NET CAPITAL REQUIREMENTS FOR BROKERS OR DEALERS
SEA Rule 15c3-1

(a) NET CAPITAL REQUIREMENTS FOR BROKERS OR DEALERS

Every broker or dealer must at all times have and maintain net capital no less than the greater of the highest minimum requirement applicable to its ratio requirement under paragraph (a)(1) of this section, or to any of its activities under paragraph (a)(2) of this section, and must otherwise not be "insolvent" as that term is defined in paragraph (c)(16) of this section.

/001 Moment to Moment Net Capital

Broker-dealers must maintain sufficient net capital at all times prior to, during and after purchasing or selling proprietary securities. Broker-dealers must have at all times (including intraday) sufficient net capital to meet the haircut requirements of the Capital Rule before taking on any new proprietary positions, even if the intention of the firm is to liquidate or cover the positions before the end of the same day. Broker-dealers are expected to be able to demonstrate moment to moment compliance with the Capital Rule.

(SEC Staff to NYSE) (No. 99-8, August 1999)

/01 Additional Net Capital Requirement

The net capital requirement is increased by one percent of accrued liabilities that are excluded from aggregate indebtedness under the provisions specified in interpretation 15c3-1(c)(2)(iv)(C)/095.

(SEC Letter to NASD, July 24, 1984) (No. 87-6, May 1987)
(SEC Staff to FINRA) (FINRA Regulatory Notice 21-27)

/02 Consolidations, Minimum Net Capital Requirement

The minimum net capital requirement of the consolidated entity is determined by adding the amount of net capital required for compliance by each consolidated subsidiary subject to the Rule to the minimum dollar net capital requirement of the parent broker-dealer.

See Appendix C interpretation 15c3-1c(c)/022.

(SEC Staff to NYSE)

(c)(1) DEFINITIONS; AGGREGATE INDEBTEDNESS (continued)

/08 Drafts for Immediate Credit

The immediate credit proceeds advanced on drafts with securities attached deposited for collection are included in aggregate indebtedness unless they are collateralized by securities owned (and which have not been sold) by the broker-dealer or by securities collateralizing a secured demand note pursuant to Appendix D. (See interpretation 15c3-1(c)(1)/03.)

(SEC Staff to NYSE) (No. 76-4, April 1976)

/09 Intercompany Accounts with Subsidiaries

An unsubordinated amount payable to a subsidiary is Aggregate Indebtedness of the parent.

An unsubordinated amount payable to a parent is Aggregate Indebtedness of the subsidiary.

The above apply when there is no consolidation of assets and liabilities for Net Capital purposes as stipulated in Appendix C to SEA Rule 15c3-1.

(Also, see Certain Receivables under interpretation 15c3-1(c)(2)(iv)(C)/07.)

(SEC Staff to NYSE) (No. 79-4, March 1979)

/10 Unsecured Receivables and Payable With the Same Party

See other deductions under interpretation 15c3-1(c)(2)(iv)(E)/04.

(SEC Staff to NYSE) (No. 82-2, April 1982)

/11 Accrued Liability for Concessions or Commissions Payable

That portion of such accrued liabilities that are payable more than twelve months from the computation date may be excluded from aggregate indebtedness under the provisions specified at interpretation 15c3-1(c)(2)(iv)(C)/095.

(SEC Letter to NASD, July 24, 1984) (No. 87-6, May 1987)
(SEC Staff to FINRA) (FINRA Regulatory Notice 21-27)

(c)(1) DEFINITIONS; AGGREGATE INDEBTEDNESS (continued)

/26 Fines and Other Monetary Penalties Assessed by a Governmental Agency or Self-Regulatory Organization

A fine, an order to pay restitution or similar penalty imposed by a governmental agency or self-regulatory organization ("fine"), at a minimum, shall be treated as a contingent liability of the broker-dealer and included in the computation of aggregate indebtedness at the time such fine is imposed.

In addition, under Generally Accepted Accounting Principles (GAAP), broker-dealers have an ongoing obligation to assess the specific facts applicable to each pending or decided matter that may result or has resulted in the imposition of a fine and to make a determination as to whether an actual liability must be recorded in the financial statements.

In any event, once all available appeals or other remedies have been exhausted, the broker-dealer must record the full amount of the fine as a liability in its financial statements.

Note: This interpretation does not apply to adverse awards resulting from arbitration proceedings or adverse court judgments. See interpretations 15c3-1(c)(1)/14 (Adverse Award in an Arbitration Proceeding) and 15c3-1(c)(1)/16 (Court Judgment Rendered Against a Broker-Dealer) for the applicable Net Capital treatment in such instances.

