



March 2010

COMMODITY FUTURES TRADING COMMISSION

COMMODITY FUTURES TRADING COMMISSION

FORM 1-FR-FCM

INSTRUCTIONS

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INTRODUCTION

The Commodity Futures Trading Commission ("Commission" or "CFTC") has prepared these instructions to help futures commission merchants ("FCMs") complete CFTC Form 1-FR-FCM. This form is to be used by FCMs in reporting their net capital position and other financial information, as required, under the Commodity Exchange Act ("CEAct").

When used in these instructions, the term "FCM" also applies to applicants for registration, unless otherwise specified.

The terms "Form 1-FR-FCM" and "financial report" may be used interchangeably in these instructions.

Where these instructions conflict with previous interpretations or guidance provided by the Commission's staff, these instructions take precedence.

PUBLIC REPORTING BURDEN

Public reporting burden for this collection of information is estimated to average 2.75 hours per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this, to

Agency Clearance Officer
Office of Administrative Services
Commodity Futures Trading Commission
1155 21st St. N.W.
Washington, D.C. 20581

and to

Office of Information and Regulatory Affairs
Office of Management and Budget
(Paperwork Project Number 3038-0024)
Washington, D.C. 20503.

FILINGS BY FCMs THAT ARE ALSO SECURITIES BROKERS/DEALERS

An FCM which is also registered with the Securities and Exchange Commission ("SEC") as a broker or dealer in securities ("FCM-broker/dealer") may file with the CFTC a Financial and Operational Combined Uniform Single Report under the Securities Exchange Act of 1934 ("FOCUS Report") in lieu of Form 1-FR-FCM.

A FOCUS Report submitted to the CFTC by an FCM-broker/dealer in lieu of the Form 1-FR-FCM should be prepared in accordance with SEC rules and instructions applicable to the FOCUS Report. If the SEC rules and instructions to the FOCUS report require an item to be treated differently than do these instructions, the FCM-broker/dealer should report the item in the FOCUS Report in accordance with the SEC rules and instructions to the FOCUS Report. However, if the item is material, the FCM-broker/dealer should include a separate explanation of the item with the FOCUS Report submitted to the CFTC. If the SEC rules and instructions for preparation of the FOCUS Report do not specify how an item should be treated, the FCM-broker/dealer should report the item in accordance with these instructions.

Additional general guidelines for FCM-broker/dealers are as follows.

Marking to Market Open Positions in Customers' and Noncustomers' Trading Accounts

In reporting receivables from commodity customers and noncustomers on the FOCUS Report, an FCM-broker/dealer must mark to market all open positions in its accounts. This includes reflecting the value of commodity option positions in assessing whether such accounts liquidate to a net equity (payable) or a net deficit (receivable) on a customer by customer basis.

Commodity Customers' and Noncustomers' Securities

An FCM-broker/dealer which is holding securities for customers or noncustomers as margin for their commodity accounts should reflect such securities on the Statement of Financial Condition, if the SEC rules and instructions for the preparation of the FOCUS Report, or securities regulators, require reporting securities in such manner. An FCM-broker/dealer must also reflect commodity customers' securities on the Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges, the Statement of Segregation Requirements and Funds in Segregation for Customers' Dealer Options Accounts, and the Statement of Secured Amounts and Funds Held in Separate Accounts for Foreign Futures and Foreign Options Customers required by the following section to be submitted to the CFTC in addition to the FOCUS Report.

Any FCM, whether or not also a securities broker/dealer, may for convenience report securities owned by particular customers and noncustomers at the face or maturity value of the securities if the securities represent U.S. or Foreign Government Obligations and the face or maturity value approximates market value. However, such report presentation does not impact the computation of the allowable value of such securities for the determination of an FCM-broker/dealer's required collateral for customer receivables or margin purposes in accordance with CFTC regulations.

Statement and Schedules that are not Part of the FOCUS Report

The Form 1-FR-FCM includes the following four statements, which must be completed by all FCMs, including FCM-brokers/dealers filing FOCUS Reports in lieu of all other sections of the 1-FR-FCM:

Computation of CFTC Minimum Net Capital Requirements

Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges

Statement of Segregation Requirements and Funds in Segregation for Customers' Dealer Options Accounts

Statement of Secured Amounts and Funds Held in Separate Accounts for Foreign Futures and Foreign Options Customers.

The SEC has included these statements in the current version of the FOCUS Report for the convenience of FCM-broker/dealers. However, an FCM-broker/dealer should either copy the forms for these statements directly from the Form 1-FR-FCM or verify that the forms the SEC has included in the FOCUS Report are the then current CFTC forms for these statements prior to using them for submission to the CFTC.

WHERE TO FILE FINANCIAL REPORTS

Unless an FCM is filing its financial report electronically, it should send such financial report to the following applicable office:

if the FCM is located in Illinois, Indiana, Michigan, Ohio, or Wisconsin, the FCM should file its financial reports with:

Commodity Futures Trading Commission
Audit and Financial Review Branch
525 W. Monroe Street, Suite 1100
Chicago, IL 60606
Phone: 312-596-0581
Fax: 312-596-0713;

except with respect to the states listed above, if an FCM's principal office is located east of the Mississippi River, the FCM should file its financial reports with:

Commodity Futures Trading Commission
Audit and Financial Review Branch
140 Broadway
New York City, NY 10005
Phone: 646-746-9717
Fax: 646-746-9937; and

all other FCMs should file their financial reports with:

Commodity Futures Trading Commission
Audit and Financial Review Branch
Two Emmanuel Cleaver II Blvd, Ste. 300
Kansas City, MO 64112
Phone: 816-931-7700
Fax: 816-931-7750

Electronic delivery instructions should be obtained from the FCM's designated self regulatory organization ("DSRO").

ELECTRONIC FILING OF FINANCIAL REPORTS

Generally, FCMs file financial reports with their self-regulatory organizations ("SRO") and with the Commission in an electronic, rather than paper format. However, audited financial reports provided for the FCM's fiscal year-end must also be filed in hard copy (paper) form with the Commission.

An FCM must file with its DSRO a separate user identification application form for each individual at the FCM who will submit financial reports electronically on its behalf. The application form signed by the individual must include the representation that the signer is a person duly authorized to sign the financial reports and to provide the oath or affirmation regarding the information contained therein in accordance with applicable Commission regulations. Any individual who submits a financial report for the FCM must attest that, to the best of his or her knowledge, the statements, schedules, and all other information contained in an electronically filed financial report are true and correct. This attestation is deemed made by such individual's use of a unique user authentication assigned to such individual in accordance with procedures approved by the Commission. The appropriate individual making the oath must be:

(1) if the registrant or applicant is a sole proprietorship, the proprietor; if a partnership, any general partner; if a corporation, the chief executive officer or chief financial officer, and, if a limited liability company or limited liability partnership, the chief executive officer, the chief financial officer, the manager, the managing member, or those members vested with the management authority for the limited liability company or limited liability partnership, or

(2) if the registrant or applicant is registered with the Securities and Exchange Commission as a securities broker or dealer, the representative authorized under 17 CFR 240.17a-5 to file for the securities broker or dealer its FOCUS Report.

The DSRO will provide the right to electronically submit financial reports only to appropriate attesting individual(s) at the FCM. The FCM's internal controls should ensure that only an individual assigned a user authentication knows and uses his/her unique authentication to make the attestation. When a new authorized signer for electronically filed reports is required, an FCM should promptly notify its DSRO to obtain a user authentication for the new individual making the financial report attestation.

After an FCM transmits a financial report to the Commission electronically, the FCM is responsible to confirm the Commission's receipt of such report by checking the status of the filing on the electronic server. In the event an FCM encounters difficulty transmitting any financial report to the Commission, the FCM should contact the Audit and Financial Review Branch in the Regional Office of the Commission where the FCM is required to file such report (See "WHERE TO FILE FINANCIAL REPORTS", above.)

SPECIAL CALLS FOR FINANCIAL DATA

Any SRO of which an FCM is a member may ask the FCM for a financial report or other financial information, even though the SRO is not the FCM's designated self-regulatory organization ("DSRO"). Also, a DSRO or the Commission may ask for additional financial reports or other information that is in addition to the routine 1-FR-FCM or FOCUS Report filings made by an FCM or an FCM-broker/dealer.

An FCM or FCM-broker/dealer must promptly file with the Commission an exact copy of each financial report or other financial schedule filed with any SRO, including routine filings, special calls, and amended financial reports. Unless otherwise specified, such special filings may be made by electronic delivery.

A financial report will not be considered filed until the SRO and the Commission have received it. It is not sufficient for an FCM or FCM-broker/dealer to mail a statement by its due date for the report to be filed in a timely manner.

CONTENTS OF FINANCIAL REPORTS

The financial statements included in Form 1-FR-FCM are listed in the table below. Audited statements are required only for year-end statements and should be submitted within sixty (60) calendar days of an FCM-broker/dealer's fiscal year-end or ninety (90) calendar days of an FCM's fiscal year-end. Unaudited statements are required for every month, including the year-end month, within seventeen (17) business days of the end of the month. The Statement of Cash Flows is required to be filed only at year-end, unless such statement is required to be filed by an SRO's rules or is requested in a special call. All other statements must be included in all unaudited financial reports filed with the Commission and the FCM's DSRO.

In addition to the financial report statements filed by an FCM, an FCM must also include disclosure of all material information necessary to make such statements as filed not misleading.

Contents of Report	Audited	Unaudited
Statement of Financial Condition	X	X
Statement of the Computation of the Minimum Capital Requirements	X	X
Statement of Income (Loss)	X	X
Statement of Changes in Ownership Equity	X	X
Statement of Changes in Liabilities Subordinated to the Claims of General Creditors Pursuant to a Satisfactory Subordination Agreement	X	X
Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges	X	X
Statement of Segregation Requirements and Funds in Segregation for Customers' Dealer Options Accounts	X	X
Statement of Secured Amounts and Funds Held in Separate Accounts for Foreign Futures and Foreign Options Customers Pursuant to Commission Regulation 30.7	X	X
Statement of Cash Flows	X	
Auditor's Opinion	X	
CPA's Report on Material Inadequacies	X	
Notes	X	
Attestation of the appropriate individual for the type of entity as to truth and correctness. Such individual's use of the unique user authentication assigned to it for the electronic submission of financial reports shall be deemed the making of the report attestation. Audited reports must be accompanied by a signed attestation page from the 1-FR-FCM. (See "ELECTRONIC FILING OF FINANCIAL REPORTS" above.)	X	X

Year-End Reports

An FCM is required to file both an audited and an unaudited report as of the end of its fiscal year. The unaudited report is due 17 business days after the end of the FCM's fiscal year. The audited report is to be filed either 60 or 90 calendar days after the fiscal year-end depending on whether the FCM is an FCM-broker/dealer. (See "DUE DATES FOR FILING FINANCIAL REPORTS" below.)

If there are any material differences between the unaudited and audited year-end Statement of the Computation of the Minimum Capital Requirements, Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges, Statement of Segregation Requirements and Funds in Segregation for Customers' Dealer Options Accounts, or Statement of Secured Amounts and Funds Held in Separate Accounts for Foreign Futures and Foreign Options Customers Pursuant to Commission Regulation 30.7, the FCM must file a reconciliation of the two year-end statements that includes an appropriate explanation of the items accounting for the difference. If there are no material differences between the unaudited and audited statements, the FCM should include a statement to that effect. The reconciliations should be included within the scope of the public accountant's audit report, and filed at the same time as the audited report.

If the audited financial report is presented in accordance with GAAP, an FCM must include with the report a reconciliation between the Statement of Financial Condition which is presented in accordance with GAAP and the Statement of the Computation of the Minimum Capital Requirements. The reconciliation, which must also be audited and certified by the public accountant, should take the following general form:

**Reconciliation of the Statement of Financial Condition to the
Statement of the Computation of the Minimum Capital Requirements
as of ## / ## / ##**

Total assets per statement of financial condition	\$xxx,xxx
Additions <Deductions>: Assets not reflected in the Statement of Financial Condition or not allowed as net capital under section 1.17 of the Regulations under the Commodity Exchange Act (detail)	< <u>xx,xxx</u> >
Current assets under CFTC Regulation 1.17	<u>\$xxx,xxx</u>
Total liabilities per statement of financial condition	\$ xx,xxx
Additions <Deductions>: Liabilities not reflected in the Statement of Financial Condition or not considered as a liability for minimum net capital requirements (detail)	<u>x,xxx</u>
Liabilities under CFTC Regulation 1.17	<u>\$xxx,xxx</u>

DUE DATES FOR FILING FINANCIAL REPORTS

Unless an earlier filing due date is specified by DSRO rules or in a special call by an SRO or the Commission, financial reports are to be filed within a specified number of days following the “as of” date of the financial report:

Type of Report	No. of Days Due After “As Of” Date
1. Unaudited reports	17 Business Days
2. Audited fiscal year-end report	
a. FCM-broker/dealers	60 Calendar Days
b. FCMs <u>which are not FCM-broker/dealers</u>	90 Calendar Days
3. Special calls from SROs or CFTC	As specified in the call

A financial report is considered filed when properly received by the Commission and SRO, not when transmitted or posted by the FCM.

PERTINENT REGULATIONS AND INTERPRETATIONS

In completing its Form 1-FR-FCM, an FCM should be familiar with the following sections of the Commission's Regulations:

- 1.3 -- Definitions.
- 1.10 -- Financial reports of FCMs (filing requirements; contents of reports; electronic filing; election of, and changes in, fiscal year-end; filing extensions for unaudited reports; nonpublic treatment of reports).
- 1.12 -- Maintenance of minimum financial requirements by FCMs (notices to be filed with the Commission and DSRO concerning undercapitalization, inadequate segregated funds, noncurrent books and records, material inadequacies in internal accounting control, forced position liquidations, margin calls of a single customer or group of customers exceeding adjusted net capital, precipitous reductions of net capital and excess adjusted net capital).
- 1.16 -- Qualifications and reports of accountants (independence of accountants; opinion to be expressed; report on material inadequacies; audit objectives; extent and timing of audit procedures; extensions of time for filing audited reports; and replacement of public accountant).
- 1.17 -- Minimum financial requirements for FCMs.
- 1.18 -- Records for and relating to financial reporting and monthly net capital computation by FCMs; maintenance of ledgers, journals, and supporting records.
- 1.20 through 1.30 -- Customers' money, securities, and property (for U.S. commodity futures and exchange-traded options).
- 1.31 -- Books and records; keeping and inspection (retention period; inspection by Commission and U.S. Department of Justice; microfilming of records; records on microfiche and optical disk; optical storage systems; and electronic storage media).
- 1.49 -- Denomination of customer funds and location of depositories.
- 30.7 -- Treatment of funds of foreign futures and foreign options customers.
- 32.6 -- Segregation for dealer-granted options.

The following Financial and Segregation Interpretations issued by the CFTC's Division of Trading and Markets also provide pertinent information and guidance:

- Interpretation No. 3 - "Interpretations Relating to Secured Receivables"
- Interpretation No. 5 - "Interpretation Relating to Unsecured Accounts Receivable Included in Current Assets"
- Interpretation No. 7-1 - "Investment of Funds Representing an FCM's Residual Financial Interest in Customers' Segregated Funds"
- Interpretation No. 8 - "Proper Accounting, Segregation and Net Capital Treatment of Exchange-Traded Option Transactions"

- Interpretation No. 9 - "Money Market Deposit Accounts and NOW Accounts"
- Interpretation No. 10-1 - "Treatment of Funds Deposited in Safekeeping Accounts"
- Interpretation No. 11 - "Investments of Customer Regulated Funds, Treatment of Due Bills, Unsecured Receivables"
- Interpretation No. 13 - "Accounting for Checks Received From a Parent or an Affiliated Entity for Regulatory Compliance Purposes"
- Interpretation No. 14 - "Accounting for Deposits and Contractual Obligations Between an FCM and Its Introducing Brokers and Associated Persons"

The following interpretative letters issued by CFTC, as published in *Commodity Futures Law Reports* by Commerce Clearing House, Inc. ("CCH"), provide additional information pertinent to completion of the Form 1-FR-FCM:

<u>No.</u>	<u>Subject</u>
86-16	Treatment of Deficits in Customers' Accounts (CCH Para. 23,193)
86-21	Investment of Customer Funds in Municipal Securities (CCH Para. 23,266)
87-2	Classification of Accounts of Officers and Employees of Affiliated Companies (CCH Para. 23,652)
87-6	Treatment of Funds Held in Offshore Bank Accounts With Respect to Foreign Futures and Options Transactions (CCH Para. 23,971)
88-7	Designation of a Foreign Branch Office of a U.S. Bank as a Depository for a Separate Account under Reg. 30.7(c)(i) of the Foreign Futures and Options Rules (CCH Para. 24,192)
89-1	Restriction in Safekeeping Account Agreement (CCH Para. 24,404)
90-7	Secured Amount Account for Foreign Futures and Options (CCH Para. 24,826)
03-37	No-action position concerning the treatment of Clearing Corporation stock for purposes of computing adjusted net capital under Rule 1.17 (available at www.cftc.gov)

An FCM should also be familiar with the SEC's net capital rules in section 240.15c3-1 of the Code of Federal Regulations. Where the SEC has defined an asset, a percentage haircut to be applied to the value of an asset, or a liability in its rules, and this definition is not inconsistent with the CFTC's net capital rule, an FCM should use the SEC's definition in classifying its accounts. Likewise, the SEC's interpretations of its rules, to the extent not inconsistent with the CFTC's rules and interpretations, generally must also be applied. If an FCM has a question about the applicability of an SEC rule or interpretation in a particular situation, it should contact its DSRO or the Commission.

GENERAL INSTRUCTIONS FOR PREPARING FORM 1-FR-FCM

Accounting Principles

The Form 1-FR-FCM must be prepared in conformity with generally accepted accounting principles ("GAAP"), except to the extent the Commission's Regulations otherwise provide specific accounting treatment. GAAP must be applied on a basis consistent with that of the FCM's preceding financial report. The Form 1-FR-FCM must include, in the statements or in accompanying notes, all disclosures and material information necessary to make the financial report a clear and complete statement of the FCM's financial position under the Commission's rules. The FCM must properly accrue income and expenses applicable for the accounting period of the financial report. The FCM must record appropriate allowances for receivables, securities, and inventories, and must accrue unrecorded liabilities for the accounting period of the financial report.

Definitions

The terms "current assets", "liabilities", "net capital", and "adjusted net capital" are all defined terms that may be found in Section 1.17 of the Commission's Regulations. The Commission's Regulations are contained in Title 17 of the Code of Federal Regulations by section number.

Where the SEC has defined an asset, a percentage haircut to be applied to an asset, or a liability in its rules, which definition is not inconsistent with the CFTC's net capital rule, an FCM is to use such definition in classifying its accounts on the Form 1-FR-FCM. Likewise, the SEC's interpretations of its rules, to the extent not inconsistent with CFTC's rules and interpretations of CFTC rules, generally must also be applied.

Where the CFTC has defined an asset, a percentage haircut to be applied to an asset, or a liability in its rules which definition is not inconsistent with the SEC's net capital rule, an FCM-broker/dealer should use such definition in classifying its accounts on the FOCUS report. Likewise, CFTC's interpretations of CFTC's rules and haircuts, to the extent not inconsistent with SEC's rules and interpretations of SEC rules, must also be applied.

Where the SEC and CFTC rules and interpretations appear inconsistent, an FCM filing a Form 1-FR-FCM must prepare the report in accordance with CFTC rules and interpretations, and an FCM-broker/dealer filing a FOCUS Report must prepare the report in accordance with the SEC rules and interpretations.

Statement Headings

An FCM must complete fully the heading on each statement in the Form 1-FR-FCM. Each statement must show the FCM's NFA identification ("ID") number, which is issued by National Futures Association, and the "as of" date of, or the time period covered by, the statement.

If additional space is needed to detail or explain the answer to a question, the registrant should use a separate page, showing the registrant's name, NFA ID number, "as of" date of the report, name of the statement to which the separate page is a supplement, and the number of the statement line item.

