SECURITIES INDUSTRY ASSOCIATION
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August 14, 1990

Mr. Michael A. Macchiaroli
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20546

Re: Net Capital Treatment for Certain Unregistered Securities -- Rule 15c3-1

Dear Mr. Macchiaroli:

This letter is written on behalf of the Securities Industry Association Net Capital Committee ("the Committee") 1/ regarding the net capital treatment for certain unregistered obligations. We refer to Release No. 33-6862 (the "Release") issued by the Commission on April 19, 1990 upon the adoption of Rule 144A and related amendments to Rule 144 and Rule 145 under the Securities Act of 1933. This letter addresses Part IIG of the Release relating to the treatment for purposes of the Uniform Net Capital Rule (Rule 15c3-1) of securities held by a broker-dealer in its proprietary or other accounts. For

1/ The Securities Industry Association is the trade association representing over 575 securities firms headquartered throughout the United States and Canada. Its members include securities organizations of virtually all types--investment banks, brokers, dealers and mutual fund companies, as well as other firms functioning on the floors of the exchanges. SIA members are active in all exchange markets, in the over-the-ounter market and in all phases of corporate and public finance. Collectively, they provide investors with a full spectrum of securities and investment services and account for approximately 90% of the securities business being done in North America.

convenience of reference, attached as Exhibit A is a copy of Part IIG of the Release ("Part IIG") as set forth in 55 Fed. Reg. 17933 (April 30, 1990) at page 17941. A summary of the Committee's proposal that is the subject of this letter is contained in Exhibit B, hereto.

Part IIG differentiates between foreign and domestic securities held by a broker-dealer which may be resold through Rule 144A. The Committee seeks this no-action treatment for the foreign and domestic securities discussed below; without the benefit of a favorable authoritative interpretation, broker-dealers are faced with the prospect of a 100% "haircut" on securities which would otherwise be "non-marketable securities" under the second clause of paragraph (c)(2)(vii) of Rule 15c3-1.

Foreign Securities

Part IIG indicates that foreign securities should continue to be given the same treatment they have been accorded since shortly after the Uniform Net Capital Rule was adopted, as set forth in an interpretive letter dated December 29, 1975 from the Division of Market Regulation to the Securities Industry Association (the "1975 SIA Letter"). The principal provisions of that interpretive letter are then repeated in subparagraphs numbered 1, 2 and 3 of the second paragraph of Part IIG, and in each of the three subparagraphs the favorable interpretation depends on, among other things, the foreign securities in question having been "publicly issued in a principal foreign securities market".

It appears by implication from the Release that foreign debt securities that would otherwise qualify under the 1975 SIA Letter (by meeting the rating criteria), but for the fact that they have not been "publicly issued in a principal foreign securities market", will be subject to a 100% net capital charge. The Committee believes that foreign debt securities that meet the necessary rating

criteria,2/ however, should be eligible for the favorable net capital treatment afforded under Rule 15c3-1(c)(2)(vi)(F), (G) or (f)(3)(i), as appropriate, (hereinafter collectively referred to as "subparagraph (F)"), even if the instrument is not publicly issued in a principal securities market and even if the instrument is not Rule 144A eligible. It is the Committee's position that the rating criteria is a sufficient proxy for liquidity, given the high credit quality of the issuer.

We also believe it would be appropriate to extend the net capital rule treatment afforded by subparagraph (F) to debt securities issued or guaranteed as a general obligation by a government of a foreign country, its provinces, states or cities, or a supranational entity, that: (1) have any outstanding debt securities which were publicly issued in a principal foreign securities market; or (2) have explicit or implicit ratings in one of the four highest rating categories by two NRSROs.3/

2/ The SIA committee recommends that the following rating criteria be used:

1) The instrument is rated in one of the four highest rating categories by two Nationally Recognized Statistical Rating Organizations ("NRSRO"); or

2) The instrument ranks in a credit position equal or superior to securities of the same issuer that have been rated in one of the four highest rating categories by two NRSROs; or

3) The instrument is guaranteed by an entity whose debt securities have been rated in one of the four highest rating categories by two NRSROs.

