



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Swap Dealer and
Intermediary Oversight

CFTC Letter No. 18-19
No-Action
August 13, 2018
Division of Swap Dealer and Intermediary Oversight

Ms. Mary Kay Scucci
Managing Director
Securities Industry and Financial Markets Association
120 Broadway
New York, NY 10271

Ms. Allison Lurton
Senior Vice President and General Counsel
Futures Industry Association
2001 Pennsylvania Avenue, NW
Washington, DC 20006

Ms. Melinda Schramm
Chairman
National Introducing Brokers Association
55 West Monroe
Chicago, IL 60603

Re: Commission Regulation 1.17 – Staff No-Action Position Regarding the Treatment of Operating Leases Caused by a Change in Accounting Principles

Dear Ms. Scucci, Ms. Lurton and Ms. Schramm:

This responds to your letters dated February 8, 2018 and March 14, 2018 to the Division of Swap Dealer and Intermediary Oversight (“DSIO”) of the Commodity Futures Trading Commission (“Commission”). You submitted your letters on behalf of the Capital Steering Committee of the Securities Industry and Financial Markets Association (“SIFMA”), the Financial Management Committee of the Futures Industry Association (“FIA”) and the National Introducing Brokers Association (“NIBA”). By your letters, you request confirmation that DSIO staff will not recommend an enforcement action to the Commission if a futures commission

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merchant (“FCM”), retail foreign exchange dealer (“RFED”) or an introducing broker (“IB”) (collectively, “Commission Registrant”), in computing its adjusted net capital under Regulation 1.17,¹ treats the asset and liability arising from an operating lease in the manner described below.²

Based upon the representations in your letters, we understand that the following facts are relevant to your request. Currently, generally accepted accounting principles (“GAAP”) do not require a lessee, including a Commission Registrant, to include an asset or liability on its balance sheet with respect to an operating lease.³ The Financial Accounting Standards Board (“FASB”), however, issued an Accounting Standards Update for Leases on February 25, 2016 (“Lease Accounting Update”).⁴ The Lease Accounting Update will change the treatment for operating leases under GAAP by requiring a lessee, including a Commission Registrant, to include on its balance sheet an asset and a liability arising from the operating lease. Generally, the amount of the lease asset and liability will be calculated as the present value of unpaid lease payments and 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. 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.

Regulation 1.17 requires Commission Registrants to compute their adjusted net capital by determining their assets and liabilities under GAAP and then making certain adjustments to account for assets that are non-current or otherwise non-allowable (e.g., assets that are not reasonably expected to be realized in cash or sold during the next 12 months), as well as to adjust the assets for market risk and credit risk.⁵ Under Regulation 1.17(c)(2), an operating lease asset would be a non-current or non-allowable asset and, therefore, a Commission Registrant would need to deduct the asset from its current assets when computing its adjusted net capital. The operating lease liability, however, is required to be deducted from current assets under Regulation 1.17(c)(4) and, therefore, a Commission Registrant would need to deduct it from its current assets when computing its adjusted net capital. Accordingly, the implementation of the Lease Accounting Update would result in a decrease in regulatory capital as compared to the current accounting treatment.

The Lease Accounting Update will also impact Commission Registrants that are SEC registered broker-dealers. Commission Registrants that are broker-dealers are required to

¹ Commission regulations are found at 17 CFR Ch. 1.

² Introducing brokers that operate pursuant to guarantee agreements with FCMs are not subject to the capital requirements set forth in Regulation 1.17 and, therefore, are not Commission Registrants as discussed in this letter. See Regulation 1.17(a)(2)(ii).

³ Future commitments under operating leases are disclosed in the footnotes to the financial statements, but not capitalized, under current accounting principles.

⁴ See FASB ASU No. 2016-02, Leases (Topic 842).

⁵ See 17 CFR 1.17(c).