Marking Open Positions to Market

In determining "net capital":

1. All unrealized profits must be added and all unrealized losses must be deducted in an FCM's accounts, including unrealized profits and losses on fixed price commitments and forward contracts;

2. All long and all short positions in commodity options which are traded on a contract market, and in listed security options, and all long and all short commodity futures and securities positions must be marked to their market value;
3. The value attributed to (i) any commodity option which is not traded on a contract market, or (ii) any unlisted security option, shall be the difference between the option's strike price and the market value for the underlying physical or futures contract or security. In the case of a call option, if the market value for the physical or futures contract or security is less than the strike price for the option, it shall be given no value. In the case of a put option, if the market value for the underlying physical or futures contract or security is more than the strike price for the option, it shall be given no value.
4. All off-exchange traded options granted by an FCM to a producer, processor or commercial user of, or merchant handling, the commodity which is the subject of the option, as permitted under Regulations 1.19(c) and 32.4, must be valued by reference to the mark-to-market values of corresponding options traded on exchanges, with consideration given to all available relevant information.

Offsetting

An FCM may not offset balances due to and from another person unless the FCM has a "right of setoff" in accordance with GAAP. FCMs should refer to Financial Accounting Standards Board Interpretation No. 39 "Offsetting of Amounts Related to Certain Contracts" for guidance.

Foreign Currency

Account balances designated in a foreign currency on an FCM's books must be expressed in United States dollars in the Form 1-FR-FCM, translated in accordance with GAAP, at the applicable rate of exchange (that is, the rate as of the balance sheet date for most items).

Letters of Credit

Letters of credit received or obtained by the FCM may not be reported on the Statement of Financial Condition, or the Statements of Segregated and Set-aside Funds. Also, a letter of credit is not considered satisfactory collateral for securing any form of receivable.

If a commodity exchange allows a member-FCM to accept letters of credit as margin for customers' and noncustomers' accounts, and the letters of credit accepted by the FCM conform to the requirements established by the exchange, an FCM may recognize such letters of credit in determining its charge for undermargined accounts, up to the amount of the maintenance margin required for each such account. No portion of the letter of credit can be used as collateral for a deficit that might exist in the undermargined account. (The maintenance level is used to determine the net capital charge, even though some exchanges allow letters of credit for initial margin.)

Material Adverse Events

Any fact or condition that would have a material adverse effect on the reporting FCM's financial or operational condition must be reported as a note to the Statement of Financial Condition in order to make such statement as filed not misleading. Contingent liabilities at the date of the financial report and actual transactions occurring between the period end date of the financial report and the date the financial report is filed, which have a material effect on the reported adjusted net capital or on excess adjusted net capital, must be reported in an attachment to the financial report when filed.

If any supplemental information has previously been reported to the DSRO and the Commission, it need not be repeated unless a significant change has occurred.

Readily Marketable

Where the term *ready market* (or *readily marketable*) is used in the Commission's Regulations, the Commission applies the same definition as that found in SEC Rule 240.15c3-1(c)(11), as follows:

(i) The term "ready market" shall include a recognized established securities market in which there exist independent bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined for a particular security almost instantaneously and where payment will be received in settlement of a sale at such price within a relatively short time conforming to trade custom.

(ii) A "ready market" shall also be deemed to exist where securities have been accepted as collateral for a loan by a bank as defined in section 3(a)(6) of the Securities Exchange Act of 1934 and where the [FCM] demonstrates to its [regulator] that such securities adequately secure such loans as that term (adequately secured) is defined in [SEC Rule 240.15c3-1(c)(5)].

Secured Receivables

A loan or advance or any other form of receivable shall not be considered secured unless it is secured by readily marketable collateral that is otherwise unencumbered and can be readily converted into cash. Also, such collateral must be in the possession or control of the FCM, or the FCM must have a legally enforceable, written security agreement signed by the debtor and a perfected security interest in the collateral within the meaning of the laws of the state in which the readily marketable collateral is located.

The value of any securities or property held by an FCM as collateral for a receivable must be reduced by the appropriate haircut to determine the extent to which such receivable is secured.

Warehouse receipts accepted for delivery on a futures contract at a designated contract market may secure receivables, if the commodity covered by the warehouse receipt has a ready market, and otherwise meets the conditions set forth above.

The following, which is not an all inclusive list, are not acceptable collateral for a receivable to be considered secured:

- Futures and option contracts
- Exchange memberships
- Letters of credit

Unresolved Differences and Amounts in Dispute

If a material, unfavorable difference or disputed amount exists in an account with a bank, a carrying broker, a commodity or securities clearing organization, or a securities depository, and that difference has not been resolved by the date the financial report is filed or due to be filed (without regard to extensions granted), whichever is earlier, the FCM must treat the amount as a noncurrent asset. If the amount involves a balance in a segregated or set-aside account maintained for customers' domestic or foreign commodity funds, the amount must be excluded from segregated or set-aside funds.

Unresolved favorable and unfavorable differences with the same entity may be netted in determining the amount to be classified as noncurrent. A net favorable difference with the same entity should be disregarded. A difference which has been resolved with the opposing party, but which has not yet been corrected in the records, should be treated as a resolved item. (See Example below.)

Example

The FCM in this example is required to file a December 31, 2003, Form 1-FR-FCM by no later than 17 business days after December 31, 2003. The FCM receives a December 31, 2003 statement from its carrying broker on January 3, 2004, and prepares a reconciliation of the account. The reconciliation discloses the following two differences in the customer origin, neither of which the FCM has resolved by the time it files its financial report:

	Item One	Item Two	Net
Margin deposit - books	\$100,000	\$50,000	
Margin deposit - statement	<u>80,000</u>	<u>55,000</u>	
Differences (Unfavorable)	<u>(\$ 20,000)</u>	<u>\$ 5,000</u>	<u>(\$15,000)</u>

The FCM must reclassify \$15,000 of the \$150,000 margin deposit as a noncurrent asset in its December 31 report. It is expected that FCMs will resolve such differences and not carry them over to the next month-end. The same treatment applies to reporting of material unresolved differences in an FCM's monthly net capital computation.

Consolidated Financial Report

If an FCM guarantees, endorses, or assumes, either directly or indirectly, the obligations or liabilities of any subsidiary or affiliated company, the Commission's Regulations require the FCM to consolidate the assets and liabilities of the subsidiary or affiliate in its financial report. If the consolidation results in an increase in excess adjusted net capital over that which the FCM would have reported had it filed an unconsolidated report, the FCM may recognize the increase only if it has obtained an opinion of counsel which contains the representations as to the distribution of net assets of the subsidiary of the FCM prescribed in Commission Regulation 1.17(f)(2).

The opinion of counsel must be renewed with each annual audit and retained by the FCM. The opinion need not be filed with the Form 1-FR-FCM, unless requested by an SRO or the Commission. If a benefit results from the consolidation, but the FCM is unable to obtain a favorable opinion from counsel, the FCM must make a net adjustment eliminating the benefit on Line 20, "Adjustment to eliminate benefits of consolidation" of the Statement of the Computation of the Minimum Capital Requirements in the Form 1-FR-FCM. Also, any benefit that qualifies for recognition shall not be counted toward a registered FCM's fulfillment of its minimum required net capital, but shall only be counted as an increase in the consolidated excess net capital.

The opinion of counsel, which an FCM is required to obtain before it can take advantage of any consolidation benefit, must be obtained from outside counsel. An opinion from an attorney who is an employee of the FCM is not satisfactory.

If the facts on which counsel relied in rendering his opinion change materially, the FCM should promptly obtain a new opinion from counsel.

If the company being consolidated into the FCM is located outside of the United States, and the FCM is taking a benefit to net capital from the consolidation, the counsel's letter must specifically address any provisions of local law that might preclude the prompt transfer of assets from the subsidiary to the FCM.

A consolidated financial report should always clearly identify and exclude from consolidated net capital the value of any third party or minority equity interests or ownership in an FCM's subsidiary that is not wholly owned.

In consolidating an affiliate that is neither an FCM nor a broker-dealer, the affiliate's accounts must be treated as if it were a registered FCM for purposes of classifying assets and liabilities and charges against net capital. If an FCM consolidates with a subsidiary that is also a registered FCM or securities broker-dealer, the FCM may recognize a net capital benefit only up to an amount that represents the subsidiary's excess capital over the most stringent of the subsidiary's equity capital withdrawal limitations, or other limitation whether by contract or regulation.

If a consolidated subsidiary has subordinated debt, such debt cannot be excluded from liabilities in the consolidation, unless the subordination extends to the present and future creditors of the parent FCM and all consolidated subsidiaries.

The Commission's Division of Clearing and Intermediary Oversight has interpreted Commission Regulation 1.17(f) to permit, in practice, an FCM to file an unconsolidated report, which reports its interest in a subsidiary as a one-line asset on Line 16, "Investments in subsidiaries", of the Statement of Financial Condition under certain conditions.

In the case in which a parent company and its subsidiary are both registered FCMs, and the subsidiary consolidation results in a flow through capital benefit to the parent, the parent may, in lieu of fully consolidating all accounts of the subsidiary, report its net investment in the subsidiary, less any allowable flow through capital benefit, as a non-current asset and separately report the flow through capital benefit of the subsidiary as a current asset on Line 16 (Investment in Subsidiaries). The total of these two amounts should equal the parent's total investment in the subsidiary. If Line 16 reflects investments in more than one subsidiary, the FCM must provide a supplemental schedule reconciling the balance to the investment in each subsidiary. The parent must also provide a supplemental schedule detailing the calculation of the flow through capital benefit reported on Line 16, and a supplemental schedule reconciling the adjusted net capital of the subsidiary to the amount of the flow through capital benefit claimed on Line 16.

One-line reporting in lieu of full consolidation of all accounts will not be accepted for the year-end audited financial statements. Such statements must be presented on a fully consolidated basis in accordance with Commissions regulations and GAAP, and the parent must file a supplemental schedule reconciling the year-end audited financial statements to the unconsolidated unaudited 1-FR-FCM filed for the same period.

If an FCM is not otherwise required to consolidate with an affiliate, and it guarantees a specific liability of such affiliate, it may in lieu of preparing a consolidated financial report reflect only the amount of such liability on Line 27.J., "Other payables", of the Statement of Financial Condition. The FCM should explain the item on an attachment to the schedule.

Retention Requirements

An FCM must retain for 5 years, or such longer period as may be required by an SRO's rules, a copy of each Form 1-FR-FCM it files, together with all the working papers and memoranda used in the preparation of the report. Working papers and memoranda must be made available promptly for review by representatives of the Commission or the FCM's DSRO.

FORM 1-FR-FCM COVER PAGE – HARD COPY PAPER FORM

The Cover Page must be answered in its entirety. If an item does not apply, the FCM should write "None" or "N/A" on the line item, as applicable.

A report is incomplete until all statements and schedules have been filed and all relevant questions answered by the registrant.

Item 0010 Show the name of the Company as it is registered with the Commission. Do not use DBAs or divisional names. Do not abbreviate.

Item 0020 Show the employer identification number issued by the Internal Revenue Service. If such number has not yet been assigned, as may be the case with applicants for registration, show the status as either "applied for" or "not yet applied for".

Item 0030 Show the registration identification number assigned by NFA. If such number has not yet been assigned (applicants only), show "not yet assigned" in the box.

Item 0040 Identify the person who should be contacted concerning this report. The person need not be an officer or partner of the FCM, but should be a person who can answer any questions concerning this specific report.

Item 0050 Show the address of the registrant's headquarters office. If the records supporting this report are maintained at a location other than the headquarters office, show the records location address and note in the box "Records Address".

Item 0060 Show the telephone number of the contact person whose name appears in item 0040.

Item 0065 Show the email address of the contact person whose name appears in Item 0040.

Line 1. Show the beginning and ending dates of the report. This same time period should be used in preparing the Statement of Income (Loss), Statement of Changes in Ownership Equity, and Statement of Changes in Liabilities Subordinated to the Claims of General Creditors.

Line 2. Check the appropriate box to identify the type of report. If the report was one requested by either the Commission or an SRO, check the "Special Call" box and identify who requested the report by specifying "CFTC" or the name of the SRO.

Line 3. Check the appropriate box to identify whether the report is an initial filing or an amended report.

Line 4. Identify the registrant's Designated Self-Regulatory Organization. This will be either a commodity exchange or National Futures Association. If the registrant is not a member of either NFA or a commodity exchange, write "None".

Line 5. Show only those companies that are consolidated in the FCM's Form 1-FR-FCM. Do not include unconsolidated companies. Show the full name of the company, the FCM's percentage ownership in the company and the company's line of business. If there are multiple classes of stock or types of ownership interests, the FCM should show individually its interest in each class or type.

Attestation An SRO may require an FCM to file a separate attestation page with supplemental schedules it requests. If the FCM files such separate attestation page, the FCM's appropriate person must nevertheless sign the attestation on the Cover Page to the Form 1-FR-FCM and type or print the signer's name below the signature. The title or capacity of the signer (general partner, managing member, chief executive or financial officer, etc.) must also be evident. The date the attestation was signed must be shown.

FORM 1-FR-FCM COVER PAGE – ELECTRONIC FILING

The Cover Page must be answered in its entirety. If an item does not apply, the FCM should write "None" or "N/A" on the Line item, as applicable.

A report is incomplete until all statements and schedules have been filed and all relevant questions answered by the registrant.

Name of Company Show the name of the Company as it is registered with the Commission. Do not use DBAs or divisional names. Do not abbreviate.

Person to Contact Concerning This Report Identify the person who should be contacted concerning this report. The person need not be an officer or partner of the FCM, but should be a person who can answer any questions concerning this specific report.

Address of Principal Place of Business Show the address of the registrant's headquarters office. If the records supporting this report are maintained at a location other than the headquarters office, show the records location address and note in the box "Records Address".

Telephone No. Show the telephone number of the contact person whose name appears in item 0040.

Email Address of Contact Person Show the email address of the person who should be contacted concerning this report.

Line 1. Show the beginning and ending dates of the report. This same time period should be used in preparing the Statement of Income (Loss), Statement of Changes in Ownership Equity, and Statement of Changes in Liabilities Subordinated to the Claims of General Creditors.

Line 2. Check the appropriate box to identify the type of report. If the report was one requested by either the Commission or an SRO, check the "Special Call" box and identify who requested the report by specifying "CFTC" or the name of the SRO.

Line 3. Check the appropriate box to identify whether the report is an initial filing or an amended report.

Line 4. Identify the registrant's Designated Self-Regulatory Organization. This will be either a commodity exchange or National Futures Association. If the registrant is not a member of either NFA or a commodity exchange, write "None".

Line 5. Show only those companies that are consolidated in the FCM's Form 1-FR-FCM. Do not include unconsolidated companies. Show the full name of the company, the FCM's percentage ownership in the company and the company's line of business. If there are multiple classes of stock or types of ownership interests, the FCM should show individually its interest in each class or type.

STATEMENT OF FINANCIAL CONDITION -- ASSETS

Lines 1.A. through 1.C. - Funds segregated or in separate accounts pursuant to the CEAct and CFTC regulations

An FCM should not report individual balances on the Statement of Financial Condition for funds segregated or set aside for commodity customers. Instead, total segregated assets and funds set aside should be carried forward from the appropriate supporting schedules.

Line 1.A. - U.S. exchanges (Regulation 1.20 funds)

The total amount of funds segregated for customers (including non-U.S.-domiciled customers) who are trading on U.S. commodity exchanges should be carried forward from Line 13, "Total amount in segregation" of the Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges.

Line 1.B. - Dealer options (Regulation 32.6 funds)

The total amount of funds segregated for customers who have entered into dealer options contracts should be carried forward from Line 2.C., "Total funds in segregated accounts" of the Statement of Segregation Requirements and Funds in Segregation for Customers' Dealer Options Accounts.

Line 1.C. - Foreign exchanges (Regulation 30.7 funds)

The total amount of funds set aside for customers who are trading commodity futures and options contracts on exchanges located outside the United States should be carried forward from Line 8, "Total funds in separate section 30.7 accounts" of the Statement of Secured Amounts and Funds Held in Separate Accounts for Foreign Futures and Foreign Options Customers Pursuant to Commission Regulation 30.7.

None of the amounts reported on Lines 1.A. - 1.C. should be otherwise included in the remainder of the Statement of Financial Condition.

Line 2. - Cash

Include petty cash and unrestricted cash deposits. Cash in an account that is subject to a withdrawal restriction (for example, a compensating balance or cash collateral arrangement) is to be reported as noncurrent. Cash in unrestricted depository accounts where the depository reserves the right to impose a notice period prior to releasing the funds to the FCM, but has not actually exercised such right to notice, should be reported as a current asset.

Non-negotiable certificates of deposit (bank savings certificates) may be considered current to the extent the FCM can withdraw such funds immediately after paying the depository's normal penalty for withdrawing time deposit funds before maturity. The amount reported as a current asset is the amount that would be realized upon withdrawal of the funds after payment of any penalty for early withdrawal. The amount of the maximum penalty for early withdrawal should be reported as a noncurrent asset on Line 2. Accrued interest receivable should be reported on Line 13.F. (See Example below.)

Example

CD balance per books	\$300,000
Maximum early withdrawal penalties	< <u>6,000</u> >
Net amount recoverable	<u>\$294,000</u>

Of the \$300,000 total CD balance, \$294,000 should be reported as a current asset and \$6,000 as a noncurrent asset.

Funds in money market deposit accounts should be reported as a current asset, unless the bank has actually exercised any right it has to impose a notice requirement on the depositor prior to release of the funds.

Negotiable CDs, bankers acceptances, and commercial paper should be reported on Line 3, "Securities", of the Statement of Financial Condition.

A Eurodollar or other offshore demand deposit, time deposit, or certificate of deposit should be reported as a noncurrent asset, unless the item is deposited with or issued by a major money market financial institution which has net assets in excess of \$100 million and is subject to supervision by an authority of a sovereign national government (See SEC Staff to NYSE, No. 88-14, August 1988).

In a 1992 no-action letter the SEC identified the following major money markets: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United States, and the United Kingdom (See Letter from Michael A. Macchiaroli, Division of Market Regulation, to Douglas Preston, Securities Industry Association, Inc., dated August 21, 1992 *reprinted at* 1992 SEC No-Act. LEXIS 899). In subsequent correspondence with the Division, the SEC also identified Taiwan as a major money market (Letter from Michael A. Macchiaroli, Division of Market Regulation, to Andrea Corcoran, Director, Division of Trading and Markets dated March 6, 1996).

Funds held in escrow should be reported as a noncurrent asset.

Funds with Affiliates and Subordinated Lenders

Cash, non-negotiable certificates of deposit, time deposits and money market deposits, as described above and under the conditions described above, deposited with or issued by a bank which is a parent or an affiliate of the FCM, or with a person that has loaned funds to the FCM under a subordinated loan agreement, can be included as a current asset only to the extent the balance represents a normal day-to-day operating balance.

A "normal day-to-day operating balance" is typically an amount equal to four weeks of usual and routine expenses. (See SEC Staff Letter to NYSE, dated July 1, 1986, and SEC Staff Letter to NASD, dated November 1993.)

Bank Overdrafts

Bank overdrafts are not to be netted against balances in accounts with other banks. Such bank overdrafts should be reported on Line 21.C., "Payables to banks –Overdrafts", on the Statement of Financial Condition. Overdrafts can be netted against debit balances in other accounts carried at the same bank, provided the bank has the right to offset the balances in such accounts. Overdrafts in Regulation 1.20 segregated funds accounts and Part 30 set-aside accounts should not be reflected as a liability on Line 21.C, but as a reduction of segregated or set-aside funds on the segregation and set-aside schedules. For a further discussion on this topic, see the instructions to the Statement of

Segregation Requirements and Funds in Segregation and the Statement of Secured Amounts and Funds Held in Separate Accounts.

Line 3. - Securities

Marketable securities held by an FCM must be reflected at current market value. Securities which are not readily marketable or which are restricted as to their transferability should be reported as noncurrent assets.

Securities owned by noncustomers who have deposited such securities to margin, guarantee, or secure their commodity trading accounts should be reported on Line 3.B., "Securities, at market - Noncustomer-owned", if they are in safekeeping or on hand. For convenience, U.S. Treasury and foreign government debt securities received from noncustomers may be stated at their face value on the Statement of Financial Condition, if face value approximates market value. The same value should be assigned to noncustomers' securities on Line 3.B. (asset) and Line 22.D., "Equities in commodity accounts - Noncustomers' accounts" (liability).

