

**Securities Industry Association**

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Associate Director
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Securities and Exchange Commission
450 Fifth Street, NW
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Dear Sirs:

The purpose of this letter is to summarize our understandings with respect to the application of Statement of Financial Accounting Standards ("SFAS") No. 125 in the preparation of the Financial and Operational Combined Uniform Single ("FOCUS") Report and in the computation of net capital and reserve requirements under Securities and Exchange Commission ("SEC") Rule 15c33. As you are aware, this letter reflects the consensus view of the Securities Industry Association's ("SIA") Capital Committee.

Background

In June 1996, the Financial Accounting Standards Board ("FASB") adopted SFAS 125, the subjects of which are the accounting for transfers and servicing of financial assets and the extinguishment of liabilities. SFAS 125 is to be effective for relevant transactions occurring after December 31, 1997; as of the current date, the FASB is finalizing its interpretative guidance with respect to SFAS 125.

While it is difficult to summarize SFAS 125 within a few paragraphs, an important aspect of the standard is to revise the terms under which certain assets and liabilities are classified for purposes of presenting a statement of financial condition. These revisions could lead to classifying as inventory what had historically been treated as a financing position (and vice versa) and adding to assets and liabilities collateral heretofore excluded altogether from the statement of financial condition.

Amending the FOCUS Report to Reflect SFAS 125

In discussions between the SIA's Capital Committee and representatives of the New York Stock Exchange ("NYSE") and the Securities and Exchange Commission ("SEC"), we all had concluded that:

1. Assets and liabilities as cast under current generally accepted accounting principles ("GAAP"), absent the application of SFAS 125, were the appropriate bases upon which to continue to apply SEC Rules 15c31 (Net Capital Requirements for Brokers or Dealers) and 15c33 (Customer Protection Reserves and Custody of Securities);
2. Following from (i) above, a FOCUS report filing should include information adequate for the NYSE and the SEC to derive a statement of financial condition (pages 1 through 4 of the FOCUS report) determined on the same bases as the computation of net capital (page 5 of the FOCUS report), the computation of the basic or alternate net capital requirement for brokerdealers under Rule 15c33 (pages 8 and 9 of the FOCUS report);
3. Committee members hold no strong preference with respect to accomplishing (ii) above; at the preference of the NYSE and the SEC, broker/dealers would either (a) prepare a FOCUS report under GAAP (including SFAS 125) and provide on a separate schedule the data, or entries, necessary to derive a statement of financial condition as prepared currently or (b) vice versa; with either (a) or (b), the broker/dealer would provide essentially the same reconciling schedule;
4. Until there develops a common practice with respect to the application of SFAS 125, broker/dealers would record the inclusion of assets the result of the application of SFAS 125 on line 15D (or line 930) and liabilities the result of the application of SFAS 125 on line 23F (or 1680);
5. Once common practice is established, the Capital Committee will work with the NYSE and the SEC to amend the statement of financial condition and/or develop a formal reconciliation schedule to be included as a part of the amended FOCUS report.

Examples of Reconciling Data to be Provided to the NYSE and the SEC

Below are two examples of transactions which would require the broker/dealer to provide the NYSE and SEC with reconciling data:

1. To post collateral (heretofore excluded from the statement of financial condition) with a value of \$1,000,000
2. To reclassify long government inventory as a financing transaction, in the amount of \$2,000,000

If the FOCUS statement of financial condition were prepared as it is currently, the posting and reclassification entries would be as follows:

- i. Debit line 15D \$1,000,000 (representing collateral held)
Credit line 23F \$1,000,000 (representing collateral owed to a counterpart)
- ii. Debit line 15D \$2,000,000 (representing reclassification of inventory as a receivable)
Credit line 7B \$2,000,000 (representing reclassification of inventory as a receivable)

The Capital Committee does not envision making such entries as above by transaction, but,

rather, the Capital Committee would propose that such data be provided by type of posting or reclassification.

Please call at your earliest convenience to indicate when a meeting with the Capital Committee, or certain members thereof, would be convenient to you. I will forward a copy of this letter to George Kramer of the SIA for circulation to the members of the Capital Committee's Steering Committee and another copy to Paul Bjarnason of the Commodity Futures Trading Commission. Should you have any questions or comments, please do not hesitate to call.

Very truly yours,

Mark Halloway
Chairman, SIA Capital Committee

cc:
Paul Bjarnason, Commodity Futures Trading Commission
George Kramer, SIA