



DIVISION OF  
MARKET REGULATION

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

June 12, 1992

Mr. Dominic A. Carone  
Chairman  
Capital Committee of the  
Securities Industry Association  
c/o Merrill Lynch & Co.  
P.O. Box 9000  
Princeton, New Jersey 08543-9000

Dear Mr. Carone:

This responds to letters, dated November 22, 1989 and August 14, 1990, and subsequent discussions and correspondence on behalf of the Capital Committee of the Securities Industry Association ("SIA"), concerning the applicability of certain haircut provisions of the net capital rule, Rule 15c3-1 under the Securities Exchange Act of 1934 <sup>1/</sup>, to certain foreign and domestic debt securities.

#### I. INTRODUCTION

Broker-dealers are required, pursuant to paragraph (c)(2)(vii) of the net capital rule, to deduct from their net worth 100 percent of the carrying value of securities held in their proprietary or other accounts: *(1)* for which there is no *ready market*, as defined in paragraph (c)(11) of the rule, or *(2)* that cannot be publicly offered or sold because of statutory, regulatory, or contractual restrictions. Paragraph (c)(11)(i) of the net capital rule defines the term "ready market" to include recognized established securities markets that are characterized by the presence of independent bona fide offers to buy and sell securities in order that a price for a particular security can be determined almost instantaneously. This price must reasonably be related to the last sales price or to current bona fide competitive bid and ask quotations. Settlement of the trade must take place, in accordance with custom, in a relatively short time period through receipt of payment of the sales price.

As to foreign securities, in 1975, the Division of Market Regulation ("Division") responded to a letter from the SIA requesting that the staff interpret, for purposes of paragraph (c)(11) of the net capital rule, the term "ready market." <sup>2/</sup> Among other things, the Division's staff described the circumstances under which certain debt securities of foreign issuers would be deemed to have a ready market and specified the net capital treatment for such securities. The staff stated that:

---

<sup>1/</sup> 17 C.F.R. § 240.15c3-1.

<sup>2/</sup> See letter from Nelson S. Kibler, Assistant Director of the Commission's Division of Market Regulation, to Mr. Anthony M. O'Connor, Co-Chairman of the SIA's International Committee (Dec. 29, 1975) ("1975 Letter").

debt securities of a foreign issuer not traded flat or in default as to principal or interest which were publicly issued in a *principal foreign securities market* by (a) a sovereign national government (or an entity guaranteed by such a government) or by a multi-governmental organization, or by (b) a Canadian province or municipality

were permitted to be treated under paragraph (c)(2)(vi)(F) of Rule 15c3-1, which sets forth the haircuts for nonconvertible debt securities.

Additionally, the letter provided that:

debt securities of a foreign issuer not traded flat or in default as to principal or interest which were publicly issued in a principal foreign securities market (a) which have been rated in one of the top four rating categories by at least two nationally recognized statistical rating organizations ("NRSROs") in the United States, or (b) which rank in a credit position equal or superior to securities of the same issuer which have been issued in the United States and have been rated in one of the top four rating categories by at least two [NRSROs] in the United States

should be treated under paragraphs (c)(2)(vi)(F) or (G) of the net capital rule, depending upon whether they were nonconvertible or convertible debt securities.

As to domestic securities, in the release adopting Rule 144A, the Commission announced the staff's position that securities of *domestic* issuers that are eligible for resale under Rule 144A should be treated for net capital purposes in the same manner as those securities that can be publicly offered and sold without registration and that are deemed to have a ready market for purposes of Rule 15c3-1. Consistent with the language in the net capital rule, debt securities that are traded flat or in default as to principal or interest, or are not rated in one of the four highest rating categories by at least two NRSROs were specifically excluded from this treatment. <sup>3/</sup>

## II. INTERPRETATION

Due, in part, to the language in the above release, the SIA has requested that the Division's staff clarify its position with respect to *both* foreign and domestic debt securities that are held by broker-dealers in their proprietary and other accounts. The SIA believes that the capital treatment of foreign and domestic debt securities should not be determined by whether they have been "publicly issued in a principal foreign securities market," as was required in the Division's 1975 Letter; <sup>4/</sup> rather

---

<sup>3/</sup> See Resale of Restricted Securities; Changes to Method of Determining Holding Period of Restricted Securities Under Rules 144 and 145, Release No. 33-68623; 34-27,928; IC-17,415, 55 Fed. Reg. 17,933 (Apr. 30, 1990). See also 17 C.F.R. § 230.144A(d)(3)(i)-(iii).