If securities (firm-owned and noncustomer-owned) are on deposit with a clearing organization or broker, they should be reported on Lines 5., 6., or 7., as appropriate, and not on Line 3.

An FCM should be familiar with the percentage haircuts applicable to securities. The haircuts are set forth in SEC's Rule 240.15c3-1(c)(2)(vi). Such haircuts applicable to firm-owned securities are to be reported on Line 12 of the Statement of the Computation of Minimum Capital Requirements.

If partners or members in an FCM that is a partnership or limited liability company have deposited securities as capital pursuant to their partnership or limited liability company agreement, such securities should be reflected on Line 3.C. Securities deposited by partners or members as margin for their commodity trading accounts should be reflected on Line 3.B.

Investment in a Commodity Pool

If an FCM is required to maintain a minimum investment in a commodity pool, either by law or by the terms of the investment agreement, that minimum amount must be reported as a noncurrent asset. If the FCM's investment is in excess of the minimum required, and the FCM can demonstrate that there are no restrictions on its ability to redeem its interest in the pool and to obtain the proceeds from redemption immediately upon requesting such funds, that excess portion of its investment can be treated as a current asset. If an FCM has an investment in a publicly traded pool registered with the SEC, it will be allowed to treat as current those funds it can recover within the normal settlement period for a sale of its interest in the pool, provided such settlement period does not exceed three business days following the date of sale.

That portion reported as a current asset is subject to a 15% haircut, to be reported on Line 12.F, "Other securities", of the Statement of the Computation of the Minimum Capital Requirements. The same treatment will apply to investments in commodity pools whether the commodity pool is organized as a limited or general partnership, limited liability company, or corporation.

Stock in Clearing Organization

An FCM's investment in the stock of a commodity exchange clearing organization may be reported as a current asset, provided the clearing organization allows such stock to be used as margin at the clearing organization and a margin value has been assigned to the stock by the clearing organization. The FCM should reflect the clearing organization stock at either the cost or current margin value on the Statement of Financial Condition on Line 3.D. If the FCM reflects the stock as a current asset at cost on Line 3.D., and the margin value of the stock is either higher or lower than its cost, the FCM must adjust for such difference on Line 2 of the Statement of the Computation of Minimum Capital Requirements.

In addition, the Commission's Division of Clearing and Intermediary Oversight issued a no-action letter which provides that stock of the Clearing Corporation that has been pledged to and accepted by the Clearing Corporation as a guaranty fund contribution may be recognized by FCMs as a current asset at its book value, subject to a haircut for net capital equal to the greater of (i) 15% of the book value or (ii) 100% minus the ratio, expressed as a percentage of the Clearing Corporation's liquid assets (less any margin haircuts that the Clearing Corporation would impose on such liquid assets if such assets had been deposited to satisfy original margin requirements) to the Clearing Corporation's total assets. See CFTC Letter No. 03-37 dated October 20, 2003.

Line 4. - Securities purchased under resale agreements

Securities purchased under reverse-repurchase agreements generally should be reflected as a current asset in an amount equal to the funds initially disbursed, plus interest accrued on the position. Obligations resulting from repurchase transactions should be reflected as a liability on Line 29, "Securities sold under agreements to repurchase", on the Statement of Financial Condition, and should not be netted against reverse repurchase agreements. The charges applicable to reverse-repurchase agreements are specified in SEC's Rule 240.15c3-1(c)(2)(iv)(F) and are presented as Appendix A to these instructions. Any applicable charge should be reflected on Line 13.A. of the Statement of the Computation of the Minimum Capital Requirements. Appendix A identifies certain reductions to the charge, which are allowed under SEC Rule 240.15c3-1(c)(2)(iv)(F). However, with respect to reductions to the charge allowed under SEC Rule 240.15c3-1(c)(2)(iv)(F), an FCM should not reduce deficits in reverse repurchase agreements made with house or noncustomer funds with excess collateral under any repurchase agreements or reverse repurchase agreements with the same counterparty but made as permitted investments from segregated customer funds pursuant to Commission Regulation 1.25.

Securities purchased under reverse-repurchase agreements as permitted investments of customer funds pursuant to Commission Regulation 1.25 should be reflected in the Statement of Segregation Requirements and Funds in Segregation at the lower of (i) the market value of the underlying securities held by an FCM as collateral for the reverse-repurchase agreement or (ii) the cost (amount of funds initially disbursed under the reverse-repurchase agreement) of the reverse-repurchase agreement plus accrued interest. In the event that the amount reflected must be shown at the lower market value of the underlying securities held as collateral, the difference between that market value and the cost of the reverse-repurchase plus accrued interest should be detailed and reflected on line 13.I of the Statement of Financial Condition as a current asset. The determination of charges applicable to reverse repurchase agreements as permitted investments of customer funds should be made in the same manner as specified under SEC Rule 240.15c3-1(c)(2)(iv)(F). Any reverse repurchase deficits calculated in this manner should also be included in the calculation of the charge against net capital on line 13.A. of the Statement of the Computation of the Minimum Capital Requirements. In such case, the lower market value of the underlying securities held as collateral should be included in Line 1 of the Statement of Financial Condition and either Line 7.B or Line 8.B of the Statement of Segregation Requirements and Funds in Segregation.

Securities purchased under a reverse-repurchase agreement may be considered current assets, provided the securities are in the possession and control of the FCM, and are outside the control of and are not held by the counterparty to the agreement. When the securities are deposited with an affiliate of the FCM, the securities must be held in a safekeeping account in the FCM's name for the benefit of the FCM in order for them to be considered current assets.

See Examples on following page.

Example 1

On 11-28-XX an FCM enters into a reverse-repurchase agreement with its bank and disburses \$950,000 of its own funds to the bank. The agreement is collateralized by a \$1 million U.S. Treasury bond. The agreement requires the FCM to reverse the transaction with its bank on 12-2-XX (four days later), at which time it will receive \$951,000. On 11-30 the market value of the bond is \$948,000. The FCM has no other repurchase or reverse-repurchase agreement.

On its 11-30-XX financial report the FCM will reflect \$950,500 as a current asset. In addition, the FCM must reflect a \$2,500 haircut on Line 13.A. of the Statement of the Computation of the Minimum Capital Requirements.

Amount to be realized at reversal	\$951,000
Original purchase price	<u>950,000</u>
Interest to be earned	<u>\$ 1,000</u>

Accrued interest at 11-30	\$ 500
Original purchase price	<u>950,000</u>

Current asset on statement of financial condition	\$950,500
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Market value of Treasury bond	<u>948,000</u>
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Reverse-repurchase deficit	<u>\$ 2,500</u>
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Example 2 The same situation exists as in Example 1, except that the funds are customer funds and the term of the reverse-repurchase agreement is permissible under Commission Regulation 1.25. The FCM will report \$948,000 as a current asset in the balance reported on Line 1.A of the Statement of Financial Condition and in the balance reported on Line 7.B of the Statement of Segregation Requirements and Funds in Segregation, and a \$2,500 current asset on Line 13.I of the Statement of Financial Condition. There will be a corresponding \$2,500 haircut reported on Line 13.A of the Statement of the Computation of Minimum Net Capital Requirements, (subject to there being no offsetting excess collateral under repurchase agreements or reverse repurchase agreements with the same counterparty and no calls for additional collateral outstanding less than one day).

Example 3

The same situation exists as in Example 1, except that the market value of the Treasury bond at 11-30 is \$955,000. The FCM will still report \$950,500 as a current asset on Line 4 of the Statement of Financial Condition, but there is no additional charge to be taken because the market value of the bond exceeds the amount reflected as a current asset.

Arrangements Similar to Reverse Repurchase Agreements

An FCM which enters into transactions that are similar to transactions under reverse repurchase agreements, but bearing different names, such as "overnight investments" or "sale and buy-back agreements", must report such transactions in the same manner as reverse repurchase agreement transactions.

Line 5. - Receivables from and deposits with U.S. derivatives clearing organizations

Line 5.A. - Margins

An FCM must report cash and marketable securities deposited with a U.S. derivatives clearing organization to margin proprietary and noncustomer commodity futures and options positions. Securities should be reflected at current market value. Securities which are investments of customer funds and which are deposited for margin purposes should not be reported on this line, but, instead, should be reported on Line 8.B. of the Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges or on Line 4.B. of the Statement of Secured Amounts and Funds Held in Separate Accounts, as appropriate. Investments of customer funds must be properly segregated or held in separate Part 30 accounts, as required by Sections 1.20 and 30.7 of the Commission's Regulations.

Line 5.B. - Settlement receivable

This represents the net amount due from derivatives clearing organizations for trades cleared through the "as of" date of the report. Settlement amounts due from one clearing organization should not be netted against amounts due to other clearing organizations. Settlement amounts due to an derivatives clearing organization should be reported on Line 23, "Payable to U.S. derivatives clearing organizations".

The net mark-to-market gain or loss on trades that have not cleared by the "as of" date of the report (outtrades) should be combined with the net settlement from, or to, that derivatives clearing organization. The combined amount for that clearing organization should be reported as a receivable (Line 5.B.) or payable (Line 23, "Payable to U.S. derivatives clearing organizations"), as appropriate.

Line 5.C. - Guarantee deposits

Guarantee deposits an FCM has with U.S. derivatives clearing organizations should be reflected as a current asset, whether or not the clearing organization has assigned such deposits a margin value.

Line 5.D. - Net long options value

The FCM should report, by exchange, the net long value of open option contracts in proprietary and noncustomer accounts. The net short option value by exchange should be reflected in liabilities on Line 23, "Payable to U.S. derivatives clearing organizations".

Line 6. - Receivables from and deposits with foreign commodity clearing organizations

The same treatment set forth in the instructions to Line 5 should be applied with respect to amounts due from foreign commodity clearing organizations. Any net payable to a foreign commodity clearing organization should be reported on Line 24, "Payable to foreign commodity clearing organizations".

Line 7. - Receivables from registered FCMs

Line 7.A. - Net liquidating equity

Report on Line 7.A. the net liquidating equity in accounts with other registered FCMs. The amount on Line 7.A. should include, for noncustomer and proprietary accounts, the debit or credit ledger balance, the unrealized gain or loss on open futures positions, the current net long or short value of open option contracts, and any securities at current market value. For convenience, U.S. Treasury obligations and foreign sovereign debt securities owned by noncustomers which are

deposited with an FCM to margin those noncustomers' commodity trades may be stated at their face or par value on this line, if face or par value of the securities approximates market value.

An account with another FCM that liquidates to a deficit should not be netted against accounts that liquidate to a credit. Accounts that liquidate to a deficit should be reported on Line 25, "Payable to registered futures commission merchants".

Line 7.B. - Security deposits

An FCM should reflect on Line 7.B. as a noncurrent asset any funds the carrying broker requires the FCM to deposit to maintain the clearing affiliation. These are funds which the carrying broker has compelled the FCM to keep on deposit to maintain the clearing relationship, and which the carrying broker does not recognize as margin for the FCM's account.

Line 7.C. - Other

An FCM should reflect any other receivables from the carrying broker that are not equities, security deposits, or commissions receivable. Commissions due from clearing FCMs should be reflected on Line 13.C., "Commissions and brokerage receivable", of the Statement of Financial Condition. Such "other" receivables would include amounts loaned to a carrying FCM. Such loans should be treated as current to the extent the receivable is adequately secured, and noncurrent to the extent unsecured. A loan receivable from an FCM that is a subsidiary or affiliate should not be included here, but instead should be included on Line 13.H., "Receivables from subsidiaries and affiliates".

Line 8. - Receivables from foreign commodity brokers

Lines 8.A., 8.B., and 8.C. represent balances with foreign brokers which are not registered with the Commission as FCMs. These items are similar in nature to Lines 7.A., 7.B. and 7.C. This includes receivables from foreign subsidiaries or affiliates resulting from commodity transactions. Amounts reflected as current assets on Line 8.A. and 8.C. may be subject to a five percent haircut under Regulation 1.17(c)(5)(xiii). Any required haircut is to be reflected on Line 18 of the Statement of the Computation of the Minimum Capital Requirements.

Line 9. - Receivables from traders on U.S. commodity exchanges

AND

Line 10. - Receivables from traders on foreign boards of trade

Lines 9.A. and 10.A. represent debit ledger balances and net liquidating deficits in customers' accounts, and Lines 9.B. and 10.B. represent such balances in noncustomer and proprietary (general partners) accounts.

In addition to the discussion and examples shown below, the FCM should also review the section, **Combining Accounts of the Same Owner** (for purposes of determining deficits for the segregation statement) in Section 10 of these instructions.

The total amount of customer debit and deficit accounts on Line 9.A. must agree with Line 5 of the Statement of the Segregation Requirements and Funds in Segregation, "Accounts liquidating to a deficit and accounts with debit balances".

Accrued interest on and commissions receivable from customers' and noncustomers' commodity accounts should not be reported on this line. They should be reported on Line 13.C., "Commissions and brokerage receivable", or on Line 13.F., "Dividends and interest", as appropriate.

The allowance for doubtful accounts on Lines 9.D. and 10.D. should not exceed the noncurrent receivables reported on Lines 9 and 10, respectively.

Current Receivables

An unsecured debit/deficit in a trading account can be considered current only if the FCM made a call for funds to the account owner, and:

1. There was no debit or deficit in the account the previous business day, or
2. There was a debit or deficit in the account the previous business day, but the FCM received sufficient new funds from the customer or noncustomer on the "as of" date of the report to liquidate the previous day's debit/deficit in its entirety.

See Examples below.

Examples

In each example, the FCM is calculating its net capital position as of March 31.

Example 1

Net liquidating equity March 30	\$2,000
Net liquidating deficit March 31	<\$2,500>

If on April 1 the FCM called for funds to cover the \$2,500 deficit, it can treat the \$2,500 deficit as a current asset. If no call was made, the deficit must be treated as a noncurrent asset.

Example 2

Net liquidating deficit March 30	<\$2,800>
Funds received on March 31	\$5,000
Net liquidating deficit March 31	<\$1,200>

Even though a deficit exists on both days, the FCM can treat the \$1,200 deficit as a current asset, because it was newly created on March 31. The FCM had received sufficient funds on March 31 to liquidate the March 30 deficit in its entirety. Current treatment assumes the FCM has been making margin calls for funds to the customer.

Example 3

Net liquidating deficit March 30	<\$15,000>
Funds received on March 31	\$14,000
Net liquidating deficit March 31	< \$5,000>

Even though \$4,000 of the \$5,000 deficit was newly created on March 31, the entire \$5,000 must be treated as a noncurrent asset because the \$15,000 deficit existing on March 30 was not eliminated completely with the deposit of new funds on March 31.

Securities Deposited as Margin

If a customer or noncustomer whose account is in deficit has deposited readily marketable securities to margin the account, and the FCM has written authorization from the customer or noncustomer to liquidate such securities at the FCM's discretion, the FCM may treat the deficit as current to the extent of the collateral value of such securities. The collateral value is the current market value of such securities, less the applicable safety factor haircuts specified in Section 240.15c3-1(c)(2)(vi) of the SEC's rules. (See Example below.) Customer-owned securities deposited by customers with the FCM to margin, guarantee or secure the customers' commodity futures and options trades or contracts must be segregated in accordance with Sections 1.20 or 30.7 of the Commission's Regulations, as appropriate.

Example 1

Liquidating deficit	< <u>\$10,000</u> >
Common stock at current market	\$20,000
Haircut @ 15%	3,000
Collateral value	<u>\$17,000</u>

In this instance, the FCM can treat the entire \$10,000 deficit as a current asset. The FCM may not offset the deficit against the security. The deficit is reported as a secured current receivable on Line A. or B. as appropriate.

Example 2

Liquidating deficit	< <u>\$102,000</u> >
U.S. Treasury bond at current market, matures in 10 months	\$99,500
Haircut @ 1%	<u>995</u>
Collateral value	<u>\$98,505</u>

In this instance, the FCM will be able to treat \$98,505 of the deficit as a current asset. The remaining \$3,495 may be treated as a current asset only if it was newly created on the "as of" date of the financial report. (If the account had a liquidating deficit the preceding business day which was fully collateralized, the \$3,495 unsecured portion of the deficit on the "as of" date would be considered newly created and treated as a current asset on the "as of" date.)

An FCM which carries a regulated commodity account of a customer who has deposited in the account securities having a "ready market", as defined by SEC Rule 15c3-1(c)(11)(i), as margin for the account may be permitted to offset any debit/deficit balance that may exist in the account in computing the amount of funds required to be held in segregated accounts on the Statements of Segregation Requirements and Funds in Segregation. The offset is subject to certain conditions (see **Accounts Liquidating to a Deficit with Securities** on page 10-5), and is limited to the market value of the securities less the applicable haircuts set forth in SEC Rule 15c3-1(c)(2)(vi).

In reporting such debit/deficit account on Line 9.A. or 10.A. of the Statement of Financial Condition, "Customer debit and deficit accounts", an FCM should treat the debit/deficit as a secured receivable to the extent of the market value of the securities less the applicable haircuts. The FCM should not offset the debit/deficit against the securities in the account in reporting the debit/deficit on the Statement of Financial Condition.

Securing Deficits by Equities in Other Accounts

For net capital purposes, if a customer or noncustomer has a debit/deficit in a commodity account and free funds in another type of account (for example, a securities trading account), the debit/deficit may be treated as a secured receivable to the extent that free funds are available for transfer from the other account. Such treatment will be allowed only for accounts having identical ownership interests, and only if the FCM has an enforceable written authorization signed and dated by the customer/noncustomer permitting the FCM to transfer funds between the accounts to liquidate such deficits. Free funds are funds available for transfer from the account without restriction. With respect to a commodity trading account, free funds are funds in excess of initial margin required to be on deposit in the account. Such treatment for net capital purposes does not relieve the FCM from meeting the margin requirements established for each of the accounts involved.

For example, free funds in a Section 4d(a)(2) segregated commodity account may, if certain conditions are met, be used to secure deficits in the customer's Part 30 commodity trading account or the customer's securities account. See example below.

Example

A customer has several accounts with the following balances:

	<u>Net Liquidating Equity <Deficit></u>	<u>Margin Requirement</u>	<u>Free Funds</u>
Regulated commodity account (U.S. Exchanges - section 4d(a)(2) segregated funds)	\$110,000 (a)	\$95,000	\$15,000
Foreign commodity account (Section 30.7 funds)	< 195,000>(b)	30,000	-0-
In addition, this account has common Stock with a market value of	\$200,000		
- haircut @ 15%	<u>30,000</u>		
- collateral value	<u>\$170,000</u>		
Delivery account	1,000 (c)	-0-	<u>1,000</u>
			<u>\$16,000</u>

(a) The net liquidating equity in the U.S. commodity account of \$110,000 should be reported as a liability on Line 22.A., "Customers trading on U.S. commodity exchanges", of the Statement of Financial Condition.

(b) The \$195,000 deficit will be reported as an asset on Line 10.A. of the Statement of Financial Condition (Receivables from traders on foreign boards of trade). Of the \$195,000 total, \$186,000 will be reported as a current receivable (collateral value of \$170,000 plus free funds in other accounts of \$16,000), provided there is an enforceable written authorization signed and dated by the customer on file permitting the transfer of these free funds to liquidate the deficit) and \$9,000 as a noncurrent receivable.

(c) The \$1,000 balance in the delivery account, which in this example is not included by the FCM among customer trading accounts, should be reported as a liability on Line 27.J., "Other", of the Statement of Financial Condition. (See **Delivery Accounts** on page 4-13 of these instructions.)

Guarantee Agreements

Guarantee by a Regulated Commodity Customer

An FCM cannot recognize a net capital benefit as a result of it having a guarantee from a customer to cover a debit balance, deficit, or margin deficiency in another person's account with funds in the customer's regulated commodity trading account. A customer's use of his regulated commodity account to guarantee another person's debit/deficit account will not allow an FCM to treat the debit/deficit account as a secured, current asset for net capital computation purposes. The FCM must report the debit/deficit account balance as a noncurrent asset. (See Example below.)

