LEX JOLLEY & CO., INC.

1508 WILLIAM-OLIVER BUILDING

ATLANTA, GEORGIA 30303

November 03, 1975

Mr. Nelson Kiebler

Securities and Exchang~ Commission

500 W. Capital Street

Washington, D.C.

RE: Comments on 17CFR 240.15C3-1

Dear Mr. Kiebler:

Lex Jolley & Co., Inc. has been in business since January 1, 1964, and since that time has been registered with the SEC and a member of the NASD. Our primary business has been underwriting and trading municipal bonds.

I have tried to study the above rule as carefully as I can and make the following observations about the problems I see with the rule in its present form:

1. Posting of Books:

A broker/dealer should not be penalized for posting his books on a trade date basis versus settlement date basis, or vice versa. There are several areas where the broker/dealer who posts on a trade date basis is penalized for doing so. The most important are:

A. Aggregate indebtedness computations:

The "trade date poster" is penalized for the accumulation of 4 business days' transactions which count in aggregate indebtedness that would not count for the "settlement date poster". For the purpose of computing Aggregate Indebtedness, those items that would ordinarily be included based on settlement date posting should be the only one includable for trade date posting.

This could be done by allowing a deduction from Aggregate Indebtedness for liabilities to Broker/Dealers and/or customers arising out of trades that have not yet reached settlement date.

B. Computation of net capital under paragraph (f):

Here the trade poster is severely penalized for posting on a trade date basis. The "trade date poster" has the accumulation of four business days' trades shown in the debit items of 15C3-3 exhibit A. This results in the trade date poster having to have more capital for the identical trade than a "settlement data poster".

A purchase of $20,000,000 worth of bonds from the trust department of a bank and sale the same day of

C. Undue concentration haircut;

The trade date vs settlement date posting problem also arises with the "undue concentration haircut. When does the 11 days begin? At settlement date or trade date? It should begin at settlement date for everyone.

I realize that one solution to the problems above is for everyone to post their books on a settlement date, however, the small broker, in my opinion, is far better off posting on a trade date basis. It practically eliminates the problem of selling short unintentionally.

2. When issued:

The entire concept of classifying "when, as and if issued" securities as contractual commitments presents problems for underwriters of municipal bonds.

A. Unlike corporate securities, municipal bonds are generally on a "when Issued" status for a period of 30 to 60 days after they are sold by a municipality to an underwriting group. This is primarily because of the validation process required in many states.

As "when issued" municipal bond underwriting accounts can go on for 30 to 60 days before delivery of the bonds, the requirement that "when issued" contracts to considered "contractual commitments• creates several problems. How do we haircut our liability In the unsold portion of an undivided liability account? If the

total liability in the unsold portion of the account is greater than 10% of "net capital" is a undue concentration haircut required? If so, when does the eleven days begin? How do you include "when issued" contracts in aggregate indebtedness computations when the profit on the underwriting does not appear in "net capital" since the securities do not appear on the books until 5 business days before the delivery date or until delivery date depending on whether broker/dealer posts on a trade date or settlement date basis?

I would recommend that "when issued" securities not be considered open contractual commitments until the initial delivery date of the securities except for those securities taken down out of the account and unsold by the broker/dealer. In that event they should be haircut and if required an undue concentration haircut should be applied 11 business days after what would be normal settlement date if the bonds were not "when issued."

3. Haircuts:

A. As a matter of philosophy, there should be nothing in the rule to require a broker/dealer to take haircuts on positions over which he has no control. I refer specifically to the "Aged Falls to Deliver" section of the above rule. A municipal broker/dealer has the option of selling his inventory if he does not wish to haircut it. He can also refuse his subordinate debt securities if he does not wish to haircut those securities or have an undue concentration haircut. In the case of fails to deliver, he has no choice but to take a haircut on a position he no longer owns and which probably has resulted from either a fail to receive or security in transfer problem. Unlike corporate bonds, the municipal broker/dealer has no buy in or sell out procedure and therefore can do absolutely nothing but absorb what for small broker/dealers would most likely be both an undue concentration haircut and a 5% securities position haircut.

