

Number 06-5
June 28, 2006

**PLEASE ROUTE TO FINANCIAL AND OPERATIONS OFFICER/PARTNER
AND COMPLIANCE DEPARTMENT**

**TO: ALL MEMBER ORGANIZATIONS AND INTERPRETATION
HANDBOOK SUBSCRIBERS**

**SUBJECT: UPDATE OF INTERPRETATION HANDBOOK – SEA RULES 15c3-1,
15c3-1b AND 17a-5**

The accompanying updated Interpretation Handbook pages are being distributed as replacements for existing pages. The update includes clarification of existing rules, amended interpretations and new interpretations. These interpretations should be carefully reviewed before insertion into the Interpretation Handbook.

SEA Rule 15c3-1
Page & Reference

Subject

| | |
|------------------------|---|
| 99, (c)(1)(ii)/01 | Continuous Net Settlement (CNS) Balances Allocation |
| 128, (c)(2)(iv)(B)/092 | Non-Marketable Securities Collateralizing Purpose Borrow Transactions |
| 138, (c)(2)(iv)(C)/08 | Rebates or Interest Receivable Resulting From Securities Borrowed or Securities Loaned |
| 139, (c)(2)(iv)(C)/081 | Rebates or Interest Receivable From Institutions Pursuant to Securities Borrowed Transactions |

SEA Rule 15c3-1**Page & Reference****Subject**

| | |
|------------------------------|---|
| 153, (c)(2)(iv)(E)/06 | Eurodollar and Other Offshore Deposits (RESCINDED) |
| 153, (c)(2)(iv)(E)/061 | Offshore Demand Deposits and Time Deposits |
| 154, (c)(2)(iv)(E)/062 | Cayman Island Branches of Foreign Banks |
| 165, (c)(2)(iv)(F)(3)(ii)/06 | Non-Marketable Securities Collateralizing Reverse Repurchase Transactions |
| 215, (c)(2)(vi)(M)(1)/01 | Municipal Securities – Undue Concentration Charge |
| 216, (c)(2)(vi)(M)(4)/01 | Municipal Securities – Undue Concentration Charge |
| 271, (c)(2)(xii)/01 | Reverse Repurchase Agreements (RESCINDED) |
| 271, (c)(2)(xii)/011 | Reverse Repurchase Agreements |
| 272, (c)(2)(xii)/03 | Regulation T Calls for Margin |

SEA Rule 15c3-1b**Appendix B****Page & Reference****Subject**

| | |
|-------------------|--------------------------------------|
| 351, (a)(3)(x)/01 | Short Commodity Options Value Charge |
|-------------------|--------------------------------------|

SEA Rule 17a-5**Page & Reference****Subject**

| | |
|------------------|---|
| 2271, (m)(3)/01 | Exemption From Filing Initial Annual Audit Report |
| 2271, (m)(3)/011 | Broker-Dealer Not Effectuating Transactions Through a Special Bank Account for the Exclusive Benefit of Customers |

Interpretation Memo 06-5 Notes:

