

November 17, 1980

Mr. Nelson Kibler

Division of Market Regulation Securities and Exchange Commission

500 North Capitol Street, N.W. Washington, D.C. 20549

Dear Nelson:

At our meeting on November 7 with you, your staff and representatives of the NASD we agreed to provide you with a written presentation concerning the net capital issue raised by the NASD as a result of its recent examination of Warburg Paribas Becker Incorporated. Specifically, the issue relates to the treatment to be accorded WPB's investment portfolio under Rule 15c3-1 in view of the fact that such portfolio is subject to a Revolving Credit and Term Loan Agreement with Morgan Guaranty Trust Company (the "Loan Agreement"), a copy of which is enclosed for your information.

As background information, WPB, as you know, is the investment banking subsidiary of The Becker Warburg Paribas Group Incorporated ("BWP Group"), a financial services holding company, and is engaged primarily in providing corporate finance services to corporate issuers, including public underwritings and private placements, and financial advisory services in connection with merger and acquisition transactions. A.G. Becker Incorporated, the other principal broker/dealer subsidiary of the BWP Group, is engaged in a diversified retail and institutional securities and commodities brokerage and dealer business. WPB does not carry customer accounts inasmuch as A.G. Becker acts as selling agent for WPB in connection with all of its underwriting activities. Currently, the BWP Group has total capital of more than \$115 million. WPB's capital funds are approximately \$22 million.

WPB uses the aggregate indebtedness method of calculating its net capital under the Commission's Net Capital Rule. At September 26, 1980, WPB's net capital requirement was calculated to be \$430,412 and its net capital (under WPB's interpretation of the treatment to be accorded the investment portfolio) was \$2,204,453. A copy of WPB's September 26 FOCUS Report is enclosed for your information.

WPB's investment portfolio consists of various venture capital-type investments, all of which are restricted as to public resale by virtue of agreements with the issuers and/or the Securities Act of 1933. Morgan Guaranty has agreed to accept the WPB investment portfolio, subject to rights of substitution, as collateral for a revolving credit of up to \$5 million. For this credit facility (which WPB has drawn down to date as much as \$4.5 million and \$4.2 million currently), WPB pays Morgan a commitment fee of $\frac{1}{2}$ of 1% per annum on the unused portion of the bank's commitment.

Under the Loan Agreement, WPB is required to maintain at all times collateral in the form of securities from the investment portfolio having an estimated fair value of the investment portfolio is determined at least quarterly by the Investment Valuation Committee of the BWP Group in accordance with the following accounting policies, consistently applied, which are audited by the firm's independent auditors, Arthur Andersen & Co.:

- (1) Restricted securities are valued at the quoted market price of their marketable equivalents, less appropriate discount
- (2) Non-marketable securities are valued by reference to bona fide sales of the same securities or similar securities of the same issuer, application of an earnings multiple or other significant factors.

At the last quarterly meeting of the Investment Valuation Committee in August, the WPB investment portfolio was determined to have an aggregate estimated fair value of \$7.1 million.

Prior to entering into the loan agreement with Morgan, as you may recall, I had informal telephone discussions with the Staff regarding the net capital treatment that would apply after the loan commitment was in place. It was my understanding that the Staff concurred with the view that the acceptance of the investment portfolio by the bank as collateral under the loan agreement rendered the securities "readily marketable" by definition under subparagraph (c)(11) of Rule 15c3-1, and, furthermore, that the haircut to be applied to these securities, in view of the loan commitment, need be only the amount of the margin required by the bank, 16-2130 (i.e., the reciprocal of the 120% collateral coverage requirement), instead of the 30% applied to "other securities" under the Rule. We now understand

that this treatment goes beyond what the Staff has previously permitted in public interpretations as the NASD correctly notes.

From a strictly literal standpoint, we submit that the investment securities in question are entitled to treatment as marketable securities since subparagraph (c)(11) provides that "a ready market shall be deemed to exist where securities have been accepted as collateral for a loan by a bank" and it can be demonstrated that "such securities adequately secure such loans." Clearly, in our case, Morgan Guaranty, in extending the loan facility, has accepted the securities as collateral for a loan facility which at all times will be adequately secured within the literal meaning of the foregoing terms. The fact that the credit facility is revolving and may be drawn down and repaid from time to time as the need arises does not change the demonstrable fact that an independent third party has agreed to take the securities for value on two day's notice. Indeed, it had been my understanding from my earlier discussions with the Staff that it was this demonstrable "bankability" of the securities which was the essence of subparagraph (c)(11).

