

# Joint Audit Committee

## Regulatory Update

TO: Chief Financial Officers  
Chief Compliance Officers

0103

DATE: June 4, 2001

SUBJECT: CFTC Regulation 1.25 – Investments of Customer Segregated Funds

CFTC Regulation 1.25 was revised effective December 28, 2000 to greatly expand the list of allowable investments of customer segregated funds. Under certain conditions, FCMs may now invest customer segregated funds in municipal securities, government sponsored agencies and other instruments as well as transact repurchase agreements with invested customer segregated funds' securities. Refer to the attached [Guide to CFTC Reg.. 1.25](#) and the final rule for more information and restrictions.

The final rule and subsequent corrections were published in the *Federal Register* and can be found on the CFTC's web site at [www.cftc.gov](http://www.cftc.gov) and on the Joint Audit Committee's web site at [www.wjammer.com/jac](http://www.wjammer.com/jac).

If you have any questions, please contact your DSRO.

## Investments of Customer (Segregated) Funds

This Guide provides general information regarding CFTC Regulation 1.25 and is intended to supplement, not replace, the CFTC requirements. It is the responsibility of the FCM to keep informed of, and to comply with, the requirements of the CFTC. The Joint Audit Committee is not responsible for any errors or omissions contained in this Guide.

Type of Investment	Readily Marketable	Rating by NRSRO	Concentration Limits Apply	Other Requirements
U.S. Government Securities	Yes	Not Applicable	Not Applicable	None
Municipal Securities	Yes	Yes (1)	Yes (3)	None
Government Sponsored Agency Securities	Yes	Yes (1)	Yes (3)	None
Certificates of Deposit (bank issued)	Yes	Yes (1)	Yes (3)	Yes (4)
Commercial Paper	Yes	Yes (1)	Yes (3)	None
Corporate Notes – Asset Backed	Yes	Yes (2)	Yes (3)	None
Corporate Notes – Non-Asset Backed	Yes	Yes (1)	Yes (3)	None
Foreign Sovereign Debt	Yes	Yes (2)	Not Applicable	Yes (5)
Money Market Mutual Funds	No	If rated (2)	Not Applicable	Yes (6)

**Notes:**

- (1) The investment must have the highest short-term rating of at least one Nationally Recognized Statistical Rating Organization (“NRSRO”) or one of the two highest long-term ratings of at least one NRSRO.
- (2) The investment must have the highest rating of at least one NRSRO (Note: Money Market Mutual Funds are not required to be rated).
- (3) The investment of any single issuer may not exceed 5% or, for Government Sponsored Agency Securities, 25% of total segregated assets (excluding customer owned securities). Securities issued by entities that are affiliated shall be aggregated and deemed to be the securities of a single issuer for concentration limit purposes. These concentration limits also apply to securities owned by the FCM that are subject to repurchase agreements. Note: Separate concentration limits apply to collateral to reverse repurchase agreements. Refer to Reg. 1.25 for details.
- (4) Certificates of Deposit, if negotiable, must be able to be liquidated in one business day or, if non-negotiable, must be redeemable at the issuing bank within one business day. In addition, the written agreement must provide that any early withdrawal penalty is limited to accrued interest earned.
- (5) An FCM may invest in the sovereign debt of a country to the extent that it has customer segregated liabilities denominated in that country’s currency.
- (6) Special rules apply to Money Market Mutual Funds regarding registration, calculation of Net Asset Value, redemption of shares and the pledging/transferring of shares.

## **Investments of Customer (Segregated) Funds**

### General Restrictions and Requirements:

- Investments in Reverse Repurchase and Repurchase Agreements are allowed. Refer to Reg. 1.25 for details.
- The dollar-weighted average of the time-to-maturity of the portfolio (excluding Money Market Mutual Funds) cannot exceed 24 months.
- No instrument may contain an embedded derivative (except a Money Market Mutual Fund), an interest-only feature, or provide payments which are linked to a commodity, currency, reference instrument, index or benchmark except that variable rate securities are permitted under certain circumstances.
- An FCM cannot invest in obligations of its affiliates but may invest in a fund affiliated with the FCM.
- If an instrument is downgraded by a NRSRO below an acceptable rating, the instrument must be valued at the lesser of the current market value or the market value on the day preceding the downgrade, less 20% of that value for each day since the downgrade.