act or in Rule 506 of Regulation D thereunder.

3 FINRA Rule 5130(b) provides that "[b]efore selling a new issue to any account, a member must in good faith have obtained within the twelve months prior to such sale" an eligibility representation from a customer.

control. You argue that the relatively high legal and administrative costs of setting up additional Private Investment Funds or Privately-offered RICs to open accounts at a single broker-dealer should discourage a Private Investment Fund or Privately-offered RIC from doing so to evade the Note E(5) Reduction. You also represent that it would be a significant operational burden to analyze whether every client that is a Private Investment Fund or Privately-offered RIC is narrowly held and, if so, whether the investment fund or investment company is under common control with other investment funds or investment companies.[4] For these reasons, you argue that, if the amount of the debit balances in one or more accounts of a single Private Investment Fund or single Privately-offered RIC does not exceed 2.5% of the broker-dealer's tentative net capital, the account(s) of the fund or company should not be required to be treated as being under common control.[5] You represent that this treatment would allow broker-dealers to focus their common control analysis on larger clients, would ease operational burden, and would have a minimal effect, if any, on the rationale for applying the Note E(5) Reduction.

Based on your representations and the reasons explained in your letter, the Staff will not recommend enforcement action to the Commission if a broker-dealer, for the purposes of the Note E(5) Reduction, does not treat the account(s) of a Publicly-offered RIC as being under common control with the account(s) of one or more investment company or investment fund notwithstanding that the entities share a common investment manager or have affiliated investment managers.

In addition, the Staff will not recommend enforcement action to the Commission if a broker-dealer, for the purposes of the Note E(5) Reduction, does not treat the account(s) of a Private Investment Fund or Privately-offered RIC as being under common control with the account(s) of one or more investment companies or investment funds notwithstanding that the entities share a common investment manager or have affiliated investment managers if any of the following conditions is met:

1. The aggregate amount of debit balances in the account(s) of the Private Investment Fund or Privately-offered RIC does not exceed 2.5% of the broker-dealer's tentative net capital; or

2. The Private Investment Fund or Privately-offered RIC is not narrowly held,[6] or;

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4 For example, you indicate that many large broker-dealers would be required to contact and analyze the accounts of over 1,000 customers to make this determination.

5 2.5% of tentative net capital is 10% of the 25% of tentative net capital threshold in the Note E(5) Reduction.

6 For the purposes of this letter, a Private Investment Fund or a Privately-offered RIC will not be deemed to be "narrowly held" if the broker-dealer has determined within the last 12 months that the fund or company has at least ten investors and no single investor has more than a 10% ownership interest in the Private Investment Fund or the Privately-offered RIC.

3. If narrowly held, the Private Investment Fund or Privately-offered RIC does not have ownership in common[7] with any other Private Investment Fund or Privately-offered RIC that shares a common investment manager or has affiliated investment managers.[8]

This Staff position is based on the facts you have presented and the representations you have made in your letter. Any different facts and circumstances from those set forth in this letter may require a different response. This response, furthermore, expresses the Staff's position regarding enforcement action only and does not purport to express any legal conclusions on the question presented. The Staff expresses no view with respect to any other questions that the activities discussed above may raise, including the applicability of any other federal or state laws, or rules of a self-regulatory organization. This position is subject to modification or revocation at any time.

If you have any questions regarding this letter, please call me at (202) 551-5525 or Tom McGowan at (202) 551-5521.

Sincerely,

Michael A. Macchiaroli
Associate Director
Division of Trading and Markets

cc: Yui Chan, Managing Director ROOR, FINRA
David M. Katz, Partner, Sidley Austin

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7 For purposes of this letter, ownership in common will be deemed to occur whenever a Private Investment Fund or Private Investment Company shares at least one investor in common with another Private Investment Fund or Private Investment Company.

8 This no-action position addresses only the question of "common control," and does not address other types of "related accounts," such as accounts subject to "cross guarantees," as those terms are used in Note E(5) to Line Item 10. Moreover, the no-action position does not address the circumstance in which a single account, even an account of a Publicly-offered RIC or of a Private Investment Fund or Privately-offered RIC that is not narrowly held, exceeds the tentative net capital limit described in Note E(5) to Line Item 10. In that circumstance, Note E(5) to Line Item 10 requires the broker-dealer to reduce the debit balance in the single margin account by the amount by which it exceeds 25% of the broker-dealer's tentative net capital.

sifma

Invested in America

January 8, 2020
Mr. Michael A. Macchiaroli, Esq.
Associate Director
U.S. Securities and Exchange Commission
Division of Trading and Markets
100 F Street NE
Washington, D. C. 20549

Re: Concentrated Debit Analysis: Note E(5) and "common control" exceptions

Dear Mr. Macchiaroli:

The Capital Steering Committee of the Securities Industry and Financial Markets Association (SIFMA)[1] respectfully requests that the staff of the U.S. Securities and Exchange Commission (the "SEC") issue no action relief for certain investment companies that are registered ("RICs") under the U.S. Investment Company Act of 1940 (the "1940 Act") and certain hedge funds that not registered under the 1940 Act, in each case, meeting specific criteria from inclusion in "common control" for purposes of Note E(5) set forth in Appendix A to Rule 15c3-3 under the U.S. Securities Exchange Act of 1934 (the "1934 Act") for the reasons set forth below.