(SEC Staff to FINRA) (FINRA Regulatory Notice 13-44)

(NEXT PAGE IS 180)

(c)(1) DEFINITIONS; EXCLUSIONS FROM AGGREGATE INDEBTEDNESS

(i) Indebtedness adequately collateralized by securities which are carried long by the broker or dealer and which have not been sold or by securities which collateralize a secured demand note pursuant to Appendix (D) to this section, 17 CFR 240.15c3-1d; indebtedness adequately collateralized by spot commodities which are carried long by the broker or dealer and which have not been sold; or, until October 1, 1976, indebtedness adequately collateralized by municipal securities outstanding for not more than one business day and offset by municipal securities failed to deliver of the same issue and quantity, where such indebtedness is incurred by a broker or dealer effecting transactions solely in municipal securities who is either registered with the Commission or temporarily exempt from such registration pursuant to 17 CFR 240.15a-1(T) or 17 CFR 240.15Ba2-3(T);

/01 Commingled and Inadequately Secured Loans

Commingled bank loans and inadequately secured firm bank loans are treated as follows:

- If a bank loan which has been arranged as a customer loan contains securities other than customers' securities, the entire bank loan should be treated as aggregate indebtedness.

- If the bank loan contains any non-exempted securities (until June 1, 1976, other than municipals), the 4% option set forth in subparagraph (c)(2)(xiii) is not available.

- If a bank loan which has been arranged as a firm loan contains non-firm (customers' and/or "non-customers'") securities, the amount of the bank loan should be prorated based upon the loan value of the collateral and the prorated amounts treated in accordance with the pertinent provisions of SEA Rule 15c3-1, as either:

  a) excluded from aggregate indebtedness;

  b) included in aggregate indebtedness; or

  c) if appropriate, as eligible for the 4% option set forth in subparagraph (c)(2)(xiii).

The following formula is used for pro-ration:

$$\text{Amount includable in aggregate indebtedness (or eligible for 4\% option)} = \text{Amount borrowed} \times \frac{\text{loan value of non-firm collateral}}{\text{loan value of all collateral}}$$

(c)(1)(i) DEFINITIONS; EXCLUSIONS FROM AGGREGATE INDEBTEDNESS (continued)

/01 Commingled and Inadequately Secured Loans (continued)

For example, assume that the amount borrowed is $1,000,000; that firm collateral market value is $2,000,000; that non-firm collateral market value is $1,000,000; and that the broker can borrow 50% on firm collateral and 80% on non-firm collateral.

$$\text{Amount includable in aggregate indebtedness} = \frac{\$1{,}000{,}000 \times 80\% \text{ of } \$1{,}000{,}000}{80\% \text{ of } \$1{,}000{,}000 + 50\% \text{ of } \$2{,}000{,}000}$$

$$= \$444{,}444$$

If a bank loan which has been arranged as a firm loan contains firm securities only but is not "adequately secured", the amount of the bank loan should be prorated between adequately secured and unsecured based upon the loan value of the collateral and the prorated amounts treated in accordance with the pertinent provisions of SEA Rule 15c3-1, as either excluded from, or included in, aggregate indebtedness.

Notes: The terms "non-customer" and "adequately secured" are defined in the rule.

Securities that are the subject of satisfactory subordination agreements are considered firm securities for purposes of these interpretations.

(SEC Staff to NYSE)

(c)(1)(i) DEFINITIONS; EXCLUSIONS FROM AGGREGATE INDEBTEDNESS (continued)

/02 Indebtedness in the Proprietary Trading Account of a Broker-Dealer

When a broker-dealer has a proprietary trading account carried by another broker-dealer, indebtedness in such account is considered "adequately collateralized" if the broker-dealer's equity in such account is at least equal to the haircut requirements specified in SEA Rules 15c3-1(c)(2)(vi) and (vii) on the positions in such account. If the proprietary trading account is not adequately collateralized (i.e., the equity in the account is less than the haircuts required on the positions), the excess of the haircut amount over the equity in the account, up to the amount of the indebtedness, shall be included as aggregate indebtedness. The remainder of the indebtedness may be considered adequately collateralized and may be excluded from aggregate indebtedness.

Example: A broker-dealer has incurred $100,000 of indebtedness in a proprietary trading account carried by another broker. The account also contains $100,000 of marketable equity securities and $50,000 of non-marketable securities. In this case, the firm's equity in the account is $50,000, and the SEA Rule 15c3-1(c)(2)(vi) and (vii) haircut requirements on the positions in the account are $65,000 (15% of $100,000 and 100% of $50,000). Since the firm's equity is less than the haircut requirements, the indebtedness is not adequately collateralized. The firm must include the amount by which the haircuts on the positions exceed the equity in the account (i.e., $15,000) in aggregate indebtedness. The remainder of the indebtedness (i.e., $85,000) may be excluded from aggregate indebtedness.

(SEC Staff to FINRA) (FINRA Regulatory Notice 21-27)

(c)(2)(i) DEFINITIONS; NET CAPITAL: ADJUSTMENTS TO NET WORTH RELATED TO UNREALIZED PROFIT OR LOSS, DEFERRED TAX PROVISIONS, AND CERTAIN LIABILITIES (continued)

(E) Adding to net worth any actual tax liability related to income accrued which is directly related to an asset otherwise deducted pursuant to this section.

