



DIVISION OF  
TRADING AND MARKETS

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

November 8, 2016

Mary Kay Scucci, PhD, CPA  
Managing Director  
SIFMA  
120 Broadway, 35<sup>th</sup> Floor  
New York, NY 10271-0080

Re: Treatment of operating leases under Rule 15c3-1

Dear Ms. Scucci,

In your letter dated May 31, 2016 on behalf of the Securities Industry and Financial Markets Association (“SIFMA”), you request assurances that the staff of the Division of Trading and Markets (“Division”) would not recommend enforcement action to the Securities and Exchange Commission (“Commission”) under Rule 15c3-1 under the Securities Exchange Act of 1934 (“Exchange Act”)<sup>1</sup> if a broker-dealer treats the asset and liability arising from an operating lease in the manner described below.

I understand that the following facts are relevant to your request. The Financial Accounting Standards Board (“FASB”) issued an Accounting Standards Update for Leases on February 25, 2016 (“Lease Accounting Update”).<sup>2</sup> Depending on the type of entity, the Lease Accounting Update is effective for fiscal years beginning after December 15, 2018 or for fiscal years beginning after December 15, 2019. Currently, generally accepted accounting principles (“GAAP”) do not require a lessee to include an asset or liability on its balance sheet with respect to an operating lease. The Lease Accounting Update will change that treatment under GAAP by requiring a lessee to include on its balance sheet an asset and liability arising from an operating lease. Generally, the amount of the lease liability will be calculated as the present value of unpaid lease payments. The amount of the lease asset also will reflect the present value of unpaid lease payments, but it will also reflect any initial direct costs, prepaid lease payments, and lease incentives. Consequently, the amount of the lease asset may not equal the amount of the lease liability.

Under Exchange Act Rule 15c3-1, a broker-dealer computes its net capital by determining its net worth under GAAP and then making certain adjustments to net worth.<sup>3</sup> Among these adjustments, a broker-dealer must deduct from net worth any asset that is not readily convertible into cash (a non-allowable asset).<sup>4</sup> Further, under Rule 15c3-1, a broker-

<sup>1</sup> See 17 CFR 240.15c3-1

<sup>2</sup> See FASB ASU No. 2016-02, Leases (Topic 842).

<sup>3</sup> See 17 CFR 240.15c3-1(c)(2).

<sup>4</sup> See 17 CFR 240.15c3-1(c)(2)(iv).

dealer is required to maintain net capital in an amount that is at least equal to the greater of a fixed-dollar amount specified in the rule and an amount determined by applying one of two financial ratios: the 15-to-1 aggregate indebtedness to net capital ratio (i.e., the AI standard) or the alternative 2% of customer debit items ratio.<sup>5</sup> Under the AI standard, the amount of all liabilities of the broker-dealer that count towards aggregate indebtedness cannot be more than 1500% of the firm's net capital (i.e., the broker-dealer's minimum net capital requirement is 1/15 or 6.67% of its aggregate indebtedness).<sup>6</sup>

In your letter you represent that the Lease Accounting Update does not alter the economic or legal characteristics of an operating lease; namely, an operating lease still represents a financial transaction that is a temporary use of an asset. Currently, because operating lease assets and liabilities are not reflected on the lessee's balance sheet they do not factor into a broker-dealer's net capital computation or a broker-dealer's determination of its minimum net capital requirement under the AI standard. However, the Lease Accounting Update will require a broker-dealer lessee to reflect an asset and liability on its balance sheet arising from an operating lease. Under paragraph (c)(2)(iv) of Exchange Act Rule 15c3-1, the operating lease asset would be non-allowable and, therefore, a broker-dealer would need to deduct it from net worth when computing its net capital. Additionally, a broker-dealer using the AI standard for determining its minimum net capital requirement would be required to include the operating lease liability in its calculation.

Based on the facts and representations set forth in your letter and discussions with the Staff as collectively set forth in this letter, the Division will not recommend enforcement action to the Commission under Exchange Act Rule 15c3-1 if a broker-dealer computing net capital adds back an operating lease asset to the extent of the associated operating lease liability. If the value of the operating lease liability exceeds the value of the associated operating lease asset, the amount by which the liability's value exceeds the associated lease asset must be deducted for net capital purposes. A broker-dealer cannot add back an operating lease asset to offset an operating lease liability unless the asset and the liability arise from the same operating lease; nor can a broker-dealer add back combined or aggregated operating lease assets to offset combined or aggregated operating lease liabilities.

