INTERNAL AUDITORS DIVISION
An Affiliate of SIFMA

Customer Reserve Formula Under SEC Rule 15c3–3

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Note: The following guideline is to assist the internal auditor in reviewing their firm's compliance with the Customer Reserve Formula under SEC Rule 15c3-3 and does not cover any aspects of possession or control of customer securities. At the time of updating this guideline, IAD was aware of proposed Rule changes that are not reflected in this document. Moreover, due to the frequency of updates to the Rule, this guideline should be used in conjunction with the current version of the Rule and the related interpretations.

I. BACKGROUND

SEC Rule 15c3-3, the customer protection rule, was adopted on November 10, 1972 to address severe recordkeeping problems plaguing the securities industry. From 1968 to 1970, increases in trading volume and limited automation resulted in more than a dozen failed NYSE Firms and customer losses exceeding $100 million. To stop the erosion of public confidence in the securities industry the Exchange established a "Special Trust Fund", which was financed by assessments on all members, to cover customer losses at failed member firms.

During this period a number of practices contributed to customer losses and loss in public confidence. It was not uncommon for broker-dealers to use customer securities and funds for their own business purposes. The increased volume and inability of broker-dealers to keep abreast with the surge in transactions resulted in significant recordkeeping problems, a large volume of "questioned trades" (uncompared trades), a breakdown in recordkeeping over the custody of securities and location, significant and recurring accounting out-of-balance conditions and a large volume of fail contracts. When failed firms were liquidated, it was discovered that customer fully paid securities were pledged as collateral for bank loans and were liquidated by the lending banks to pay off the loans, customer free credit balances had been used to finance the broker-dealers' business, and customer securities could not be located.

As a result of these problems and customer losses Congress enacted the Securities Investor Protection Act of 1970 (SIPA), which created the Securities Investor Protection Corporation (SIPC) and required the SEC to strengthen customer protection and increase investor confidence in the securities industry by increasing the financial responsibility of broker-dealers.

The Rule requires a broker-dealer to take certain steps to protect the credit balances and securities it holds for customers. Under the Rule, a broker-dealer must, in essence, segregate customer funds and fully paid and excess margin securities held by the firm for the accounts of customers. The intent of the Rule is to require a broker-dealer to hold customer assets in a manner that enables their prompt return in the event of an insolvency, which, in turn, increases the ability of the firm to wind down in an orderly self-liquidation and, thereby avoid the need for a proceeding under SIPA.

Firms may claim exemption from the Rule if they carry no customer accounts and restrict their activities, as specified by the Rule (sections (k)(i) and (k)(ii)). Securities firms subject to the Rule must perform periodic calculations known as the computation of the reserve requirement pursuant to the Rule, which identifies and presents all debit and credit account balances attributable to customer-related activities or transactions. A customer is any person from whom or on whose behalf a broker-dealer has received or acquired or holds funds or securities of that person; defined in negative terms as a client of the broker-dealer who is not a:

(a) Broker-Dealer

(b) Municipal Securities Dealer

(c) General Partner

(d) Director or Principal Officer

The term does include the following to the extent they are clients of the firm:

(a) Special or Limited Partner

(b) Subordinated Lender

(c) Join Account, Custodian Account, Hedge Fund or Limited Partnership (or part of)

(d) Broker-Dealer who Maintains Omnibus Account for the Account of Customers with the Broker-Dealer

The above noted definitions of customer and non-customer are not all-inclusive. Please refer to the Rule itself, related interpretations, and "no-action" letters for further details.

To perform the calculation, total customer-related debits are subtracted from the total customer-related credits. If the result of the computation is a net credit, the firm must deposit that amount of cash or qualified securities, as defined by the Rule, in a "special reserve bank account for the exclusive benefit of customers." If the result of the formula is a net debit balance, no deposit is required. Typically, brokers will keep a specific amount of excess funds deposited in the reserve account to insulate them from being in violation of the Rule which could result in censure and penalties assessed by the SEC or other regulatory bodies as well as adverse publicity.