/01 Add-Back to Net Worth of Deferred Tax Liabilities Directly Related to Certain Non-Allowable Assets

A broker-dealer may add-back to net worth the amount of its deferred tax liabilities which are directly related to the following non-allowable assets:

- Software assets capitalizing certain costs associated with internal software development;
- Prepaid advertising; and
- Distribution network and prepaid selling commission.

(SEC Letter to Charles Schwab & Co., Inc., October 25, 1999)
(SEC Letter to Advanced Clearing, Inc., October 25, 1999) (No. 01-3, March 2001)
(SEC Letter to John Hancock Funds, LLC, December 12, 2006) (No. 07-4, April 2007)

(F) Subtracting from net worth any liability or expense relating to the business of the broker or dealer for which a third party has assumed the responsibility, unless the broker or dealer can demonstrate that the third party has adequate resources independent of the broker or dealer to pay the liability or expense.

(G) Subtracting from net worth any contribution of capital to the broker or dealer:

(1) Under an agreement that provides the investor with the option to withdraw the capital; or

(2) That is intended to be withdrawn within a period of one year of contribution. Any withdrawal of capital made within one year of its contribution is deemed to have been intended to be withdrawn within a period of one year, unless the withdrawal has been approved in writing by the Examining Authority for the broker or dealer.

(c)(2)(i)(G) DEFINITIONS; NET CAPITAL: ADJUSTMENTS TO NET WORTH RELATED TO UNREALIZED PROFIT OR LOSS, DEFERRED TAX PROVISIONS, AND CERTAIN LIABILITIES (continued)

/01 Services Arrangement with a Parent or an Affiliate

Any payment made by a broker-dealer, directly or indirectly, to its parent or an affiliate, in connection with an arrangement whereby the parent or affiliate provides services to the broker-dealer ("services arrangement") shall be considered a capital withdrawal for purposes of SEA Rules 15c3-1(c)(2)(i)(G) and 15c3-1(e), unless the broker-dealer demonstrates that the following conditions are met:

1. at the time the service(s) were provided to the broker-dealer, the services arrangement was in writing and specified such service(s) with a reasonable and consistent basis for determining the cost of each service (e.g., utilizing a percentage of the broker-dealer's net income to determine the cost to be charged by a parent or affiliate for technology services provided by a parent or affiliate, for example, may not be deemed "a reasonable basis" because the cost of obtaining such services generally does not fluctuate based on the level of a broker-dealer's net income);

2. the service(s) provided were related to the broker-dealer's business;

3. the parent or affiliate had the ability to provide such service(s); and

4. the parent or affiliate provided the service(s).

For purposes of this interpretation, "payment" shall include any reduction or forgiveness of a receivable from the broker-dealer's parent or affiliate.

(SEC Staff to FINRA) (FINRA Regulatory Notice 21-27)

(NEXT PAGE IS 241)

(c)(2)(iv)(B) DEFINITIONS; NET CAPITAL: ASSETS NOT READILY CONVERTIBLE INTO CASH (continued)

/14 Customer Deficits in Listed Currency Options Secured by Letters of Credit

A letter of credit received from a customer shall be recognized to the extent it covers the margin required by the Philadelphia Stock Exchange for listed currency options. A liquidating deficit on the basis of not allowing value for the letter of credit must be deducted in computing net capital and the account treated as a partly secured account.

(SEC Staff to NYSE) (No. 93-6, November 1993)

/15 Ownership of Collateral

In order for collateral to secure an otherwise non-allowable asset in conformity with the net capital rule, the collateral itself, among other things, must be an allowable asset under the rule. The securities collateralizing the receivable held by a firm must be in the bearer, nominee, or firm name to have value for net capital purposes. Securities that are registered in the name of a custodian, such as Depository Trust Company, or securities that have been forwarded to a transfer agent for transfer into the name of the firm, can be considered acceptable for purposes of securing a receivable, provided all required documentation for transfer have been forwarded with the securities.

(SEC Staff of DMR to NASD, December 1983)

/16 Deficits or Unsecured Balances in Securities Transactions with a Federal Reserve Bank

Deficits or unsecured balances in securities transactions with a Federal Reserve Bank need not be deducted in computing net capital under SEA Rule 15c3-1(c)(2)(iv)(B).

(SEC Staff to FINRA) (FINRA Regulatory Notice 21-27)

(c)(2)(iv)(C) DEFINITIONS; NET CAPITAL: ASSETS NOT READILY CONVERTIBLE INTO CASH (continued)

/09 Commissions or Concessions Receivable versus Commissions or Concessions Payable - Rescinded (FINRA Regulatory Notice 21-27)

/091 Concessions Receivable from Individual Variable Annuities are Allowable for 30 Days; from Group Variable Annuities an Offset is Permitted

The staff of the SEC's Division of Market Regulation has concluded that since *individual* variable annuity products are registered under the Investment Company Act of 1940 ('40 Act), any concessions receivable therefrom come within the "...mutual fund concessions receivable and management fees receivable from registered investment companies..." language of SEA Rule 15c3-1(c)(2)(iv)(C). Therefore, a broker-dealer may give allowable asset treatment to concessions receivable from the sale of *individual* variable annuities for 30 days from the date they arise.

