

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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Mr. John B. Pinto, Jr.

Senior Vice President,

Surveillance Department

National Association of

Securities Dealers, Inc.

1735 I Street, N.W.

Washington, D.C. 20036

Dear Mr. Pinto:

The Division of Market Regulation has on several occasions been asked to provide guidelines for determining the market value for certain over-the-counter ("OTC") traded securities for purposes of Securities Exchange Act Rule 15c3-1 (17 CFR §240.15c3-1).

As we understand the problem, frequently, OTC securities quoted through the National Daily Quotation Service ("pink sheets") do not have actual price quotations listed beside the names of the firms making markets in those securities. A firm interested in such a security would make a telephone call to one of the listed market makers in order to receive a quotation. Additionally, where actual quotations do appear in the pink sheets, they are often thought to be unreliable because they may not reflect recent activity in the particular security.

Paragraph (c)(11)(i) of Rule 15c3-1 defines the term "ready market" to include "a recognized established securities market in which there exists independent bona fide offers to buy and sell so that a price reasonably related to the last sale' price or current bona fide competitive bid and offer quotations can be determined for a particular security almost instantaneously..." Where a "ready market", as defined by

(c)(11)(i), does not exist, securities held in proprietary or other accounts of the broker-dealer are subject to a 100% haircut pursuant to paragraph (c)(2)(vii).

Where a "ready market" does exist, the securities are subject to the appropriate haircut requirement of paragraph (c)(2)(vi). The subject OTC securities quoted through the pink sheets are treated under subparagraph (K) of (c)(2)(vi).

Subparagraph (K)(i) requires that a broker-dealer establish that there are "regular quotations in an inter-dealer quotations system..." by three or more independent market makers..." for securities in which they have positions in order to receive the haircut treatment as provided by subdivision (J). Subparagraph (K)(ii) applies where there are "regular quotations in an inter-dealer quotation system..." by only one or two independent market makers..." Where (K)(ii) applies the required deduction to net worth for the securities is 40%.

Due to the lack of or unreliability of the quotations in the pink sheets, regarding securities in which they may have established positions, broker-dealers are unable to show there is a "ready market" for the securities as that term is defined in paragraph (c)(11). The result of the above is that certain securities positions of broker-dealers would be subject to the 100% "haircut" of (c)(2)(vii) rather than that provided for in paragraph (K) regardless of whether a market in fact exists for those securities.

Based on the foregoing, the Division of Market Regulation will raise no question nor recommend any action to the Commission if a broker-dealer faced with the above problem applies subparagraph (K)(i) to its positions under the following circumstances:

- 1) the broker-dealer can show that there are three or more market makers (other than the computing broker-dealer) in the pink sheets, even if the market makers do not display actual quotations in the pink sheets; and
- 2) the broker-dealer can show the existence of bona fide inter-dealer trades within five business days before or after the date of valuation. The trades must be of sufficient volume to justify a reasonable belief that the price used would support the liquidation of the entire position at or near that price. It should be emphasized that at all times the broker-dealer has the burden of proving the existence of a "ready market" for its securities positions. A

broker-dealer that is unable to prove a "ready market" exists for a particular securities position must take a 100% haircut on that position. When it can be established that the marketplace can absorb only a limited number of shares of a security for which a ready market seemingly exists, the non-marketable portion of that position is subject to a 100% deduction under (c)(2)(vii).

The Division expects that the responsible Designated Examining Authority ("DEA"), as part of an examination, will conduct checks of the prices used by the broker-dealer for valuing its securities positions. Such review would likely entail placing telephone calls with three market makers for the security in question to receive their quotes. Further, if in the opinion of the DEA, there is insufficient evidence to support the valuation of the broker-dealer's entire position, the DEA can value only that portion of the position that appears marketable at the established price.

I trust the above is responsive to the problem. Should you have any question please do not hesitate to contact me.

Sincerely,

Michael A. Macchiaroli

Assistant Director