



DIVISION OF
TRADING AND MARKETS

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

October 23, 2018

Mary Kay Scucci, PhD, CPA
Managing Director
SIFMA
120 Broadway, 35th 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 requested 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”)¹ if a broker-dealer treats the asset and liability arising from an operating lease in the manner described below.²

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”).³ 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.

¹ See 17 CFR 240.15c3-1.

² In a letter dated November 8, 2016, the Division advised that it would 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, subject to certain conditions set forth in the letter. See Letter to Mary Kay Scucci, Managing Director, SIFMA, from Michael A. Macchiaroli, Associate Director, Division, Commission (Nov. 8, 2016) (the “November 2016 Letter”). The Division is withdrawing the November 2016 Letter and issuing this letter in its place.

³ See FASB ASU No. 2016-02, Leases (Topic 842).

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.⁴ Among these adjustments, a broker-dealer must deduct from net worth any asset that is not readily convertible into cash (a non-allowable asset).⁵ Further, under Rule 15c3-1, a broker-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.⁶ 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).⁷

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. 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; and the amount of the asset as to each lease may not exceed the liability of the balance sheet arising from that lease.

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

⁴ See 17 CFR 240.15c3-1(c)(2).

⁵ See 17 CFR 240.15c3-1(c)(2)(iv).

⁶ See 17 CFR 240.15c3-1(a)(1)(i)-(ii).

⁷ See 17 CFR 240.15c3-1(a)(1)(i).

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 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 staff'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.

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