In contrast, *group* variable annuities are exempt from registration under the '40 Act; therefore, concessions receivable from the sale of these products are *not* allowable assets under SEA Rule 15c3-1(c)(2)(iv)(C). However, the staff of the SEC's Division of Market Regulation has no objection to member firms considering concessions receivable from the sale of group variable annuities as allowable assets if the member complies with interpretation 15c3-1(c)(2)(iv)(C)/095.

(SEC Staff of DMR to NASD, May 1999)
(SEC Staff to FINRA) (FINRA Regulatory Notice 21-27)

/092 Concessions Receivable, Offset Not Permitted with Payables of a Particular Program or Syndication

The permissible offset between concessions receivable and related commissions payable pursuant to *NASD Notices to Members 84-48* and *85-5* may not be extended to payables related to sales of a particular program or syndication. For example, a broker may not offset concessions receivable against legal fees payable.

(SEC Staff of DMR to NASD, April 1985)

(c)(2)(iv)(C) DEFINITIONS; NET CAPITAL: ASSETS NOT READILY CONVERTIBLE INTO CASH (continued)

/093 Distinction between Commission and Concession Receivable

A commission is generally considered to be a charge added to the gross price of securities purchased or deducted from the gross price of securities sold. A concession is an amount included in the gross price of the transaction that is retained by or payable to the broker-dealer executing the transaction. While a commission may occur in a retail transaction between a broker-dealer and a customer or between broker-dealers, a concession is more likely to occur between a broker-dealer and an issuer or another member of an underwriting group.

(SEC Staff to DMR to NASD, 1985)

/094 Concessions Receivable from a "Best Efforts" Offering, from Bank Escrow Agent

A broker-dealer shall receive allowable asset treatment for concessions receivable arising from a "best efforts" offering of securities in which an escrow account is utilized as required by SEA Rule 15c2-4, provided there is a written agreement between the bank escrow agent and the broker-dealer specifying that the bank escrow agent accepts responsibility *for direct* disbursement of the sales concessions due the broker-dealer.

(NASD Notice to Members 80-49, September 24, 1980)

(c)(2)(iv)(C) DEFINITIONS; NET CAPITAL: ASSETS NOT READILY CONVERTIBLE INTO CASH (continued)

/095 Unsecured Receivables and Related Payables

Instances arise where a broker-dealer accrues revenue in connection with the sale of products or for services it has provided and at the same time accrues expenses incurred as a result of selling such products or providing such services.

An unsecured amount receivable that results from the recording of such revenue need not be deducted from net worth to the extent the broker-dealer has also accrued a payable as the direct result of the expenses incurred in connection with such revenue, and:

1. A written contract exists between the broker-dealer and the payee, in which:

   a. The broker-dealer's liability for the amount payable is limited solely to the proceeds of the receivable; and

   b. The payee waives payment of the amount payable until the broker-dealer has received payment of the related amount receivable; and

2. If the broker-dealer is subject to the Aggregate Indebtedness Standard of paragraph (a)(1)(i),

   a. The portion of the payable due within twelve months is included in aggregate indebtedness; and

   b. The broker-dealer's net capital requirement shall be increased by an amount equal to one percent of the portion of the payable that was not included in aggregate indebtedness.

(SEC Staff to FINRA) (FINRA Regulatory Notice 21-27)

(c)(2)(viii)(C) DEFINITIONS; NET CAPITAL: OPEN CONTRACTUAL COMMITMENTS (continued)

/031 Underwriting Commitments

Where a firm commitment is contingent upon the effectiveness of a registration statement the appropriate deductions will apply when the registration becomes effective.

Where securities underwritten are not subject to registration requirements deductions will be applied when the broker or dealer is irrevocably committed to the underwriting.

(SEC Staff to NYSE) (No. 84-9, November 1984)

/032 Offsetting Sale Commitments in a Registered Offering

Underwriting commitments in a registered offering may be reduced by binding contracts for sale.

So called "indications of interest" received prior to the effectiveness of a registration statement are not binding contracts for sale. The Securities Act prohibits the sale of a security in a registered offering until the registration statement has become effective.

(SEC Letter to NYSE, November 18, 1983) (No. 84-9, November 1984)
(SEC Staff to FINRA) (FINRA Regulatory Notice 21-27)

/033 Offsetting Sale Commitments in an Unregistered Offering

Underwriting commitments in an unregistered offering may be reduced by binding contracts for sale, including bona fide presales.