3/ The concept of implicit ratings was used by the Board of Governors of the Federal Reserve in its recent amendment to Regulation T, 12 CFR 220. The amendment extended good faith loan value to debt securities issued or guaranteed by a foreign sovereign, its provinces, states or cities, or a supranational entity, if explicited or implicitly rated in one of the two highest rating categories by one NRSRO.

For the same reasons discussed above in regard to foreign corporate debt, it is not necessary to require that a particular foreign sovereign debt issue be publicly issued in a principal foreign securities market to demonstrate liquidity. The Committee believes that liquidity can be demonstrated in two ways. First, liquidity can be demonstrated by the existence of other outstanding publicly issued debt: the existence of such securities demonstrate the credit worthiness of the issuer, and, therefore, the liquidity of its securities. Second, liquidity can be demonstrated by explicit or implicit investment grade ratings. While explicit ratings have traditionally been accepted by the Commission as an indication of quality (and therefore liquidity), we believe implicit ratings are also an appropriate indication of quality for foreign sovereign debt. When a NRSRO reviews a private issue, it also reviews the issuer's country's credit worthiness, with the sovereign's evaluation providing a ceiling for the private issuer. Therefore, the sovereign will carry an implicit rating at least equal to the highest rated private issuer located in that sovereignty. Regardless of whether the rating is explicit or implicit, it is an accurate gauge of the issuer's credit worthiness.

In regard to foreign equities, the Committee requests that the staff confirm that securities which meet the criteria contained in the 1975 SIA Letter be treated as having a ready market, even if the security is not eligible for resale under Rule 144A. The fact that the equity security is traded on a principal exchange in a major foreign money market demonstrates the instrument's liquidity; Rule 144A thus becomes irrelevant.

Domestic Securities

For the same reasons discussed in regard to foreign corporate debt, the committee respectfully requests that unregistered domestic debt be treated as readily marketable as long as it carries appropriate ratings, even if the instrument is not Rule 144A eligible. As previously discussed, the Committee believes that subparagraph (F) net capital treatment is warranted because the ratings are an appropriate proxy for liquidity.

In regard to domestic equity securities, the Committee understands that Rule 144A eligibility itself will not automatically cause a security to be treated as readily marketable. Conversely, it is our understanding that any security (debt or equity, foreign or domestic) may be treated as readily marketable if the instrument independently meets the requirements contained in the ready market definition in Rule 15c3-1(c)(11). In other words, unregistered securities will not be treated as per se unmarketable.

Finally, the Committee requests that the staff confirm that American Depositary Receipts ("ADR"s) be considered to have a ready market (regardless of whether the ADR is registered under the Securities Act of 1933 or Rule 144A eligible) as long as the ADR, within a period of 90 days, is readily convertible into or exchangeable for a foreign security that is deemed to have a ready market as described above. As long as the ADR is readily convertible into a marketable instrument, there is no compelling reason to differentiate it from the underlying security. Similarly, the Committee believes that warrants (domestic or foreign) on securities that would be deemed to have a ready market pursuant to this letter should likewise be deemed to have a ready market, so long as the warrant is convertible into or exchangeable for the underlying security within a period of 90 days subject to no conditions other than the payment of money. The Committee believes that this treatment is justified because the market value of such warrants moves in tandem with the market value of the readily marketable underlying security.4/

4/ The market values move in unison when the warrant is deep in-the-money. Conversely, as the warrant moves out-of-the-money, the warrant will move by a decreasing percentage relative to the underlying security.