The same problem occurs with "when, as and if issued" contracts as "open contractual commitments." Here again a broker/dealer is forced into a haircut on a securities position he cannot sell until the underwriting account closes. I am speaking here of an "undivided liability" underwriting account in which there are securities unsold.

B. The haircutting of "accrued interesr does not reflect the purpose of a haircut. As I understand haircuts, they are a charge against capital as a hedge against a decrease In market value. As you know, debt securities are sold at a price plus accrued interest. For a given inventory of specific debt securities, accrued interest must be an ever Increasing figure no matter what the market value becomes. The only way accrued interest can decrease is for accrued interest to be paid, in which event it becomes cash, or in the event of a defaulted security which trades flat. Accrued interest due on marketable debt securities should be a good asset not subject to being haircut.

4. Exclusions from Aggregate Indebtedness:

A. Under exclusions from aggregate indebtedness (vi) "are deposited" should mean are deposited or will be deposited within the required amount of time. The computation is made at the end of the month for "net capital" and the amount on deposit at the end of the month is the deposit computed at the end of the previous week or previous month depending on whether the 15C3-3 reserve is computed weekly or monthly. The aggregate indebtedness computation is made at the end of the month and the deduction should reflect the deposit required based on the end of the month calculation not the previous week or previous month.

5. Ready Market:

A. The rule provides for establishing the market value of a "security without a ready market" through showing that the security is accepted as collateral for a fully secured bank loan. The rule implies that the securities act as collateral for a loan actually made. This puts an unnecessary burden on a broker/dealer who does not need to have a loan at all times. In order to keep his capital from fluctuating, he must pay interest on a loan he may not need.

It seems to me that a letter from a bank accepting the securities at some stated value as collateral for a fully secured loan should be acceptable in establishing the market value. To prevent sweetheart deals between a banker and a broker whereby the banker issues the letter and the broker agrees on the side never to use the loan, the Commission might want the broker to show that the loan is used from time to time in the normal course of business or require that the letter be a secured line of credit for a specified period of time. Some solution needs to be

found other than a broker having to pay interest on a loan he doesn't need all the time.

There are some of the major problems I have with the rule as written. I am sure that some of what I have said is unclear, but I would hope I could clear up any questions over the telephone. Please do not hesitate to call me.

Very truly yours,

LEX JOLLEY & CO., INC.

Gordon K. Mortin

Vice President

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CC: Mr. Ken Newman, Securities Investigator

CC: Mr. Richard M. Towsend, Securities Investigator

CC: Mr. Frank Birgfeld, Assistant Director, Natl. Assoc. of Securities Dealers, Inc.

CC: Mr. Leonard Berman, Natl. Assoc. of Securities Dealers, Inc.

CC: Mr. Bert C. Madden, Sr. Vice President & Manager, Municipal Bond Department of Trust Company of Georgia

March 15, 1976

Mr. Gordon K. Mortin

Vice President

Lex Jolley & Co., Inc.

1508 William-Oliver Bldg.

Atlanta, Georgia 30303

Dear Mr. Mortin:

This is in response to your letter of November 3, 1975 written on behalf of Lex Jolley & Co., Inc., regarding Rule 15c3-1 (17 CFR 240.15c3-1) under the Securities Exchange Act of 1934.

Specifically, you state that a broker-dealer should not be penalized for preparing and maintaining its books and records on a trade date ("TD") basis versus settlement date ("SD") basis.

In this context you note several areas, which include the determination of aggregate indebtedness (AI), the net capital requirement under paragraph (f) (the alternative) and the undue concentration provisions of Rule 15c3-1, wherein a broker-dealer utilizing TD posting is penalized.

You explain that a firm, which posts its books and records on a TD basis, is penalized for the accumulation of 4 business days transactions in Its determination of AI which are not reflected on the books and records of a firm posting on a SD basis and that the 4 day accumulation of debits included in Exhibit A of Rule 15c3-1, by which the net capital for firms operating pursuant to paragraph (f) is determined, occurs in a TD basis and not on a SD basis.