A bona fide presale is a binding purchase commitment that is:

1. received by the broker-dealer prior to the effectiveness of its underwriting commitment; and

2. not subject to any conditions (other than the issuance of the securities) at the time the underwriting commitment becomes effective.

A bona fide presale may be evidenced in a variety of ways, including a written schedule of the bona fide presales, maintained by the broker-dealer as a record pursuant to SEA Rules 17a-3 and 17a-4.

Under the Securities Act, the sale of a security, which includes entry into a binding contract for sale, may be made without registration if the security is an exempted security or the transaction is exempt from registration.

(SEC Staff to FINRA) (FINRA Regulatory Notice 21-27)

(c)(2)(viii)(C) DEFINITIONS; NET CAPITAL: OPEN CONTRACTUAL COMMITMENTS (continued)

/04 Selling Group Participations

Haircuts need not be applied to best efforts selling group participations in firm commitment underwritings to the extent that the selling group member has an unconditional right evidenced by a written agreement with the underwriting participants to return any unsold securities.

Once the issue trades regular way, haircuts do not apply to unsold shares returned to the underwriter or participant no later than the settlement date of the issue.

$5,000 broker-dealers may not participate in firm commitment underwritings even on a best efforts basis.

(SEC Letter to NASD, December 15, 1976) (No. 83-2, April 1983)

/05 Removed (No. 97-5, September 1997)

/06 Underwriting Backstop Agreement

A member of an underwriting syndicate in a firm commitment underwriting (the "backstop recipient") is not required to take an open contractual commitment charge arising from its underwriting commitment if the backstop recipient enters into a written agreement with another syndicate member (the "backstop provider") that:

1. is executed and effective at or before the time the backstop recipient becomes obligated to the underwriting commitment;

2. requires the backstop provider to deduct in its net capital computation any applicable open contractual commitment charge that the backstop recipient would otherwise be required to take into account in its net capital computation; and

3. unequivocally requires the backstop provider to purchase any unsold securities allocated to the backstop recipient under the underwriting agreement.

The backstop provider and backstop recipient must comply with all other applicable laws, rules, and regulations of the Commission and any self-regulatory organization of which they are members.

(SEC Staff to FINRA) (FINRA Regulatory Notice 19-11)

(NEXT PAGE IS 671)

(e) LIMITATION ON WITHDRAWAL OF EQUITY CAPITAL (continued)

(4) MISCELLANEOUS PROVISIONS

(i) Excess net capital is that amount in excess of the amount required under paragraph (a). For the purposes of paragraphs (e)(1) and (e)(2), a broker or dealer may use the amount of excess net capital and deductions required under paragraphs (c)(2)(vi) and Appendix A of this section reported in its most recently required filed Form X-17A-5 for the purposes of calculating the effect of a projected withdrawal, advance or loan relative to excess net capital or deductions. The broker or dealer must assure itself that the excess net capital or the deductions reported on the most recently required filed Form X-17A-5 have not materially changed since the time such report was filed.

(ii) The term equity capital includes capital contributions by partners, par or stated value of capital stock, paid-in capital in excess of par, retained earnings or other capital accounts. The term equity capital does not include securities in the securities accounts or partners and balances in limited partners' capital accounts in excess of their stated capital contributions.

(iii) Paragraphs (e)(1) and (e)(2) of this section shall not preclude a broker or dealer from making required tax payments or preclude the payment to partners of reasonable compensation, and such payments shall not be included in the calculation of withdrawals, advances, or loans for purposes of paragraphs (e)(1) and (e)(2).

(iv) For the purposes of this paragraph (e), any transaction between a broker or dealer and stockholder, partner, sole proprietor, employee or affiliate that results in a diminution of the broker or dealer's net capital shall be deemed to be an advance or loan of net capital.

(e) LIMITATION ON WITHDRAWAL OF EQUITY CAPITAL (continued)

/01 Services Arrangement with a Parent or an Affiliate

Any payment made by a broker-dealer, directly or indirectly, to its parent or an affiliate, in connection with an arrangement whereby the parent or affiliate provides services to the broker-dealer ("services arrangement") shall be considered a capital withdrawal for purposes of SEA Rules 15c3-1(c)(2)(i)(G) and 15c3-1(e), unless the broker-dealer demonstrates that the following conditions are met:

1. at the time the service(s) were provided to the broker-dealer, the services arrangement was in writing and specified such service(s) with a reasonable and consistent basis for determining the cost of each service (e.g., utilizing a percentage of the broker-dealer's net income to determine the cost to be charged by a parent or affiliate for technology services provided by a parent or affiliate, for example, may not be deemed "a reasonable basis" because the cost of obtaining such services generally does not fluctuate based on the level of a broker-dealer's net income);

2. the service(s) provided were related to the broker-dealer's business;

3. the parent or affiliate had the ability to provide such service(s); and

4. the parent or affiliate provided the service(s).

