

Joint Audit Committee

Regulatory Update

TO: Chief Financial Officers
Chief Compliance Officers

#08-02

DATE: March 25, 2008

SUBJECT: Liquidity of CFTC Regulation 1.25 Permitted Investments

CFTC Regulation 1.25 details the permitted investments of customer funds. Current events reported in the structured finance and mortgage markets (i.e. various write-downs, credit downgrades, SIV-related exposures, sub-prime mortgage crisis) have resulted in the possibility that certain investments may satisfy specific requirements that are set forth in CFTC Regulation 1.25, but fail to comply with the general obligation under CFTC Regulation 1.25 to preserve principal and maintain liquidity.

More specifically, CFTC Regulation 1.25(b) *General terms and conditions* indicates that an FCM is required to manage the permitted investments consistent with the objectives of preserving principal and maintaining liquidity. Therefore, investments such as mortgage-backed securities, collateralized debt obligations, collateralized mortgage obligations, and specific tranches of these obligations, even if potentially included as permitted investments under CFTC Regulation 1.25, may not be acceptable investments of customer funds pursuant to CFTC Regulations if they do not meet the objective of preserving principal and maintaining liquidity. Further, firms should consider these conditions for any such investments for capital and secured 30.7 purposes.

FCMs are reminded to carefully and continuously review their investment portfolios.

If you have any questions, please consult your DSRO.