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maintain adjusted net capital that is equal to or in excess of the amount of adjusted net capital computed under Regulation 1.17 or the amount of net capital required by SEC Rule 15c3-1(a).⁶ SEC Rule 15c3-1 treats operating lease assets as non-allowable assets for purposes of computing net capital. SEC Rule 15c3-1 also would require a broker-dealer that determines its minimum net capital requirement under the aggregated indebtedness standard (“AI Standard”) to include operating lease liabilities in its aggregate indebtedness.⁷

To preserve the existing regulatory capital treatment of operating leases, you request relief to allow a Commission Registrant, in computing its adjusted net capital, to include an operating lease asset as a current asset under Regulation 1.17 in an amount not greater than the Commission Registrant’s operating lease liability for that operating lease. You also request relief to allow Commission Registrants that are SEC registered broker-dealers to include operating lease assets as an allowable asset. You further request relief to provide that Commission Registrants that compute their minimum capital under the AI Standard may exclude operating lease liabilities from their aggregate indebtedness.

In support of your request, you represent that the Lease Accounting Update is purely a matter of accounting that does not alter the existing 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. You further note that FASB was not intending to alter the manner in which Commission Registrants compute their regulatory capital in adopting the Lease Accounting Update. Rather, you state that the impact on the capital computation of Commission Registrants was simply an unintended consequence of the manner in which FASB’s and Commission’s regulations interact. In further support of your request, you note that the SEC staff issued a no-action letter addressing the Lease Accounting Update and providing that staff would not recommend an enforcement action if a broker-dealer, in computing net capital, added back an operating lease asset to the extent of the associated operating lease liability.⁸ SEC staff further provided that it would not recommend an enforcement action if a broker-dealer determining its minimum net capital requirement under the AI Standard excluded from its aggregate indebtedness the amount of an operating lease liability to the extent of the associated operating lease asset.⁹

Based on the facts and representations set forth in your letters and discussions with DSIO staff as collectively set forth in this letter, DSIO will not recommend enforcement action to the Commission under Regulation 1.17 if a Commission Registrant in computing its adjusted net capital under Regulation 1.17, or its net capital under SEC Rule 15c3-1 for dual-registrants, adds

⁶ Regulation 1.17(a)(1)(i) and (iii).

⁷ Under the AI standard, the amount of all liabilities of the broker-dealer that counts toward aggregate indebtedness cannot be more than 1500% of the firm’s net capital. *See* 17 CFR 240.15c3-1(a)(1)(i).

⁸ *See* Securities Industry and Financial Markets Association (SEC No-Act, November 8, 2016).

⁹ *Id.*

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back an operating lease asset to the extent of the associated operating lease liability recorded on the balance sheet. A Commission Registrant 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 value of the operating lease as to each lease may not exceed the liability on the balance sheet arising from that lease.

Further, based on the facts and representations set forth in your letters and discussions with the DSIO staff as collectively set forth in this letter, DSIO will not recommend enforcement action to the Commission under Regulation 1.17 if a Commission Registrant, that is also a securities broker-dealer, in 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 Commission Registrant's aggregate indebtedness. A Commission Registrant 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 Commission Registrant add back combined or aggregated operating lease assets to offset combined or aggregated operating lease liabilities.

This letter, and the position taken herein, are based upon the representations made to us and are subject to compliance with the conditions stated above. Any different, changed or omitted material facts or circumstances might require DSIO to reach a different conclusion and render this letter void. You must notify DSIO immediately in the event there is any change to the facts presented to the Division. This letter does not provide no-action relief from any provision of Regulation 1.17 except as specifically noted above, or from any other applicable requirements in the Commodity Exchange Act or in the Regulations issued thereunder. Further, this letter represents the position of the Division only and does not necessarily represent the views of the Commission or of any other division or office of the Commission. Finally, this letter does not create or confer any rights for or obligations on any person or persons subject to compliance with the Commodity Exchange Act that bind the Commission or any of its other offices or divisions.

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If you have any questions concerning this correspondence, please feel free to contact Mark Bretscher, Special Counsel at 312-596-0529.

Sincerely,

Thomas Smith
Deputy Director