Conclusion

In summary, the SIA strongly believes that the following securities (even if not Rule 144A eligible) should be deemed to have a ready market, and, therefore, be treated for net capital purposes in the following manner:

(1) Debt securities issued or guaranteed as a general obligation by a government of a foreign country, its provinces, states or cities, or a supranational entity, that are not in default as to principal or interest, and where such issuer has either (A) any outstanding debt securities which were publicly issued in a principal foreign securities market, or (B) explicit or implicit ratings in one of the four highest rating categories by two NRSROs, will be subject to the haircuts specified in 15c3-1(c)(2)(vi)(F);

(2) Domestic and foreign corporate debt securities that are not in default as to principal or interest, and which have been rated in one of the top four rating categories by at least two NRSROs, will be subject to the haircuts specified in 15c3-1(c)(2)(vi)(F), (G) or (f)(3)(i), as appropriate;

(3) Foreign equity securities that meet the requirements of the 1975 SIA Letter will be subject to the haircuts specified in 15c3-1(c)(2)(vi)(J) or (f)(3)(ii), as appropriate; and

(4) ADRs or warrants that are readily convertible into or exchangeable for securities that qualify as readily marketable pursuant to paragraphs (1)-(3) above will be subject to the haircut that is appropriate for that underlying security, so long as such conversion or exchange can take place within a period of 90 days subject to no conditions other than the payment of money.

For paragraphs (2) or (4) above, it is sufficient if the security: (a) ranks in a credit position equal or superior to securities of the same issuer that have been rated in one of the top four rating categories by two NRSROs; or (b) is guaranteed by an entity that has outstanding securities that have been so rated.

Thank you for your consideration in this matter. If you have any questions or comments, please contact either Scott H. Rockoff at (212) 322-1287, or Rochelle K. Pullman at (212) 322-1787.

Sincerely,

Stephen J. Bier
Chairman
Capital Committee

EXHIBIT A

purchasers; ... dealer undertakings to make a market in the security; and (4) the nature of the security and the nature of the marketplace trades (*e.g.*, the time needed to dispose of the security, the method of soliciting offers, and the mechanics of transfer).

A commenter requested that the Commission make clear that Rule 144A resales of securities of investment companies do not constitute a "public offering" within the meaning of Sections 3(c)(1)[63] or 7(d)[64] of the Investment Company Act. Section 3(c)(1) exempts "private" investment companies from registration under the Investment Company Act if the company's outstanding securities (other than short-term paper) are beneficially owned by not more than 100 persons and the company is not making and does not presently propose to make a public offering of its securities. Section 7(d) prohibits foreign investment companies from using jurisdictional means to publicly offer their securities for sale in the United States unless the company receives an order permitting it to register under the Investment Company Act. In *Touche Remnant* (pub. avail. August 27, 1984), the staff of the Division of Investment Management took the position that a foreign investment company could engage in a private offering to U.S. persons coincident with a public offering outside the U.S. without traditional concepts of integration applying [See Securities Act Release No. 4708 (July 9, 1964)] as long as the offering using jurisdictional means in the U.S. did not cause shares of the fund to be beneficially owned by more than 100 U.S. residents. Thus, the term "public offering" in Section 7(d) of the Act was interpreted to include an offer by jurisdictional means that causes the shares of a foreign investment company to be beneficially owned by more than 100 U.S. residents.

The Commission believes that resales of privately placed investment company securities pursuant to the safe harbor provisions of Rule 144A would not cause the issuing investment company to lose the exemption provided by Section 3(c)(1) or cause a violation of Section 7(d) of the Investment Company Act as long as after the resale the securities are held, for purposes of Section 3(c)(1), by no more than 100 beneficial owners or, for purposes of Section 7(d), by no more than 100 beneficial owners who are U.S. residents. Moreover, the Commission believes that a resale in reliance on Rule 144A, even if anticipated by the issuing investment company, would not, in and of itself, result in the company "having reason to believe that such security will be made the subject of a public offering within the meaning of Section 7(a) of the Investment Company Act."[65] However, Rule 144A will not obviate the obligation of a company to register or, in the case of a foreign investment company, to apply for an exemptive order permitting it to register, under the Investment Company Act if, with regard to a domestic company, there are more than 100 beneficial owners of its securities, or, with regard to a foreign company, there will be more than 100 U.S. residents who are beneficial owners of its securities.