Having discussed the specific matter of WPB's investment portfolio with the Staff in the foregoing terms, I had understood that the real interpretative hurdle to be gotten over was what "haircut" was appropriate for the securities in view of the legally enforceable commitment by the bank to lend. I believed, and I understood the Staff to have concurred, that it was a rational interpretive extension of the Rule to require a "haircut" only to the extent of the margin required by the bank, despite the fact that other marketable securities are generally subject to a 30% haircut. The rationale for applying the smaller haircut was that there was an independent third party who was not only ready and able, but legally committed, to extending \$5 for each \$6 of estimated fair value in the investment securities. We believe that this position is supportable in view of the bona fides of the loan commitment and the objectivity of Morgan Guaranty, which has satisfied itself that the investment portfolio represents solid economic value appropriately discounted to assure marketability, in a liquidation sense, to the small but nonetheless real market of professional investors willing to purchase restricted securities at discounted values.

We appreciate fully the concerns that were expressed by the NASD representatives at our meeting about the dangers of extending this treatment to registered broker/dealers generally in view of the apparent potential for abuse due to the

inherently subjective valuation and margin judgments involved. After further reflection, we have been unable to develop a formula containing objective standards which would guard against such potential abuses and yet not discriminate against smaller brokers. We also appreciate that the Staff might be reticent in the absence of objective standards to issue a public interpretation or no-action position which might be interpreted as having general applicability. Nevertheless, we believe that there are policy considerations which justify the continued use by WPB of the treatment discussed above for its investment portfolio.

As noted above, WPB does not carry customer accounts or otherwise have custody of either securities or cash of "customers" as defined in subparagraph (c)(6) of the Rule. Accordingly, there is no real need for WPB to have the liquidity which the Net Capital Rule is designed to provide for the benefit of customers having securities or cash held by brokers which do carry customer accounts. We submit that there is, therefore, no policy reason for applying subparagraph (c)(11) restrictively to WPB under the circumstances described above.

We believe that the lack of customer accounts should provide the necessary distinguishing factor which could provide the basis for a no-action letter to WPB that would not be construed as having broader applicability. Alternatively, we believe that our situation presents an appropriate case for a partial exemption under subsection (c)(3). Before handling this on either a no-action or exemptive basis, however, we would like to have the opportunity of providing a formal request in proper form especially in view of the confidential information contained in this letter. We will be happy to discuss the contents of this letter with you at your convenience or provide additional information as you may need to reach a conclusion about this matter. In the meantime, we appreciate your consideration and thank you again for the opportunity you afforded us to discuss this matter personally.

Very truly yours,

Albert Kopin

Senior Vice President and Treasurer AK:1m cc: Mr. John Cox Mr. Gerald Cuny

March 16, 1982

Albert Kopin

Senior Vice President and Treasurer

Warburg Paribas Becker, Inc.

Two First National Plaza Chicago, Ill. 60603

Dear Mr. Kopin,

This is in response to your letter of November 17, 1980, on behalf of Warburg Paribas Becker, Inc. ("WPB") regarding the net capital treatment of certain restricted securities in WPB's investment portfolio under Rule 15c3-1 (17 CFR 240.15c3-1) of the Securities Exchange Act of 1934.

I understand the pertinent facts to be as follows: WPB, a registered broker-dealer that carries no customer accounts, maintains an investment portfolio consisting of securities which are restricted as to public resale by virtue of agreements with issuers and/or the Securities Act of 1933. This investment portfolio has been accepted by Morgan Guaranty Trust Company under a Revolving Credit and Term loan Agreement (the "loan agreement") as collateral for revolving credit of up to \$5,000,000. Under the loan agreement, WPB is required to maintain at all times collateral in the form of securities from the investment portfolio having an estimated fair market value of 120% of the outstanding principal amount borrowed. Recently, WPB's investment portfolio was determined to have an aggregate estimated fair market value of T 7, 100,000,

In your opinion, acceptance by the bank of the investment portfolio as collateral under the loan agreement renders the securities "readily marketable" within the meaning of subparagraph (c)(11)(ii) of Rule 15c3-1. Furthermore, it is your opinion that the haircut to be applied to these securities should only be the amount of margin required by the bank instead of the 30% haircut normally applied to securities under the net capital rule.

Paragraph (c)(2)(vii) of Rule 15c3-1 requires broker-dealers to deduct from net worth in computing net capital 100% of the carrying value of securities for which there is no "ready market" as defined in paragraph (c)(11) and securities which

cannot be publicly offered or sold because of statutory, regulatory or contractual arrangements or other restrictions.

Based on the facts outlined above, it is the view of the Division that, since the securities in the investment portfolio are restricted as to public resale, WPB must deduct 100% of the carrying value of those securities in computing net capital. The fact that the securities may be "readily marketable" within the meaning of paragraph (c)(11) is irrelevant since the securities cannot be publicly offered or sold. In addition, paragraphs (c)(2)(iv) and (c)(1) (viii) are not applicable since the restricted securities were not acquired for use in the ordinary course of trade or business and since the revolving credit agreement with Morgan Guaranty Trust Company is not a sole recourse loan.

Please call or write me if you have any further questions.

Sincerely,

Nelson S. Kibler

Assistant Director