

Interpretation Memo

Member Firm Regulation

NYSE

New York
Stock Exchange, Inc.

20 Broad Street
New York, NY 10005

Number 90-7
September 20, 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 USE OF FOREIGN SETTLEMENT DATES

The SEC will permit the use of foreign settlement dates for fails to deliver of certain foreign issued and settled securities. The customary settlement cycle in certain countries may be used to determine the debits to be included in Item 12 of the Reserve Formula under Rule 15c3-3. A no-action letter issued by the SEC on August 9, 1990 to the Securities Industry Association is attached.

The no-action letter also provides relief, through use of foreign settlement dates, in the quarterly securities count requirements of paragraphs (b)(2) and (b)(3) of Rule 17a-13.

Separately the SEC advised us that Mexico could be added to the list of countries in the interpretation under Rule 15c3-1(c)(2)(ix)/06 Foreign Issued, Foreign Settled Securities Fail to Deliver - Haircut Alternative on pages 235 and 236. They also requested a correction to subparagraph 1 of the interpretation to change, "Five calendar days after settlement date.." to read "Five business days after settlement date...".

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RETAIN ALL INTERPRETATION/INFORMATION MEMOS FOR FUTURE REFERENCE



DIVISION OF
MARKET REGULATION

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

August 9, 1990

Mr. Jeffrey C. Bernstein
Co-Chairman
Compliance Committee
International Operations Association
Securities Industry Association
c/o Bear, Stearns & Co. Inc.
2 Broadway
New York, New York 10004

Dear Mr. Bernstein:

This is in response to your April 17, 1989 letter on behalf of the Compliance Committee of the International Operations Association Division of the Securities Industry Association. Specifically, you ask that Rule 15c3-3 and Rule 17a-13 under the Securities Exchange Act of 1934 (17 C.F.R. §§ 240.15c3-3, 240.17a-13, respectively) be interpreted to recognize foreign settlement dates as to foreign issued and settled securities for purposes of the "Formula For Determination of Reserve Requirement For Brokers and Dealers Under Rule 15c3-3" ("Reserve Formula") (17 C.F.R. § 240.15c3-3a) and the quarterly securities count required by Rule 17a-13. You also request relief from the provision of Rule 15c3-3 that requires exclusion from the Reserve Formula of fails to deliver outstanding over thirty (30) calendar days.

I.

We understand the pertinent facts prompting your request to be as follows: To comply with the provisions of Rules 15c3-3a and 17a-13, broker-dealers have developed extensive computer programs that are able to recognize only two dates for any transaction: trade date and settlement date. These computer systems must use the actual settlement dates of securities transactions so that appropriate entries in the stock records and general ledgers can be made and to provide the cashiering and money management departments with correct and timely information. Any other date used for settlement date would inhibit severely the cashiering and money management departments from performing their functions in an efficient, economical, and timely manner.

The international securities market, however, is characterized by diverse settlement periods and procedures. Some countries have similar or more rapid automated securities settlement procedures than those found in the United States, while other countries' settlement systems are substantially slower than those in the United States. The manual securities settlement procedures that are used, such as physical delivery of certificates and multiple clearing agents, are relatively inefficient and result in high fail rates. Additionally, settlement delays, often in excess of sixty days, are prevalent in many countries due to the limitations of their securities settlement systems.

A. Settlement Date

1. Reserve Formula - Rule 15c3-3a

Paragraph (e)(1) of Rule 15c3-3 requires every broker-dealer to maintain a "Special Reserve Bank Account for the Exclusive Benefit of Customers" ("Special Reserve Bank Account") in which the broker-dealer must deposit cash or qualified securities in amounts computed in accordance with the Reserve Formula set forth in Exhibit A to Rule 15c3-3. Additionally, broker-dealers are required by paragraph (e)(3) of Rule 15c3-3 to make weekly computations to determine, in conformity with the Formula, the amount required to be deposited in the Special Reserve Bank Account.