Further, based on the facts and representations set forth in your letter and discussions with the Staff as collectively set forth in this letter, the Division will not recommend enforcement action to the Commission under Exchange Act Rule 15c3-1 if a broker-dealer determining its minimum net capital requirement using the AI standard does not include in its aggregate indebtedness an operating lease liability to the extent of the associated operating lease asset. If the value of the operating lease liability exceeds the associated operating lease asset, the amount by which the lease liability exceeds the lease asset must be included in the broker-dealer's aggregate indebtedness. A broker-dealer cannot add back an operating lease asset to offset an operating lease liability unless the asset and the liability arise from the same operating lease; nor

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<sup>5</sup> See 17 CFR 240.15c3-1(a)(1)(i)-(ii).

<sup>6</sup> See 17 CFR 240.15c3-1(a)(1)(i).

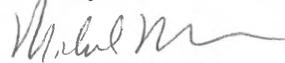
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can a broker-dealer add back combined or aggregated operating lease assets to offset combined or aggregated operating lease liabilities.

This staff position is based strictly on the facts and circumstances discussed in this letter, and any different facts and circumstances may require a different response. This response, furthermore, expresses the Division's position regarding enforcement action only and does not purport to express any legal conclusions on the question presented. The Staff expresses no view with respect to any other questions that the activities discussed above may raise, including the applicability of any other federal or state laws, or self-regulatory organization rules. This position is subject to modification or revocation as necessary or appropriate for the public interest or the protection of investors.

If you have any questions regarding this letter, please call me at (202) 551-5525, Tom McGowan at (202) 551-5521, Randall Roy at (202) 551-5522, or Raymond Lombardo at (202) 551-5755.

Sincerely,



Michael A. Macchiaroli  
Associate Director



*Invested in America*

May 31, 2016

Mr. Stephen Luparello  
Director, Division of Trading and Markets  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

Re: Regulatory capital consequences resulting from the Financial Accounting Standards Board's *Accounting Standards Update No. 2016-02, Leases (Topic 842)*.

Dear Mr. Luparello:

The Capital Steering Committee and other member firms of the Securities Industry and Financial Markets Association (SIFMA)<sup>1</sup> respectfully request that the staff of the Securities and Exchange Commission (the "Commission") issue an interpretation to correct the significant impact that the Financial Accounting Standards Board's ("FASB") recent publication of *Accounting Standards Update No. 2016-02, Leases (Topic 842) (Feb. 25, 2016)* would otherwise have on the net capital computations of broker-dealers.

The new accounting standard provides for the recognition of certain operating lease assets and liabilities on a lessee's balance sheet. Under the current lease accounting framework, capital leases are recognized as assets and liabilities on a lessee's balance sheet, but operating leases, regardless of term, are not. Under the new standard, for operating leases with a term greater than twelve months, lessees will be required to recognize (i) their obligations to make lease payments as a liability (the "lease liability"), initially measured at the present value of the lease payments, and (ii) their ability to use the leased property as a corresponding asset (a "right-of-use asset").

This change in the treatment of operating leases is purely a matter of accounting. That is, the new standard does not alter the economic or legal characteristics of these leases. Further, in adopting the standard, FASB was not intending to alter the manner in which broker-dealers computed their net capital; this was simply an unintended consequence of the manner in which FASB's and the Commission's rules interact. Accordingly, there is no reason for the new standard to impact a broker-dealer's net capital as computed pursuant to Rule 15c3-1 under the Securities Exchange

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<sup>1</sup>SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit [www.sifma.org](http://www.sifma.org).

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Act. However, absent regulatory relief, the new accounting standard will reduce firms' net capital and excess net capital, potentially by very material amounts.

We first note that recognizing the lease liability and the right-of-use asset on a broker-dealer's balance sheet will not have any inherent effect on a broker-dealer's GAAP equity (as the amounts will offset for this purpose). However, because a right-of-use asset would not currently be considered an allowable asset under the net capital rule, it cannot be used to offset a lease liability for purposes of the computation of net capital, so the lease liability would diminish net capital and that liability would not be offset by a right-of-use asset. In addition, broker-dealers using the aggregate indebtedness ("AI") method in computing their net capital requirement would be required to include the lease liability in their calculation of capital requirements.