The computation is typically performed every Monday as of the close of business of the previous Friday. All required deposits must be made by 10:00 a.m. the second business day following the computation date (Tuesday in our scenario). It should be noted that a deposit cannot generally be withdrawn until a new computation is prepared. Certain broker-dealers may be permitted to make the computation monthly. These firms are required to deposit not less than 105% of the excess of total credits over total debits.

There are reserve requirement computation differences for broker-dealers who calculate their net capital using the aggregate indebtedness ("AI") method which vary from those using the alternative method. For example, debit balances in customers' cash and margin accounts included in the formula are reduced by 1% of their aggregate value by broker-dealers computing net capital using the AI method. Broker-dealers computing net capital using the alternative method reduce aggregate formula debits by 3% in lieu of reducing debit balances in customers' cash and margin accounts by 1%. In addition, the time frame for including as credits certain operational items (like suspense) are shorter under the alternative method. The notes to Exhibit A and interpretations of the Rule clearly distinguish this difference as well as other variations.

The following is a listing of the text of specific sections of the Rule applicable to the reserve formula.

(a) Definitions

(b) Physical Possession or Control of Securities

(c) Control of Securities

(d) Requirement to Reduce Securities to Possession or Control

(e) Special Reserve Bank Account for the Exclusive Benefit of Customers

(f) Notification of Banks

(g) Withdrawals from the Reserve Bank Account

(h) Buy-in of Short Security Differences

(i) Notification in the Event of Failure to Make a Required Deposit

(j) (Reserved)

(k) Exemptions

(l) Delivery of Securities

(m) Completion of Sell Orders on Behalf of Customers

(n) Extension of Time

(o) Security Futures Products

It should be noted that brokers and dealers are required by SEC Rule 17a-5 to have an independent auditor evaluate, on an annual basis, the system of internal accounting control for material inadequacies. An internal control letter is issued by the independent auditor to the broker and dealer and forwarded to the SEC and the firm's other regulatory bodies which states the independent auditor's conclusion and/or findings on the internal control structure of the broker-dealer.

The internal control letter specifically refers to the auditor's study of the practices and procedures followed in making periodic computations of the reserve required by the Rule and obtaining and maintaining possession or control of all fully paid and excess margin securities. An AICPA Task Force is currently addressing whether the internal control letter will cover the PAIB computation.

Exhibit A

Formula for Determination of Reserve Requirement for Brokers and Dealers Rule 15c3-3 and related interpretations. This exhibit represents details of items to be included in the reserve formula computation.

It should be noted that a substantial segment of the *New York Stock Exchange Interpretation Handbook* is devoted to a review of interpretations relating to all aspects of these rules and provides meaningful insight for their comprehension. This comprehensive reference, the *Interpretation Handbook,* is available for purchase from the NYSE on a subscription basis and is also available from certain online services. In addition, the NASD periodically publishes a *Guide to Rule Interpretations.*

Proprietary accounts of introducing brokers

In addition to regular customer accounts held by a clearing broker on behalf of the introducing broker, an introducing broker itself may maintain a proprietary trading account, or PAIB, with a clearing broker. When computing its net capital, an introducing broker typically includes its proprietary cash and securities held by the clearing broker as allowable assets. However, because the customer protection rule specifically excludes brokers and dealers from the definition of "customer," the clearing broker is not subject to the restrictions of Rule 15c3-3 with regard to PAIB assets. Therefore, a clearing broker is not required to maintain the physical possession or control of PAIB assets, nor is the clearing broker restricted as to its use of PAIB assets which, if attributable to "customers," would constitute customer credits in the customer reserve formula.