For purposes of this interpretation, "payment" shall include any reduction or forgiveness of a receivable from the broker-dealer's parent or affiliate.

(SEC Staff to FINRA) (FINRA Regulatory Notice 21-27)

(NEXT PAGE IS 1001)

(a)(1) DEFINITIONS; CUSTOMER (continued)

/01 Customer/Non-Customer Classification (continued)

Non-Customer

- General partner;
- Director or principal officer, i.e., president, executive vice president, treasurer, secretary or any person performing a similar function;
- A broker or dealer (other than omnibus accounts);
- A non-bank registered municipal securities dealer;
- A bank municipal securities dealer that either does or does not transact its municipals securities business through a separately identified department or division, and either does or does not register as an undivided entity is a non-customer only with respect to its transactions effected in the capacity of a municipal securities dealer. All other transactions shall be treated as customer transactions;
- A foreign bank which engages in the business of buying and selling securities for its own account through a broker or otherwise within the meaning of Section 3(a)(5) of the Act (i.e., dealer), provided the foreign bank must not fall within the definition of "bank" set forth in Section 3(a)(6) of the Act (see interpretation 15c3-3(a)(1)/032). If the foreign bank falls within the definition of a bank, it is to be treated as a customer;
- The other participant(s)' interest in a joint trading and investment account carried on the books of the reporting broker-dealer and the other participant(s)' interest in a Joint Foreign and Domestic Arbitrage Account when such other participant(s) is a non-customer;
- The Federal Reserve Bank; and
- The proprietary account of a foreign broker-dealer would be treated as a non-customer.

(SEC Staff to FINRA) (FINRA Regulatory Notice 21-27)

(j)(2)(ii) TREATMENT OF FREE CREDIT BALANCES

(B) For any account:

(1) The broker or dealer provides the customer with the disclosures and notices regarding the Sweep Program required by each self-regulatory organization of which the broker or dealer is a member;

(2) The broker or dealer provides notice to the customer, as part of the customer's quarterly statement of account, that the balance in the bank deposit account or shares of the money market mutual fund in which the customer has a beneficial interest can be liquidated on the customer's order and the proceeds returned to the securities account or remitted to the customer; and

(3)(i) The broker or dealer provides the customer with written notice at least 30 calendar days before:

(A) Making changes to the terms and conditions of the Sweep Program;

(B) Making changes to the terms and conditions of a product currently available through the Sweep Program;

(C) Changing, adding or deleting products available through the Sweep Program; or

/01 Changing, Adding or Deleting Products Available Through a Sweep Program

For purposes of SEA Rule 15c3-3(j)(2)(ii)(B)(*3*)(*i*)(*C*), "changing, adding or deleting products available through the Sweep Program" includes changing, adding or deleting a money market mutual fund product or a bank in such Sweep Program, as applicable.

(SEC Staff to FINRA) (Regulatory Notice 21-27)

(D) Changing the customer's investment through the Sweep Program from one product to another.

(ii) The notice must describe the new terms and conditions of the Sweep Program or product or the new product, and the options available to the customer if the customer does not accept the new terms and conditions or product.

(NEXT PAGE IS 2501)

NOTES REGARDING THE CUSTOMER RESERVE BANK ACCOUNT COMPUTATION (continued)

Note E(5) (continued)

/02 Exclusion of Omnibus Accounts from the Requirements of Note E(5)

The term "omnibus account" in Note E(5) refers to an omnibus credit account maintained in compliance with the requirements of section 7(f) of Regulation T (12 CFR 220.7(f)). Omnibus credit under section 7(f) may only be extended to a broker-dealer registered under section 15 of the Exchange Act.

The exclusion of omnibus account from the requirements of Note E(5), therefore, is not available for accounts established for non-U.S. registered broker-dealers, nor for an account that is classified as a customer account under paragraph (a)(1) of Rule 15c3-3, because it contains assets of customers of a non-U.S. registered broker-dealer (sometimes referred to as a "single consolidated margin account").

(SEC Staff to FINRA) (FINRA Regulatory Notice 21-27)

(6) Debit balances in joint accounts, custodian accounts, participation in hedge funds or limited partnerships or similar type accounts or arrangements that include both assets of a person or persons who would be excluded from the definition of customer ("noncustomer") and assets of a person or persons who would be included in the definition of customer must be included in the Reserve Formula in the following manner: if the percentage ownership of the non-customer is less than 5 percent then the entire debit balance shall be included in the formula; if such percentage ownership is between 5 percent and 50 percent then the portion of the debit balance attributable to the non-customer must be excluded from the formula unless the broker or dealer can demonstrate that the debit balance is directly related to credit items in the formula; or if such percentage ownership is greater than 50 percent, then the entire debit balance must be excluded from the formula unless the broker or dealer can demonstrate that the debit balance is directly related to credit items in the formula.

