# Interpretation Memo

NYSE
New York
Stock Exchange, Inc.
20 Broad Street
New York, NY 10005

Member Firm Regulation

Number 90-11
December 31, 1990

PLEASE ROUTE TO FINANCIAL AND OPERATIONS OFFICER/PARTNER
AND COMPLIANCE AND MARGIN DEPARTMENTS

TO: MEMBERS, MEMBER ORGANIZATIONS AND HANDBOOK SUBSCRIBERS

SUBJECT: UPDATE OF INTERPRETATION HANDBOOK FOR SEC RULES 15c3-1, 15c3-3 and 17a-13

The attached no-action letter issued by the staff of the SEC, dated November 26, 1990 stipulates that a two percent deduction from the aggregate principal amount of variable interest rate long-term corporate put bonds is appropriate, based on the circumstances as described in the letter. An interpretation will be issued shortly for insertion into the handbook.

Also, the accompanying updated handbook pages are being distributed as replacements for existing pages. Included are several interpretations which have not been previously available and the following should be carefully reviewed before insertion into the handbook.

| Page & Reference<br>Rule 15c3-1 | Subject |
|---|---|
| 106,(a)(2)(iv)/02 | Riskless OTC trades are not counted as "occasional transactions". |
| 106,(a)(2)(iv)/021 | Commodities trades are not counted as "occasional transactions". |
| 127,(b)(1)/01 | A specialist, market maker or competitive options trader may not engage in trading non-specialist securities. A specialist or market marker in "baskets"may use index options as a hedge. Excess funds may be invested in reverse repurchase agreement trades as often as necessary. |
| 129,(b)(2)/03 | No haircut need be taken on floor broker error trades when the security position is immediately liquidated upon discovery. |
| 132,(c)(1)/12 | The full amount of long term liabilities for damages, penalities, etc. in a law suit are included as Aggregate Indebtedness (not the present value amount under GAAP). |

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| 142,(c)(2)/012 | When long term liabilities are recorded on the books on a present value basis the full amount of the liability, and not the present value amount, must be treated as a liability in the net worth computation and the full amount must be deducted in the net capital computation. |
| 170,(c)(2)(iv)(C)/081 | Rebates or fees receivable from institutions on securities borrowed need not be deducted under prescribed conditions. |
| 176,(c)(2)(iv)(E)/07 | Custodial fees receivable for IRA accounts need not be deducted under prescribed conditions. |
| 179,(c)(2)(iv)(E)/14 | CNS system fails to receive are continually current and are not subject to "aging". |
| 194,(c)(2)(vi)/08 | Unhedged foreign currency balances shall be treated as a security subject to a haircut and not as U.S. cash. A haircut charge of 6% shall be taken on the unhedged currency risk exposure of the seven major currencies; all others, 20%. |
| 210,(c)(2)(vi)(F)(6)/07 | Haircut charges applicable on Secondary Mortgage Market Enhancement Act (SMMEA) debt securities. |
| 210,(c)(2)(vi)(F)(6)/08 | Haircut charges applicable on Defense Security Assistance Agency Guaranteed debt securities. |
| 226,(c)(2)(vii)/01 | Subsequent sale of securities deemed non-marketable due to marketplace blockage may be considered as demonstration that a ready market exists. Case-by-case determination. |
| 287, App. A (a)(2)/011 | Unlisted options exercisable at or after a specified future date shall be treated as if immediately exercisable. |
| 294, App. A (a)(2)/09 | Haircut and minimum charges applicable on forward positions hedging foreign currency options. |
| 304, App. B (a)(3)(ix) (C)/01 | Unhedged foreign currency balances shall be treated as "inventory" subject to a haircut charge to cover the currency risk exposure - 6% on the seven major currencies; 20% on all others. |
| 305, App. B(a)(3)(ix) (E)/01 | Haircuts applicable on the unhedged foreign currency risk on forwards in foreign currency. |