Consequently, the interaction between the net capital rule and customer protection rule served to permit an introducing broker to treat PAIB assets as allowable assets for purposes of Rule 15c3-1 while a clearing broker excluded these assets as credits from the customer reserve formula. This permitted clearing brokers to use the same PAIB assets free of the restrictions imposed by Rule 15c3-3 that were otherwise applicable to a broker-dealer's use of customer funds and securities. The clearing broker could treat the assets as their own, free of any restrictions. Consequently, the assets may not have been readily available to the introducing broker if its correspondent clearing broker failed or otherwise experienced financial difficulties. This result is inconsistent with subparagraph (c)(2)(iv) of the net capital rule which requires that assets "not readily convertible into cash" be deducted from a broker- dealer's net worth, and accordingly, PAIB assets should be considered as non-allowable assets, and an introducing broker should deduct such assets from its net worth when calculating its net capital if the following computation is not performed by the clearing broker.

This reserve computation is an elective procedure that permits the introducing broker to treat its PAIB assets as allowable assets for purposes of its net capital calculation. Specifically, for an introducing broker to treat its PAIB assets held at a clearing firm as allowable for purposes of the net capital rule, an introducing broker and its correspondent clearing broker must agree (in writing) to perform the PAIB calculation in accordance with the following provisions ("PAIB Agreement"):

1. The clearing broker must perform a computation for PAIB assets of all its introducing brokers in accordance with the customer reserve computation set forth in Rule 15c3-3.
2. The PAIB reserve computation must include all the proprietary accounts of all introducing brokers covered by the PAIB agreement and all PAIB assets must be kept separate and distinct from customer assets under the customer reserve formula in Rule 15c3-3.
3. The PAIB reserve computation must be prepared within the same timeframes as those prescribed by Rule 15c3-3 for the customer reserve formula.
4. The clearing broker must establish and maintain separate "Special Reserve Account for the Exclusive Benefit of Customers" and for any PAIB reserve requirement.
5. A PAIB reserve deposit requirement can be satisfied by excess debits in the customer reserve formula of the same date. However, a customer reserve deposit requirement cannot be satisfied with excess debits from the PAIB reserve computation of the same date.
6. An introducing broker must notify its Designated Examining Authority (DEA) in writing that it has entered into a PAIB Agreement with a clearing broker within two days of executing such agreement.
7. Commissions receivable and other receivables of an introducing broker from its clearing broker are not to be included in the PAIB reserve computation under certain circumstances.
8. The proprietary account of an introducing broker that is a guaranteed subsidiary of the clearing broker, or who guarantees the clearing broker, is to be excluded from the PAIB reserve computation.
9. Upon discovery that any deposit to the PAIB Reserve Bank Account did not satisfy the deposit requirements, a clearing broker must immediately notify its DEA and the SEC by facsimile or by telegram. In addition, notification to its introducing brokers is to be made unless certain conditions are met.

II. RISKS

Customer Reserve Formula

Regulators have consistently taken a stringent enforcement approach to Rule 15c3-3 without regard to materiality. This could subject the firm to censure by regulators, as well as financial penalties and fines. In the most extreme case, the regulators may prevent the firm from conducting customer business or ban the firm's officers from the securities business for a period of time. Below summarizes the primary risks associated with the Rule:

1. Failure to properly compute the reserve formula.
2. Failure to make any required deposit within the prescribed time frames.
3. Failure to make any notifications required by the Rule with regard to a hindsight deficiency.
4. Failure to maintain a special reserve bank account for the exclusive benefit of customers with the specified provisions/language.

Another significant risk is the "embarrassment" risk to the firm which is associated with publicized instances of failures to comply with the Rule. Such negative publicity may result in the loss of customers and other related business.

PAIB Reserve Formula

Failure to properly address this rule change could pose serious risks to clearing and introducing brokers. These risks include, but are not limited to, regulatory, operational, technological and business risks.

