



May 21, 2015

## **FINRA Enforcement Sanctions Increased**

### **SEC Issues No-Action Guidance on Prompt Forwarding of Customer Funds with Subscription-Way Securities**

In a major shift in policy with respect to the processing of customer checks by broker-dealers in subscription-way securities, the United States Securities and Exchange Commission (“SEC”) issued a No Action Letter on March 12, 2015 to NYLIFE Securities, Inc. stating that the Staff in the SEC’s Division of Trading and Markets would not recommend enforcement action if a broker-dealer holds customer checks payable to issuers if the purpose for holding the customers’ funds is to complete a principal suitability review of each sale of a recommended subscription-way security.

This provides a relief for broker-dealers from the traditional requirement for a firm operating under paragraph (k) of Rule 15c3-3 is that funds or securities had to be promptly forwarded by noon of the next business day of receipt, especially in light of the additional principal review requirements established by FINRA Rule 2111 (Suitability). The combination of the two requirements have made it difficult for principals to effectively complete their suitability review so that checks could be forwarded by noon the next business day. The additional review time necessary to properly approve or disapprove a transaction placed firms in the position of violating Rule 15c3-3, and therefore their membership agreement with the Financial Industry Regulatory Authority.

The relief provided by the SEC’s no action letter provides relief to broker-dealers caught in this dilemma as long as the following measures are implemented by the broker-dealer:

1. Policies and procedures are established that are reasonably designed to ensure that each check is safeguarded and that a registered representative of the firm who recommends a sale of a security on a subscription-way basis promptly prepares and forwards a complete and correct application package to an OSJ of the firm regarding such security;
2. Registered principal is required to perform a suitability review in accordance with FINRA Rule 2111 and determines whether he or she approves of each recommended subscription-way sale within seven business days after an OSJ of the firm receives a complete and correct application package;
3. The check is transmitted no later than noon of the business day following the date the registered principal reviews and determines whether he or she approves the transaction;

4. A copy of each such check is maintained and a record of the date the check was received from the customer and the date the check was transmitted to the issuer if approved, or was returned to the customer if rejected is maintained; and
5. A disclosure is made to customers of its process for handling customer checks payable to issuers for subscription-way securities transactions in advance of each transaction.”

While the no action letter reflects a major change for firms engaged in subscription way business and now affords the same treatment as with variable annuities, FINRA member firms are reminded that registered representatives are still prohibited from holding customer checks or securities. The extension for promptly forwarding is based only on the additional review time required for principal review.

We hope that this information has been helpful to you. Should you have any additional questions or concerns, please feel free to contact Daniel E. LeGaye or Michael Schaps by e-mail or phone, at 281-367-2454, or consult with your legal counsel or compliance consultant. This legal update has been provided to you courtesy of The LeGaye Law Firm, P.C., 2002 Timberloch Drive, Suite 200, The Woodlands, Texas 77380. Visit our web site at [www.legayelaw.com](http://www.legayelaw.com).

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