

Joint Audit Committee

REGULATORY UPDATE

TO: Chief Financial Officers
Chief Compliance Officers

#09-02

DATE: February 10, 2009

SUBJECT: FDIC Temporary Liquidity Guaranteed Collateral

Recently, clarification has been requested in determining the acceptability of collateral issued under the Federal Deposit Insurance Corporation ("FDIC") Temporary Liquidity Guarantee Program ("TLGP").

Under this program, newly issued unsecured debt issued by participating entities, meeting certain criteria imposed by the FDIC, may be afforded a FDIC guarantee of principal and interest.

CFTC Regulation 1.25 defines permitted investments of customer funds. Further, under the terms of CFTC Regulation 1.25, investments must be consistent with the objectives of preserving principal and maintaining liquidity. These same objectives should be followed with respect to investments of customer secured amounts under CFTC Regulation 30.7. Similarly, CFTC Regulations 1.17(c)(3)(i) and 1.32(b) allow a net deficit in a particular account to be secured or offset, respectively, against the current market value of readily marketable and highly liquid securities, less applicable haircuts. SEC Rule 15c3-1(c)(11) defines readily marketable, in part, as including the existence of independent bona fide offers to buy and sell securities with quotations that can be determined almost instantaneously.

As of yet, there has been no demonstration that these TLGP issued debt instruments are highly liquid or have immediate quotations from independent bona fide offers to meet the requirements of these CFTC regulations. Therefore, this debt is not an acceptable investment for customer segregated or customer secured funds, and is not an acceptable security to offset or secure a debit/deficit on the segregation/secured statement or balance sheet, as applicable.

In addition, the following criteria should be used in determining the capital treatment of TLGP issued debt held in the firm's inventory:

- Debt securities issued by un-affiliated entities which meet the conditions of the TLGP should be reflected as a current asset. SEC Rule 15c3-1(c)(2)(vi)(A)(Government Securities) should be followed for the appropriate securities haircut.
- Debt securities issued by affiliated entities which meet the conditions of the TLGP should be reflected as a non-current asset unless conditions are met as required by SEC Rule 15c3-1(c)(2)(vi)/061(Intercompany Securities Holding-Redeemable Debt Instruments).

If you have any questions, please consult your DSRO.