<sup>4/</sup> See *supra*, note 2.

the capital treatment for these securities should be determined by the existence of ratings in one of the four highest rating categories by at least two NRSROs. It is the opinion of the SIA that rating criteria, which indicate the high credit quality of securities, are a sufficient proxy for the securities' liquidity, regardless of whether the market in which they were issued is a "principal foreign securities market."

Based on the above discussion, the Division will not recommend enforcement action to the Commission if broker-dealers, in computing their net capital, apply the haircuts described below to the securities held in their proprietary and other accounts. For purposes of this letter, it is irrelevant whether the securities may be publicly offered or sold without registration under Section 5 of the Securities Act.

***A. Foreign Securities - Sovereign Issued Debt***

A debt security that: (1) is issued as a general obligation of a sovereign government; (2) has a fixed maturity date; (3) is not traded flat or in default as to principal or interest; and (4) is rated (implicitly or explicitly) in one of the four highest rating categories by at least two NRSROs may be treated in accordance with the haircut provisions set forth in paragraph (c)(2)(vi)(F) of the net capital rule.

***B. Nonconvertible Debt Securities Issued By A Supranational Organization or Domestic or Non-Domestic Issuer***

A nonconvertible debt security that: (1) is issued by a supranational organization or a domestic or non-domestic issuer; (2) has a fixed rate of interest and fixed maturity date; (3) is not traded flat or in default as to principal or interest; and (4) is rated in one of the four highest rating categories by at least two NRSROs may be treated in accordance with the haircut provisions set forth in Rule 15c3-1 (c)(2)(vi)(F).

***C. Convertible Debt Securities***

A debt security that: (1) is issued by a domestic or non-domestic issuer; (2) has a fixed rate of interest and a fixed maturity date; (3) is not traded flat or in default as to principal or interest; (4) is convertible into an equity security; and (5) is rated in one of the four highest rating categories by at least two NRSROs or readily convertible within ninety days into a security that is deemed to have a ready market may be treated in accordance with the haircut provisions set forth in paragraph (c)(2)(vi)(G) of Rule 15c3-1.

***D. Preferred Stock***

Cumulative, nonconvertible preferred stock ranking prior to all other classes of stock of the same issuer that is: (1) issued by a domestic or non-domestic issuer; (2) rated in one of the four highest rating categories by at least two NRSROs; and (3) not in arrears as to dividends may be treated in accordance with the haircut provisions set forth in paragraph (c)(2)(vi)(H) of the net capital rule. Convertible preferred stock that is: (1) issued by a domestic or non-domestic issuer; (2) rated in one of the four highest rating categories by at least two NRSROs or readily convertible within ninety days into a security that is deemed to have a ready market;

Mr. Dominic A. Carone  
Page 4

and (3) not in arrears as to dividends may be treated in accordance with the haircut provisions of paragraphs (c)(2)(vi)(J) or (f) of the net capital rule.

***E. Securities Issued Under the Secondary Mortgage Enhancement Act of 1984 5/***

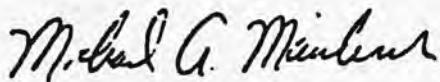
Debt securities that are issued under the Secondary Mortgage Enhancement Act of 1984 and rated in one of the two highest rating categories by at least one NRSRO may be treated in accordance with the haircut provisions set forth in paragraph (c)(2)(vi)(F) of Rule 15c3-1.

**III. CONCLUSION**

All previous letters addressing this issue should be disregarded. This letter, however, does not address the capital treatment of any currency risk incurred by holding non-domestic securities.

You should be aware that this is a staff position with respect to enforcement only and does not purport to express any legal conclusions. The Division's position is confined to the facts as you have represented them; any material change therein may warrant a different result and should be brought to our attention. If you have any questions, please feel free to contact the undersigned, at (202) 272-2904, or K. Susan Grafton, at (202) 272-7458.

Sincerely,



Michael A. Macchiaroli  
Assistant Director

cc: Thomas R. Cassella  
National Association of  
Securities Dealers, Inc.

Raymond J. Hennessey  
New York Stock Exchange, Inc.