Clearing Broker-Dealer

- The operational burden is now on the clearing broker-dealers to include all of these PAIB in range or manner that would treat these accounts appropriately under the new requirements and trigger this Rule15c3-3 special reserve calculation pursuant to the PAIB Agreement. Operational and regulatory risk exists if the clearing broker-dealer does not properly "lock up" these amounts.
- The clearing broker-dealer must also establish a separate special reserve computation for all of its introducing brokers with signed agreements. There is potential operational, regulatory and systems risk in creating the new reserve computation, for instance, failure to include all appropriate accounts due to possible account range recording errors.
- If the clearing broker-dealer cannot properly establish appropriate correspondent PAIB account ranges on its books and records, it may not execute PAIB Agreements with all of its introducing broker-dealers. Consequently, the clearing broker-dealer could have significant business and regulatory risk of not satisfying its fiduciary and regulatory obligations to its introducing broker-dealer.
- Failure to properly identify all of the PAIB correspondent accounts would result in not executing all PAIB Agreements with its introducing broker-dealers. Consequently, introducing broker-dealers not covered by a PAIB Agreement may face regulatory capital deficiencies which could potentially lead to loss of correspondent business.

Introducing Broker-Dealer

- If no formal PAIB Agreement has been executed between the introducing and clearing broker-dealer, then the introducing broker-dealer would have to prepare a special net capital computation of PAIB assets held at the clearing broker-dealer and treat the assets held at the clearing broker-dealer as non-allowable.

  This may create risk of undercapitalization and can result in a violation of 15c3-1. In addition, the introducing broker-dealer's PAIB assets would not be protected by its clearing broker-dealer; consequently, the introducing broker- dealer may bear exposure should the clearing broker-dealer fail or otherwise experience financial difficulties.
- Failure to execute the PAIB Agreement may also force the introducing broker-dealer to increase its regulatory capital base because of the SEC's treatment of PAIB assets as non-allowable assets.

General

Based on the auditor's assessment of such risks, the auditor should consider the need and extent for performing detailed procedures in connection with computations prepared throughout the year. The overall assessment of the risk associated with the computations of the reserve formulas would depend upon the auditor's judgment, after considering pertinent factors, including:

- The results of prior audit examinations and findings as documented in reports prepared by regulatory authorities in connection with their examinations.
- The nature and complexity of the issues affecting the firm's computations and the firm's approach to dealing with these issues, including the nature and complexity of the firm's allocation priorities and related procedures, whether manual or computerized.
- The financial condition of the firm and its history of compliance with the requirements of the Rule.
- The state of the control environment and the regulatory knowledge and awareness of personnel responsible for preparing and reviewing computations.
- The sensitivity of management to the requirements of the Rule.
- The impact of amendments to the Rule, and interpretations issued by self-regulatory authorities, and their applicability to the firm.
- Changes in the firm's business.

III. CONTROL POINTS

Management's controls over the preparation of the reserve formulas should seek to minimize the risks of failing to compile the required information on a timely basis and failing to maintain adequate amounts on deposit in the respective special reserve accounts.

Typical controls implemented by management to address these risks would include:

(a) ensuring that adequate firm policies and procedures exist relating to the chart of accounts, requirements for opening of new accounts, changes to the nature of accounts, etc.;

(b) establishing policies and procedures for preparing the computations and complying with the Rule and ensuring that these procedures are adequately documented and regularly updated;

(c) ensuring that responsible personnel, including operations and accounting departments, are familiar with the Rule's requirements and that they review the current text of any new requirements;

(d) performing an analytical review relating to the consistency of the computations to prior periods and investigating significant variations; and

(e) management's review and assessment of customer and proprietary accounts of introducing brokers balances and reserve formula requirements in relation to the financial position of the firm.

These controls also extend to preparation of the reserve formulas as a means of ensuring completeness, accuracy, and proper classification of amounts included in the computations. Such controls would include:

(a) reconciling detail of accounts used in the calculations to control totals or general ledger accounts;

(b) determining the propriety and accuracy of account detail through adequate EDP application and integrity controls;

(c) comparing debit and credit balances and adjustments included in the reserve formulas to the Rule to ensure propriety;

(d) recalculating the final reserve formula computations;

(e) verifying the continued completeness and accuracy of the allocation methodology as the firm's customer and PAIB base and operations change;

(f) verifying the data obtained from the operations and accounting departments is complete and accurate (including aging where relevant); and

(g) confirming segregation deposit with the bank.

