

December 9, 1997

Charles H. Felker, Managing Director of Regulatory Affairs
First Empire Securities, Inc.
8000 Towers Crescent Dr., Suite 1350
Vienna, VA 22182

Re: Part 703 of the NCUA Rules and Regulations
Your Letter of August 11, 1997.

Dear Mr. Felker:

You have asked whether First Empire's safekeeping and settlement procedures meet the requirements of Section 703.60 of the National Credit Union Administration (NCUA) Rules and Regulations, effective January 1, 1998. Yes.

First Empire, a broker-dealer that sells securities to federal credit unions (FCUs), has delegated clearing and safekeeping functions to another broker-dealer, Morgan Stanley. The clearing agreement between First Empire and Morgan Stanley provides that Morgan Stanley will clear securities transactions for First Empire and its clients, maintain account records for each client, act as custodian for the client's securities, if the client has elected to safekeep with Morgan Stanley, and prepare and transmit statements of account to the clients. Morgan Stanley maintains the documentation necessary to establish that a client who has elected to safekeep with it is the beneficial owner of the security. Further, Morgan Stanley may not transfer securities from a client's account without the prior written authorization of the client.

The NCUA Board amended Section 703.60(c) at its November 24, 1997 meeting. The amendment replaced the prohibition against a selling broker-dealer from acting as a safekeeper contained in the final amendments issued in June 1997 with the following: "Any safekeeper you [an FCU] use must be regulated or supervised by either the Securities and Exchange Commission or a federal or state depository institution regulatory agency." 62 Fed. Reg. 64146 (1997). The question you raised about whether Morgan Stanley would be considered independent under the previous Section 703.60(c) is now moot.

You also note that in the arrangement between Morgan Stanley and First Empire, securities transactions are settled by Morgan Stanley. Securities purchased must be paid for on the settlement date, when the securities are to be received by Morgan Stanley. While Morgan Stanley may not receive the funds and the securities at exactly the same moment, it does not release the client's funds until it receives the securities. The client is always in possession of either the securities or the funds.

Section 703.60(e) requires that all investment purchases and sales be settled delivery versus payment, defined as payment for an investment occurring simultaneously with its delivery. You ask whether Morgan Stanley's clearing procedure meets the requirement of Section 703.60(e). Morgan Stanley's practice of holding a client's funds until it receives the security meets the delivery versus payment requirement.

Sincerely,

Sheila A. Albin
Associate General Counsel

GC/LH:bhs
SSIC 4660
97-0904