Example

An FCM carries a regulated commodity account for a Mr. Smyth which has the following position:

Net liquidating equity	\$20,000
Initial margin required	<u>14,000</u>
Free funds	<u>\$ 6,000</u>

The FCM also carries a separate regulated commodity account for Mr. Smyth's wife, which has no open positions, but has had a debit ledger balance of \$3,000 for the last week. The FCM has obtained from Mr. Smyth a written agreement whereby the FCM can transfer funds from his account to that of his wife at any time to liquidate a debit balance or deficit that may exist. Until the FCM actually transfers funds from Mr. Smyth's account to his wife's account, the FCM must report the debit balance in her account as a noncurrent asset.

Guarantee by a Person Other Than a Regulated Commodity Customer

If an FCM has received an agreement from a noncustomer or owner of a nonregulated account whereby such person (a "guarantor") agrees to satisfy a debit balance or net liquidating deficit in another customer's or noncustomer's account, the FCM may be able to recognize the existence of such guarantee agreement in determining whether the debit balance or deficit is secured. A debit balance or deficit may be reported as a current asset to the extent there are free funds in the account of the guarantor. However, an FCM may not consider a guarantee agreement as a substitute for margin in customers' and noncustomers' accounts, and may not reduce an undermargined account charge by the amount of free funds in a guarantor's account.

To be satisfactory to secure a debit balance or deficit in another customer or noncustomer's account, a guarantee agreement must contain at least the following elements:

1. The agreement must be in writing, legally enforceable by the FCM and signed and dated by the guarantor, and must state the guarantor's agreement to satisfy a debit balance or liquidating deficit that may arise in the account(s) guaranteed. If the guarantor is a corporation, the FCM must also receive evidence of a resolution properly adopted by the corporation's board of directors to authorize the guarantee;
2. The guarantee agreement, or a separate agreement satisfying the same criteria listed above to which the guarantee agreement refers, must include the guarantor's specific authorization for the FCM to transfer funds from the guarantor's account at the FCM's discretion in the event the account guaranteed has a debit balance or is in deficit;
3. The accounts of the guarantor must be specified by name and account number;
4. Any limits on the dollar amount of the guarantee must be specified, or that no limit exists; and,

5. The accounts guaranteed must be specified by name and account number. In lieu of specific account identification, the agreement may specify all accounts in a particular sales code as being beneficiaries of the guarantee.

See Example that follows.

Example

An FCM's account executive has a trading account at the FCM which would be classified by the FCM as a noncustomer account. The account has the following position:

Net liquidating equity	\$45,000
Initial margin required	<u>14,000</u>
Free funds	<u>\$31,000</u>

The account executive has entered into an agreement whereby he guarantees to satisfy the debit balances and deficits in all of the trading accounts carried under his salesman code, no. 123, at the FCM. The agreement contains each of the elements specified above. The FCM carries the following accounts under that code:

Customer	Trading Account Equity / <Deficit>	Margin Required	Margin Deficiency
A	\$ 5,000	\$7,000	\$2,000
B	<\$ 3,000>	-0-	-0-
C	<\$ 4,000>	\$1,000	\$5,000
D	<u><\$27,000></u>	-0-	<u>-0-</u>

Gross Deficits (B,C,D) <\$34,000> Gross Margin Def. \$7,000

The FCM can consider \$31,000 of the \$34,000 in deficits adequately secured for net capital purposes. The remaining \$3,000 will be reported as either a current or noncurrent asset depending on the deficit's age.

None of the margin deficiencies can be reduced, and the FCM may be required to take a charge against net capital for the undermargined accounts. (This would be so even if the free funds in the account executive's account were greater than the \$34,000 in customers' deficits, because the guarantee cannot be substituted for actual margin deposits by the customers.)

Commission Holdbacks

Debits and liquidating deficits in customers' and noncustomers' accounts can be considered current assets secured by earned commissions withheld from account executives. Commission holdbacks can be considered adequate security, provided all of the following conditions are met:

1. Commissions held back are for amounts otherwise due and payable to the account executive at the report date;
2. There is a legally enforceable written agreement between the FCM and the account executive which specifically provides that the FCM can withhold commissions due the account executive to guarantee customer/noncustomer debits and deficits;
3. The written agreement is specific in regard to the extent to which commissions may be withheld and the manner in which they will be withheld. For example, an agreement might

specify that no more than X% or \$Y of commissions earned will be held back, or that such held back commissions will be maintained in a special bank account;

4. The agreement is specific in regard to the customer/noncustomer accounts to be covered by the holdback agreement. The agreement may specify customers'/noncustomers' names or account numbers, or specify that all accounts within specified sales codes are covered;
5. The FCM must demonstrate it has actually held back such commissions, and withholds them from the account executive until the customer/noncustomer repays his debit or deficit;
6. The agreement must be signed for the FCM by a person authorized to enter into such agreements, and by the person from whom commissions may be withheld. If commissions may be withheld directly from an account executive, the account executive must sign the agreement; if they may be withheld from an introducing broker (an "IB"), it must be signed by a person authorized to sign on behalf of the IB.

An FCM may include bonuses as part of the commission holdbacks securing deficits, provided the bonuses can be determined from the FCM's commission rate schedule. An FCM may not include bonuses which it declares at its discretion.

An FCM may not apply commissions held-back to a margin deficiency in determining whether a customer/noncustomer's account is appropriately margined in accordance with exchange margin rules.

The amounts held-back must be reflected as a liability on Line 27.B., "Salaries, wages, commissions and bonuses payable".

Delivery Accounts

If an FCM records customers' and noncustomers' delivery transactions in accounts other than their normal trading accounts, any debits in such delivery accounts should be shown on Line 9.C. or 10.C., as appropriate. Credit balances which may exist in such delivery accounts should be reflected on Line 27.J. as an "Other payable".

If an FCM lends funds to its account holders to finance delivery transactions, such loans receivable should be reflected on Line 9.C. or 10.C., as appropriate. For net capital purposes, debits in customers' and noncustomers' accounts that result from deliveries taken against futures contracts may be considered secured to the extent of the collateral value (market value less applicable haircuts under Regulation 1.17(c)(5)(ii)) of the commodity taken on delivery and held by the FCM for the customer/noncustomer.

If the FCM records deliveries in accounts other than customers' or noncustomers' trading accounts, balances in the trading and delivery accounts for each customer/noncustomer should be considered in determining the extent to which the debit balance or deficit in the delivery account is current. A debit balance or deficit in a delivery account may be considered secured by free funds in another account owned by the customer or noncustomer, provided the ownership interest in such other account is identical to that of the delivery account and the FCM has authority to transfer funds between the accounts. (See example that follows.)

Example

In this example, the FCM records deliveries of commodities against futures contracts for its customers in delivery accounts, the balances in which are **not** included in customers' regulated commodity trading accounts.

<u>Regulated commodity trading account</u>			
-net liquidating equity		\$25,000	
-initial margin required			<u>4,000</u>
Free funds in trading account			\$21,000
 <u>Delivery account</u>			
-debit ledger balance		<\$85,000>	
-M.V. of commodity	\$90,000		
-M.V. of commodity haircut (20%)	<u>18,000</u>	<u>72,000</u>	<u><13,000></u>
Free funds in excess of unsecured debit			<u>\$ 8,000</u>

The \$25,000 net liquidating equity will be reported on Line 6, "Amount required to be segregated", of the Statement of Segregation Requirements and Funds in Segregation and on Line 22.A., "Customers trading on U.S. commodity exchanges", of the Statement of Financial Condition. The \$85,000 debit balance in the delivery account should be reported on Line 9.C. of the Statement of Financial Condition as a current asset. The debit balance is secured in full by the collateral value of the warehouse receipt (\$72,000) and the free funds in the trading account (\$21,000). The debit balance in the delivery account will not be reflected on the segregation statement in this case, because deliveries are handled by the FCM outside of the regulated customer account system.

If an FCM records deliveries in customer/noncustomer accounts that are included among customer/noncustomer trading accounts, the balance in the accounts for deliveries should be combined with other accounts of the same customer/noncustomer and reported on Line 9.A./B. (U.S.) or Line 10.A./B. (foreign), as appropriate. If the FCM does not record delivery transactions in accounts carried in the customer/noncustomer trading account structure, any debit/deficit that might result should be reported on Line 9.C. or Line 10.C.

Classification of Trading Accounts of IBs and APs and Security Deposits by IBs and APs

Security deposits by an FCM's IBs or associated persons ("APs") are not funds deposited to margin, guarantee or secure the commodity trades of the IBs or APs, and, consequently, should not be credited to any commodity account. FCMs should not include any amounts constituting a security deposit of an IB in segregated funds or commodity accounts of the IB. To the extent excess margin in an IB's account is not reasonable to the trading activity of the IB, and no security deposit is held by the FCM for the IB, it will be presumed that one-half of the balance in the trading account is a security deposit and should be treated by the FCM as a non-current asset. With respect to the classification of trading accounts owned by the FCM's IBs and APs, and the treatment of security deposits with the FCM by its IBs and APs, the FCM should refer to the Commission's Financial and Segregation Interpretation No. 14.

Line 11. - Inventories of cash commodities, raw materials, work in progress and finished goods

FCMs that are also in the business of merchandising goods will reflect inventories on this line at current market value. Obsolete inventory should be written off in accordance with GAAP and not be classified as a current asset.

Covered Inventory

Inventory that is covered should be reported on Line 11.A. and uncovered inventory on Line 11.B. Cover is defined in Regulation 1.17 (j) and certain cover transactions are enumerated. The Commission may recognize other transactions as cover, if the FCM can demonstrate in writing to the Commission that the transaction is economically appropriate to the reduction of risk in the conduct and management of a commercial enterprise.

Inventory Haircuts

Inventory reported as a current asset, but which is not covered, is subject to a 20% haircut against its market value. That charge should be shown on Line 9, "Twenty percent of the market value of uncovered inventories", on the Statement of the Computation of the Minimum Capital Requirements. Inventory reported as a current asset and which is covered is subject to a 5% haircut on Line 8 of the Statement of the Computation of the Minimum Capital Requirements. If the inventory is registered as deliverable against a futures contract on a contract market and is covered, there is no charge.

Line 12. - Secured demand notes

A secured demand note ("SDN") collateralized by readily marketable collateral should be shown at the note's face value as a current asset. The market value of the collateral and the required safety factor haircut against the collateral must be shown parenthetically on this line. Per CFTC Regulation 1.17(h)(1)(iii), any securities pledged to secure SDNs are subject to haircuts equaling the percentage deductions specified in SEC Rule 240.15c3-1d(a)(2)(iii).

If the collateral value of readily marketable collateral supporting an SDN is less than the face value of the note, the full amount of the note should still be reflected as a current asset. The deficiency in the collateral will be shown as a charge against net capital on Line 18 of the Statement of the Computation of the Minimum Capital Requirements.

Example

Secured demand note	\$175,000
Collateral - XY&Z common stock	
Market value	\$230,000
Haircut (30%)	<\$ 69,000>
Collateral value	\$161,000
SDN deficiency	\$ 14,000

The \$175,000 SDN should be shown as a current asset and a \$14,000 charge should be reflected on Line 18 of the Statement of the Computation of the Minimum Capital Requirements.

Only cash and securities which are fully paid for, otherwise unencumbered and have a "ready market", as that term is defined in SEC Rule 240.15c3-1(c)(11), and which may be publicly offered or sold without registration under the Securities Act of 1933, and the offer, sale and transfer of which are not otherwise restricted, may be pledged as collateral to secure a secured demand note. See **Readily Marketable** in Section 2 of these instructions.

In order for securities to be acceptable collateral for an SDN for the purpose of classifying an SDN as a current asset, the securities must be in bearer form, or registered in the FCM's name or the name of the FCM's nominee or custodian.

Excess value in the collateral for one SDN may not be applied to a deficiency in another SDN's collateral.

The lending of securities to an FCM under a subordinated loan agreement is not recognized under CFTC Regulation 1.17(h), and the resulting liability will not be excluded from liabilities in calculating net capital. A satisfactory subordinated loan agreement covers only the lending of cash, or a demand note secured by cash or readily marketable securities.

If a deficiency in SDN collateral exists, the FCM must immediately notify the lender, the FCM's DSRO, and the CFTC in writing. There are alternative corrective actions that can be taken to remedy the deficiency which include reducing the unpaid principal amount of the SDN subject to certain limitations. The FCM should review section 1.17(h)(2)(vi) of the Regulations or consult with its DSRO and the CFTC concerning those actions.

Line 13. - Other receivables and advances

Various types of receivables not reported elsewhere should be reported here.

Line 13.A. - Merchandising accounts receivable

Reflect on this line accounts receivable resulting from an FCM's marketing of inventories. Merchandising receivables may be classified as a current asset only if they are outstanding no longer than three calendar months from the date they are accrued.

Line 13.B. - Notes receivable

A note receivable will be considered current if it is secured by readily marketable collateral. A merchandising receivable converted to an unsecured note receivable will be considered noncurrent at the time of conversion even if three months has not elapsed since the original accrual of the merchandising receivable.

Line 13.C. - Commissions and brokerage receivable

Report on this line commissions and brokerage receivable from carrying brokers or dealers dealing in commodities or securities; and management fees from registered investment companies and commodity pools. If the amount is outstanding longer than 30 days from the date it was earned, it must be reported as a noncurrent asset. If any such receivable is held back by the other FCM or broker to cover potential losses or as a security deposit, such amount is to be treated as a noncurrent asset even though the receivable was accrued less than 30 days earlier.

Example

Commissions receivable as of March 31, 20XX	\$30,000
During April 20XX:	
Prior commissions collected	<28,000>
New commissions earned	<u>22,000</u>
Total commissions receivable as of April 30, 20XX:	<u>\$24,000</u>
Current commissions receivable	\$22,000
Noncurrent commissions receivable	<u>2,000</u>
Total Commissions receivable	<u>\$24,000</u>

Accrued "Half-turn" Commissions

One-half of the accrued commissions on customers' and noncustomers' open positions may be reflected on Line 13.C. Such accrual can be considered current to the extent each of the accounts involved has sufficient equity to cover the respective commission accrued. Amounts accrued on open positions in accounts that liquidate to a deficit are treated as noncurrent because they are unsecured receivables. This accrual is optional, but if it is made, the FCM must also accrue commissions due on open positions with carrying brokers and any brokerage payable on open positions.

Line 13.D. - Receivables from employees and associated persons

Non-trading receivables from employees and associated persons, including loans and advances, also includes amounts due from officers and partners of an FCM. The receivable is classified as noncurrent, unless secured by readily marketable collateral as defined in Regulation 1.17(c)(3). If secured, the receivable can be treated as current to the extent of the securities' collateral value, which is the market value of the collateral reduced by the appropriate haircut. (See **Secured Receivables** on page 2-3.)

Line 13.E. - Advances on cash commodities

FCMs who are in the business of buying and selling spot commodities should report cash advances made to sellers of such commodities against future deliveries. Advances outstanding more than three calendar months from the date they are paid are to be reported as a noncurrent asset.

Line 13.F. - Dividends and interest

Interest receivable outstanding no more than 30 days from its due date should be shown here as a current asset. A dividend receivable outstanding no longer than 30 days from its payable date should also be shown as a current asset.

If interest or dividends are outstanding more than 30 days, such amounts should be reported as a noncurrent asset. Do not net receivables against payables in reporting dividends and interest.

Line 13.G. - Taxes receivable

Taxes receivable are to be reported as a noncurrent asset, even if a taxing authority has certified the tax refund payable to the FCM.

Line 13.H. - Receivables from subsidiaries and affiliates

Receivables from affiliates should be reported as a noncurrent asset, unless the affiliate has delivered readily marketable collateral to the FCM. The FCM may not deposit such collateral with any affiliated company, nor may it accept securities issued by the affiliate as collateral. If it does either, the receivable must be classified as a noncurrent asset.

Affiliates include the FCM's parent company (including companies having direct or indirect control of the parent), companies under the direct or indirect control of the FCM, and companies under common control with the FCM.

A receivable from an affiliate that is an FCM, foreign broker, or securities broker/dealer should not be reported here, if it represents the type of receivable that should be reported elsewhere on the Form 1-FR-FCM (for example, equity in a trading account with an affiliated FCM or foreign commodity broker would be reported on Line 7 or Line 8 of the Statement of Financial Condition; a deficit in an affiliate's trading account with the FCM should be reported on Line 9.B. or 10.B.).

An unsecured receivable resulting from expenses paid by an FCM on behalf of an affiliate should be reflected as a noncurrent asset.

An FCM may not offset the receivables and payables due from/to any of its affiliates unless such offsetting is made pursuant to a right of setoff that fulfills all requirements of GAAP and in addition, is set forth in a legally enforceable written agreement between the FCM and the party or parties whose balances are subject to such right of setoff. An FCM can refer to Financial Accounting Standards Board Technical Bulletin No. 88-2, Definition of a Right of Setoff, for guidance.

Line 13.I. - Other

Material amounts included on this line must be itemized on a separate page attached to the financial report. The itemization must show the amount and a description of the receivable, and, if classified as a current asset, the basis for classifying it as such.

Proceeds from Sale of Exchange Memberships or Stock in an Exchange

The proceeds due an FCM from the sale of exchange memberships or exchange stock that it had carried as an asset may be reported as a current asset, unless the FCM is aware of any claims pending against the proceeds from the sale. Any proceeds from the sale that are subject to claims must be reported as noncurrent. If the FCM knows that it may not be able to collect the proceeds from the sale promptly, in the normal course of business following the end of the exchange's required posting period, the FCM must report such proceeds as noncurrent.

Other

Other noncurrent assets to be reported here include, but are not limited to:

- rent and utility deposits
- accrued interest receivables on debit balances in customers' or noncustomers' accounts

Line 13.J. - Allowance for doubtful accounts

Report here the balance in an FCM's allowance for accounts doubtful of collection. The allowance should not exceed noncurrent assets reported on Line 13.

Line 14. - Unrealized gains on forward contracts and commitments

An FCM should report on this line any mark-to-market gain on forward contracts entered into for its own account including gains on forward contracts in foreign currencies or other commodities. Unrealized gains may be offset against unrealized losses, if the contracts are open with the same counterparty and the FCM has the legal right through a written agreement with that counterparty to make such offsets. Unrealized losses that cannot be offset are to be shown on Line 27.G, "Unrealized losses on forward contracts and commitments", of the Statement of Financial Condition.

Unrealized gains on forward contracts, other than in foreign currencies, which have not been offset as noted above, are to be reported as a non-current asset on Line 14. An unrealized gain in a foreign currency forward contract may be treated as a current asset, if the counterparty to the contract is a U.S. bank or trust company or a U.S. registered securities broker/dealer, and the currency is one of the G-7 country currencies, including the Euro. Other counterparties may be added to those recognized as appropriate counterparties upon approval by the Commission. An FCM wishing to request approval should direct its application to the Director of the Division of Clearing and Intermediary Oversight in the Commission's Washington, D.C. office. In making its request, the FCM

should follow the guidelines of Commission Regulation 140.99. The request should specifically address the counterparty's financial condition and the issues of credit and market risk.

Line 15. - Exchange memberships

Report as a noncurrent asset the cost of exchange memberships owned. Report parenthetically the market value (lower of last sale or current bid) of such memberships.

Line 16. - Investments in subsidiaries

Requirements for the consolidation of subsidiaries are contained in CFTC Regulation 1.17. Each registered entity within a consolidation must have sufficient capital of its own to meet its minimum capital requirement regardless of consolidation. Majority-owned and controlled subsidiaries should generally be consolidated. See Statement of Financial Accounting Standards No. 94 (Consolidation of All Majority-Owned Subsidiaries). (See also **Consolidated Financial Report** on page 2-4.)

Other investments in a company where the FCM has the ability to exercise significant influence over the company's operating and financial policies will require the FCM to account for such investment under the equity method. Such ability to influence is presumed for investments of 20% or more. If the FCM's investment in the subsidiary is readily marketable, the current market value should be reported as a current asset on Line 3.A., "Firm owned securities". See the definition of **Readily Marketable** on page 2-3 of these instructions. If not readily marketable, the FCM should report such investment on this line as a noncurrent asset.

Under the following specified conditions, an FCM with a wholly owned subsidiary which is also a registered FCM may file an unconsolidated financial report that includes its interest in the subsidiary as a one-line asset reported on this line.