To compute the Reserve Formula, broker-dealers must identify fails to receive, fails to deliver, stock loans, and stock borrowings that are attributable to customer accounts. Where it is impractical or unduly burdensome to determine whether failed to receive contracts and failed to deliver contracts relate to proprietary accounts or customer accounts or whether securities loaned and securities borrowed are for proprietary purposes or are customer related, the broker-dealer may make an appropriate allocation on a conservative basis. Broker-dealers making such allocations are required to make and maintain records of each such allocation on a settlement date basis. The allocation procedure requires the use of stock records.

Defining settlement date for Reserve Formula purposes as five business days past trade date would require broker-dealers to make extensive changes to their computer systems to enable them to recognize three dates; the trade date, the date five business days after the trade date, and the actual settlement date for foreign issued and settled securities transactions.

You state that, given the current available technology, such a change to broker-dealers' computer programs would be extremely expensive and would not achieve any measurable increase in customer protection.

2. Securities Count Rule - Rule 17a-13

Paragraph (b)(2) of Rule 17a-13 requires certain broker-dealers at least once in each calendar quarter to:

[a]ccount for all securities in transfer, in transit, pledged, loaned, borrowed, deposited, failed to receive, failed to deliver, subject to repurchase or reverse repurchase agreements or otherwise subject to [the broker-dealer's] control or direction but not in [the firm's] physical possession by examination and comparison of the supporting detail records with the appropriate ledger control accounts.

Paragraph (b)(3) of Rule 17a-13 requires certain broker-dealers to:

[v]erify all securities in transfer, in transit, pledged, loaned, borrowed, deposited, failed to receive, failed to deliver, subject to repurchase or reverse repurchase agreements or otherwise subject to [the broker-dealer's] control or direction but not in the [firm's] physical possession, where such securities have been in said status for longer than thirty days.

You assert that broker-dealers encounter the same operational problems conducting their quarterly counts of foreign issued and settled securities as discussed above in connection with Rule 15c3-3a.

Accordingly, you request that the settlement date used for purposes of compliance with the requirements of Rule 15c3-3a, the Reserve Formula, and Rule 17a-13 be defined as "the customary settlement cycle in the foreign country" or, if the settlement cycle is on a "seller's option basis," no more than thirty (30) days from the trade date.

B. Fails to Deliver vs. Fails to Receive

Rule 15c3-3a allows broker-dealers to exclude both the debit and credit for securities failed to deliver that allocate to securities failed to receive of the same quantity and issue if the failed to deliver contract is not older than

thirty (30) calendar days. Securities failed to deliver are excluded from the Reserve Formula if the failed to deliver contract is older than thirty (30) calendar days, no matter to what they allocate. Foreign securities often are characterized by high fail rates due to the inability of broker-dealers to "buy-in" or borrow foreign securities failed to receive and the settlement procedures employed in many foreign countries (which often involve the physical delivery of certificates).

You request permission for a broker-dealer to include in the Reserve Formula aged failed to deliver contracts that allocate to failed to receive contracts or other includable items as long as the security is a foreign issued and settled security, the failed to deliver contract is not older than 120 calendar days, and the broker-dealer reduces the debit item on a mark-to-market basis by the appropriate proprietary haircut charge.

II.

Based on the above, the Division will not recommend any action to the Commission if, for purposes of the Rule 15c3-3 Reserve Formula and paragraphs (b)(2) and (b)(3) of Rule 17a-13, broker-dealers treat the settlement date of foreign issued and settled securities as the customary settlement cycle in the particular country. In those instances where the settlement cycle is on a "seller's option basis," the settlement date must be a date no more than thirty (30) days from the trade date.

A broker-dealer using a foreign settlement date shall maintain in its records a schedule of the current settlement cycle of each country in which it trades and must file a written notice with its designated examining authority stating the broker-dealer's intention to apply this definition of settlement date to foreign security transactions.