IV. AUDIT OBJECTIVES

Prior to reviewing the broker-dealer's computations of the reserve formulas as set forth by the Rule, the auditor should test various procedures to determine that the firm has adequate policies and procedures regarding compliance with the Rule and performance of the computations. Written policies and procedures form the basis for, and may be indicative of, a firm's compliance system. The auditor should ensure that the preparers of the computations consider, and are familiar with, the latest requirements of the Rule and related interpretations. Likewise, the auditor should determine the extent of management's review of the computations for propriety and analyzing computations for significant fluctuations.

The auditor should determine that procedures and controls are in place to determine that applicable requirements of the Rule are being addressed and that the reserve formula computations are being prepared accurately and on a timely basis. Additionally, controls should be in place to determine that:

(a) account balances and stock record positions attributable to customers, proprietary accounts of introducing brokers and other balance sheet and off-balance sheet accounts are properly identified and analyzed for inclusion in the computation;

(b) documentation supporting the computations are being agreed to related control accounts, general ledger accounts or schedules from various operating departments (i.e., customer and PAIB debits and credits, aged security count differences, stock borrow, fail to deliver/ receive, etc.);

(c) procedures and controls are in place over the completeness, accuracy, propriety, validity, and consistency of the stock record allocations impacting the reserve formulas' requirements;

(d) the reserve formulas computations and supporting schedules are mathematically correct;

(e) appropriate criteria and percentages specified in the Rule are being considered and utilized in the calculation of the various components of the computations; and

(f) appropriate consideration is given to intercompany arrangements as these may require special treatment under the Rule.

V. AUDIT PROCEDURES

A review of the reserve formulas should determine that the firm's computations are consistent with the Rule and that management is regularly reviewing and analyzing the computations to ensure that significant variations or risks are addressed and investigated. In testing the firm's reserve formula computations, the auditor should determine that supporting schedules to the computations are based on accurate and complete information and that the calculation is mathematically accurate and consistent with the Rule. The following audit procedures, which are not intended to be all inclusive, may be used to achieve these objectives:

1. Determine that the firm is preparing periodic computations as required by the Rule and that such computations are prepared on a consistent basis and within the time frames established by the Rule:
   - Computations must be made weekly, as of the close of the last business day of the week.
   - A broker-dealer with aggregate indebtedness ("A.I.") less that 800% of its net capital and which carries customer funds less than $1,000,000 (as computed at the last required computation) may select to make the computations monthly, as of the close of the last business day of the month.
   - Computations must be made as of the month- end closing date in lieu of the regular weekly computations.
   - Computations must be made as of the audit date in lieu of the regular weekly/monthly computations.
2. Determine that deposits of reserve requirements, if required, are received by the bank within the first hour after the opening of banking business on the second business day following the reserve calculations.
3. Ascertain that pertinent amendments or interpretations to the Rule have been appropriately addressed and considered for the computations.
4. Determine that the firm has procedures and controls in place to provide assurance on compliance with the Rule.
5. Ascertain that items reported in the computations agree with appropriate accounting records, or other supporting documentation.
6. Ascertain that the computations of reserve requirements are performed in accordance with the provisions of the Rule.
7. Ensure that cash or qualified securities are deposited into an account held for the exclusive benefit of customers or PAIBs as required on a timely basis.
8. Ensure that securities deposited in reserve bank accounts are qualified securities under the Rule.
9. If total credits exceed total debits, ascertain that the client has

sufficient qualifying funds on deposit and has made the required deposit in the appropriate time frame.

10. Obtain a list of all bank accounts established as "Special Reserve *Bank* Accounts for the Exclusive Benefit of Customers" and "Special Reserve *Bank* Accounts for the Exclusive Benefit of Introducing Brokers". Examine agreements with the banks to ascertain if the agreements are in accordance with the Rule.