If both the parent company and its subsidiary are registered FCMs, and the subsidiary consolidation results in a flow through capital benefit to the parent, the parent may, in lieu of fully consolidating all accounts of the subsidiary, report its net investment in the subsidiary, less any allowable flow through capital benefit, as a non-current asset and separately report the flow through capital benefit of the subsidiary as a current asset on Line 16 (Investment in Subsidiaries). The total of these two amounts should equal the parent's total investment in the subsidiary. If Line 16 reflects investments in more than one subsidiary, the FCM must provide a supplemental schedule reconciling the balance to the investment in each subsidiary. The parent must also provide a supplemental schedule detailing the calculation of the flow through capital benefit reported on Line 16, and a supplemental schedule reconciling the adjusted net capital of the subsidiary to the amount of the flow through capital benefit claimed on Line 16.

One-line reporting in lieu of full consolidation of all accounts will not be accepted for the year-end audited financial statements. Such statements must be presented on a fully consolidated basis in accordance with Commissions regulations and GAAP, and the parent must file a supplemental schedule reconciling the year-end audited financial statements to the unconsolidated unaudited 1-FR-FCM filed for the same period.

For treatment of an FCM's investment in a commodity pool, see the instructions for Line 3.A. of the Statement of Financial Condition.

Line 17. - Plant, property, equipment and capitalized leases

Report as a noncurrent asset the cost (net of accumulated depreciation and amortization) of all fixed assets - property, furniture, equipment, leasehold improvements, capitalized leases and all other non-security assets - that cannot be readily converted into cash. However, an FCM may treat fixed assets, and assets which otherwise would be considered noncurrent, as current --

a. to the extent such assets adequately collateralize long term debt and were acquired for use in the ordinary course of the FCM's business;

OR

b. to the extent such assets adequately collateralize long term debt, if liquidating such assets is the sole recourse of the creditor for nonpayment of the long term debt.

Liabilities are considered adequately collateralized only if they are secured by identified assets pursuant to a legally enforceable written instrument, the market value of the assets exceeds the amount of the liability, and the assets are not otherwise encumbered.

Long term debt may be excluded for the purpose of determining net capital to the extent of the net book value of property, plant and equipment used in the ordinary course of an FCM's trade or business other than the business of commodities futures or options or securities brokerage; provided that no portion of such property, plant and equipment is included as current assets.

Example 1

FCM A, whose only business activity is commodity futures and options brokerage, purchases land for speculation with funds borrowed under a five-year note. Under the terms of the loan agreement, the creditor could secure a lien against the land as well as any other assets of the FCM if the FCM fails to repay the loan. The land is not encumbered in any other manner.

In this situation the land would be treated as a noncurrent asset because the land was not acquired for use in the FCM's trade or business and the creditor has recourse for nonpayment to assets other than the land. The loan payable would not be excluded from liabilities in calculating net capital.

Example 2

The same situation exists as in example No. 1, and the purchase price of the land was \$500,000 and the long-term portion of the debt is \$400,000. Also the sole recourse of the creditor for nonpayment of the loan obligation by the FCM is to foreclose against the land. In this case, even though the land is not being used in the trade or business of the FCM, the FCM can treat \$400,000 of the \$500,000 purchase price of the land as a current asset because the creditor's sole recourse for nonpayment is to the land and \$400,000 is the value of the long term obligation outstanding. Also, the loan obligation would not be excluded from liabilities. The FCM would report a \$400,000 current asset, a \$100,000 non-current asset, a \$400,000 long-term debt obligation, and \$100,000 current debt obligation (the remainder of the purchase price financed was current, not long-term, debt).

Example 3

FCM B purchased \$24,000 of office furniture to be used in its futures brokerage business and finances part of the purchase with a \$15,000 three-year loan. Annual payments of \$5,000 are to be made with the first payment due six months from the date of the FCM's financial report.

In this case, \$10,000 of the \$24,000 in furniture, equal to the amount of the long term portion of the debt, can be treated as a current asset and none of the total \$15,000 loan obligation will be excluded from liabilities in computing net capital. (If the furniture that was purchased is used in a segment of the FCM's business other than commodity futures or options, or securities brokerage, such as a bookkeeping service for others, the FCM has available the alternative treatment. In such case, none of the \$24,000 in furniture would be considered a current asset and \$10,000, the noncurrent portion of the loan obligation, could be excluded from liabilities for the purpose of determining net capital. The exclusion of the liability is made on Line 5.D., "Long term debt", of the Statement of the Computation of the Minimum Capital Requirements.)

Line 18. - Prepaid expenses and deferred charges

Prepaid expenses and deferred charges are to be reported as noncurrent assets.

Line 19. - Other assets

The FCM should report here assets not readily classifiable into any other previously identified category. The FCM must itemize on an attachment to the report both the current and noncurrent portions of material amounts included on this line. The itemization should include for each material item a brief description of the asset, the basis for treating a portion of the asset as current, and the amounts reported as current and non-current assets.

Cash Surrender Value of Life Insurance

Cash surrender value of life insurance may be treated as a current asset, reported on Line 19, if --

- a. the FCM owns the policy; and
- b. the face amount of the policy is payable to the FCM.

Line 20. - Total assets

For each column show the total of Lines 1. through 19. The sum of the totals for the current and noncurrent asset columns should equal the sum of the total assets column. Total current assets should be carried to Line 1, of the Statement of the Computation of the Minimum Capital Requirements.

STATEMENT OF FINANCIAL CONDITION -- LIABILITIES

Line 21. - Payables to banksLine 21.A. - Secured loans

Report here bank loans that are adequately collateralized. A loan is considered adequately collateralized if, pursuant to a legally enforceable written instrument, it is secured by identified assets that are otherwise unencumbered and the current market value of which exceeds the balance of the loan. Report accrued interest payable on Line 27.A., "Accounts payable and accrued expenses". Report loans payable to persons other than banks on Line 27 or 28, as appropriate.

Line 21.B. - Unsecured loans

Report all uncollateralized amounts due to banks, except for bank account overdrafts. Report accrued interest payable on Line 27.A.

Line 21.C. - Overdrafts

Report on this line overdrafts in nonsegregated accounts that cannot be offset against other accounts at the same bank (see instruction for Line 2 -- Overdrafts).

Overdrafts in accounts used to segregate funds for customers trading on U.S. commodity exchanges and customers trading in dealer options, as well as in accounts used to set aside funds for customers trading on foreign commodity exchanges, should not be reported here. Instead, these overdraft amounts should be shown as a reduction of total segregated assets on the appropriate segregation or set-aside schedule.

Line 22. - Equities in commodity accounts

The FCM should report on Lines 22.A through 22.E. the net liquidating credit equities for various types of commodity trading accounts. Net liquidating credit equity in each account includes the net debit or credit ledger balance, unrealized profit or loss on open futures contracts, the value of open long and short option contracts, and the market value of all securities and property held to margin, secure or guarantee commodity transactions. For convenience, U.S. Treasury obligations and foreign sovereign debt securities received from customers and noncustomers may be stated at their face or par value on the Statement of Financial Condition, if the face or par value of the securities approximates market value.

Accounts that liquidate to a net deficit, or that contain only a debit ledger balance, may not be netted against accounts liquidating to a credit equity, unless the accounts are of the same type (origin) with identical ownership. (A net equity in John Smith's U.S. regulated commodity account cannot be netted against a deficit in his foreign trading account, although the deficit may be secured by free funds in the account with an equity -- see instructions to Lines 9. and 10. of the Statement of Financial Condition.) Net liquidating deficits and debit ledger balances should be reported on Lines 8, 9, or 10, as appropriate, of the Statement of Financial Condition.

If the FCM records delivery transactions in customer/noncustomers' trading accounts, no reclassification of amounts relating to such transactions need be made for reporting purposes. If the deliveries are recorded in other than the trading accounts, any resulting credit balances should be reported on Line 27.J., "Other", of the Statement of Financial Condition.

In classifying accounts as customer or noncustomer, the FCM should refer to Commission Regulations 1.3(k), 1.3(y) and 1.17(b) for guidance.

With respect to the classification of trading accounts owned by the FCM's IBs and APs, and the treatment of security deposits with the FCM by its IBs and APs, the FCM should refer to the Commission's Financial and Segregation Interpretation No. 14. A trading account of an IB which is not otherwise in a relationship with the FCM described in Commission Regulation 1.3(y) should be treated as a customer account. A trading account of an AP employed by the FCM should be treated as a proprietary account. Security deposits by an FCM's IBs or APs are not funds deposited to margin, guarantee or secure the commodity trades of the IBs or APs, and, consequently, should not be credited to any commodity accounts of such IBs or APs.

Line 22.A. - Customers trading on U.S. commodity exchanges

This amount includes the net liquidating equities in accounts of customers trading on U.S. commodity exchanges. Both U.S.- and foreign-domiciled customers are to be included. The amount shown should agree with the sum of Line 4, "Net equity (deficit)", and Line 5, "Accounts liquidating to a deficit and accounts with debit balances – gross amount", on the Statement of Segregation Requirements and Funds in Segregation.

Line 22.B. - Customers trading on foreign exchanges

This amount includes the net liquidating credit equities in accounts of U.S.- and foreign-domiciled customers trading on foreign commodity exchanges. This amount will not agree with the amount shown on Line 1, "Amount to be set aside in separate section 30.7 accounts", of the Statement of Secured Amounts and Funds Held in Separate Accounts, unless the set-aside amount on this Statement is computed using the net liquidating equity method for each domestic and foreign customer account, rather than the strict secured amount method. (See discussion of the possible methods for calculating the Part 30 secured amount under **Determining a Method for Calculating the Secured Amount** on page 12-1.)

Line 22.C. - Customers' dealer options accounts

This amount includes the net liquidating credit equities in accounts of U.S.- and foreign-domiciled customers trading in dealer options in accordance with Part 32 of the Commission's Regulations. The amount shown may not agree with the amount on Line 1 of the Statement of Segregation for Customers' Dealer Options Accounts, because only 90% of the money, securities, or property accepted from a dealer option customer as payment of the purchase price is required to be segregated.

Line 22.D. - Noncustomers' accounts

This amount includes the net liquidating credit equities in all other commodity trading accounts carried by the FCM except for proprietary accounts (accounts of general partners and the FCM's own trading account). Typically, these will be the accounts of directors, stockholders, officers, account executives, certain other employees, certain relatives of the preceding, and affiliated companies. This list is not all inclusive. See also **Definition of "Customer"** on page 10-1.

Line 22.E. - Partners' and Members' trading accounts (not included in capital)

Include here the liability to any partner for the net liquidating credit equity in the partner's trading account, which has not been included in ownership equity (Line 34.B. of the Statement of Financial Condition) in accordance with the partnership agreement.

Where the FCM is organized as a limited liability corporation ("LLC"), include here the liability to any LLC member for the net liquidating credit equity in the LLC member's trading account which has not been included in ownership equity (Line 34.B. of the Statement of Financial Condition) in accordance with the LLC agreement.

Line 23. - Payable to U.S. derivatives clearing organizations

and

Line 24. - Payable to foreign commodity clearing organizations

The FCM must report on Line 23 or 24, as appropriate, settlement variation payments due to clearing organizations in settlement of **proprietary and noncustomer trades**, and the net short value of open option contracts in proprietary and noncustomer accounts, by exchange or applicable clearing organization.

Settlement pays and collects and net short option values between different clearing organizations should not be netted, but should be reported gross on the Statement of Financial Condition. The net mark-to-market gain or loss on trades that have not cleared by the "as of" date of the report (outtrades) should be combined with the net settlement from, or to, that exchange clearing organization. The combined amount for that clearing organization should be reported as a receivable (Line 5.B. or 6.B.) or payable (Line 23 or 24), as appropriate.

The net receivable/payable from/to a clearing organization for **customer regulated commodity trades on U.S. commodity exchanges** should not be reported here on Line 23, but, instead, should be reported on Line 9, "Net settlement from clearing organizations", on the Statement of Segregation Requirements and Funds in Segregation.

The net receivable/payable from/to a clearing organization for **customer foreign commodity trades on foreign exchanges** should be reported on Line 4.C., "Amount due to clearing organization", on the Statement of Secured Amounts and Funds in Separate Accounts, if the FCM uses balances with foreign commodity clearing organizations as part of its Part 30 set-aside funds; otherwise, the FCM should report the payable for customer foreign commodity trades here on Line 24 of the Statement of Financial Condition, and report the receivable for such trades on Line 6.B., "Settlement receivable", of the Statement of Financial Condition.

Line 25. - Payable to registered futures commission merchants

Report on this line omnibus accounts used to clear proprietary and noncustomers' trades that liquidate to a deficit (payable to the other FCM). An omnibus account that the reporting FCM carries at another FCM that liquidates to a deficit should not be offset against any other omnibus accounts that liquidate to equity, unless such accounts are carried at the same FCM and are in the same origin.

Customer omnibus accounts that liquidate to a deficit but would otherwise be included in segregated assets should be reported on the Statement of Segregation Requirements and Funds in Segregation as a reduction of other segregated assets. Similarly, customer omnibus accounts that liquidate to a deficit but would otherwise be included in Part 30 set-aside funds should be reported on the Statement of Secured Amounts and Funds Held in Separate Accounts as a reduction of Part 30 set-aside funds.

Line 26. - Payable to foreign commodity brokers

Report on this line omnibus accounts used to clear proprietary and noncustomers' trades that liquidate to a deficit (payable to a foreign commodity broker). An omnibus account that the reporting FCM carries at a foreign commodity broker, which liquidates to a deficit, should not be offset against any other omnibus accounts that liquidate to equity, unless such accounts are carried at the same foreign commodity broker and are in the same origin.

Customer omnibus accounts held with foreign commodity brokers that liquidate to a deficit but would otherwise be included in segregated assets should be reported on the Statement of Segregation Requirements and Funds in Segregation as a reduction of other segregated assets. Similarly, customer omnibus accounts held with foreign commodity brokers that liquidate to a deficit but would

otherwise be included in Part 30 set-aside funds should be reported on the Statement of Secured Amounts and Funds Held in Separate Accounts as a reduction of Part 30 set-aside funds.

Line 27. - Accounts payable, accrued expenses and other payables

Report on this line in the appropriate category, the total accounts payable, accrued liabilities, accrued expenses, and all other such liabilities of the FCM not previously reported elsewhere, as follows.

Line 27.A. - Accounts payable and accrued expenses

Report all accounts payable, accrued expenses, and such other liability items not classified elsewhere. Report accrued income taxes and payroll taxes on Lines 27.C. and D. as appropriate.

Accruals should be made for contingent liabilities when occurrence of a loss is probable, and the amount can be reasonably estimated, including liabilities resulting from guarantees. In some circumstances GAAP may also require the fair value of a financial guarantee to be recognized even when the occurrence of a loss is not probable.

Accruals should also be reported for amounts payable for profit sharing, contributions to Employee Stock Ownership Plans (ESOPS), etc.

Line 27.B. - Salaries, wages, commissions and bonuses payable

Include here the accrual for earned but unpaid salaries, wages, commissions, and any declared but unpaid bonuses. Include commissions payable to other FCMs on this line.

Line 27.C. - Taxes payable

Report here estimated accruals for federal, state, and local income taxes. Payroll taxes withheld but not yet deposited and the FCM's portion of accrued payroll taxes should be reported on this line.

Line 27.D. - Deferred income taxes

Report here the deferred tax liability accrued due to timing differences in reporting net income between the firm's books and its income tax returns. In some instances, the deferred tax liability may be excluded from total liabilities in computing net capital on Line 5.B., "Certain deferred income tax liability", of the Statement of the Computation of Minimum Capital Requirements. (See Regulation 1.17(c)(4)(iv).)

Line 27.E. - Security deposits held

Report here the liability for all security or guarantee deposits held by the firm. Include on this line commissions due account executives or introducing brokers that have been held back as a guarantee for collection of deficit balances. Do not net commissions held back against deficits in customers' and noncustomers' accounts. Also, include on this line amounts received from account executives, introducing brokers, and other FCMs that represent security or escrow deposits by such persons.

Line 27.F. - Advances against commodities

This line item, largely relevant to a firm which is also engaged in a spot commodities business, is to record cash deposits received against delivery of cash commodities.

Line 27.G. - Unrealized losses on forward contracts and commitments

Report unsettled mark-to-market losses on forward contracts and other commitments entered into by the FCM for its own account. Unrealized losses may be offset against unrealized gains, if the contracts are open with the same counterparty and the FCM has the right through agreement with that counterparty to make such offsets. Unrealized gains not offsettable must be shown on Line 14, "Unrealized gains on forward contracts and commitments". (See **Line 14 - Unrealized gains on forward contracts and commitments** on page 4-18 of these instructions.)

Line 27.H. - Due to subsidiaries and affiliates

Report on this line amounts owed to affiliates. This includes funds borrowed and expenses paid by the affiliate for the benefit of the FCM. Amounts due to affiliates which represent equities in trading accounts of the affiliates should not be reported here, but on Line 22.D., "Noncustomers' accounts". Funds borrowed pursuant to subordination agreements should be reported on Line 31.

Unless an FCM can demonstrate a legal right of setoff, it may not net the receivables and payables due from/to its affiliates. An FCM can refer to Financial Accounting Standards Board Technical Bulletin No. 88-2, Definition of a Right of Setoff, for guidance. Besides the conditions set forth in Bulletin No. 88-2, the FCM's right of setoff must be evidenced in an agreement signed by the parties whose balances are subject to setoff.

Affiliates include the FCM's parent (including companies that have direct or indirect control of the parent), companies under direct or indirect control of the FCM, and companies under common control with the FCM.

Line 27.I. - Notes, mortgages and other payables due within twelve months

Report here the current portion of notes and mortgages payable to persons other than banks. Loans payable to banks should be reported on Line 21.

Line 27.J. - Other (itemize on a separate page)

Miscellaneous payables not classifiable elsewhere are reported here and material amounts must be itemized on a separate page to be submitted with the Form 1-FR-FCM.

If an FCM does not record delivery transactions in customers' and noncustomers' trading accounts, but instead records such transactions in separate delivery accounts, the FCM should report here any credit balances that might exist in such delivery accounts.

FCMs Which Are Sole Proprietors

An FCM which operates as a sole proprietorship should include on Line 27.J. the excess of liabilities which have not been incurred in the course of its business as an FCM over assets not used in such business.

Line 28. - Notes, mortgages and other payables not due within twelve months of the date of this statement

Report here secured and unsecured long-term debt, except for amounts owing to banks. Amounts due banks should be reported on Line 21.

Line 29. - Securities sold under agreements to repurchase

Report here the proceeds received on the sale, as principal, of proprietary securities under repurchase agreements plus any accrued interest payable as of the report date. Include the

repurchase side of matched agreements. For purposes of this report, such sales of securities are not to be treated as sales, but rather as financing arrangements.

An FCM that enters into repurchase transactions must be familiar with the charges it may be required to take against net capital. Such charges are specified in SEC Rule 240.15c3-1(c)(2)(iv)(F)(3).

Haircuts applicable to repurchase agreements are specified in Appendix A to these instructions. Any applicable haircut should be reflected on Line 13.B of the Statement of the Computation of Minimum Capital Requirements. An FCM may not reduce any charge applicable to house or noncustomer repurchase agreements or reverse repurchase agreements by offsetting any such charges with excess collateral under segregated funds repurchase agreements or reverse repurchase agreements made with the same counterparty.

Example - Repurchase Agreement

On 11-28-XX the FCM enters into a repurchase agreement with its bank and receives \$950,000 from the bank. The agreement is collateralized by a \$1 million U.S. Treasury bond owned by the FCM. The agreement requires the FCM to reverse the transaction with its bank on 12-2-XX, at which time it will disburse \$951,000. On 11-30 the market value of the Treasury bond is \$954,000. The FCM has no other repurchase or reverse-repurchase agreement.

On its 11-30-XX financial report the FCM will reflect \$950,500 as a current liability. There is no charge against net capital because the repurchase agreement deficit does not exceed 5% of the contract price. (The percentage to be applied varies with the type of security -- see SEC Rule 240.15c3-1(c)(2)(iv)(F)(3).)