Additionally, the Division will recommend no action to the Commission if a broker-dealer, in computing its Reserve Formula pursuant to Rule 15c3-3, includes as a debit item foreign issued and settled failed to deliver securities contracts outstanding more than thirty (30) days past the customary settlement date that allocate to either failed to receive contracts or other includable credits if:

- (1) the aged failed to deliver security is a foreign issued and settled equity security traded on an exchange or a foreign issued and settled debt security in Australia, Austria, Belgium, Canada, Denmark, the Federal Republic of

Mr. Jeffrey C. Bernstein
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Germany, Finland, France, Hong Kong, Italy, Japan, Luxembourg, Malaysia, Mexico, the Netherlands, New Zealand, Norway, Portugal, Singapore, South Africa, Spain, Sweden, Switzerland, and the United Kingdom;

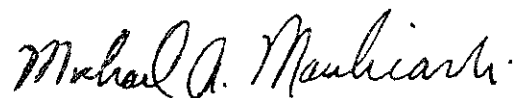
(2) the broker-dealer reduces the aged failed to deliver on a mark-to-market basis thirty (30) days after the customary settlement date by an amount computed in accordance with paragraph (c)(2)(ix) of Rule 15c3-1 under the Securities Exchange Act of 1934 (17 C.F.R. § 240.15c3-1), the net capital rule. For purposes of this calculation, broker-dealers are not required to apply paragraph (c)(2)(vii) of Rule 15c3-1; and

(3) the failed to deliver security contract is not outstanding more than sixty (60) calendar days past the customary settlement cycle in the foreign country or, if the settlement cycle is on a "seller's option basis," more than ninety (90) days from the trade date.

You should understand that the positions expressed herein are staff positions with respect to enforcement only and do not purport to express any legal conclusions on these matters. The Division's positions necessarily are confined to the facts as represented herein. Any material change in these conditions must be brought immediately to the Division's attention.

The Division expects to monitor this program to assure that the procedures outlined function in a manner consistent with the objectives of Rule 15c3-3 and Rule 17a-13.

Sincerely,



Michael A. Macchiaroli
Assistant Director

cc: Edward Kwalwasser
New York Stock Exchange, Inc.

John Pinto
National Association of
Securities Dealers, Inc.

EXHIBIT A

The following illustrates what we understand to be the current settlement cycles in certain foreign countries:

<u>COUNTRY</u>	<u>SETTLEMENT CYCLE</u>
Australia	Seller's option
Austria	Second Monday after trading week
Belgium	Cash market: same day settlement as trade date
Canada	Five business days after trade date
Denmark	Three business days after trade date
Federal Republic of Germany	Two business days after trade date
Finland	Five business days after trade date
France	Cash market: immediate settlement and delivery Term market: one day per month, usually last business day
Hong Kong	First business day after trade date
Italy	One day per month, usually last business day Cash market: three business days after trade date
Japan	Three business days after trade date
Luxembourg	Five business days after trade date
Malaysia	Ready Bargains: not later than 3 PM on: 1) first Wednesday following trading week if clients are selling; 2) first Thursday following trading week if brokers are dealing with Securities Network Services ("SCANS"); 3) first Friday following trading week if SCANS is dealing with buying brokers

Exhibit A

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Mexico	Corporate bonds and equities: two business days after trade date All other fixed income securities: one business day after trade date
Netherlands	Bond and equity transactions: delivery within ten days
New Zealand	Ten business days after trade date, otherwise buy-in procedures are enforced against the seller Brokers: Trades are settled on an individual basis by the delivery of transfer documents against payment. Investors: upon receipt of the contract note
Norway	Generally, seven business days after trade date
Portugal	Six business days after trade date
Singapore	First Tuesday after trading week
South Africa	Normally, first Tuesday after trading week
Spain	Brokers: settlement process begins on first Wednesday after trading week; cash payment occurs on Friday All others: seven to thirty business days after trade date
Sweden	Five business days after trade date
Switzerland	Three business days after trade date
United Kingdom	Corporates (equities): fortnightly Gilts: next day