

Joint Audit Committee

Regulatory Update

TO: Chief Financial Officers
Chief Compliance Officers

#08-07

DATE: November 19, 2008

SUBJECT: Offsetting/securing deficits with readily marketable collateral

For segregation statement reporting purposes, CFTC Regulation 1.32(b) allows a net deficit in a particular customer's segregated account to be offset against the current market value of readily marketable securities, less applicable haircuts, held in the same customer's segregated account. This treatment should also be considered for reporting deficit balances on the secured statement.

Similarly, CFTC Regulation 1.17(c)(3)(i) allows a net deficit in a particular customer or noncustomer account to be secured by the current market value of readily marketable securities, less applicable haircuts, held in the same origin in the same customer/noncustomer's account for balance sheet reporting purposes.

The "ready market" definition is, in part, the ability to obtain independent bona fide offers to buy and sell securities so that a price, reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined almost instantaneously and where payment will be received in settlement of a sale at such price within a relatively short time.

Current events reported in the structured finance and mortgage markets (i.e. various write-downs, credit downgrades, SIV-related exposures, CDS portfolio exposures, sub-prime mortgage crisis) have resulted in the possibility that competitive bona fide bid and offer quotations may not be available or that a desired sale of these securities may not be possible on an immediate basis. Firms must be able to provide evidence that the required conditions are met and that the security is both readily marketable and highly liquid, a condition which is inherent in the "ready market" definition or the security should not be considered acceptable for the offsetting or securing of deficit balances on the segregation/secured statements or balance sheet, as applicable.

Please be aware that the requirements regarding the treatment of futures customer and noncustomer debit/deficits are governed by the CFTC regulations. The SEC interpretive non-action letters permitting reduced capital charges for certain investments meeting specific requirements that were otherwise not considered "readily marketable" only apply to the computation of capital and do not impact the offsetting or securing of debit/deficit balances on the segregation/secured statements or balance sheet, as applicable.

Firms are reminded to carefully and continuously review securities accepted from its account holders.

If you have any questions, please consult your DSRO.