The reduction in broker-dealer's regulatory capital, and the increase in capital requirements for an AI firm, due to the change in the lease accounting standard is quite significant. SIFMA has conducted a preliminary survey of twenty-two (22) broker-dealers with diverse business models (e.g. large banks, foreign banks, regional broker-dealers, introducing broker-dealers, on-line broker-dealers and asset managers). These 22 firms' initial estimates show an impact on their collective regulatory capital of \$9.8 billion, with a disproportionate amount of that impact (as a percentage of excess net capital) on regional, smaller and introducing broker-dealers. There is also likely to be a disproportionate impact on firms that maintain multiple retail locations and that provide services to retail customers. Our preliminary estimate for these 22 firms does not include the impact of "in substance fixed lease payments"<sup>2</sup> which also will be brought on to the broker-dealers balance sheets.<sup>3</sup>

To preserve the existing regulatory capital treatment of operating leases, we request that the Commission's staff issue an interpretation stating that the right-of-use asset arising from operating leases is considered to be an allowable asset under Rule 15c3-1 equal to the firm's lease liability for operating leases. In other words, if the right-of-use asset for operating leases exceeds the lease liability, any such excess right-of-use asset value would be treated as a non-allowable asset. If the operating lease's right-of-use asset value is equal to or less than the operating lease liability, there would be no deduction from (or addition to) net capital. Moreover, we request that firms computing net capital under the AI method be permitted to exclude lease liabilities for operating leases in the determination of their net capital treatment. The relief we are requesting effectively preserves the existing regulatory capital treatment of operating leases under Rule 15c3-1.<sup>4</sup>

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<sup>2</sup> The accounting guidance stipulates that lease payments include "in substance fixed lease payments", when the payments are economically indistinguishable from lease payments.

<sup>3</sup> Two (2) firms separately provided the impact of their "in substance fixed lease payments" and the impact changed from a minimal impact to between 10-30% of their excess net capital.

<sup>4</sup> For the same reasons that FASB's accounting update should not change broker-dealers' calculation of net capital, it also should not affect firms' calculation of their leverage ratios under FINRA 10-44 *New Alert - Reporting Criterion for Leverage in FOCUS Report* or under the Commission's anticipated rulemaking related to leverage ratios.

We believe this relief is necessary because the existing regulatory capital requirements were designed to be sufficient under the existing lease accounting standard, and the new accounting standard does not alter the legal or economic reality, but merely modifies the manner in which operating lease assets and liabilities are presented in an entity's financial statements. The new accounting standard does not affect a broker-dealers' economic position; therefore, the change in the recognition of operating leases should not change the amount of net capital requirements for broker-dealers.

We also emphasize that the securities industry is of the view that material changes to net capital requirements under Rule 15c3-1 should be effected only through the Commission's formal rulemaking process.

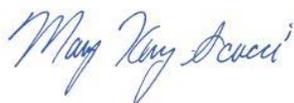
Accordingly, we request the Commission's staff issue the following interpretation:

To the extent that operating leases are required to be recognized on balance sheet pursuant to *Accounting Standards Update No. 2016-02, Leases (Topic 842)*, a broker-dealer may treat the right-of-use assets as allowable assets equal to the amount of the lease liabilities that are recorded under ASU No #2016-02. Firms calculating capital under the Aggregate Indebtedness Standard may exclude lease liabilities under operating leases.

Respectfully we urge the Commission's staff to act on this request on an expedited basis due to the very significant regulatory capital impact this accounting change would otherwise impose on broker-dealers, and the need for firms to commence strategic planning initiatives to modify their business models and lease agreements absent immediate regulatory guidance. This new lease accounting standard is effective for fiscal years beginning after December 15, 2018 for public business entities, with an early application permitted for all entities. We are concerned that broker-dealers may inadvertently be impacted if a parent company decides to elect an early adoption.

Thank you for this opportunity to provide you with the industry's concerns regarding the consequences of the new lease accounting standard. SIFMA's Capital Steering Committee and other impacted member firms would be pleased to discuss our views with the Commission or provide any additional information needed to receive this regulatory relief. Please contact me at 212-313-1331 if you have questions concerning our letter.

Regards,

A handwritten signature in blue ink that reads "Mary Kay Scucci".

Mary Kay Scucci, PhD, CPA  
Managing Director  
SIFMA

cc:

Securities and Exchange Commission

Gary Barnett - Deputy Director, Division of Trading & Markets

Michael Macchiaroli - Associate Director, Division of Trading & Markets

Thomas McGowan, - Associate Director, Division of Trading & Markets

Randall Roy - Deputy Associate Director, Division of Trading & Markets

Michelle Danis - Assistant Director, Risk Supervised Broker-Dealer Program, Division of Trading & Markets

FINRA

William Wollman, Executive Vice President, Member Regulation – Risk Oversight & Operational Regulation

Kris Daily, Vice President, Risk Oversight & Operational Regulation