

# Joint Audit Committee

## Regulatory Update

TO: Chief Financial Officers  
Chief Compliance Officers

#04-04

DATE: August 20, 2004

SUBJECT: CFTC Adoption of Risk-Based Capital and Other Reporting Requirements

The CFTC recently adopted amendments to its minimum and early warning capital levels, subordinated debt and equity withdrawal levels, notification requirements, and other reporting requirements. These amendments are summarized below and become effective September 30, 2004.

### Risk-Based Capital Requirements

The CFTC adopted a risk-based minimum capital requirement for FCMs computed as 8% of the total risk margin requirement for all positions carried in customer accounts plus 4% of the total risk margin requirement for all positions carried in noncustomer accounts. The risk-based capital requirement replaces the capital computation based on segregated and secured funds. Such risk-based capital requirement is identical to the requirement already adopted and enforced by several exchanges and NFA.

An early warning capital level was adopted as 110% of the risk-based capital requirement.

Note: The Form 1-FR-FCM has been revised to incorporate the above changes and further, such changes are currently being incorporated in the WinJammer™ system, an electronic financial statement filing system.

### Subordinated Debt and Equity Withdrawal Requirements

In conjunction with the changes to its capital requirements, the CFTC incorporated the following levels into the various requirements concerning subordinated loan agreements:

- 120% of risk-based capital for permissive (greater than 1 year outstanding) prepayments of subordinated loans.
- 125% of risk-based capital for special (equal to or less than 1 year outstanding) prepayments of subordinated loans.
- 120% of risk-based capital for suspended repayments of subordinated loans, to provide notification of maturity or accelerated maturity of subordinated loans, and restrictions on use of temporary subordinated loans.

Note: Satisfactory subordinated loan agreements in effect as of September 30, 2004 will be grandfathered in and shall continue to be deemed satisfactory subordinated debt until maturity. However, any

subordinated loan agreements which are amended or renewed for any reason after such date must be amended for the new requirements as detailed in the regulations.

Further, in conjunction with the changes to its capital requirements, the CFTC incorporated 120% of risk-based capital as part of its equity withdrawal restrictions.

#### Notification Requirements

An FCM must provide written notification within 24 hours after it knows or should have known that its adjusted net capital is less than early warning capital levels.

If an FCM fails to maintain current books and records as required by the regulations, such FCM must on the same day such event occurs, provide written notice of the noncurrent books and records. Further, within 48 hours of filing such notice, a written report must be filed stating the steps taken or to be taken to correct the situation.

An FCM must provide written notification within 24 hours whenever it discovers or is notified of the existence of a material inadequacy and must within 48 hours of filing such notice file a written report stating the steps taken or to be taken to correct the material inadequacy.

Note: The above notifications must be provided to the CFTC, the firm's DSRO, the SEC if a dually registered FCM-Broker/Dealer, and to all other self-regulatory organizations as required by their individual rules.

#### Reporting Requirements

All FCMs must submit to the Commission and their DSRO a monthly Form 1-FR-FCM or for dually registered FCM-Broker/Dealers a monthly FOCUS Report within 17 business days of month-end.

The persons providing the oath or affirmation required on all Form 1-FR-FCM and FOCUS Reports has been clarified and expanded for limited liability companies to include chief executive officers, chief financial officers, managers, managing members or those members vested with management authority.

#### Reporting Requests

FCMs may request and receive approval from their DSRO for extensions of time to file uncertified financial reports and for changes in fiscal years. Copies of the requests and approval/denial letters must be filed with the Commission.

Finally, the amendments do not include any changes, as originally proposed, to the capital charges for undermargined accounts.

The amendments were published in the Federal Register on August 12, 2004 and may be found on the CFTC's Web Site at [www.cftc.gov](http://www.cftc.gov). Further, the CFTC has updated the 1-FR-FCM Instruction Manual, also available on the CFTC's Web Site, for these rule amendments.

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