With regard to subparagraph (c)(2)(vi)(M) (undue concentration) you question when the eleven day grace period commences for a firm posting on a TD basis.

It is the view of the Division that a broker-dealer must apply its accounting methods consistently by recording all transactions either on a trade date basis or a settlement date basis for the purpose of complying with Rule 15c3-1. Therefore, the trial balance and net capital computation, calculated therefrom, must be consistent with the method by which a broker-dealer prepares and maintains its books and records.

The Division wishes to note, however, that its position is currently under review to determine if it may be appropriate for a broker-dealer, posting on a TD basis, to perform certain adjustments in determining Its AI or capital requirement under paragraph (f) of Rule 15c3-1. Until such time as the Division has determined the appropriateness of such adjustments, the views noted above continue to apply.

In addition, you have raised a number of questions regarding the application of various provisions of Rule

15c3-1 relating to:

1. When Issued underwritings;
2. Aged falls to deliver;
3. Accrued interest on bonds;
4. Exclusion from AI; and
5. Ready market.

With respect thereof we are providing the Division view's in the form of questions and answers.

1. When, As and If Issued

Question: If the unsold position of an undivided liability account of a municipal securities offering exceeds 10% of net capital before certain haircut adjustments is an undue concentration haircut applied, and if so, when?

Answer: The Commission in Release No. 11854 amended subparagraph (c)(2)(vi)(M) and (f)(3)(iil) to exempt until June 1, 1976 municipal securities from the undue concentration charge and has Invited public comment and Impact studies concerning this matter.

Question: On what basis is the contractual commitment haircut applied on when as, and if issued undivided liability account underwritings?

Answer: The charge required by subparagraph (c)(2)(viii) on open contractual commitments applies to the net cost to the broker-dealer of each net long and each net short position contemplated by any open contractual commitment. Therefore, each participants commitment plus its proportionate share of any unsold position of the underwriting is subject to subparagraph (c)(2)(vii). However, the commitment is reduced by orders received and by the reduction of the unsold position.

2. Aged Fails to Deliver

Question: Does the aged fail to deliver charge required by subparagraph (c)(2)(ix) of Rule 15c3-1 on fail to deliver contracts outstanding fifteen business days or longer apply to municipal securities although there are no buy in or sell out procedures for such transactions?

Answer: The Commission in the Release No. 11854 recognized the need for the establishment of efficient clearance and settlement systems for municipal securities and noted that since it would be inappropriate to establish during the period of transition of municipal broker-dealers to financial regulation a standard which may be unrealistic, extended until June 1, 1975, the time frame from fifteen business days to twenty-five business days for fails in municipal securities.

3. Accrued Interest

Question: Is Accrued interest on bonds subject to the haircut provisions of Rule 15c3-1?

Answer: Accrued interest receivable on debt securities are not subject to the haircut provision of Rule 15c3-1. However, such receivables shall be deducted from net worth if such are outstanding for a period exceeding thirty calendar days past payable date.

4. Exclusions From AI

Question: Subparagraph (c)(1)(vll) excludes amounts payable from AI to the extent funds and qualified securities are required to be and are on deposit in the Reserve Account. Is this exclusion based on the amount deposited as of the date of the capital computation or the amount required to be on deposit based on that month's end Reserve Formula computation?

Answer: The exclusion permitted by subparagraph (c)(1)(vii) shall be the amount that is required to be on deposit and on deposit as of the date of the capital computation.

5. Ready Market

Question: A ready market is deemed to exist where securities have been excepted as collateral for a loan, provided that such securities adequately secure the loan. Would a letter from a bank accepting such securities as collateral for a loan, which is utilized from time to time satisfy the ready market definition or must the loan be outstanding?

Answer: In order to establish that a ready market for securities exists for securities for which no recognized market exists, such securities must adequately collateralized an outstanding bank loan.

If we can be of further assistance, please contact us.

Sincerely,

Robert L. Smith

Securities Operations Specialist