

CFTC Letter No. 02-94

August 8, 2002

No Action

Division of Clearing and Intermediary Oversight

X
XX
XXX
XXXX
XXXXX

Re: No action position concerning the treatment of XXX stock for purposes of computing adjusted net capital under Rule 1.17.

Dear X:

This is in response to your letter dated June 3, 2002, submitted on behalf of the XXX (“XXX”), in which you request that the Division of Clearing and Intermediary Oversight (“Division”), of the Commodity Futures Trading Commission (“Commission”), not recommend that the Commission commence an enforcement action with respect to a futures commission merchant (“FCM”) that includes the value of XXX stock as a current asset in computing its adjusted net capital under Commission Rule 1.17.^[1] Commission Rule 1.17(c)(2)(viii) permits an FCM to include the stock of a clearing corporation as a current asset in computing its adjusted net capital, to the extent of the margin value of such stock. XXX, however, does not accept XXX stock as margin.

In July 1995, the Commission’s Division of Trading and Markets (“T&M”) issued a letter (“Prior Letter”) to the XXX, which stated that T&M would not recommend that the Commission commence an enforcement action against an FCM that included the value of XXX stock as a current asset in its calculation of adjusted net capital for purposes of determining compliance with Rule 1.17.^[2] T&M’s position was conditioned upon, among other things, that XXX maintain at least 85 percent of its assets in cash or in a portfolio of U.S. Treasury securities. At the time the Prior Letter was issued, Commission Rule 1.25 limited the investment of customer segregated funds by a clearing organization to obligations of the United States, general obligations of any state or political subdivision thereof, or in obligations fully guaranteed as to principal and interest by the United States.

The Commission recently amended Rule 1.25 by expanding the list of permitted investments for customer segregated funds to include, among other investments, U.S. Treasury securities, municipal securities, money market mutual funds, corporate notes, and certificates of deposit.^[3] The June 3, 2002 letter requests that the Division amend the Prior Letter in light of the revisions to Rule 1.25 so that XXX

may invest customer segregated funds in the Rule 1.25 permitted investments without requiring FCMs to classify XXX stock as a non-current asset for purposes of computing adjusted net capital under Rule 1.17.

You represent that, as of December 31, 2001, XXX had approximately \$186,200,000 in capital, of which approximately \$139,700,00 was invested in U.S. Treasury notes and bills having a maturity of two years or less, and approximately \$25,800,000 was held in cash. You further represent that in an emergency situation, a clearing member's stock could be converted to cash in a few days from XXX's immediately available liquid assets, except for a reasonable amount held back to cover any unpaid amounts, which would consist primarily of clearing fees.

Based upon the facts and representations set forth in your June 3, 2002 letter and the Prior Letter,^[4] the Division will not recommend that the Commission commence an enforcement action against an FCM that includes the value of XXX stock as a current asset in its calculation of adjusted net capital, subject to the following conditions:

- An FCM must take a 5 percent haircut on the value of its XXX stock in its computation of adjusted net capital;
- XXX will maintain at least 85 percent of its assets in cash or in investments permitted under Rule 1.25;
- XXX will notify the Division in advance of the event of an anticipated failure to maintain at least 85 percent of its assets in cash or Rule 1.25 investments; and
- XXX will routinely provide the Division copies of its quarterly and annual financial statements, which will detail the composition of its assets.

This letter is based upon the representations you have made to the Division and is subject to compliance with the conditions set forth above. Any different, changed or omitted facts or circumstances might render the positions taken herein void. Further, this letter represents the views of this Division only and does not necessarily represent the views of the Commission or of any other office or division of the Commission. If you have any questions regarding this letter, please contact me or Thomas Smith, Deputy Director, at (202) 418-5495.

Very truly yours,

Jane Kang Thorpe
Director

cc: Regina Thoele, Compliance
National Futures Association

[1] Commission rules referred to herein are found at 17 C.F.R. Ch I *et seq.* (2001).

[2] Letter dated July 17, 1995 from Andrea M. Corcoran to W.

[3] 65 FR 77993 (December 13, 2000); 65 FR 82270 (December 28, 2000).

[4] In support of your request you state that the facts and representations included in the Prior Letter have remained unchanged with the exception of amount and composition of XXX capital, which is set forth as of December 31, 2001, above.