G. *Uniform Net Capital Rule*

In 1975, at the time of the adoption of the present Uniform Net Capital Rule, the Division of Market Regulation issued an interpretive letter concerning the liquidity of foreign securities for purposes of the net capital rule.[66] Foreign securities held by a broker-dealer in its proprietary accounts which may be resold through Rule 144A will be treated for net capital purposes as securities discussed in that interpretive letter. That interpretation discussed which foreign securities were liquid for purposes of the net capital rule.

The interpretation treats as liquid those securities which are:

1. 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[67] by:

(a) a sovereign national government (or an entity guaranteed by such a government) or by a multi-governmental organization; or

(b) a Canadian province or municipality.

2. 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 and which:

(a) have been rated in one of the top four rating categories by at least two nationally recognized statistical rating services in the United States; or

(b) 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 nationally recognized statistical rating services in the United States.

[63] 15 U.S.C. §80a-3(c)(1).

[64] 15 U.S.C. §80a-7(d).

[65] 15 U.S.C. §80a-7(a).

[66] Division of Market Regulation letter dated December 29, 1975, to the Securities Industry Association.

[67] The Securities Industry Association as well as individual broker-dealers have asked for reconsideration of the definition of principal foreign securities markets. Their views are presently being considered by the Division of Market Regulation.

... Securities of a foreign issuer which were ... issued in a principal foreign securities market and which are listed on one of the principal exchanges in the major money markets outside the United States.

As to domestic securities, the Division of Market Regulation's position is that those securities which may be resold through Rule 144A (and which otherwise would be subject to a 100% haircut), except for corporate 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 of the nationally recognized statistical rating organizations, 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 the net capital rule.

III. *CHANGES TO RULE 144 AND RULE 145*

In connection with its consideration of Rule 144A, the Commission has reexamined the principles underlying the determination of holding periods for purposes of Rules 144 and 145. As a result, the Commission today is adopting amendments to Rule 144's tacking concept.[68] While these amendments arose in the context of the development of Rule 144A, they are applicable to all restricted securities, not only to those sold under Rule 144A.

Under Rule 144 as previously in effect, restricted securities[69] generally were required to be held for at least two years before the holder could sell the securities in reliance upon the safe-harbor provisions of Rule 144.[70] Except in limited instances,[71] the holding period of predecessor owners was not combined with, or "tacked" to, the holding period of the person wishing to sell in reliance on Rule 144.[72]

As a result of its reexamination of the tacking concept embodied in Rule 144, the Commission today is amending the Rule to permit holders of restricted securities acquired in a transaction or series of transactions not involving any public offering to add to their own holding period those of prior holders unaffiliated with the issuer. No such tacking will be permitted, however, where the seller has purchased from an affiliate of the issuer whose presence in the chain of title will trigger the commencement of a new holding period. The changes to Rule 144 apply to public resale of securities acquired in reliance upon proposed Rule 144A, including those securities issued by non-reporting foreign private issuers, as well as to public resale of other restricted securities.[73] Requiring securities to be held for two years by each successive holder before permitting Rule 144 resales, without regard to the time elapsed from the date of the sale of the security by the issuer or an affiliate, is unnecessarily restrictive. In the Commission's view, a single period running from the date of the purchase from the issuer or an affiliate of the issuer is sufficient to prevent the distribution by the issuer of securities to the public.

Rule 144(d)(1) thus is amended to allow the two-year period prescribed therein to run continuously from the acquisition of restricted securities from the issuer, or from any affiliate thereof, until the subsequent resale of the securities by either the initial holder or a subsequent holder. Because of its "issuer" status for purposes of the Rule,[74] an affiliate's resale of securities acquired at some point in a chain of transactions occurring within two years of a non-affiliate's initial acquisition of such securi-

[68] Conforming amendments to Rule 145 also are adopted.