- Interpretation 15c3-1(c)(2)(iv)(B)/092 (Non-Marketable Securities Collateralizing Purpose Borrow Transactions) was amended for clarification purposes and to change the number of days the condition has existed before the net capital charge is applied.
- Interpretation 15c3-1(c)(2)(iv)(C)/08 (Rebates or Interest Receivable Resulting From Securities Borrowed or Securities Loaned) was amended to replace the word “fees” with the word “rebates”.
- Interpretation 15c3-1(c)(2)(iv)(C)/081 (Rebates or Interest Receivable From Institutions Pursuant to Securities Borrowed Transactions) was amended for clarification purposes and to replace the word “fees” with the word “interest”. In addition, provisions were added to address the requirements of the interpretation for purposes of securities borrows transacted pursuant to agency securities lending arrangements.
- Interpretation 15c3-1(c)(2)(iv)(E)/06 (Eurodollar and Other Offshore Deposits) was rescinded and replaced with new interpretation 15c3-1(c)(2)(iv)(E)/061 (Offshore Demand Deposits and Time Deposits).
- Interpretation 15c3-1(c)(2)(iv)(E)/061 (Cayman Island Branches of Foreign Banks) was renumbered as interpretation 15c3-1(c)(2)(iv)(E)/062 (Cayman Island Branches of Foreign Banks).
- Interpretation 15c3-1(c)(2)(iv)(F)(3)(ii)/06 (Non-Marketable Securities Collateralizing Reverse Repurchase Transactions) was amended for clarification purposes and to change the number of days the condition has existed before the net capital charge is applied.
- Interpretation 15c3-1(c)(2)(xii)/01 (Reverse Repurchase Agreements) was rescinded and replaced with new interpretation 15c3-1(c)(2)(xii)/011 (Reverse Repurchase Agreements).
- Interpretation 15c3-1(c)(2)(xii)/03 (Regulation T Calls for Margin) was amended to delete the sentence: “The fact that Regulation T allows 7 business days under section 220.4(c)(3) has no bearing on this provision of 15c3-1.”
- All other interpretations included in Interpretation Memo 06-5 are new interpretations to SEA Rules 15c3-1, 15c3-1b (Appendix B) and 17a-5.
- Copies of the SEC no-action letters to the NYSE and NASDR, referenced in new interpretations 15c3-1b(a)(3)(x)/01 (Short Commodity Options Value Charge) and 17a-5(m)(3)/01 (Exemption From Filing Initial Annual Audit Report), are attached for your reference.

Questions regarding this Interpretation Memo should be directed to your Finance Coordinator.

Filing Instructions

Remove Pages

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RETAIN ALL INTERPRETATION/INFORMATION MEMOS FOR FUTURE REFERENCE



DIVISION OF
MARKET REGULATION

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

December 16, 2005

Ms. Kris Dailey, Managing Director
Member Firm Regulation
New York Stock Exchange, Inc.
20 Broad Street
New York, New York 10005

Ms. Susan DeMando, Associate Vice President
Department of Member Regulation
NASD Regulation, Inc.
1735 K Street, NW
Washington, D.C. 20006-1500

Re: Annual Audited Financial Statement Filing Requirements Under Rule 17a-5

Dear Ms. Dailey and Ms. DeMando:

Broker-dealers are required, pursuant to Rule 17a-5(d) of the Securities Exchange Act of 1934 ("Exchange Act"),¹ to file annually with the Commission, on a calendar or fiscal year basis, a report which shall be audited by an independent public accountant. The report must be as of the same fixed or determinable date each year, unless a change is approved in writing by the broker-dealer's designated examining authority ("DEA"). The audit report's scope includes, among other things, the broker-dealer's balance sheet, income statement, net capital computation,² and customer reserve computation.³ The balance sheet and net capital computation are made available to the public, while the remainder of the audit report is kept confidential if the broker-dealer requests such treatment. The audit report provides the Commission with an independent confirmation of the broker-dealer's financial condition and compliance with the Commission's financial responsibility rules. It provides the firm's customers with a confirmation of the state of the firm's solvency.

Each year, the Division of Market Regulation ("Division") of the Securities and Exchange Commission ("Commission") receives requests from broker-dealers for no-action relief from the requirement to obtain an audit pursuant to Rule 17a-5(d) where the registration of the broker-dealer with the Commission became effective shortly before the

¹ 17 CFR 240.17a-5(d).

² The Commission's net capital rule requires a broker-dealer to maintain a minimum level of highly liquid assets as part of its net worth. 17 CFR 240.15c3-1.

³ The Commission's customer protection rule requires a broker-dealer that carries customer securities and cash to set aside in a special bank account a reserve equal to the net amount of cash it owes its customers. 17 CFR 240.15c3-3.

Ms. Kris Dailey
Ms. Susan DeMando
December 16, 2005
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end of the initial audit period. When the audit period is three months or less, these broker-dealers assert that the benefits associated with the Commission's audit requirement are minimal and do not outweigh the costs. As part of their request, the broker-dealers agree that their audited annual report for the next audit period will cover the entire period from the effective date of the broker-dealer's registration with the Commission.