/01 Netting of Same Customer's Balances – Rescinded (No. 04-3, June 2004)

/011 Netting of Same Customer's Balances

A short sale credit balance, other than a balance resulting from an open short versus the box position, may not be used for netting purposes with a debit balance with the same customer in arriving at the excludable debit balance portion from the reserve formula pursuant to Notes E(4), E(5), and E(6).

(SEC Staff to NYSE) (No. 04-3, June 2004)

RESERVE FORMULA (EXHIBIT A – GENERAL) (continued)

/012 Netting a Customer's Account Balances when Preparing the Reserve Formula Computation under the Alternative Standard

A broker-dealer that elects to be subject to the Alternative Standard of SEA Rule 15c3-1(a)(1)(ii) may use a customer's net account balance (i.e., net of cash account, margin account and bona fide short account), when preparing the weekly and month-end reserve formula computations under SEA Rule 15c3-3(Exhibit A).

When a customer's net account balance is used for the reserve formula computation, the broker-dealer must consider other requirements under SEA Rule 15c3-3(Exhibit A) where adjustments are required to be made in the reserve formula computation (e.g., interpretations 15c3-3(Exhibit A – General)/011 and 15c3-3(Exhibit A – Note E(6))/011).

Note: See interpretation 15c3-3(Exhibit A – General)/01 (Weekly Computation) for netting of customer account balances when preparing the reserve formula computation, for a broker-dealer that elects to be subject to the Aggregate Indebtedness Standard of SEA Rule 15c3-1(a)(1)(i).

(SEC Staff to FINRA) (FINRA Regulatory Notice 21-27)

/02 Annual Audit

Where the audit date may not fall on a date for which a computation would be required, the broker-dealer shall make a computation as of the audit date and shall make any required deposit within the time specified in the rule. For firms who compute weekly, this audit date computation will be in lieu of the normal computation required for that period. For firms who compute monthly, the audit date computation will be in lieu of any computation required for the calendar month within which the audit falls; provided, that when the audit date is not a month end date the subsequent computation must not be more than 40 calendar days from the date of the audit.

(SEC Letter to NASD, April 28, 1975)

RESERVE FORMULA (EXHIBIT A – GENERAL) (continued)

/03 Allocation

Responses to certain of the items contained in the computation may require the determination of an amount that relates to customer accounts, transactions, or activity undertaken to consummate customer transactions based on an allocation method. If it is impractical or unduly burdensome to determine which fail to receive contracts and fail to deliver contracts relate to customer accounts and which securities loaned and securities borrowed are for customer accounts, an appropriate allocation may be made on a conservative basis to accomplish maximum protection for customers. If an allocation is used with regard to the foregoing items, the broker or dealer should be able to demonstrate that the results so obtained regarding designations of customer versus proprietary or non-customer positions would be comparable to those which would be obtained if the respective positions had been developed without the use of an allocation.

(SEC Letter to NYSE, May 3, 1985)

/031 Allocation on Stock Borrow/Stock Loan – (Rescinded, No. 02-7, August 2002)

/032 Allocation on Stock Borrow/Stock Loan

If a market value allocation is used, the general ledger balances (contract value) of stock borrows and stock loans need to be reduced by the excess contract value over market value for only those items excluded from the reserve formula.

(SEC Staff to NYSE) (No. 02-7, August 2002)

/04 Making and Retaining a Record of Allocation

When an allocation is required to determine balances, positions or accounts allocable to customers, the broker-dealer shall make and maintain a record of each such allocation and preserve it in accordance with SEA Rule 17a-4.

(SEC Staff to NYSE)

/05 Repurchase, Reverse Repurchase and Matched Repurchase Agreement Transactions are Proprietary

These transactions shall be treated as proprietary transactions in the formula and allocated as such.

(SEC Staff to NYSE) (No. 78-1, May 1978)

RESERVE FORMULA (EXHIBIT A - ITEM 10); CUSTOMER DEBIT BALANCES (continued)

/06 Weekly Computation - Netting of Customers' Debit and Credit Balances

When net capital is computed under the basic method and customers' debit and credit balances are netted for the weekly formula computations (other than at month-end, see interpretation 15c3-3(Exhibit A - General)/01), a net debit balance shall be reduced (and a net credit balance at Item 1 of this formula computation shall be increased) by the amount determined at the prior month-end that reflected customers' credit and debit balances separately, for the following:

- The reduction required for customers' unsecured debits, accounts doubtful of collection [see (Exhibit A – General)/01)] and partly secured accounts (see Item 10 /012);
- The reduction required because deficits exist in special omnibus accounts or similar accounts [see Item 10 /013 and (Exhibit A - Note E)(2)];
- The reduction required because an account with a debit balance includes a participation interest of a "non-customer" [see (Exhibit A - Note E)(6)];
- The reduction required for household members and other persons related to principals or affiliated persons of the broker-dealer [see (Exhibit A - Note E)(4)];
- The reduction required because a single customer's debit balance exceeds 25% of the broker-dealer's tentative net capital [see (Exhibit A - Note E)(5)];
- The reduction required because of concentrated collateral for margin debits [see (Exhibit A - Note E)(1)]; and
- The 1% required reduction of aggregate debits [see (Exhibit A - Note E)(3)];