Amount to be disbursed at reversal	\$951,000
Original sales price	<u>950,000</u>
Interest to be earned by bank	<u>\$ 1,000</u>
Accrued interest payable at 11-30	\$ 500
Original sales price	950,000
Liability to be shown on statement of financial condition (Contract price)	<u>\$950,500</u>
Market value of Treasury bond	954,000
Repurchase agreement deficit	\$ 3,500
5% of the contract price (5% x \$950,000)	\$ 47,500
Charge against net capital	<u>-0-</u>

Line 30. - Securities sold not yet purchased, at market value

Enter the total market value of all proprietary securities sold short.

Line 31. - Liabilities subordinated to claims of general creditors

Line 31.A. - Subject to a satisfactory subordination agreement

Commission Regulation 1.17(h) sets forth minimum and nonexclusive requirements that must be met for a subordinated loan to qualify for exclusion from liabilities, including a satisfactory

subordination agreement. A subordinated loan agreement involves a lender providing an FCM with cash, or with a secured demand note collateralized by the lender's pledge of securities or cash.

Interest on Subordinated Loans

Generally, interest on subordinated debt must be included in liabilities in determining adjusted net capital. Accrued interest on subordinated debt can be excluded from liabilities only if all of the following conditions are met:

1. the interest rate can be ascertained from the subordination agreement or related note;
2. by the terms of the agreement, the accrued interest cannot be paid to the lender for a year after it is due to be paid. Example: The FCM prepares a year end 1-FR. Accrued interest of \$5,000 is due and payable on that date. The agreement prohibits the FCM from paying the interest before one year from that date;
3. all accrued interest due on a subordinated loan must be treated the same way. The entire amount accrued on a loan must be either included or excluded from liabilities, except that interest accrued in the last year of a subordination agreement's term may not be excluded; and
4. the subordinated loan agreement had an original maturity of at least one year.

Cash as Collateral for Secured Demand Note

An FCM that receives cash as collateral for a secured demand note may use such cash in its ongoing operations. The FCM must record the cash received and a corresponding liability. The liability should be reported on Line 27.J., "Other", and must be described in the separate itemization required for this line.

Line 31.B. - Not subject to a satisfactory subordination agreement

Report on this line liabilities which are effectively subordinated to the claims of creditors, but which are not subject to an agreement that satisfies the requirements of Regulation 1.17(h) for a satisfactory subordination agreement.

Line 32. - Total liabilities

Show here the total of liabilities reflected on Lines 21.A through 31.B. The total should be carried forward to Line 4, "Total Liabilities" of the Statement of the Computation of the Minimum Capital Requirements.

STATEMENT OF FINANCIAL CONDITION - OWNERSHIP EQUITY

Line 33. - Sole proprietorship

Report the total equity of a sole proprietorship. Sole proprietors should note that they are required to report the excess of non-business liabilities over non-business assets on Line 27.J. of the Statement of Financial Condition. See **FCMs Which Are Sole Proprietors** on page 5-5 of these instructions.

Line 34. – Partnership and Limited Liability Company

Report ownership equity for a partnership or a limited liability company ("LLC") on lines 34.A., 34.B. and 34.C.

Do not include in partnership or LLC capital any equities in partners' or LLC members' trading accounts which have been reflected on Line 22.E.

Line 34.A. – Partnership or LLC contributed and retained capital

Report the total equity of a partnership or LLC.

Line 34.B. - Additional capital per partnership or LLC agreement

Equities in partners' or LLC members' trading accounts should not be included here, unless the governing partnership or LLC agreement specifies that equities in partners' or LLC members' trading accounts will be considered partnership or LLC capital. If not so specified, partners' or LLC members' accounts with net liquidating credit equities should be reported on Line 22.E., and such accounts liquidating to a net debit or deficit balance should be reported on line 9.B. or 10.B.

Line 34.C. - Total

This is the total of Lines 34.A and 34.B.

Line 35. - Corporation

Report in the appropriate category preferred and common stock issued, additional paid in capital and retained earnings. The sum of these, shown at item E, will be reduced by capital stock in treasury, shown at item F.

Line 36. - Total ownership equity

Show the balance appearing on Line 33, 34.C., or 35.G., as appropriate.

Line 37. - Total liabilities and ownership equity

The total of liabilities plus ownership equity must equal total assets as reflected on Line 20, "Total Assets".

STATEMENT OF THE COMPUTATION OF THE MINIMUM CAPITAL REQUIREMENTS

Line 1. - Current assets

The amount on this line should agree with the amount of current assets shown on Line 20, "Total Assets", of the Statement of Financial Condition.

Line 2. - Increase/(decrease) to U.S. clearing organization stock to reflect margin value

Stock owned in a U.S. commodity clearing organization may be reported as a current asset on Box 1100 on Line 3.D. of the Statement of Financial Condition, provided the clearing organization allows such stock to be used as margin at the clearing house and has assigned a margin value to the stock.

An FCM may report such stock at either the cost of the stock or the current margin value of the stock, as assigned by the clearing organization. If U.S. clearing organization stock is reported as a current asset on Line 3.D. of the Statement of Financial Condition at cost, increase or decrease the cost of such stock on this line as necessary to equal the current margin value assigned by the clearing organization for such stock included in current assets. If there is no applicable margin value assigned to such stock and the stock is included in current assets at cost on the Statement of Financial Condition based on the no-action position taken in CFTC Letter No. 03-37, there is no increase or decrease to the book value of such stock on this line, but appropriate charges against such value as set forth in CFTC Letter No. 03-37 should be taken on line 12.F. of this Statement of the Computation of Minimum Capital Requirements.

Line 3. - Net current assets

Combine Lines 1 and 2 and show the result here.

Line 4. - Total liabilities

The amount on this line should agree with the amount shown on Line 32, "Total Liabilities", on the Statement of Financial Condition.

Line 5. - Deductions from total liabilities

Line 5.A. - Liabilities subject to satisfactory subordination agreements

Show on this line liabilities subordinated to the claims of general creditors. A liability will only be considered subordinate to the claims of all general creditors, and therefore deductible, if: (1) the liability is subordinated pursuant to a subordination agreement which meets all of the conditions specified in Regulation 1.17(h); and (2) the subordination agreement has been reviewed and found satisfactory by the FCM's DSRO or the Commission.

Line 5.B. - Certain deferred income tax liability

Enter the amount of any deferred income tax liability related to the following:

- (a) The lesser amount resulting from applying the appropriate Federal and State income tax rates against the unrealized gain or the applicable haircut deduction.

Example: An FCM owns common stock with a current market value of \$10,000 and it has an unrealized gain of \$1,000. Assuming a 50% tax rate results in a deferred tax of \$500. The applicable haircut for the common stock results in a \$1,500 charge against net capital (15% haircut). Therefore, the deduction for deferred tax

liability is \$500, which is the lesser of applying the 50% tax rate against the \$1,000 unrealized gain (\$500 tax) and the amount that results from applying the tax rate to the \$1,500 haircut (\$750 tax).

- (b) Any deferred tax liability related to income accrued which is directly related to any noncurrent asset. An example is accrued income receivable on debt securities without a ready market.
- (c) Any deferred tax liability related to unrealized appreciation in value of any noncurrent asset. An example is the deferred tax liability on the unrealized gain on securities without a ready market.

Line 5.C. - Certain current income tax liability

Enter the amount of any current tax liability related to income accrued which is directly related to any noncurrent asset. An example is commission income receivable from another FCM that has been outstanding for more than 30 days.

Line 5.D. - Long term debt pursuant to Regulation 1.17(c)(4)(vi)

An FCM may exclude an amount of long term debt from total liabilities to the extent of:

1. the net book value of plant, property, and equipment used in the ordinary course of the FCM's business in a business segment other than the business of commodities futures or options or securities brokerage;
2. provided that the net book value of such plant, property, and equipment has not been included in current assets.

For purposes of this exclusion, long-term debt and business segment are ascribed their respective meanings in accordance with GAAP.

See also the instructions to Line 17, "Plant, property, equipment and capitalized leases", of the Statement of Financial Condition.

Example

An FCM carries on a commodity futures business and operates a retail farm implement sales outlet. The extent of the FCM's implement sales operation is such that it would be treated as a separate business segment under generally accepted accounting principles. Net book value of property and equipment used in the ordinary course of the FCM's farm implement sales operation is \$5,500,000. It reports the entire \$5,500,000 as a noncurrent asset on Line 17 of the Statement of Financial Condition. The FCM carries a liability for a mortgage of \$3,000,000, \$300,000 of which represents principal payments due within the next twelve months. The FCM may show \$2,700,000 of the mortgage liability on Line 5.D.

Line 5.E. - Total deductions

The total of Lines 5.A. through 5.D.

Line 5.F. - Adjusted liabilities

Subtract Line 5.E. from Line 4.

Line 6. - Net capital

Subtract Line 5.F. from Line 3.

Lines 7. through 19. - Charges against net capital

These lines reflect various charges the FCM is required to take against net capital. They are detailed in Regulation 1.17(c)(5).

Line 7. - Excess of advances paid on cash commodity contracts

An FCM will use this line if it enters into a purchase of any commodity, has made an advance payment against the purchase price but has not yet taken possession of the commodity, and the amount of the advance exceeds ninety-five percent (95%) of the current market value of the commodity. The extent to which the advance payment exceeds ninety-five percent (95%) of the current market value of the commodity should be entered here.

Lines 8. through 11. - Haircuts on cash commodity inventories, fixed price commitments and forward contracts

The following charges are to be taken against cash commodities in the FCM's inventory, fixed price commitments, and forward contracts. The various positions that may be combined must qualify under the definition of "cover" in Regulation 1.17(j). (See **Covered Inventory** on page 4-14.) In combining the positions, the FCM may combine them in a manner most favorable to the FCM. If futures and equivalent options positions exceed inventory, a charge is applicable to such futures/options positions and is to be shown on Line 16.

These charges are not applicable to securities owned by the FCM. Charges against such securities are taken on Line 12.

	<u>% of Market Value To be Deducted</u>
(a) Inventory covered by open futures contracts and registered as deliverable on a contract market.	0 %
(b) Inventory covered by open futures contracts or commodity options, but not registered as deliverable on a contract market.	5%
(c) Inventory not covered by open futures contracts or commodity options.	20 %
(d) Fixed price commitments and forward contracts covered by open futures contracts or commodity options.	10 %
(e) Fixed price commitments and forward contracts not covered by open futures contracts or commodity options.	20 %

Foreign Currency Positions

If an FCM carries forward contracts in foreign currencies or deposits in foreign currencies, there is no charge to be taken if (1) the currencies are of the type traded on a contract market, and (2) the forward contract or deposit is covered.

An FCM that carries assets and liabilities, which are denominated in a foreign currency, must take a charge against net capital for the net amount of uncovered foreign currency balances. Nonsegregated and segregated assets, liabilities, forward contracts, and fixed price commitments in the same currency are to be factored together in the determining the amount subject to the charge. The net balances in British pounds, Japanese yen, Canadian dollars, Swiss francs and Euros are subject to a 6% charge. The net balance in any other currency is subject to a 20% charge.

Example

An FCM carries the following balances in British pounds:

Nonsegregated British pound bank account	30,000
Part 30 set-aside funds	<u>20,000</u>
Total assets denominated in pounds	<u>50,000</u>
Amount due foreign customers	15,000
Amounts due U.K. vendors	<u>1,000</u>
Total liabilities denominated in pounds	<u>16,000</u>
Excess of pound assets over liabilities	<u>34,000</u>
Pounds translated to U.S. dollars @ \$1.56/	<u>\$53,040</u>
Charge against net capital @ 6%	<u>\$ 3,182</u>

The charge should be reported on Line 9 of the Statement of the Computation of Minimum Capital Requirements.

Line 12. - Haircut on securities held by FCM

All marketable securities are to be reflected in the Statement of Financial Condition at current market value. However, for net capital computation purposes, securities may not be allowed their full market value. The FCM should show the market value of securities included in current assets on lines 12.A. through F. under the Market Value column and the related haircut under the Charge column. All securities owned by the FCM should be included under the Market Value column, even if there is no applicable haircut. In addition to all firm-owned securities, the FCM should include securities representing investments of funds segregated for customers trading on U.S. commodity exchanges and investments of funds in Part 30 set-aside accounts for customers trading on foreign boards of trade, which are reflected on the Statement of Segregation Requirements and Funds in Segregation and on the Statement of Secured Amounts and Funds Held in Separate Accounts of the Form 1-FR-FCM. Any charges applicable to open contractual commitments relating to securities transactions should also be reflected on Line 12.

The percentage charges to be applied are found at SEC Rule 15c3-1(c)(2)(vi), (vii) and (viii).

Line 13. - Charges against repurchase and reverse repurchase transactions

Line 13.A. - Charges against securities purchased under agreements to resell ("reverse-repurchase agreement")

Enter the amount of the deficiency, if any, between the contract price of the agreement, which includes accrued interest, and the market value of the securities subject to the reverse-repurchase agreement, including permissible offsets, all calculated as provided by SEC Rule 15c3-1(c)(2)(iv)(F)(2). A charge will not also be taken against the security itself. An FCM may not reduce any charge applicable to house or noncustomer repurchase agreements or reverse repurchase agreements by offsetting any such charges with excess collateral under segregated funds repurchase agreements or reverse repurchase agreements made with the same counterparty.

See page 4-5 for an example of the calculation of a charge against a reverse-repurchase agreement.

If the FCM enters into an agreement that is similar to a reverse-repurchase agreement, regardless of the name appended to the transaction (for example, sale and buy-back agreements or overnight investments), the charge to be taken is the same as that for reverse-repurchase agreements.

Line 13.B. - Charges against securities sold under agreements to repurchase ("Repurchase agreement")

Enter the amount based on the percentages specified by SEC rule 15c3-1(c)(2)(iv)(F)(3). Also, the appropriate securities inventory haircuts should be taken on Line 12. because such securities at market value are considered continuously owned by the FCM due to the FCM's contractual obligation to reacquire the securities.

See page 5-6 for an example of the calculation of a charge against a repurchase agreement.

Line 14. - Charges on securities options

Enter the amount specified by SEC Rule 240.15c3-1 for any securities options positions carried (Appendix A to 17 CFR 240.15c3-1) or SEC Rule 15c3-1(c)(2)(x), if the FCM qualifies for such deduction.

Line 15. - Undermargined commodity futures and commodity option accounts

- A. Customer accounts
- B. Noncustomer accounts
- C. Omnibus account

CFTC Regulations 1.17(c)(5)(viii) and (ix) specify the charges an FCM must take against its net capital for undermargined customer, noncustomer and omnibus accounts. These charges are also applicable to the accounts of customers and noncustomers trading on non-U.S. markets.

An FCM must take a charge against net capital for undermargined accounts equal to the amount necessary to meet the maintenance margin required by a board of trade, or if there are none, applicable margin requirements of the clearing organizations to such position, after application of current calls for margin which are outstanding three business days or less for customer accounts and two business days or less for noncustomer or omnibus accounts. If there are no maintenance margin requirements, the charge will equal the amount necessary to restore original margin if original margin has been depleted by fifty percent (50%) or more, after application of current calls for margin which are outstanding three business days or less for customer accounts and two business days or less for noncustomer or omnibus accounts. Days will be counted from the end of the day the margin call is

made. Therefore, a charge will occur at the end of the second or third business day after the day the call was originally made, as applicable.

A margin call will be considered current only to the extent that it represents a bona-fide attempt to obtain funds from customers, noncustomers, or omnibus accounts. A margin call which has as its primary purpose the avoidance of an undermargined charge which would otherwise apply will not be considered current. Margin calls that are older than the time specified in the net capital rule and are merely called again within the allowable business day period may not be deducted in determining the safety factor charge. A margin call made to a person that the FCM has reason to believe will not be able to cover the call also will not be deductible against the charge.

If an FCM does not promptly call for margin from its customers where a margin deficiency exists, or if its calls are not for the full amount of a margin deficiency, the amount of the deficiency must be immediately taken as a charge against net capital to the extent not called.

If an exchange does not require its members to collect margins from its customers, the FCM must use the exchange clearing house's margin requirements in determining the charge.

Margins Handbook

The Joint Audit Committee has published a *Margins Handbook* that provides a more detailed explanation of the charges to be taken against net capital for undermargined accounts and provides examples of how the capital charge is to be computed. However, in the event that the handbook contradicts these instructions, these instructions should be followed. The handbook can be accessed on the Internet at www.wjammer.com/jac.

The examples provided in the handbook are not intended to be all inclusive. If an FCM needs additional guidance, it should consult with its DSRO or Commission staff.

Line 16. - Charges against open commodity positions in proprietary accounts

To determine adjusted net capital, an FCM must take a charge against net capital for uncovered futures or options or cleared OTC derivative positions in any proprietary account it carries. For the purposes of this charge, a proprietary account is a trading account carried for the FCM itself or for any general partners of an FCM. The charge is equal to a percentage of the margin requirements applicable to speculative positions in such accounts as set forth in Commission Regulation 1.17(c)(5)(x). Examples and further discussion can be accessed in the Joint Audit Committee's *Margins Handbook*.

Line 16.A. - Uncovered proprietary positions

The total charge to net capital for open proprietary contracts shall be included on Line 16.A.i and is derived from the margin requirements for such accounts as set forth in Commission Regulation 1.17(c)(5)(x). See explanation below.

Explanation and Examples

Commission Regulation 1.17(c)(5)(x) provides charges applicable to uncovered open futures and granted (sold) commodity option contracts held in the FCM's proprietary accounts. The charge applies to positions on U.S. markets as well as those on foreign markets. The amount of the charge is determined by the FCM's membership in a clearing organization or self regulatory organization as follows:

A. – the charge equals one hundred percent (100%) of the clearing organization's applicable margin requirement if the FCM is a clearing member of the clearing organization and clears such positions;

B. – the charge equals one hundred fifty percent (150%) of the greater of the board of trade or clearing organization's maintenance margin requirement if the FCM is a member of a self-regulatory organization; or otherwise;

C. – the charge equals two hundred percent (200%) of the applicable maintenance margin requirement of the applicable board of trade or clearing organization; or

D. – the charge equals two hundred percent (200%) of the applicable initial margin requirement for uncovered open futures and granted (sold) option contracts held in an FCM's proprietary accounts for which there are no applicable maintenance margin requirements.

Cover

In determining whether open commodity futures and granted (sold) commodity options contracts held in an FCM's proprietary accounts are covered, both the futures/options position and the related cover position (inventory or forward contracts) must be held by the reporting FCM. It is not sufficient that the cover be held by an affiliated company.

Example

Assume an open position in the FCM's proprietary account for contract A has a \$4,000 initial and a \$3,000 exchange imposed maintenance margin requirement. The clearing organization's margin requirement is \$2,500.

<u>Situation</u>	<u>Applicable %</u>	<u>Charge</u>
1. FCM is a clearing member of Exchange X and clears its own trade in contract A at Exchange X's clearing organization.	100%	\$2,500
2. The FCM is a clearing member of Exchange X, but clears its Exchange X trade in contract A through another clearing member of Exchange X. Percentage of 150% is to be applied to greater of exchange maintenance or clearing organization requirement.	150%	\$4,500 (150% of \$3,000)
3. The FCM is not a member of any exchange, but is a member of National Futures Association, an SRO. Percentage of 150% is to be applied to greater of exchange maintenance or clearing organization requirement.	150%	\$4,500 (150% of \$3,000)
4. The firm is a registered FCM, but does not handle customer accounts and has not joined any self-regulatory organization. Percentage of 200% is to be applied to the greater of the exchange maintenance or clearing organization requirement.	200%	\$6,000 (200% of \$3,000)

If an exchange happens not to have specified a maintenance margin level, the charge is 200% of the exchange's initial margin requirement, which would be \$8,000 (200% of \$4,000).

Portfolio Margining Systems

If the applicable clearing organization's or an exchange's rules provide for margining futures and options positions in an account on a composite basis (so called portfolio margining), the amount subject to the applicable percentage charge is the amount calculated under the portfolio margining system. Under this system, only the risk component of the portfolio's margin requirement is used to compute the proprietary positions account charge. The charge in such case should be shown on Line 16.A. rather than 16.C.

