

Joint Audit Committee

Regulatory Update

**TO: Chief Financial Officers
Chief Compliance Officers**

9802

DATE: January 22, 1998

RE: CFTC PROPOSAL FOR NOTIFICATIONS OF UNDERSEGREGATED CONDITIONS

Attached is the CFTC's proposal published in the January 14, 1998 [Federal Register](#) of notifications of undersegregated or undersecured conditions at an FCM. CFTC Rule 1.12 currently provides for early warning reporting requirements which are designed to provide advance notice of an FCM's financial or operational problems in order for corrective action to be taken on a timely basis. However, these notifications currently focus on capital problems. The new proposal will incorporate such notifications for undersegregated or undersecured conditions.

The proposal requires an FCM to notify both its designated self regulatory organization (DSRO) and the CFTC immediately when it knows or should know that it has failed to maintain sufficient funds in segregation or in separate set-aside accounts. The proposal acknowledges that the timing of such notification will depend on the circumstances. However, in the event of major market moves, the CFTC expects an FCM to consider the impact of the move on their segregated/secured positions. If the FCM has reason to believe that this impact could be material (and negative to its customers' positions), the CFTC advises the FCM to report a "possible" undersegregated condition. In situations where losses are spread among many accounts and the firm does not know it is undersegregated until the completion of its daily segregation computation on the following day, notification should be made at that point.

In addition, the proposal amends current rules which require notification within 24 hours of an undercapitalized situation to immediate notification.

The JAC strongly encourages FCMs to comment on this proposal. Comments are due to the CFTC by March 16, 1998. In addition, if you have any questions regarding the proposal, please call your DSRO.