Based on the foregoing, the Division will not recommend enforcement action to the Commission when a broker-dealer does not file the audited annual report of financial statements required by Rule 17a-5(d) for its initial audit period under the following circumstances:

- (a) the registration of the broker-dealer with the Commission became effective within three months of the end of its initial audit period;⁴
- (b) the broker-dealer does not clear transactions, does not carry customer accounts, and is not a broker-dealer that effectuates financial transactions with customers in accordance with Exchange Act Rule 15c3-3(k)(2)(i);⁵
- (c) the broker-dealer's audited annual report for the next audit period will cover the entire period from the effective date of the broker-dealer's registration with the Commission; and
- (d) the broker-dealer sends notice to the Commission and to its DEA before its audited annual report is due that it has met the above conditions.

This letter applies only to the filing of audited financial statements in accordance with Rule 17a-5(d). The DEA of a broker-dealer may have separate rules for other required filings of financial statements.

This letter expresses a staff position with respect to enforcement only and does not purport to state any legal conclusion on this matter. The Division's position is confined to the facts as described in this letter. Any material change in circumstances may warrant a different conclusion and should be brought immediately to the Division's attention.

Sincerely yours,



Thomas K. McGowan
Assistant Director

⁴ A broker-dealer whose initial fiscal year ended before the issuance date of this letter but whose audit is due after the issuance date may rely on this letter, provided that all the conditions are met.

⁵ 17 CFR 240.15c3-3(k)(2)(i).



DIVISION OF
MARKET REGULATION

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

February 7, 2006

Ms. Kris Dailey
Managing Director, Regulatory Development Services
New York Stock Exchange, Inc.
20 Broad Street
New York, NY 10005

Ms. Susan DeMando
Director, Financial Operations
NASD Regulation, Inc.
1735 K Street, NW
Washington, DC 20006-1500

Re: Short Option Value Charge

Dear Ms. Dailey and Ms. DeMando:

Certain firms have raised issues regarding the deduction known as the "short option value charge" required by subparagraph (a)(3)(x) of Appendix B to Rule 15c3-1 under the Securities Exchange Act of 1934 (the "Exchange Act")¹ for commodity options granted (sold) by certain customers. The short option value charge requires that a broker-dealer, when calculating net capital under Rule 15c3-1, deduct from its net worth four percent of the market value of commodity options granted (sold) by option customers on or subject to the rules of a contract market. These firms are concerned that the short option value charge does not reflect accurately the risk of the customer short option values to the firm.

In response to these concerns, the Division of Market Regulation (the "Division") will not recommend enforcement to the Securities and Exchange Commission (the "Commission") if a firm, when computing the short option value charge under subparagraph (a)(3)(x) of Appendix B to Rule 15c3-1, does not take a charge on short commodity options for accounts where:

1. The customer has aggregate open short option positions with the firm that are valued in excess of \$25 million;
2. The firm stress tests each of these customer margin accounts and fully revalues the positions accounting for both movement in the underlying asset and implied volatility;

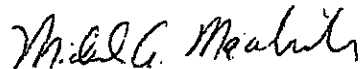
¹ 17 CFR 240.15c3-1b(a)(3)(x).

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3. The firm retains the results of the calculations in paragraphs 2 above
4. The firm must establish and follow written risk management procedures detailing the calculation of required margin, the timing of margin calls, procedures followed when customers fail to meet margin calls, and the evaluation of the stress tests calculations.

This is a staff position with respect to enforcement only and does not purport to express any legal conclusions. This position is based solely on the foregoing description. Factual variations could warrant a different response, and any material change in the facts must be brought to the Division's attention. This position adds to and does not replace the previous guidance regarding the short option value charge. This position may be withdrawn or modified if such action is necessary for the protection of investors, in the public interest, or otherwise in furtherance of the securities laws.

Sincerely,

A handwritten signature in dark ink, appearing to read "Michael A. Macchiaroli". The signature is fluid and cursive, with the first name "Michael" and last name "Macchiaroli" clearly distinguishable.

Michael A. Macchiaroli
Associate Director