11. Review financial statements and account analyses for items which would ordinarily be taken into consideration in the computations of the reserve formulas and determine that these items are appropriately addressed.

12. Ascertain that records of the computations are maintained in accordance with Rule 17a-4.

13. Verify the mathematical accuracy of the computations.

14. Determine that accounts are properly classified by type (e.g., customer, PAIB, inventory, fails, borrows, loans, etc.)

15. Determine that accounts are properly included and/ or excluded from the reserve formulas.

    - Refer to SEC Rule 15c3-3 (Exhibit A) and related interpretations for guidance on the items included and excluded from the reserve formulas.

16. Review procedures for determining the following:

    - Dividend and interest-related aged items
    - Aged transfer and reorganization positions
    - Suspense related aged items

17. Ascertain that the allocation process is deemed acceptable per the Rule, and that such allocations are consistent throughout the year, computed accurately and are periodically reviewed.

    - If it is impractical or unduly burdensome to determine fail to receive contracts and fail to deliver contracts relate to customer and PAIB accounts, an appropriate allocation may be made on a conservative basis to accomplish maximum protection for customers and introducing broker-dealers. If an allocation is used with regard to the foregoing items, the broker-dealer should be able to demonstrate that the results so obtained regarding designations or customer and introducing broker-dealer 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. Also, the broker-dealer must maintain a record of that allocation.

    - Refer to SEC Rule 15c3-3(Exhibit A)/08 for the reserve formula allocation chart showing the relationship between the various allocable items and may be used in conjunction with the interpretations when an allocation is required to determine the debit and credit values includible in the customer reserve formula calculation.

    - Refer to SEC Rule 15c3-3(PAIB) for the reserve formula allocation chart showing the relationship between the various allocable items and may be used in conjunction with the interpretations when an allocation is required to determine the debit and credit values includible in the PAIB reserve formula calculation.

18. Review that all payables to customers or PAIBs, drafts payable to customers or PAIBs (which have been applied against credit balances), and all overdrafts in customer or PAIB related bank accounts maintained by the broker-dealer are included in the computations (inclusion of soft dollar payables should be discussed with regulators).

19. Ascertain that all bank loans and letters of credit collateralized by customer-or PAIB-owned securities are reported. Review the bank loans and any letters of credit excluded from the formulas and ensure that the collateral, if any, does not constitute customer or PAIB property. The auditor would ordinarily perform procedures that the broker-dealer has adequate procedures for identifying collateral as belonging to customers, PAIBs or the firm so that "commingling" of collateral does not occur.

20. Review the procedures and compliance for buying in aged security count differences and certain foreign securities.

21. Ascertain that all liabilities related to securities lending activities for which the securities loaned (collateral) are identified as relating to customers or PAIBs are reflected in the computations. In addition, ensure the inclusion of the amount by which the market value of the securities loaned exceeds the payable recorded for the stock loan transactions, on a broker-by-broker basis.

22. Determine that all payable amounts for customer or PAIB related fail-to-receive items are identified. In addition, verify that the amount by which the market value of the securities not received exceeds the related payable amount for fail to receives over 30 days old is included in the formulas.

23. Determine that the market value of all "short" firm inventory positions where the "long" position is identified as relating (i.e., allocates) to customers or PAIB are included in the computations.

24. Review the market value of aged short securities located in the suspense accounts (not to be offset by longs or debits) as defined by the Rule.

25. Determine that debit balances in customers' and PAIB's cash and margin accounts (excluding unsecured and partially secured accounts and accounts doubtful of collection) are included in the formulas.

26. Determine that receivables from securities borrowed transactions are included in the formulas only to the extent that such borrowings relate to customer and PAIB positions. Ensure that the amount is properly reduced for receivables related to securities borrowed which were in "excess" for purposes of possession or control calculations for more than one day (i.e., borrowing securities without a need). Stock borrows which allocate versus possession or control may be included as a debit if the security is returned on the business day following the computation date and the stock borrow previously allocated versus a credit in the formulas.