[69] The term "restricted securities" previously had been defined in Rule 144(a)(3) [17 CFR 230.144(a)(3)] as securities that are acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a transaction or chain of transactions not involving any public offering, or securities acquired from the issuer that are subject to the resale limitations of Regulation D or Rule 701(c) (§230.701(c) of this chapter) under the Act, or securities that are subject to the resale limitations of Regulation D and are acquired in a transaction or chain of transactions not involving any public offering.

The Commission is amending this provision to reflect the elimination of securities acquired in Rule 144A transactions.

[70] Rule 144(d)(1) [17 CFR 230.144(d)(1)].

[71] Prior to today's amendments, Rule 144(d)(4) set forth specific provisions that permitted a holder or transferee of restricted securities to "tack" (a) the holding period of the transferor, based on an identity of interest between such transferors and transferees as a pledgor and pledgee (Rule 144(d)(4)(iv)), donor and donee (Rule 144(d)(4)(v)), settlor and trust (Rule 144(d)(4)(vi)), and a decedent and his estate (Rule 144(d)(4)(vii)), and (b) the period of time certain restricted securities were held to the holding period of "related" securities subsequently acquired from the issuer as a dividend or pursuant to a stock split or recapitalization (Rule 144(d)(4)(i)), for consideration consisting solely of such other securities of the same issuer surrendered for conversion (Rule 144(d)(4)(ii)), or as a contingent payment of the purchase price of an equity interest in a business, or the assets of a business, sold to the issuer or an affiliate of the issuer (Rule 144(d)(4)(iii)).

[72] See Securities Act Release No. 5223 (Jan. 11, 1972) [37 FR 591]. *See also* J. Halperin, *Private Placement of Securities* §8.19, at 278, 279 (1984); D. Goldwasser, *A Guide to Rule 144* 439 (1978); Securities Act Release No. 6099 (Aug. 2, 1979) [44 FR 46752] (Questions 33 and 34).

[73] *See supra* n. 69.

[74] For purposes of Rule 144, an affiliate of an issuer "is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such issuer." Rule 144(a)(1). *See* Rule 405 [17 CFR 230.405]. Section 2(11) of the Securities Act defines the term "issuer" to include an affiliate of the issuer. Accordingly, any person purchasing from an affiliate may be deemed a statutory underwriter.

EXHIBIT B

Unregistered Securites
under Rule 15c3-1

Proposed Treatment

SECURITY	MUST BE PUBLICLY ISSUED IN PRINCIPAL FOREIGN SECURITIES MARKET	MUST BE LISTED ON PRINCIPAL EXCHANGE IN MAJOR FOREIGN MONEY MARKET	MUST BE COLLATERALIZING BK LN	MUST NOT BE IN DEFAULT AS TO P OR I	MUST BE 144A RESALE ELIBIBLE	MUST BE RATED	HAIRCUT 15c3-1 (c)(2)(vi)\1
. FOREIGN							
A. Sovereign or sovereign guaranteed, multi-governmental or Canadian provincial/ municipal debt	Yes\2,\3	No		Yes	No	Dual Investment Grade\2 (Express or Implied)	F
B. Corporate Debt	No	No		Yes	No	Dual Investment Grade	F or G
						-OR- In a credit position equal or superior to D.I.G securities of issuer	F or G
						-OR- Guaranteed by entity with D.I.G. rating	F or G
C. Equity	No	Yes		N/A	No	No	J
1. DOMESTIC							
A. Corporate Debt			No	Yes	No	Dual Investment Grade	F or G
						-OR- In a credit position equal or superior to D.I.G securities of issuer	F or G
						-OR- Guaranteed by entity with D.I.G. rating	F or G
B. Equity			Yes	N/A	No	No	J
C. ADR's / Warrants			Yes\4	N/A	No	No	J

\1 Or such haircut prescribed by 15c3-1(f).
\2 Public issuance or ratings test required.
\3 Or where issuer has other outstanding debt meeting this requirement.
\4 Or readily convertible into foreign securities which otherwise conform to this proposal.