Background

Note E(5) was adopted in October 1985[2] and limits the amount of debit balance that a broker-dealer (a "BD") can recognize in item 10 of the customer (and, also, the PAB) reserve formula with respect to (i) a single customer's account (other than an omnibus account), (ii) guaranteed accounts, (iii) accounts under "common control", and (iv) other "related accounts." The primary purpose of Note E(5) is to protect customers' free credit balances carried by a BD against fraudulent debits as well as the credit risk arising from margin debits of a large customer. We understand that the SEC did not, as adopted in 1985, contemplate that investment funds, with different beneficial ownership,

[1] SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $18.5 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org

[2] See Exchange Act Release No. 34-22499 (October 3, 1985).

but that have a common manager or that have affiliated managers that are under common control – either public or private funds, would be subject to Note E(5).[3]

Request

With respect to what constitutes "common control" for the purposes of Note E(5), we are requesting that the SEC should exclude RICs whose shares/interests issued thereby are publicly offered (that is, whose shares/interests issued thereby are registered under the U.S. Securities Act of 1933 (the "1933 Act")), even if such RICs have the same investment manager or have affiliated managers, as described above.

In addition, we believe that the SEC should also exclude from "common control" for the purposes of Note E(5) certain private investment (hedge) funds (that is, investment funds that are not registered under the 1940 Act, but are excluded from the definition of "investment company" under the 1940 Act by reason of Section 3(c)(1) or Section 3(c)(7) thereunder) that are privately offered (each, a "Private Investment Fund"), as well as RICs that are privately offered (each, a "Privately-offered RIC"), in each case, whose shares/interests issued thereby are not registered under the 1933 Act[4], provided that such Private Investment Fund or Privately-offered RIC either (i) is not "narrowly held", as defined below, (ii) has an item 10 debit under Appendix A to SEC Rule 15c3-3 which does not exceed 10% of the limit imposed under Note E(5) (that is, which does not exceed 2.5% of the BD's tentative net capital as computed in accordance with SEC Rule 15c3-1), or (iii) does not have ownership in common with any other Private Investment Fund or Privately-offered RIC that shares a common investment manager or has affiliated investment managers.

To the extent that any such Private Investment Fund or Privately-offered RIC is not excluded by (i) or, (ii) of the immediately preceding paragraph, then depending on the particular facts and circumstances which could be difficult to determine, such Private Investment Fund or Privately-offered RIC could be deemed to be under "common control" with another Private Investment Fund or Privately-offered RIC with a common manager or affiliated managers.

Moreover, without the exclusion of Private Investment Funds or Privately-offered RICs with "de minimis" debits under (iii) above (that is, debit balances which do not exceed 10% of the limit imposed under Note E(5), or 2.5% of the BD's tentative net capital as computed under SEC Rule 15c3-1), BDs would have to reach out to a very high number of clients (for larger broker-dealers in excess of one thousand) to determine

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[3] See, for example, footnote 8 to the Commission's proposed release relating to, among other things, Note E(5) – 1934 Act Release No. 34-20655 – where the Commission stated that for purposes of establishing control under Note E(5), "ownership of 10% or more of the common stock of the relevant entity will be deemed to be sufficient." The latter suggests that the Commission was contemplating control of a non-fund corporate entity, and not an investment fund.

[4] Private Investment Funds and Privately-offered RICs would generally be offered without registration under the 1933 Act in reliance on exemption in Section 4(a)(2) of the 1933 Act (for offerings of securities by an issuer not involving a public offering) and Rule 506 of Regulation D thereunder.

the details of their ownership structure because that information is currently not collected by broker-dealers. This would create a significant operational burden to broker-dealers. With the de minimus exception, however, broker-dealers would be able to focus on larger funds for the determination of concentration (for larger broker-dealers, often less than 5% of the funds), which would ease the operational burdens of complying with Note E(5), but not undermine the SEC's goal of employing a concentration requirement for large debit balances of any single fund because we expect that excluding the smaller funds would have a minimal effect on the outcome of the analysis, if any effect at all. In addition, we think that the legal and administrative costs of setting up any additional/new fund would undermine the utility for a client to set up multiple funds at a single broker-dealer for the purpose of circumventing concentration under Note E(5).

For these purposes, a Private Investment Fund or Privately-offered RIC would not be deemed to be "narrowly held" (that is, would be not narrowly held) if the applicable fund has at least 10 investors and no single investor has more than a 10% ownership interest in the applicable fund.

We also respectfully request that the SEC permit a BD to rely on a determination that a fund is not narrowly held for up to 12 months. Such an approach would be consistent with the determination of "restricted person" investors in a private fund under the "new issues" rules promulgated by the Financial Industry Regulatory Authority, Inc. ("FINRA"), in particular, FINRA Rules 5130 and 5131(b).[5]

Summary

We appreciate your consideration of this request. Thank you for this opportunity to provide you with our concerns and request for relief. We would be pleased to discuss our views or provide any addition information. Please contact me at 212-313-1331 if you have any questions.

Regards,

Mary Kay Scucci

Mary Kay Scucci, PhD, CPA
Managing Director
Securities Industry and Financial Markets Association

cc:
Brett Redfearn, Director, SEC Trading and Markets

[5] See, for example, FINRA Rule 5130(b) which states that "[b]efore selling a new issue to any account, a member must in good faith have obtain within the twelve months prior to such sale" an eligibility representation from a customer.

Thomas K. McGowan, Deputy Associate Director, SEC Trading and Markets
Randall Roy, Deputy Associate Director, SEC Trading and Markets
Ray Lombardo, Assistant Director, SEC Trading and Markets

Bill Wollman, Exec Vice President, Risk Oversight & Operational Regulation, FINRA
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David M. Katz, Sidley Austin LLP