Rule 15c3-3

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| 513,(b)(2)/032 | The interpretation which permitted the borrowing of securities to process "Today for Tomorrow's" delivery instructions, which was in effect until January 31, 1989, has been deleted from the Interpretation Handbook. |
| 513,(b)(2)/05 | Bonds required to be held in possession or control may be removed for redemption. If the redemption has not been completed within 30 days, thereafter the market value shall be included as a credit at Item 6 of the reserve formula computation until the redemption is accomplished. |
| 513,(b)(2)/06 | When a security subject to a stock split or similar distribution is held at the Depository Trust Company on the payable date, it may be considered as in possession or control for five business days. |
| 515,(b)(3)(iii)/03 | Amendments to securities borrowed agreements must be limited to the specific collateral stated as acceptable in the rule text or interpretation. |
| 516,(b)(4)(ii)/02 | Proprietary FNMA or FHLMC securities subject to repurchase may be delivered to Federal National Mortgage Association or Federal Home Loan Mortgage Corporation for exchange into newly issued or other derivative securities and may be considered as in control locations for not more than five business days. |
| 525,(c)(5)/03 | Firm and customer securities may be commingled in one custody account when the custody agreement contains the appropriate language and the securities are in fact not pledged or subject to any lien or claim by or through the bank. |
| 540,(d)(1)/03 | Securities held in excess of possession or control requirements may be moved to a pending delivery box non-control location a day prior to pledge as collateral to bank loan or stock loan. |
| 542,(d)(2)/022 | CNS system fails to receive are continually current, not subject to "aging" and need not be bought in. |
| 557,(k)(2)(i)/04 | Securities certificate tranfers for customers are permitted when promptly completed and forwarded. |

Rule 15c3-3
Reserve Formula

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| 600, Item 2/021 | Letters of credit secured by customer and non-customer securities. |
| 651, Item 10/09 | Accrued custodial fees receivable for IRA accounts. |
| 667, Item 13/04 | Letters of credit secured by customer and non-customer securities. |

Rule 17a-13

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| 2500/03 | LOANET confirmations of securities borrowed or loaned. |

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
MARKET REGULATION

November 26, 1990

Mr. Salvatore Pallante
Senior Vice President
New York Stock Exchange, Inc.
20 Broad Street
New York, New York 10005

Mr. Thomas Cassella
Vice President
National Association of Securities Dealers, Inc.
1735 K Street, N.W.
Washington, D.C. 20006

Dear Messrs. Pallante and Cassella:

We have received several questions concerning the deductions applicable to variable interest rate long-term corporate put bonds under Securities Exchange Act Rule 15c3-1 (17 C.F.R. §240.15c3-1).

It has come to our attention that registered broker-dealers have been structuring long-term corporate bonds with a non-severable demand feature entitling the holder to put the bonds to the issuer at 100 percent of the bond's principal amount plus accrued interest at certain designated times. The bonds are supported by an irrevocable letter of credit, standby bond purchase agreement or other liquidity facility ("Credit Facility") provided by a credit-worthy institution and covering the payment of principal, interest and any premium on any bonds tendered to an issuer under the put feature. The indenture specifies the times at which holders of the bonds may put the bonds back to the issuer (the "Put Date"). The broker-dealer however, does not endorse, guarantee or assume any obligation under the put, other than that as remarketing agent described below.

Interest on the bonds accrues on a variable or flexible rate basis. As such, the rate of interest is reset, depending on the terms of the indenture, on a periodic basis. The bonds generally trade at par. The bonds are rated by at least two of the nationally recognized statistical rating organizations.

Generally, the registered broker-dealer acts as a remarketing agent and agrees to attempt to sell any bonds that have been put back to the issuer. During the period of time the broker-dealer remarkets the bonds, it may hold the bonds that have been tendered in inventory, and therefore would take a percentage deduction from the principal amount thereof in computing net capital pursuant to paragraph (c)(2)(vi) of Rule 15c3-1. Generally, broker-dealers have been deducting the percentages set forth in paragraph (c)(2)(vi)(F) of the net capital rule, with the maturity for the purposes of that section being the time to maturity of the bond.

Broker-dealers have asserted that these charges materially misstate the risks and volatilities of these bonds. Based on the circumstances described above, with respect to variable interest rate corporate debt securities with a non-severable periodic demand feature that: (i) are supported by a Credit Facility provided by a credit-worthy institution that covers the payment of principal, interest and premium on any bonds tendered to the issuer under the put; (ii) trade generally at par; (iii) are rated in one of the four highest rating categories by at least two of the nationally recognized statistical rating organizations; (iv) have a Put Date no greater than six months from the previous Put Date; and (v) otherwise meet the criteria set forth in paragraph (c)(2)(vi)(F), the Division of Market Regulation will recommend no-action to the Securities and Exchange Commission if registered broker-dealers take a two percent deduction from the aggregate principal amount of bonds in their proprietary accounts.

Sincerely,

Michael A. Macchiaroli
Assistant Director