



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)¹ 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

¹SIFMA 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.

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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"² which also will be brought on to the broker-dealers balance sheets.³

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 15c3-1.⁴

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

³ 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.

⁴ 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". The signature is fluid and cursive, with the first name "Mary" and last name "Scucci" clearly legible.

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

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