Line 16.A.ii. - less: equity in proprietary accounts included in liabilities

Include on this line any equity in a proprietary trading account (Line 22.E. of the Statement of Financial Condition) which is not otherwise included in net capital.

Proprietary account equity not otherwise included in net capital reduces the deduction calculated for Line 16.A.i. The deduction to the charge to net capital for open proprietary positions equals the equity in such proprietary accounts to the extent not otherwise included in net capital. This deduction will be made only where the equity in the account of an FCM's partner is reported as a liability rather than as an element of partnership capital. Corporate FCMs do not report as a liability equity in their own trading accounts. Gains and losses are reported in a corporate FCM's P&L.

Line 16. B. – Charge for commodity options not traded on a contract market

Pursuant to Commission Regulation 1.17(c)(5)(xi), if an FCM is the purchaser of a commodity option not traded on an exchange, which has value and has been included in net capital, there is a charge equal to ten percent (10%) of the market value of the physical or futures contract which is the subject of such option, such charge not to exceed the value attributed to such option included in net capital. This deduction for dealer options traded under Part 32 of the Commission's Regulations is limited to the lesser of the 10% charge or the value of the long option if it was included in net capital. The "market value of commodities" is determined using the spot price of the underlying commodity, not the futures price.

Line 16.C. - Commodity options which are traded on contract markets and carried long in proprietary accounts. Charge is the same as would be applied if applicant or registrant was the grantor of the options (the charge is limited to the value attributed to such options)

The deduction is computed by multiplying the applicable percentage for the FCM per paragraphs A. through D. above for line 16.A. by the applicable option margin requirement. The resulting deduction should be no greater than the option's value included in current assets, nor can it be greater than the charge which would have been calculated for a comparable futures position.

FCM Interest in Joint Trading Account

If an FCM carries a trading account in which the FCM has a financial interest, the charges against net capital, if any, should be determined on the basis of the percentage interests in the account.

Example

Assume the following situation relating to a commodity account in which the FCM, a clearing member, has a 50% interest and a noncustomer individual has the remaining 50% interest:

Net liquidating equity	\$ 8,000
------------------------	----------

Maintenance margin required on open speculative positions cleared by the FCM	\$10,000
--	----------

Exchange clearing organization margin requirement for the positions \$10,000

\$4,000 (50% of the account equity) should be treated as a liability and \$4,000 should be treated as owners' equity.

A charge of \$1,000 (50% of the \$2,000 margin deficiency) should be taken against net capital on Line 15.B., "Noncustomer accounts", of the Statement of the Computation of the Minimum Capital Requirements.

This charge is related to the noncustomer individual's interest in the account. The charge would be taken only if the account was not subject to a current margin call outstanding for less than two business days.

The FCM should also take a charge against net capital of \$5,000 (50% of the applicable clearing organization margin requirement) on Line 16.A.i. This charge is related to the FCM's own interest in the joint account.

Line 17. - Five percent (5%) of all unsecured receivables

This charge applies to any unsecured receivable included in current assets which are not due from:

- an FCM registered with the Commission;
- a securities broker or dealer registered with the SEC; or,
- a foreign broker who has been granted "comparability relief" pursuant to Commission Regulation 30.10, provided that, when the receivable is due from a foreign broker which is not registered as an FCM with the Commission or as a securities broker or dealer with the SEC, the amount which can be excluded from the 5% charge is limited to the greater of 150% of deposits required to maintain current futures and option positions (that is, margin or performance bond requirements) in the accounts (across origins), or 100% of the greatest amount required to support futures and option positions in the accounts (across origins) at any time during the preceding six-month period. In addition, where such receivable represents customer funds, the account at the foreign broker must be treated in accordance with the applicable Commission order issued under Regulation 30.10.

The Commission has delegated to NFA the authority to verify the fitness of and representations made by firms applying for confirmation of 30.10 relief and to confirm the availability of that relief. A list of the foreign regulatory and self regulatory organizations that have been granted Part 30.10 orders is located on the Commission's website at <http://www.cftc.gov/opa/backgrounder/opap30bkoia.htm>.

Line 18. - Deficiency in collateral for secured demand notes

Any deficiency in collateral for a secured demand note after the application of haircuts is to be charged against net capital here. (See the instructions at Line 12 of the Statement of Financial Condition for determining the collateral value of securities pledged to SDNs.)

Example

Secured demand note	\$175,000
Collateral - XY&Z common stock	
Market value	\$230,000
Haircut (30%)	< <u>69,000</u> >
Collateral value	\$161,000
SDN deficiency	<u>\$ 14,000</u>

The \$14,000 deficiency will be reflected on this line as a charge.

If a deficiency in SDN collateral exists, the FCM must immediately notify the lender, the FCM's DSRO, and the CFTC in writing. There are alternative corrective actions that can be taken to remedy the deficiency, including obtaining additional collateral, liquidating collateral until the unpaid principal is adequately secured, or reducing the unpaid principal amount of the loan by agreement of the parties thereto with consent of the FCM and its DSRO or the Commission. The FCM should review section 1.17(h)(2)(vi) of the Commission's Regulations or consult with its DSRO and the CFTC concerning these actions.

Line 19. - Adjustments to eliminate benefits of consolidation

An FCM that files a consolidated financial report should review the discussion under **Consolidated Financial Report** on page 2-4 of these instructions.

If an FCM is required to file a consolidated financial report, but is not able to obtain the opinion from counsel required by Regulation 1.17(f)(2)(ii) with respect to distribution of the affiliate's net assets, the FCM must take a charge on this line against net capital for the net benefit, if any, derived from the consolidation. A net benefit is derived if the consolidated computation of excess adjusted net capital is greater than the excess that would have resulted from an unconsolidated computation for the FCM alone. An FCM may not rely on a net benefit from consolidation to meet its minimum net capital requirement.

Example 1

The FCM is required to file a consolidated financial report with a subsidiary, but it is not able to obtain an opinion from counsel that the subsidiary's net assets can be distributed within 30 calendar days.

Excess adjusted net capital for the consolidated group	\$600,000
Excess adjusted net capital for the FCM only	<u>480,000</u>
Charge to be taken	<u>\$120,000</u>

Example 2

The same situation exists as in Example 1 except that the consolidated group's excess capital is less than the FCM's own excess capital.

Excess adjusted net capital for the consolidated group	\$300,000
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Excess adjusted net capital for the FCM only	<u>320,000</u>
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Charge to be taken	<u>\$ 0</u>
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The FCM will report excess net capital of \$300,000.

If an FCM is not otherwise required to consolidate with an affiliate, and it guarantees a specific liability of such affiliate, it may in lieu of preparing a consolidated financial report reflect only the amount of such liability on this line. The FCM should explain the item on an attachment to the schedule.

Line 20. - Total charges

This is the total of Lines 7 through 19.

NET CAPITAL COMPUTATION

Line 21. - Adjusted net capital

Deduct the total charges on Line 20 from net capital on Line 6.

Line 22. - Net Capital Required

The FCM computes its minimum capital requirement in this section.

Line 22.A.i. - Amount of customer risk maintenance margin requirement

Enter the total of all risk maintenance margin/performance bond requirements for all customers' domestic and foreign futures and options on futures contracts, non-futures/option positions permitted by the Commission to be held in 4d accounts, and cleared OTC derivatives positions carried in any customer account, on Line 22.A.i. Include all domestic and foreign customers, including foreign customers excluded from the secured amount requirement. An FCM may, but is not required to, deduct from this amount any risk maintenance margin/performance bond on long options that are not hedging or otherwise used to reduce the risk of other positions maintained in a customer's account.

Line 22.A.ii. - Enter 8% of Line 22.A.i.

Enter on this line 8% of the amount shown on Line 22.A.i.

Line 22.A.iii. - Amount of noncustomer risk maintenance margin requirement

Enter the total of all risk maintenance margin/performance bond requirements for all noncustomers' domestic and foreign futures and options on futures contracts, cleared OTC derivatives positions, and all other positions that are carried in the noncustomers' accounts, on Line 22.A.iii. An FCM may, but is not required to, deduct from this amount any noncustomer risk maintenance margin/performance bond on long options that are not hedging or otherwise used to reduce the risk of

other positions maintained in a noncustomer's account. Do not include in this amount any risk maintenance margin/performance bond for proprietary accounts.

Line 22.A.iv. - Enter 8% of Line 22.A.iii.

Enter on this line 8% of the amount shown on Line 22.A.iii.

Line 22.A.v. - Sum of Lines 22.A.ii. and 22.A.iv

Enter the sum of Lines 22.A.ii and 22.A.iv on this line. This amount equals the FCM's risk-based minimum capital requirement.

Line 22.B. – Minimum dollar amount requirement

Enter the amount of \$1,000,000.

Line 22.C. – Other NFA requirement

See NFA website for other applicable minimum adjusted net capital requirements.

Line 22.D. - Enter the greatest of Lines 22.A.v.; 22.B.; 22.C., or any greater SEC capital requirement applicable to the registrant.

This is the FCM's minimum net capital requirement under the Commission's rules.

Line 23. - Excess net capital

Subtract Line 22.D. from Line 21. If the FCM shows a net capital deficiency, the FCM must take immediate corrective action and file the appropriate notices with its regulators. The FCM should review the section **REPORTING REQUIREMENTS WHEN AN FCM's ADJUSTED NET CAPITAL IS BELOW THE MINIMUM REQUIREMENTS (UNDERCAPITALIZATION)** on page 14-2 of these instructions.

Line 24. - Computation of early warning level

Enter 110% of Line 22.A.v, or, if either of the amounts in Line 22.B and 22.C is greater than the amount in Line 22.A.v, enter 150% of the greater of Line 22.B or 22.C.

The amount on Line 24 is the FCM's early warning capital level. If the amount on Line 21 is less than the amount on Line 24, or is less than its applicable SEC early warning requirement if the FCM is also a BD, the FCM is subject to the reporting requirements of Regulation 1.12(b). See also the section "REPORTING REQUIREMENTS WHEN ADJUSTED NET CAPITAL IS BELOW THE FCM'S 'EARLY WARNING' LEVEL" in these instructions.

STATEMENT OF INCOME (LOSS)

The period covered by this statement should be the period since the Form 1-FR-FCM was last filed.

STATEMENT OF CHANGES IN OWNERSHIP EQUITY

The period covered by this statement should be the period since the Form 1-FR-FCM was last filed.

Line 1. - Total ownership equity as previously reported

The amount reported should reflect the total ownership equity reported as of the date of the immediately preceding financial report filed with the Commission. Applicants for registration, which have not been operating any other business, should show zero. Applicants that have been operating another business should show the amount of ownership equity at the close of their last fiscal year.

Line 2. - Net income (loss) for period

Add net income (deduct a loss) resulting from operations for the period. The amount on Line 2 should agree with page 9, Line 26.

Line 3. - Other additions to capital

Add the amount of any increases in ownership equity during the period and explain fully in the space provided. If stock was issued, the class should be identified.

Line 4. - Dividends

Deduct the amount of any dividends declared or paid during the period.

Line 5. - Other deductions from capital

Deduct the amount of any reduction in ownership equity during the period and explain fully in the space provided.

Line 6. - Balance

The result of the foregoing additions and deductions should be entered and should agree with the amount reported on Line 36, "Total ownership equity", of the Statement of Financial Condition.

STATEMENT OF CHANGES IN LIABILITIES SUBORDINATED TO THE CLAIMS OF GENERAL CREDITORS PURSUANT TO A SATISFACTORY SUBORDINATION AGREEMENT

Two columns are shown for each line item. The FCM should show in the left column total satisfactory subordinated debt, and in the right column the FCM should show that portion of subordinated debt that qualifies as equity capital. Equity capital is determined pursuant to Commission Regulation 1.17(d)(1).

Line 1. - Total subordinated borrowings as previously reported

The amount reported should reflect the total subordinated debt reported as of the date of the immediately preceding financial report filed with the Commission.

Line 2. - Increases

Add the amount of any increase in satisfactory subordinated debt during the period and explain fully in the space provided. In the space provided for the date, show the date the funds were received. If the funds were received on a date before or after the agreement was approved by the FCM's DSRO, show the approval date as part of the explanations section.

Line 3. - Decreases

Deduct the amount of any decreases in satisfactory subordinated debt during the period and explain fully in the space provided. The explanation should include whether the decrease was due to maturity, prepayment before maturity, conversion to capital, etc. Rollovers should be reported as both a decrease (maturity) and an increase (new subordinated loan). Subordinated loan prepayments (including conversions of subordinated debt to capital) must be approved by the FCM's DSRO prior to the prepayment being made.

There may be a decrease in subordinated debt that qualifies as equity capital without a corresponding decrease in total subordinated debt. This will occur when the time to maturity of subordinated debt that previously qualified as equity capital becomes less than one year. In such instance, the explanation of the decrease should state that the term to maturity has become less than one year.

Line 4. - Balance

The total reported on Line 4 should agree with the amount reported on Line 31.A., "Liabilities subordinated to claims of general creditors – Subject to a satisfactory subordination agreement", of the Statement of Financial Condition.

Equity Capital

Equity capital is the total of:

- a. An FCM's ownership equity/partnership capital accounts, and
- b. that amount of the FCM's total satisfactory subordinated debt that qualifies as equity capital.

Subordinated debt qualifies as equity capital if it meets **all** of the following conditions:

- a. the subordinated loan agreement was entered into by a partner or stockholder in the FCM;
- b. the subordination agreement has an initial term of at least three years;

- c. the agreement has a remaining term of at least one year. This means subordinated debt covered by an agreement that matures in the next year no longer qualifies as equity capital, even if it had qualified previously;
- d. the agreement has no provision for acceleration of its maturity date, as provided in sections 1.17(h)(2)(ix)(A) or 1.17(h)(2)(x)(A) or (B);
- e. the agreement has no provisions for special prepayment under section 1.17(h)(2)(vii)(B); and
- f. the funds are, in fact, maintained as equity capital pursuant to the provision of Regulation 1.17(e). (See below regarding the Debt-Equity Ratio calculation.)

Debt-Equity Ratio

Pursuant to Commission Regulation 1.17(d), an FCM's equity capital must be no less than 30% of its debt-equity total as defined in Commission Regulation 1.17(d)(2). An FCM can determine whether its debt-equity ratio is above or below 30% by making the following calculation:

A. Total satisfactory subordinated debt (from Line 31.A. of the Statement of Financial Condition)	\$ _____
B. Total ownership equity (from Line 36 of the Statement of Financial Condition)	_____
C. (A+B) Total Debt-Equity	\$ _____.
D. 30% of Line C. above	\$ _____.
E. Total ownership equity (from Line B. above)	\$ _____
F. Qualifying subordinated debt (from Line 4., "Debt that Qualifies as Equity Capital" on the Statement of Changes in Liabilities Subordinated to the Claims of General Creditors Pursuant to a Satisfactory Subordination Agreement")	_____
G. Total Equity Capital (Sum of Lines E. and F.)	\$ _____.
H. Debt-Equity Ratio (Line G. divided by Line C.)	_____
I. Excess Equity Capital (Deficiency) (Line G. minus Line D.)	\$ _____.

An FCM that has an equity capital deficiency should consult with its DSRO or the Commission concerning the remedial action to be taken. See Regulation 1.17(e)(2).

**STATEMENT OF SEGREGATION REQUIREMENTS AND FUNDS IN SEGREGATION FOR
CUSTOMERS TRADING ON U.S. COMMODITY EXCHANGES**

General Information

This schedule must be prepared by an FCM who carries accounts of customers trading on U.S. commodity exchanges. Accounts of U.S.-domiciled and foreign-domiciled customers must be included.

An FCM must prepare a separate segregation statement daily for each type of currency in which customers' commodity accounts are denominated. In completing the Statement of Segregation Requirements and Funds in Segregation for the Form 1-FR-FCM, an FCM must translate all foreign currencies to U.S. dollars and combine the separate segregation statements prepared at month-end for each currency type. Prior to aggregating currency balances in applying Commission Regulation 1.49 to calculate the separate segregation statements, any positive balance or net liquidating equity in a regulated commodity customer account denominated in one currency must be used to offset any debit or deficit in a regulated commodity customer account of the same customer in the same origin denominated in a different currency. If the customer has more than one currency with a positive balance or net liquidating equity available to be applied to the deficit, the FCM may choose to offset the currency deficit with any such available currency or currencies it chooses.

Pursuant to Commission Regulation 1.49, there must be sufficient segregated assets denominated in U.S. Dollars held in the United States to meet all U.S. Dollar obligations to customers. Also, there must be sufficient segregated assets in each currency other than U.S. Dollars to meet all obligations to customers in that foreign currency, subject to an FCM's ability to meet any such foreign currency denominated obligation with excess funds held in U.S. Dollars or with excess funds held in any money center currencies held in the United States or in money center countries. Money center currencies and money center countries are set forth in Commission Regulation 1.49.

Customer Cross-Margin Accounts

An FCM must prepare daily a separate segregation statement for accounts carried for customers who are cross-margining their commodity futures/options and securities options positions. The FCM should prepare one cross-margin segregation statement for all of its cross-margin customers. In completing its Form 1-FR-FCM, an FCM should combine balances in cross-margin and non-cross-margin accounts in one Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges.

An FCM is required to maintain sufficient funds in segregated cross-margin deposit accounts for its cross-margin customers at all times. Excess segregated cross-margin funds cannot be used to offset a deficiency in funds segregated for non-cross-margin customers. Likewise, excess funds in segregation for non-cross-margin customers cannot be used to offset a deficiency in funds segregated for cross-margin customers.

Definition of "Customer"

A customer is any person whose commodity account is carried by an FCM, except for the types of accounts included under the definition of *proprietary account* in Commission Regulation 1.3(y). Proprietary accounts include the firm's own account and noncustomers' accounts -- typically, the accounts of the FCM's directors, stockholders, officers, account executives, certain other employees, certain relatives of the preceding, and affiliated companies. This list of proprietary/noncustomers' accounts is not all inclusive. If an FCM has a question about the classification of a trading account as customer or proprietary, it should consult the Commission.

SEGREGATION REQUIREMENTS

Line 1.A. - Cash

The FCM should report the net debit or credit ledger balance in all customers' accounts combined.

Line 1.B. - Securities

The FCM should report here all securities and property deposited by customers to margin, guarantee, or secure their trading in regulated commodities. Securities should be reported at market value. For convenience U.S. Treasury obligations and foreign sovereign debt obligations received from customers may be stated at their face value, if face value approximates market value.

Letters of credit received from customers to margin their accounts should not be included here.

Line 1.B should agree with the total of Lines 7.C., 8.C., 11.C., and 12., "Securities held for particular customers", on this page.

Line 2. - Net unrealized profit (loss) in open futures contracts traded on a contract market

Report the net unrealized profit (loss) in futures contracts open in accounts of customers trading on U.S. contract markets. Include trades that have not yet cleared at exchange clearing organizations.

Line 3. - Exchange traded options

Report on Line 3.A. the current value of open option contracts carried long in customers' accounts. Report on Line 3.B. as a deduction the current value of open short options contracts. The amounts should not be netted against each other.

Line 4. - Net equity (deficit)

Combine Lines 1, 2 and 3 and show the net amount on this line.

Line 5. - Accounts liquidating to a deficit and accounts with debit balances

An account is in deficit when the combination of an account's cash ledger balance (debit or credit), unrealized gain or loss on open futures contracts, and the value of open option contracts liquidates to an amount less than zero. Any securities used to margin the account are not included in determining a customer's deficit. See below for exceptions. The FCM should show on line 5 the total of the deficits in customers' regulated commodity accounts.

Combining Accounts of the Same Owner

If a customer has more than one regulated commodity account, an FCM must combine all such accounts in determining whether a customer has a net deficit on the FCM's books. A customer's accounts may be combined only if the customer's ownership interest in each account is identical, or if the conditions discussed in Example 4, which follows, are applicable with respect to an individual general partner's equity being used to offset the partnership's net deficit. Conversely, equity in a partnership account would not be allowed to offset an individual partner's net deficit.

See examples that follow.

Example 1

A customer has the following regulated commodity accounts with his FCM:

	Equity <Deficit>
John Smith - Speculative	<\$3,000>
John Smith - Hedge	4,000
John Smith - Spread	<u>6,000</u>
Net liquidating equity	<u>\$7,000</u>

Even though Mr. Smith's speculative account liquidates to a deficit, the FCM must exclude the entire amount from Line 5. The ownership interest (John Smith, an individual) is identical in each account and accounts liquidating to an equity exceed accounts liquidating to a deficit.