27. Determine that only receivables for failed-to-deliver transactions which relate to customer and PAIB short positions not more than thirty days old (i.e., stock record fail-to-deliver (long) allocating to customer and PAIB (short) are included in the formula.) Fail-to- delivers which allocate versus physical control locations may be included if the securities were negotiable and in "excess" for purposes of possession or control requirements for not more than three days.

28. Review all asset and liability accounts not included as debits and credits, respectively, in the reserve formula and ensure that they are not customer. Also, Examining Authority was notified within two days of executing a PAIB agreement introducing broker related, as defined.

29. Review withdrawals from the Special Reserve Accounts, if any, to ensure that such withdrawals are made in accordance with the Rule.
30. Ensure intercompany and other affiliate accounts are properly contemplated under the Rule.
31. Test the market values of specific securities contained in the reserve formula computation (i.e., allocation system, count differences, stock dividends, suspense, unconfirmed transfers, reorganization and redemption shorts, etc.).
32. Verify that management is reviewing the computations for propriety as well as analyzing the computations for significant fluctuations.
33. If the broker dealer is exempt from Rule 15c3-3, the auditor should ascertain that the conditions of the exemption were being complied with during the period since the last audit.
34. Ensure that all payments made by a customer or PAIB to a broker dealer for the purchase of securities prior to settlement date and resulting in a customer or PAIB credit balance are included in the appropriate Reserve formula.
35. Ensure that all customer and PAIB accounts are identified, and kept separate and distinct for the reserve formula calculations.
36. Ascertain that debits and credits used in the customer reserve formula calculation are not included in the PAIB reserve computation.
37. Ensure that all proprietary accounts of introducing brokers that are excluded represent a valid exemption such as that they a guaranteed subsidiary of the clearing firm.
38. If an introducing broker, ensure that the Designated Examining Authority was notified within two days of executing a PAIB agreement.
39. Ensure that customer reserve requirements are not being satisfied with excess debits from the PAIB reserve computation of the same date.
40. Ensure that if the clearing firm will not enter into a PAIB Agreement, the introducing broker takes a non-allowable capital charge on its assets deposited at the clearing firm.
41. Ensure that proprietary accounts of foreign introducing brokers are excluded from the PAIB reserve calculation.
42. Ensure that introducing brokers without proprietary trading accounts with their clearing broker have PAIB agreements with their clearing broker in order to treat its deposit at the clearing firm as a good asset for capital purposes.
43. Ensure that commissions receivable and other receivables of an introducing broker from its correspondent clearing broker (excluding clearing deposits) that are otherwise allowable assets under the net capital rule are not to be included in the PAIB reserve computation, provided the amounts have been clearly identified as receivables on the books and records of the introducing broker and as payables on the books of the clearing broker.
44. Review margin on deposit with the OCC (a debit) and its offsetting credit by money borrowed collateralized by customer securities.

It should be noted that specific experts should be utilized when analyzing this Rule where applicable. This should include discussions with regulators, compliance, or the law department.

REFERENCE MATERIAL

1. *AICPA Audit and Accounting Guide: Brokers and Dealers in Securities* by the American Institute of Certified Public Accountants, 2006.
2. *Montgomery's Auditing* by Vincent M. O'Reilly, Murray B. Hirsh, Philip L. Defliese, Henry R. Jaenicke, Eleventh Edition, 1990.
3. *Securities and Exchange Commission, Rule 15c3- 3, Customer Protection – Reserves and Custody of Securities* by the New York Stock Exchange, 1977.
4. *Securities and Exchange Commission, No Action Letter Number 98-10* by the New York Stock Exchange, 1998.
5. New York Stock Exchange Interpretation Memo Number 99-6 by the New York Stock Exchange, 1999.
6. *IAD SIA Newsletter: The SEC's New Required Treatment for PAIB's: What Does it Mean for Broker-Dealers* by Anthony Giglio and Paul E. Tortorella, June 1999.
