

Joint Audit Committee

Regulatory Update

TO: Chief Financial Officers
Chief Compliance Officers

03-02

DATE: February 20, 2003

SUBJECT: CFTC Regulation 1.25 – Allowable Investments of Customer Segregated Funds

With the adoption of CFTC Regulation 1.25 in December 2000, the list of allowable investments of customer segregated funds was greatly expanded. During the past two years, many FCMs have invested customer segregated funds in money market mutual funds as allowed under the Regulation. Through its risk-based examinations of FCMs, the Joint Audit Committee has been reviewing these investments and has identified several errors in the calculation of capital charges. With respect to computing the capital haircuts on money market mutual fund investments:

- Generally, SEC Rule 15c3-1(c)(2)(vi)(D) states that a haircut of 2% of the market value of investments in “money market funds” is required to be deducted from net capital.
- The same 2% haircut is applicable on the market value of money market mutual fund investments in Chicago Mercantile Exchange Inc.’s Interest Earning Facility–2 (IEF[®]2) Program.
- Firms must include both the investment and accrued dividend earnings when computing the capital haircut on money market mutual fund investments.
- Lastly, firms are reminded that the 2% haircut on money market mutual fund investments must be considered when determining intra-month capital compliance.

Regulation 1.25 was published in the Federal Register and may be found on the CFTC’s Web site at www.cftc.gov and on the Joint Audit Committee’s Web site at www.wjammer.com/jac.

If you have any questions, please consult your DSRO and/or the Commission.