Joint Audit Committee

Regulatory Update

TO: **Chief Financial Officers** **9808**
Chief Compliance Officers

DATE: **September 21, 1998**

RE: **CFTC Final Rule on Notifications of Undersegregated Conditions**

The CFTC recently amended its early warning reporting requirements. CFTC Rule 1.12 requires notice of an FCM's financial or operational problems in order for corrective action to be taken on a timely basis.

The new rules require *immediate* notification by an FCM to both its DSRO and the CFTC if an FCM *knows or should know* that it is in an undersegregated or undersecured condition (i.e. the FCM has insufficient funds in segregated or set aside accounts to meet the FCM's obligations to customers). The Commission has defined *should know* as the point "at which a party, in the exercise of reasonable diligence, should become aware of an event". The Commission has also offered the following example of when an FCM *knows or should know* that it may be undersegregated or undersecured and should report: (1) there is a significant undermargined account; (2) the customer makes clear that it is unable or unwilling to meet the margin call; and (3) the FCM is aware that it will be unable to transfer enough funds from its own accounts into segregated or secured accounts to cover the shortfall.

In adopting the new rule, the Commission did not intend that FCMs make additional segregation calculations on a routine basis, but only to do so if a problem arises. It also recognized the need for time to consult with senior management prior to determining that immediate notification is required.

The new rules also require immediate telephonic notice of Rule 1.12(a) undercapital and Rule 1.12(f)(2) margin call events and codify industry practice of allowing Rule 1.12 notices to be filed by facsimile, in lieu of telegraphic means.

Attached is a copy of the Federal Register.

If you have any questions, please call your DSRO.
