

Joint Audit Committee

Regulatory Update

TO: Chief Financial Officers
Chief Compliance Officers

#05-01

DATE: June 17, 2005

SUBJECT: **AMENDMENT OF INTERPRETATION NO. 10 RE: THIRD PARTY CUSTODIAL ACCOUNTS**

The CFTC's Division of Clearing and Intermediary Oversight (DCIO) has amended Financial and Segregation Interpretation No. 10, Treatment of Funds Deposited with Safekeeping Accounts.

Interpretation No. 10 was initially adopted in 1984 to address the issue of whether customer funds may be deposited at a bank in a safekeeping or custodial account (generally known as a "third-party custodial account") in lieu of posting such funds directly with an FCM, without being deemed to violate the segregation requirements. Since Section 17(f) of the Investment Company Act of 1940, at the time, was interpreted by Securities and Exchange Commission (SEC) staff to generally bar registered investment companies (RICs) from using FCMs and futures clearinghouses as custodians of fund assets, it was decided that the use of third-party custodial accounts should not be banned altogether and that Section 4d(a)(2) should be interpreted to permit customer funds to be held in such accounts, subject to standards designed to ensure the carrying FCM's right of immediate access to customer funds.

However, in 1996, the SEC adopted Rule 17f-6, which permitted RICs, with limited exception, to deposit, hold and maintain their assets with FCMs in connection with futures transactions executed on U.S. and foreign exchanges. The exception pertains to an FCM that is precluded from holding RIC assets due to an affiliation with a RIC or its advisor. In addition to this ruling, certain practical and operational factors have come to light since the adoption of Interpretation No. 10 that may impair the carrying FCM's right of immediate and unfettered access to customer funds.

Accordingly, Interpretation No. 10 has been amended to provide that, with the exception of an FCM that is affiliated with a RIC or its advisor, FCMs may not deposit, hold or maintain customer margin in a third-party account., FCMs have until February 13, 2006 to come into compliance with the amended interpretation. The full text of the Federal Register Release concerning this amendment may be found at:

<http://www.cftc.gov/foia/fedreg05/foi050511b.htm>

If you have any questions, please consult your DSRO.