

Joint Audit Committee

Regulatory Update

TO: Chief Financial Officers
Chief Compliance Officers

04-01

DATE: March 3, 2004

SUBJECT: CFTC Regulation 1.25 Amendments – Investment of Customer Funds

CFTC Regulation 1.25 was amended to allow FCMs and derivatives clearing organizations (“DCOs”) to enter into repurchase agreements (“repos”) with customer deposited securities and to modify the time-to-maturity requirements for securities deposited in certain collateral management programs of DCOs. The amendments become effective March 11, 2004.

Repos with Customer-Owned Securities

FCMs and DCOs may engage in repos with customer-owned securities subject to:

- The customer-owned securities must be readily marketable;
- The customer-owned securities shall not be “specifically identifiable property” as defined in CFTC Regulation 190.01(kk). In general, direct obligations of the U.S. government are allowable;
- The terms and conditions of the repurchase agreement must be in compliance with CFTC Regulation 1.25(d); and
- Upon default by a counterparty to a repurchase agreement, the FCM or DCO must act promptly to ensure that the default does not result in any direct or indirect cost or expense to the customer.

Amended CFTC Regulation 1.25 does not contain a requirement for written disclosure and customer consent to engage in repos with customer-owned securities. However, customers may require, through their account agreements, that their FCM obtain prior consent before engaging in repos with their customer-owned securities.

Customer-owned securities that are subject to a repo should be treated as direct investments for concentration purposes under CFTC Regulation 1.25(b)(4)(ii).

Finally, the amendments to CFTC Regulation 1.25 concerning repos with customer-owned securities replace CFTC Staff Letter 84-24.

Time-to-Maturity Requirements for Certain Collateral

In computing the time-to-maturity requirements for a portfolio of permitted investments, amended CFTC Regulation 1.25 permits certain instruments to be treated as if they had a time-to-maturity of one day provided:

- The instrument is deposited solely on an overnight basis with a DCO pursuant to a collateral management program that has become effective in accordance with CFTC Regulation 39.4;

- The instrument is one that the FCM owns or has an unqualified right to pledge, is not subject to any lien, and is deposited into a segregated account at a DCO;
- The DCO prices the instrument each day based on the current mark-to-market value; and
- The DCO applies a haircut of a least 2 percent to the market value of the instrument.

The amendments to CFTC Regulation 1.25 were published in the Federal Register on February 10, 2004 and may be found on the CFTC's Web site at www.cftc.gov.

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