

August 25, 1980

Mr. Thomas P. Lynch  
E.F. Hutton & Company, Inc.  
One Battery Park Plaza  
New York, New York 10004

Dear Mr. Lynch:

This is in response to your letter of March 7, 1980, on behalf of E.F. Hutton & Company, Inc. ("Hutton") wherein you request our interpretation under Rule 15c3-3 (17 CFR 240.15c3-3) of the treatment of non-regulated commodity debits and suspense accounts with brokers.

Your first question concerns non-regulated customer commodity accounts liquidating to a deficit. You ask whether the debits in these accounts may be included as debit items in the formula for determination of reserve requirement for brokers and dealers under Rule 15c3-3 ("Reserve Formula") when these debits are covered by a current margin call.

The Commission in Securities Exchange Act of 1934 Release No. 9922 (January 2, 1973) published the following Division interpretation:

The credit balance used in Item-1 of the formula is interpreted to include the net balance due to customers in non-regulated commodity accounts reduced by any deposits of cash or securities with any clearing organization or clearing broker in connection with the open contracts in such accounts [emphasis added].

Therefore, any credit item in the Reserve Formula will reflect all non-regulated commodity account credits and debits in arriving at the net credit figure. The Reserve formula contemplates an entry only when there is a net credit figure due to customers; there should be no debit entries related to non-regulated customer commodity accounts whatsoever. In other words, if balances in these accounts netted to a debit, there would be no Reserve Formula entry.

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Your second question concerns broker-to-broker reclaim items. These items represent erroneous deliveries from other brokers against payment for amount of the transaction, which cannot be immediately identified with an open fail to receive, stock loan or receive instructions for a customer's account. Many of these items are received in the last delivery of the day and cannot be returned or reclaimed until the following day. Eventually, all of these items are resolved by being applied to an open item, through adjustments of money differences or by being returned to the other broker. You request that these items be considered as fails to deliver and included as debit items in the Reserve Formula.

The Reserve Formula is designed to reflect moneys resulting from customer transactions. The fail to deliver item, debit item number 12 is for fails to deliver of customer securities not older than 30 calendar days. It is the view of the Division that the items which you describe above, since not customer related fails to deliver, may not be included in the Reserve Formula.

Sincerely,

Michael A. Macchiaroli  
Branch Chief



E F Hutton & Company Inc

One Battery Park Plaza New York, N. Y. 10004 (212) 742-5806

SECURITIES & EXCHANGE COMMISSION

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March 7, 1980

DIVISION OF MARKET REGULATION

Securities and Exchange Commission  
500 North Capitol Street, N. W.  
Washington, D. C. 20549

Attention: Mr. Nelson S. Kibler

Gentlemen:

I advised you in my letter of December 24, 1979 that the New York Stock Exchange Examiners had proposed certain adjustments to our cash reserve calculations pursuant to SEC Rule 15c3-3, and that we did not agree with two adjustments concerning the treatment of non-regulated commodity debits and suspense accounts with brokers. We have not been able to resolve our disagreement with the Exchange staff, and accordingly are requesting that the Commission review these items and advise us as to how they should be handled in future reserve calculations.

The first item involves the inclusion in the formula debits of non-regulated customer commodity accounts liquidating to a deficit. These deficits were covered by margin calls outstanding for five days or less, and accordingly were treated as good current assets under the capital rule (15c3-1), and logically should be treated as acceptable debits under Rule 15c3-3. Such accounts are included as credits in the formula when they are in equity, and should also be included when they are temporarily in deficit covered by current margin calls.

These accounts are similar to partly secured security accounts, which are considered to be acceptable debits in the formula if they are covered by a current call. The same treatment should be given to commodity accounts.

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The second item in dispute is the treatment of broker-to-broker reclaim items as bona fide fails in the cash reserve formula. These items represent deliveries from other brokers against payment for the amount of the transaction, which cannot be immediately identified with an open fail to receive, stock loan or receive instructions for a customer's account. Many of these items are received in the last delivery of the day and cannot be returned or reclaimed until the following day. Eventually, all of these items are resolved by being applied to an open item, through adjustment of money differences or by being returned to the other broker. There have been no significant losses involved with these items because the delivering brokers are all members of the exchanges and related clearing houses and are financially responsible for any erroneous deliveries. In any event, the only risk is in market fluctuation since the debits are fully secured by the securities held.

These items do not result in a capital charge until they are seven days old. SEC staff memorandum to the New York Stock Exchange (79-4) dated January 1979 states, "DK's and other suspense items, which as of the capital computation date are not yet seven days old, need not be deducted from net worth or included in Aggregate Indebtedness in the current capital computation. If resolved, such items may be treated properly (as appropriate) upon reclassification or resolution. However, all items that are seven business days or older as of the computation date described would be reported as suspense items, even if resolved before the FOCUS is filed and are treated as above." Since these items are good debits under the capital rule, they should be accorded similar treatment under the reserve formula. These items are broker receivables and the equivalent of a fail-to-deliver with the related security being held in a good control location (i. e. active box), and we have been treating them accordingly. If we receive an erroneous delivery in the last delivery of the day, we are forced to hold it overnight but can return the item and receive payment the following morning. To disallow these current items would penalize a broker for the errors of other brokers which is an unfair and unacceptable result.



**[E] Hutton**

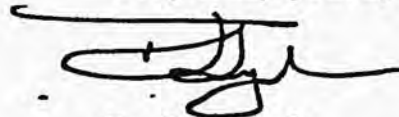
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The Commission must also consider the time-frame in which we are working. As a large firm, E. F. Hutton must calculate its reserve requirements on a weekly basis. This means that on Monday, we must do a complete calculation and review of all debit items, which total a billion dollars, and by Monday night, we must determine the amount of reserve required, if any, and make a reserve deposit on Tuesday morning, if necessary. There is simply not sufficient time to resolve and reclassify all "suspense" or reclaim items in one day as is recognized under the capital rule. Current suspense items should be allowed as an acceptable debit until they are seven days old, after which time they would become a capital charge and an unacceptable debit in the reserve formula.

The Commission is respectfully requested to concur in the procedures being followed by E. F. Hutton in the two matters described above. We would be pleased to meet with you or your staff to discuss these issues. Arthur Andersen & Co. concurs in our position and would also be available as needed.

Very truly yours,



T. P. Lynch  
Executive Vice President

Copy to Mr. John Mittler  
Senior Finance Coordinator  
New York Stock Exchange, Inc.  
55 Water Street  
New York, NY 10041