

Pierre R. Smith & Co.

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October 18, 1985

United States Securities and Exchange Commission Washington, D.C. 20549

Attention: Michael A. Macchiaroli

Dear Mr. Macchiaroli:

I am writing to you because Mr. Bill Jackson of the NASD, Cleveland office, suggested you might be able to help with a problem we are having with a recent interpretation, I believe, of SEC Rule 15c3-1, involving adjusted net capital calculations particularly haircutting of securities. Enclosed are copies of both your SEC letter and a NASD interpretation of that letter.

Before I proceed further with the problem, I should give a brief description of my firm and my position. I am president of Pierre R. Smith & Co., a SEC Registered Broker-Dealer, NASD member, and a Philadelphia Stock Exchange member. Our firm was founded in 1924 by my father. We became a NASD member in 1937. Presently, the firm has \$472,000. net capital before adjustments. Last month's liabilities/net capital ratio adjusted was about 25%. Records will show that we have run month-by-month one of the lowest liability to net capital ratios. We intend to follow this same position in the future.

We, for years, have worked with our local bank stocks striving to maintain a reasonable forum for the exchange of share interests. For over 50 years, we have served our community of Lorain County, Ohio, in this specialized capacity, providing without a doubt a very valuable service to the public. From time to time we take both trading and investment positions in the shares. Now concerning SEC Rule 15c3-1, as discussed with both Mr. John Matsumoto and Mr. Bill Jackson, the interpretation as outlined in John's letter as of July 31, 1985, leaves us in a very serious dilemma. In that letter he outlined 3 methods we could use in haircutting local stocks at the end of every monthly reporting period:

No. 1. Method-show existence of inter-dealer trades within 5 business days period  
No. 2. Method-100% haircut all issues

No. 3. Method-contact dealers requesting bids and size

Regarding No. 1 -Inter-dealer trades-Under most circumstances there may be few trades and even if there were I doubt if we could obtain this information because this is "classified" information that dealers would not be willing to share.

Regarding No. 2 -100% haircut-Obviously, we would be filing an inaccurate adjusted net capital report because bona-fide bids are published in Ohio Dealers Service Inc. Just as "NASDAQ published bona-fide bids and ask at the end of every day:

Regarding No. 3 -substantiating bids and size from other dealers-I would have to call possibly every dealer in the yellow or pink sheets at the end of every month and request his position as to size and range. But under inter-dealer traditions or rules I would then have to trade with him. This cannot and will not be done:

Obviously, all these methods, regardless which one we use, is incorrect or impractical without a doubt. To add further to this dilemma, John's letter states SEC may not accept NASD's interpretations which returns us right back to ground 'o'. The problem appears to arise in possibly a new interpretation of how to hair cut, in our case, at the end of each month-these over-the-counter non-NASDAQ shares.

When I made inquiry, 12 to 15 years ago, both from the Philadelphia Stock Exchange examiner, and the SEC the examiner and the SEC indicated it would be unreasonable and unfair to hold strictly to the interpretation of the SEC's definition of "market-maker" dealer (who will take at all times a position in a security whether long or short,) that any service which would provide bona-fide published quotations if only bid prices would be acceptable in determining whether the hair cut should be 30% or 40%.

The statement as I recall, was as follows: The SEC recognizes that many regional issues exist such as local bank stocks in which bids for the stocks exist but with few shares available or floating for an offer. Therefore, any current publication which would list bona-fide quotations even if only bid prices would be acceptable in calculating the proper hair cuts.

Such a publication, which is printed daily, does exist. Enclosed is one of the daily issues for your perusal. In many cases only bids are published here because dealers generally will not take positions on both sides, as to take a short position on local bank stock could prove to be very costly. The shares of a bank, though there may be a fair number of shareholders, are usually in very "good hands".

In July, 1985, an SEC examiner followed the footsteps of the NASD examiner. I ran this same matter by him. His feeling was that our haircutting was correct and that I should continue with that method even though it didn't follow the strict interpretation of a market-maker-(if one or two other than ourself-40% haircut; if three or more other than ourselves-30%).

In studying your letter (enclosed) I note that you were specifically referring to the pink sheets which currently carry few quotations- Bid or Ask. I don't believe you were considering other publications such as Ohio's Yellow Sheets which publishes quotations on all the listed issues and at least bids on the Ohio banks. In order to resolve this matter, since "NASD interpretation is not guaranteed to be that of the SEC's", I believe, we should have a no action letter supporting our stated method of haircutting because, no doubt, I believe, it to be the only correct and just one.

Would it be possible that you could give us this, or if not, the SEC's exact position on this matter?

With best regards,

Pierre R. Smith & Co.

John F. Smith President

August 19, 1986

Mr. John F. Smith

President

Pierre R. Smith & Co. 819 Elyria Savings & Trust Building

Elyria, Ohio 44035

Dear Mr. Smith:

This is in response to your letter dated September 18, 1985, in which you request, on behalf of Pierre R. Smith & Co., an interpretation of the Uniform Net Capital Rule as it relates to over-the-counter ("OTC") traded securities. Specifically, you inquire as to the appropriate haircut treatment for certain local bank securities that are held in proprietary or other accounts of Pierre Smith & Co., pursuant to Rule 15c3-1 (17 CFR §240. 15c3-1).

I understand the pertinent facts to be as follows: Pierre R. Smith & Co. is a registered broker-dealer, National Association of Securities Dealers, Inc. ("NASD") member, and Philadelphia Stock Exchange member. Pierre R. Smith & Co., from time to time, holds in its proprietary account securities issued by banks located in Ohio. You state in your letter, that only limited number of securities have been authorized and issued the local banks in question, and consequently there are few shares of securities of those banks available for offer. Furthermore, no dealer is currently willing to act as a "market maker" in these OTC, non-NASDAQ securities because taking a position on both sides of the market could be very costly.

In your letter you request that the Division consider the Ohio Dealer Data Service, Inc., ("ODDS") a quotation service for Ohio market makers, to qualify pursuant to the provisions of subparagraph (c)(2)(vi)(K) of Rule 15c3-1 as a valid "inter-dealer quotation system" where there exist regular quotations which represent bona fide offers to both buy and sell securities in reasonable quantities at stated prices. In the alternative, you request that the staff issue an opinion to the effect that a "ready market", as that term is defined in Rule 15c3-1(c)(11)(I), exists for the shares of the local banks in question, that are quoted in ODDS and that they qualify for haircut treatment under subparagraph (c)(2)(vi)(K) of Rule 15c3-1.

Based on the information in a letter from ODDS dated February 25, 1986 to the staff of the Division it appears that the quotations published by dealers in the Ohio Yellow Sheets contain only a bid side or ask side quotation. A dealer who does offer a quotation in ODDS is not required to trade a minimum number of shares in the security quoted. Moreover, there is no set time involved for the updating of quotes for securities, although dealers are periodically called to check if a quote should be

updated. Any and all quotes changes are made within 24 hours and duly recorded on each dealer's listing sheet.

Under the circumstances, it is the view of the Division of Market Regulation that ODDS cannot qualify for purposes of Rule 15c3-1 subparagraph (c)(2)(vi)(K) as an inter-dealer quotation system, nor as a recognized established securities market as required by the "ready market" definition in subparagraph (c)(11)(i) of Rule 15c3-1.

I trust this letter is responsive to your questions. Please contact us if we can be of further assistance.

Sincerely, Antonio J. Santos Staff Attorney

Enclosure

cc: I. William Fishkind, NASD

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