(SEC Staff to NYSE)

RESERVE FORMULA (EXHIBIT A - ITEM 10); CUSTOMER DEBIT BALANCES (continued)

/07 Debit Balances in Customers' Accounts Collateralized by Control or Restricted Securities

Debit balances in customers' accounts collateralized by control or restricted securities may only be included in the Reserve Formula computation to the extent they are secured by securities that can be publicly sold. Broker-dealers will bear the burden of proof in demonstrating that the control or restricted securities can be publicly sold. FINRA may require a legal opinion where the value of such securities is a material amount.

If an account is partially secured after the application of this interpretation, interpretation 15c3-3 (Exhibit A - Item 10)/012 (Partly Secured Accounts) should be applied to determine the includable amount of the debit balance in the Reserve Formula computation.

(SEC Staff to NYSE) (No. 92-1, January 1992)
(SEC Staff to FINRA) (FINRA Regulatory Notice 21-27)

/08 Customer Redemptions of Money Market Funds

Debit balances in customers' accounts arising from prepayments made by a broker-dealer on behalf of customers which are expected to be covered the next day upon settlement of such customers' redemptions, are treated as receivable from the fund and is not to be included as a debit in the Reserve Formula. This applies even if the broker-dealer maintains the money market fund position long in the customer's account, and the customer's account is credited for the redemption on settlement date. However, the debit may serve to reduce certain credit balances. (See interpretation 15c3-3(Exhibit A - Item 4)/08.)

The term "prepayments" would include the actual payment of funds to or on behalf of customers in the form of a check or wire (e.g., credit card charges or checks written by customers), which are covered by customers' instructions to redeem their money market fund position.

(SEC Staff to NYSE) (No. 92-13, December 1992)

/081 Netting of Money Market Fund Payables by Amounts Receivable from Money Market Funds

Money market fund payables resulting from customer purchases can be reduced by certain receivables from the same or different money market funds. A broker-dealer can net receivables and payables between the same family of money market funds, but cannot net receivables and payables between unrelated families of money market funds.

(SEC Staff to NYSE) (No. 02-7, August 2002)

/09 Credit Extended Upon Exercise of Employee Stock Option

When a broker-dealer exercises an employee stock option for a customer, it must have acknowledgement from the issuer that a freely transferable, readily salable and marketable security in negotiable form will be promptly delivered to the broker-dealer within 15 business days after exercise notice is given to the issuer (when acknowledgment is given by telephone, the condition should be restated in the transmittal to the issuer). The exercise shall be subject to the following:

1. When the security to be received from the exercise has been sold and is not received from the issuer within 15 business days after notice of exercise has been given, the position shall be subject to a cash margin deficiency charge computed without allowing any value for the security not received and is subject to the buy-in provisions under SEA Rule 15c3-3(m) unless an extension of time is requested and approved under SEA Rule 15c3-3 (n);

2. When the security to be received from the exercise has not been sold and is not received within 15 business days after notice of exercise has been given, any related debit balance shall be treated as an unsecured debit.

(SEC Staff to NYSE) (No. 96-3, April 1996)

/10 Term Debits in Customers' Accounts Collateralized by Securities Subject to Restrictions on Use

A margin debit balance in a customer account that is not payable on demand (a "term debit") may only be included in the Reserve Formula computation to the extent it is secured by securities that the broker-dealer carrying the account may use without restriction to obtain cash or funding while the term debit is outstanding.

If a term debit in an account is partially secured after the application of this interpretation, interpretation 15c3-3 (Exhibit A - Item 10)/012 (Partly Secured Accounts) should be applied to determine the includable amount of the term debit in the Reserve Formula computation.

(SEC Staff to FINRA) (FINRA Regulatory Notice 21-27)

RESERVE FORMULA (EXHIBIT A - ITEM 11); SECURITIES BORROWED FOR CUSTOMER TRANSACTIONS (continued)

/04 Banks and Institutions are Customers

Banks and financial institutions, other than broker-dealers, are defined as customers for purposes of SEA Rule 15c3-3. However if securities are borrowed from them and the appropriate securities borrowed agreements are on file which includes the language contained in SEA Rule 15c3-3(b)(3)(i), (ii), (iii) and (iv), then the securities positions should be allocated as securities borrowed. If the appropriate securities borrowed agreements are not on file or the agreements lack the needed language the securities should be allocated as customers' fully paid securities with no debit included in the formula.

(SEC Staff to NYSE) (No. 78-1, May 1978)

/041 Federal Reserve Bank as a Non-Customer - Rescinded (FINRA Regulatory Notice 21-27)

(NEXT PAGE IS 2750)