Joint Audit Committee

Regulatory Update

TO: Chief Financial Officers
Chief Compliance Officers

08-04

DATE: May 19, 2008

SUBJECT: CFTC Regulation 1.25 – Investment of Customer Funds

As evidenced during recent examinations, firms enter into repurchase agreements with securities deposited by customers as margin. The Joint Audit Committee would like to remind FCMs of the regulatory requirements relating to these types of transactions.

CFTC Regulation 1.25 allows FCMs and derivatives clearing organizations ("DCOs") to enter into repurchase agreements ("repos") with customer deposited securities that are permitted investments under 1.25.

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.

Under CFTC Regulation 1.25(b)(4)(vi), for purposes of determining compliance with the concentration limits in 1.25(b)(4)(ii), customer-owned securities that are subject to a repo transaction are not included in total assets held in segregation.

CFTC Regulation 1.25, as amended March 11, 2004, 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.

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