



Securities Industry Association

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July 9, 2001

Michael A. Macchiaroli, Esq.
Associate Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

Re Marketability of Asset Backed Securities Issued by Special Purpose Vehicles

Dear Mr. Macchiaroli:

On behalf of the Capital Committee ("the Committee") of the Securities Industry Association ("SIA")¹ we are pleased to submit the following proposal regarding the treatment of certain asset-backed securities that have been issued by a Special Purpose Vehicle ("SPV")² for purposes of calculating net capital under Rule 15c3-1 ("the Net Capital Rule") under the Securities Exchange Act of 1934 ("the Exchange Act").³ The Committee requests that the Division of Market Regulation ("the Division") not recommend enforcement action to the Securities and Exchange Commission ("SEC" or "the Commission") if broker-dealers compute their net capital charges on these securities as described below.

Paragraph (c)(2)(vii) of Rule 15c3-1 requires a broker-dealer to deduct from its net worth 100 per cent of the carrying value of securities it holds in its proprietary account for which there is no ready market or which cannot be publicly offered or sold without registration. The term "ready market" is defined in paragraph (c)(11) of Rule 15c3-1 to include a recognized established securities market in which there exists independent bona fide offers to buy and sell so that a price

¹ The Securities Industry Association is the trade association representing over 700 securities firms throughout North America. Its members include securities organizations of all types-investment banks, brokers, dealers, specialists, and mutual fund companies. SIA members are active in all markets, and in all phases of corporate and public finance. Collectively, they provide investors with a full spectrum of investment services and account for approximately 90% of the securities business conducted in the U.S.

² SPVs are bankruptcy remote trust vehicles with limited powers generally formed for the purpose of 1) acquiring mortgage loans, securities or other financial assets (the "underlying assets"); 2) issuing new securities representing the beneficial interest in the underlying assets (the asset backed securities or "ABS"); 3) collecting the cash flows on the underlying assets and distributing them to the holders of the ABS; and, 4) performing specified other actions as required to protect the beneficial interests of the ABS holders.

³ 17 CFR Sec. 240 15c3-1

reasonably related to the last price or current bona fide competitive bid and offer quotations can be determined for a particular security almost instantaneously and where payment will be received in settlement of a sale at such price within a relatively short time conforming to trade custom. Non-convertible debt securities are presumed to have a ready market, and are subject to the deduction under paragraph (c)(2)(vi)(F) of Rule 15c3-1, if the debt has a fixed interest rate and maturity date, is not traded flat or in default as to interest or principal and is rated in one of the four highest rating categories by at least two Nationally Recognized Statistical Rating Organizations ("NRSROs").

In general, the ABS market does not distinguish between single-rated or double-rated debt with an investment grade rating. NRSROs base the ratings for an ABS on the strength of the underlying assets, including excess collateralization, and on the order of distribution of the cash flows ("tranches").⁴ Similarly, institutional investors evaluate ABS on the basis of the expected collection and distribution of cash flows.

Currently, certain investment grade debt securities (including ABS) issued by an SPV are subject to a 100 per cent haircut under Rule 15c3-1. The Committee believes that the market for these securities provides liquidity sufficient to allow for a designation of ready market, and that the capital charges resulting from a 100 per cent haircut represents a significant burden on broker-dealers. Accordingly, the Committee requests that the Division not recommend enforcement action to the Commission if a broker dealer treats debt securities (including ABS) issued by an SPV as having a ready market for purposes of Rule 15c3-1 if the following are met:

1. The issuer is not in default with respect to the securities and the securities are not traded flat or in default; and meets either 2 or 3 below.
2. The securities:
 - a. have at least one investment grade rating in one of the two highest categories by a NRSRO, and
 - b. the original issue of which the security is a part, combining all tranches, has a par value of \$100 million or greater, and
 - c. the broker-dealer takes a deduction as specified under paragraph (c)(2)(vi)(F) of Rule 15c3-1, or
3. The securities:
 - a. have at least one investment grade rating, and
 - b. the broker-dealer deducts from its net worth the following percentages from the greater of the long or short value of positions in debt securities⁵ in each of the categories specified below:

1. an initial issuance of at least \$100 million	15 %
2. an initial issuance of at least \$75 million and less than \$100 million	20%
3. an initial issuance of at least \$50 million and less than \$75 million	25%

⁴ In an asset backed securitization with securities rated by an NRSRO, losses incurred are allocated in their entirety first to unrated tranches, then to rated tranches in ascending order. Accordingly, certain tranches, often referred to as first loss or equity class, share disproportionately in losses. Such tranches are usually unrated or rated as highly speculative (B or lower) and are excluded for purposes of this letter.

⁵ All issuance sizes refer to the original issue of which the security is a part, combining the par value of all tranches (as appropriate).

4. an initial issuance of at least \$20 million and less than \$50 million 50%
5. an initial issuance of less than \$20 million 100%
6. have been held in inventory for more than 90 days as the result of the failure to complete an underwriting 100%

This letter supercedes the letter dated August 6, 1999 addressing the treatment of highly rated asset backed securities for net capital purposes, pursuant to a letter from Michael A. Macchiaroli, Associate Director, Division of Market Regulation to Charles A. Vadala, Chairman, Capital Committee, Securities Industry Association.

The Committee wishes to thank you for your consideration of our proposal. If you or your colleagues have any question about our proposal, please feel free to contact either the undersigned at (347) 643-4746, or George Kramer of the SIA staff at (202) 296-9410.

Sincerely,

Cheryl M. Kallem /s/ GKramer

Cheryl M. Kallem
Chair
Capital Committee