



DIVISION OF
MARKET REGULATION

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

July 27, 2000

Mr. Charles F. Vadala
Chairman
Capital Committee
Securities Industry Association
1401 Eye Street NW
Washington, D.C. 20005-2225

Re: Marketability of Certain Securities

Dear Mr. Vadala:

This is in response to your letter dated July 14, 2000, from the Capital Committee of the Securities Industry Association ("SIA") to the Division of Market Regulation ("Division"), on behalf of its members and similarly situated broker-dealers regarding the treatment of below-investment-grade-rated and single-rated debt securities and preferred stock for purposes of calculating net capital pursuant to Rule 15c3-1 under the Securities Exchange Act of 1934.¹

Paragraph (c)(2)(vii) of Rule 15c3-1 requires a broker-dealer to deduct from its net worth 100% 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 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.

¹ 17 CFR 240.15c3-1.

Currently, there exist questions as to whether below-investment-grade-rated or single-rated debt securities and preferred stock are subject to a 100% haircut under Rule 15c3-1. The SIA believes that these securities have liquidity sufficient to allow them to be easily sold and that a possible 100% haircut is unjustified. Accordingly, the SIA has requested that certain securities without two investment-grade NRSRO ratings be subject to smaller haircuts.

Based on the foregoing, the Division will not recommend enforcement action to the Commission if a broker-dealer treats debt securities and preferred stock not rated in one of the four highest categories by at least two NRSROs as having a ready market for purposes of Rule 15c3-1 if the following conditions are met:

1. The securities:
 - (a) are issued by an issuer with outstanding non-preferred equity securities that are registered with the Commission and traded on a national securities exchange or NASDAQ;
 - (b) are issued by an issuer whose equity securities are included in the FTSE World Index;
 - (c) have current non-investment grade ratings from at least two NRSROs; or
 - (d) have one investment grade rating by one NRSRO, and the issuer has other outstanding non-preferred equity securities that are registered with the Commission and traded on a national securities exchange, NASDAQ or are included in the FTSE World Index.²
2. The issuer is not in default with respect to the securities and the securities are not traded flat or in default; and

² This category of securities overlaps, to some extent, with the section 1(a) or (b) above.

3. The broker-dealer deducts from its net worth the following percentages from the gross long or short value of positions in debt securities and preferred stock not rated in one of the four highest categories by at least two NRSROs in each of the categories specified below:
- | | |
|---|------|
| (a) An initial issuance of at least \$100 million | 15% |
| (b) An initial issuance of at least \$75 million and less than \$100 million | 20% |
| (c) An initial issuance of at least \$50 million and less than \$75 million | 25% |
| (d) An initial issuance of at least \$20 million and less than \$50 million | 50% |
| (e) An initial issuance of less than \$20 million ³ or have been held in inventory for more than 90 days as the result of the failure to complete the underwriting | 100% |

Broker-dealers may not include the value of debt securities and preferred stock not rated in one of the four highest categories by at least two NRSROs, subject to the haircut percentages set forth above, in paragraph (c)(2)(vi)(J) of Rule 15c3-1 for the purposes of netting long or short securities positions under paragraph (c)(2)(vi)(J).

The broker-dealer shall take an additional portfolio concentration charge on such securities according to the terms of the letter from the Division dated July 27, 2000 regarding portfolio concentration charges applicable to positions in securities without two investment grade NRSRO ratings.

³ Securities with an initial issuance of less than \$20 million will be deemed to be included in category (d) above if the issuer has another outstanding issue of debt securities or preferred stock not rated in one of the four highest categories by at least two NRSROs, which has an initial issuance of \$50 million or more.

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You should understand that this is a staff position with respect to enforcement only and does not purport to state any legal conclusion on this matter. Any material change in circumstances may warrant a different conclusion and should be brought immediately to the Division's attention. Furthermore, this position may be withdrawn or modified if the staff determines that such action is necessary in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the securities law.

Sincerely,

A handwritten signature in cursive script, appearing to read "Michael C. Macchiaroli".

Michael Macchiaroli
Associate Director

CC: Susan DeMando, NASD Regulation, Inc.
Raymond Hennessey, New York Stock Exchange, Inc.