Example 2

Another customer has the following regulated commodity accounts with his FCM:

	Equity <Deficit>
Frank Carter - Speculative	\$5,000
Frank Carter - Hedge	< 6,000>
Net liquidating deficit	<u><\$1,000></u>

In this instance the \$1,000 net liquidating deficit must be included on Line 5.

Example 3

A customer has a regulated commodity account in his own name which liquidates to a net equity:

Sam Price	<u>\$5,000</u>
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Sam Price is also sole shareholder in Price Investments, Inc., a corporation which maintains a regulated commodity account on the same FCM's books. The corporation's account liquidates to a net deficit:

Price Investments, Inc.	<u><\$3,000></u>
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The FCM must include the entire \$3,000 deficit in the Corporation's account on Line 5. The ownership interests in the two accounts are not identical.

Example 4

A partnership owns a regulated commodity account on the FCM's books which liquidates to a deficit:

Boole and Behr Partners	<\$8,000>
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Both Mr. Boole and Mr. Behr are general partners in the partnership. Each of them also has his own regulated commodity trading account with the FCM which liquidate as follows:

	Equity <Deficit>
Boole	\$2,000
Behr	<\$3,000>

Since Mr. Boole is a general partner in the partnership account, the FCM can reduce the \$8,000 deficit in the partnership's trading account by the \$2,000 equity in Mr. Boole's account, if the FCM has authorization from Mr. Boole to transfer funds from his account to the partnership's account. This is the only situation where, for the purpose of reducing deficits on the segregation statement, the customer's ownership interest in each account need not be identical. Equity in a partnership account cannot be used to offset a deficit in an individual partner's account.

If Mr. Boole was only a limited partner, the FCM could not use his account's equity to reduce the deficit in the partnership's account.

The treatment discussed here is applicable to partnership accounts as well as joint accounts and is allowed only where, by the terms of a written agreement between the partners (partnership agreement) or joint account owners, the individual partners or joint account owners are jointly and severally liable for the debts of the partnership or joint tenancy. In addition, the FCM must have from the individual partner or joint account owner a signed and dated agreement specifically authorizing the FCM to transfer funds from the individual's account to the partnership or joint account. Such transfer authorization can be incorporated into the partnership or joint account agreement. In the absence of a written agreement and transfer authorization, the FCM may not reduce the deficit in the partnership or joint account.

Note: The treatment discussed here is only permitted on the Statement of Segregation Requirements and Funds in Segregation, and does not apply to the Statement of Financial Condition or the Statement of the Computation of Minimum Net Capital Requirements.

Example 5

The same regulated commodity accounts exist as in Example No. 4. However, the partnership's trading account liquidates to an equity:

	Equity <Deficit>
Boole and Behr Partners	\$9,000
Boole	2,000
Behr	< 3,000>

In this case the FCM may not use the equity in the partnership's account to reduce the deficit in Mr. Behr's account, even though Mr. Behr is a general partner.

If a customer has other types of accounts in addition to his regulated commodity account(s) (such as a securities trading account, or a nonregulated commodity account) any positive balances or net liquidating equities in such other types of accounts may not be used to offset any deficit which may be in the regulated commodity account.

For purposes of computing net capital, however, an FCM may consider credit balances or net liquidating equities in other accounts as securing debits/deficits in commodity accounts, if the FCM has from the customer/noncustomer a signed and dated written authorization to transfer funds between his accounts. Only that portion of free funds in such accounts may be used to secure the debit/deficit.

Accounts Liquidating to a Deficit with Securities

If any regulated commodity account which liquidates to a deficit also contains securities which are considered "readily marketable", as defined in SEC Rule 15c3-1(c)(11), the FCM may reduce the deficit up to the amount of the market value of such securities less applicable percentage deductions (i.e., "securities haircuts") as set forth in SEC Rule 15c3-1(c)(2)(vi), if each of the following conditions is met:

1. The securities are segregated from any securities belonging to the FCM or any person other than a commodity customer. The securities must be segregated with a bank, trust company, clearing organization of a contract market, or another FCM, in an account which is titled in a manner to identify the account as containing regulated commodity customers' funds and which is covered by an acknowledgment from the depository, as required by Regulation 1.20; and
2. The FCM has a security interest in the securities that includes written authorization from the customer to liquidate the securities at the FCM's discretion in order to protect the FCM and cover any deficit in the customer's account. Appropriate language in the firm's commodity account agreement form signed and dated by the customer may suffice for such written authorization.

Although certain debit/deficit-reducing offsets may be allowed, an FCM is not required to use any such available offsets to reduce customer debit/deficit account balances in preparing its Statement of Segregation Requirements and Funds in Segregation.

See Example below.

Example

The following situation exists in the regulated commodity account of Mary Warner:

Credit ledger balance	\$ 5,000
Unrealized loss on futures	< <u>70,751</u> >
Net deficit	< <u>\$ 65,751</u> >

Securities on deposit in the account:

U.S. Treasury obligation, \$10,000 par, five months to maturity, \$9,800 market value
H.A.L. Corp. common stock, readily marketable, \$40,000 market value
Obscure Enterprises common stock, not readily marketable, \$5,000 par value

Because Obscure Enterprises common stock is not "readily marketable", as defined in SEC Rule 15c3-1(11), it may not be used to offset the deficit in the account.

Computation of amount of deficit offset by securities:

U.S. Treasury obligation	\$ 9,800 (Market)	
Less: haircut of 1/2 of 1%	<u>< 49></u>	
Amount for offsetting deficit	\$ 9,751	
 H.A.L. Corp. Common Stock	 \$40,000	 (Market)
Less: haircut of 15%	<u><6,000></u>	
Amount for offsetting deficit	<u>34,000</u>	
 Total amount for offsetting deficit	 <u>\$43,751</u>	

In the Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges, the FCM will include \$65,751 on Line 5, at item 5060; \$43,751 on Line 5, at item 5070, and \$22,000 of Ms. Warner's \$65,751 deficit on Line 5 at item 5080.

FUNDS IN SEGREGATED ACCOUNTS

General

An FCM must segregate customers funds. Segregated funds may be held at a bank or trust company, another registered FCM, or a derivatives clearing organization of a contract market.

An FCM may not include any amounts on Lines 7 through 11 unless:

1. The account in which funds are held is titled to identify the funds as belonging to customers who are trading on U.S. contract markets and,

2. the FCM has received a written statement from the depository, dated and signed by an officer of the depository, acknowledging its understanding that the funds in the account are commodity customers' funds held pursuant to the provisions of the Commodity Exchange Act. (If the depository is a derivatives clearing organization, such a statement may not be required, provided that the derivatives clearing organization has adopted rules providing for segregation of such funds.)

In some instances, an FCM may find it necessary to keep customer funds, such as customer cash, securities, warehouse receipts, or other customer property on hand at the FCM. Such funds and property must be segregated, and can only be considered properly segregated funds on deposit, if such funds on hand: (1) are kept separate from, and not commingled with, the FCM's other funds and property; (2) are separately accounted for as customer segregated funds; (3) are clearly identified as customer segregated funds; and (4) are adequately safeguarded by the FCM.

Assets Denominated in a Foreign Currency and Funds Held Outside of the United States

Subject to the terms and conditions set forth in Commission Regulation 1.49, an FCM may segregate assets denominated in certain foreign currencies to meet its obligations to customers and may hold customer segregated funds at qualified depositories outside the United States

An FCM must hold in segregated accounts in the U.S. sufficient funds in U.S. dollars to meet all of its U.S. dollar denominated obligations to customers. An FCM also must hold in segregation sufficient funds in each non-U.S. dollar currency to meet its obligations to customers denominated in that currency. Assets denominated in one currency may be used to cover obligations denominated in another non-U.S. dollar currency subject to Commission Regulation 1.49. Subject to the more specific rules of Commission Regulation 1.49, currencies may be held in the country of origin of the currency, in the United States, or in any money center country (as defined in Commission Regulation 1.49).

Segregated Funds on Hand

The Form 1-FR-FCM also includes Line 12 for reporting segregated funds on hand. Any securities or other property that is "on hand" must be marked as belonging to commodity customers and physically segregated from other property not belonging to customers in order for such securities or other property to be considered a part of segregated funds. Customer property must be safeguarded against loss, theft, and physical destruction in order for such property to be properly segregated. For example, securities held in a fire-proof vault to which access is controlled would be considered properly safeguarded, whereas securities held in desk drawer would not.

Investments of Customers' Funds

An FCM which invests customers' funds (other than for the benefit of a particular customer) must limit such investments to those types of securities permitted by Commission Regulation 1.25, and

only under the general terms and conditions specified in Commission Regulation 1.25. Generally, investments in U.S. government securities, municipal securities, government sponsored agency securities, FDIC-insured certificates of deposit, commercial paper, corporate notes, general obligations of sovereign nations, and interests in money market mutual funds are permissible, subject to the more specific descriptions of such investments and additional restrictions (for example, with respect to ratings and concentration limitations) contained in Commission Regulation 1.25. The Commission does not publish lists of specific securities that satisfy the requirements of Commission Regulation 1.25. If an FCM has questions about whether a specific investment is permitted, it should consult with the Commission's Division of Clearing and Intermediary Oversight.

Examples of the types of investments not allowed under Regulation 1.25 include:

- Investments, with the exception of money market mutual funds, containing an embedded derivative of any kind (e.g., an option, collar, cap, or floor on interest paid);
- investments containing an interest-only payment feature;
- warehouse receipts; and
- with limited exceptions for specific types of variable rate securities, investments providing payments linked to a commodity, currency, reference instrument, index or benchmark.

Accrued interest on allowable investments may be included as segregated funds.

Securities representing investments of customers' funds are subject to the same haircuts against net capital as are non-segregated securities investments. However, haircuts are to be included on Line 12 of the Statement of the Computation of the Minimum Capital Requirements, and not as reductions of segregated assets. See Appendices A and B to these instructions for the haircuts required to be taken on investments of customer funds.

Letters of Credit

Letters of credit, whether received from customers or obtained by the FCM, should not be reported as segregated assets in this statement.

Line 7. - Deposited in segregated funds bank accounts

Report cash and securities on deposit with banks in properly designated segregated accounts on the appropriate line. Except as otherwise set forth in Commission Regulation 1.25, cash in savings accounts or any other type of deposit account in which funds may not be immediately withdrawn upon demand may not be included as part of segregated funds.

Overdrafts in segregated cash accounts should be included on Line 7.A., as a reduction of segregated assets.

Report investments of customers' funds on Line 7.B. at market value. The value of securities reverse repurchase agreements are the lower of the market value of the securities which are the subject of the agreement or the amount to be realized upon resale (the cost of the securities involved plus interest accrued under the reverse repurchase agreement). When the value of securities reverse repurchase agreements are reflected at the lower market value of the underlying securities on the segregation statement, the difference between the market value of the securities involved and the amount to be realized upon resale should be recorded as a current asset on Line 13.I., "Other", of the Form 1-FR-FCM Statement of Financial Condition, and the FCM shall recognize a corresponding appropriate charge in its net capital computation. See additional discussion and example in the instructions for Line 4 of the Statement of Financial Condition.

Report securities owned by particular customers on Line 7.C. at market. For convenience, customer-owned U.S. Treasury securities and customer-owned foreign sovereign debt securities may be shown at face value, if they were included in Line 1.B. at face value, and face value approximates market.

Line 8. - Margins on deposit with derivatives clearing organizations of contract markets

Report cash and securities on deposit with derivatives clearing organizations in properly designated segregated accounts on the appropriate line.

Report investments of customers' funds on Line 8.B. at market value.

Report securities owned by particular customers on Line 8.C. at market. For convenience, customer-owned U.S. Treasury securities and customer-owned foreign sovereign debt securities may be shown at face, if they were included in Line 1.B. at face value, and face value approximates market.

Line 9. - Net settlement from (to) derivatives clearing organizations of contract markets

This is the net of all amounts due from (asset), or due to (reduction of segregated assets) derivatives clearing organizations of contract markets in settlement of cleared customer trades. In addition, include the mark-to-market value of trades not yet cleared (outtrades) as of the date of the report.

Line 10. - Exchange traded options

Show the current value of long and short options positions on Lines 10.A or B., as appropriate, for options cleared directly by the FCM at a derivatives clearing organization. Option transactions cleared through another FCM should be reported on Line 11.

Line 11. - Net equities with other FCMs

Line 11.A. – Net equities with other FCMs – Net liquidating equity

On Line 11.A. exclude investment securities (which should be reported on Line 11.B.) and securities owned by particular customers (which should be reported on Line 11.C.). Include the net of account ledger balance and open trade equity in accounts carried by other FCMs, and the values of long and short option contracts cleared through other FCMs.

Line 11.B. – Net equities with other FCMs – Securities representing investments of customers' funds (at market)

Report investments of customers' funds on Line 11.B. at market value.

Line 11.C. – Net equities with other FCMs – Securities held for particular customers or option customers in lieu of cash (at market)

Report securities owned by particular customers on Line 11.C. at market. For convenience, customer-owned U.S. Treasury securities and customer-owned foreign sovereign debt securities may be shown at face value on Line 11.C., if they were included in Line 1.B. at face value, and face value approximates market.

Line 12. - Segregated funds on hand

Include segregated funds held in the FCM's office and in safe deposit boxes. Such funds may include petty cash used for the disbursement of trading account funds to customers, securities held for particular customers, and undeposited checks received from customers, if the only reason for holding such checks is because banking facilities were closed.

Line 13. - Total amount in segregation

Combine Lines 7 through 12.

Line 14. - Excess (deficiency) funds in segregation

A deficiency in segregated funds requires immediate corrective action and immediate notification by telephone and in writing by the FCM to the Commission and the FCM's DSRO whenever the FCM knows or should have known of the deficiency. The FCM should consult with its DSRO or the Commission. Other SROs of which the FCM is a member also may require the FCM to report immediately any deficiency in segregated funds.

**STATEMENT OF SEGREGATION REQUIREMENTS AND FUNDS IN SEGREGATION FOR
CUSTOMERS' DEALER OPTIONS ACCOUNTS**

Line 1. - Amount required to be segregated in accordance with Commission Regulation 32.6

The amount reported should equal at least 90% of the purchase price paid by each dealer option customer in accordance with Commission Regulation 32.6, until such time as the option expires or, if exercised, until all rights of the option customer have been fulfilled. The amount on this line may not agree with the amount shown on Line 22.C. of the Statement of Financial Condition -- the net liquidating equities in accounts of customers trading in dealer options.

Line 2. Funds in segregated accounts

See the general requirements for funds in segregated accounts on page 10-7 of these instructions, which also apply to the funds in segregation for customers' dealer option accounts.

Line 2.A. - Cash

Reflect the cash balance which is separately accounted for and segregated as belonging to options customers. Overdrafts in segregated cash accounts should be included on Line 2.A., as a reduction of segregated assets.

Line 2.B. - Securities

Include investments of customers' funds and securities owned by particular customers on this line at market value. For convenience, U.S. Treasury securities and foreign sovereign debt securities held for particular customers may be shown at face value, if they were included on Line 1 at face value, and face value approximates market value.

Line 2.C. - Total

The sum of Lines 2.A. and 2.B. This amount should be equal to the amount reported on Line 1.B. of the Statement of Financial Condition.

Line 3. - Excess (deficiency) funds in segregation (subtract Line 2.C. from Line 1).

A deficiency in segregated funds requires immediate corrective action and immediate notification by telephone and in writing by the FCM to the Commission and the FCM's DSRO. The FCM should consult with its DSRO or the Commission.

**STATEMENT OF SECURED AMOUNTS AND FUNDS HELD IN SEPARATE ACCOUNTS FOR
FOREIGN FUTURES AND FOREIGN OPTIONS CUSTOMERS**

Explanation of Secured Amount

An FCM must maintain in a separate account(s) money, securities and property in an amount at least sufficient to cover the "secured amount" required to be set aside in the account of each U.S.-domiciled customer trading in futures or option contracts on a foreign commodity exchange. An unrealized gain on a transaction, even absent an actual credit by a foreign exchange, its clearing organization or a carrying broker, must be included in the calculation of the secured amount required to be set aside. In such instances, however, the FCM will get a dollar for dollar credit for the secured amount in respect of receivables due from the foreign exchange or carrying broker, if these assets are included in the FCM's Part 30 set-aside funds accounts.

Transactions on the London Metals Exchange

Transactions on the London Metals Exchange ("LME"), which is often referred to as a principals' spot and forward market, are subject to the Commission's Part 30 rules to the extent that LME members execute such transactions for future delivery for U.S. customers. (See 52 Fed. Reg. 28980, 28987; CCH Comm. Fut. L. Rep. ¶23,470.) As a result, an FCM must include such transactions in calculating its secured amount required to be set aside.

Determining a Method for Calculating the Secured Amount

An FCM must consider the following points in determining a method for calculating the amount of funds it is required to set aside under the Commission's foreign futures and options rules.

1. An FCM must set aside funds for U.S.-domiciled customers trading on foreign exchanges, but may also include the accounts of foreign-domiciled customers in its calculation.
2. An FCM must set-aside funds equal to the "secured amount" required to be set aside in each customer's account, but may set aside funds equal to the net liquidating equity in each account (including the market value of any securities held in such account), which will result in a larger amount set aside.
3. The accounts of customers trading futures and options on foreign exchanges may also include other "non-regulated" transactions.
4. The foreign jurisdiction where an FCM carries on business may impose a segregation requirement on FCMs that differs from that imposed by the Commission.
5. If an FCM deposits funds received from foreign-domiciled customers into a Part 30 set-aside funds account in which it also deposits funds received from U.S.-domiciled customers, it must include in the amount of funds required to be set aside as the secured amount both U.S.-domiciled and foreign domiciled customers' accounts.

The following chart summarizes possible methods for calculating the secured amount required to be set aside:

SECURED AMOUNT REQUIRED TO BE SET ASIDE CALCULATION

Does foreign jurisdiction have a segregation rule?	Account contains only foreign futures & options transactions	Account contains foreign futures and options, plus other non-regulated transactions
NO	SECURED AMOUNT required to be set aside equals for each account the <u>lesser</u> of : A. the net liquidating equity plus the market value of any securities held in the customer's account; or B. margin required, plus or minus the unrealized gain or loss on futures positions, plus long option value, minus short option value. (The FCM may set aside funds equal to the net liquidating equity (including the market value of any securities held) in each account.)	SECURED AMOUNT required to be set aside equals for each account the <u>least</u> of: A. the net liquidating equity plus the market value of any securities held in the customer's account; or B. margin required on foreign futures and options positions, plus the unrealized gain or loss on foreign futures positions, plus long option value, minus short option value; or C. foreign futures and options margin, plus the excess, if any, of the net liquidating equity over total funds required for <u>all</u> types of transactions. (The FCM may set aside funds equal to the net liquidating equity (including the market value of any securities held) in each account.)
YES	SECURED AMOUNT required to be set aside equals for each account the <u>greater</u> of : A. the amount calculated above; or B. the segregation requirement imposed by the foreign jurisdiction.	SECURED AMOUNT required to be set aside equals for each account the <u>greater</u> of: A. the amount calculated above; or B. the segregation requirement imposed by the foreign jurisdiction.

**EXAMPLE OF SECURED AMOUNT REQUIRED TO BE SET ASIDE CALCULATION FOR
COMBINED ACCOUNTS**

	Customers					
	A	B	C	D	E	F
A.1. Customer ledger balance (dr) cr	\$ 5,000	\$ 5,000	\$10,000	(\$ 2,000)	\$ 3,000	\$ 1,000
A.2. Treasury bills, at market	9,500	-0-	-0-	-0-	-0-	-0-
A.3. Unrealized gain (loss) - fgn. fut/opt	1,000	3,000	(1,000)	8,000	-0-	3,000
A.4. Unrealized gain (loss) - other non-regulated	<u>-0-</u>	<u>4,000</u>	<u>1,000</u>	<u>-0-</u>	<u>1,000</u>	<u>(5,000)</u>
A.5. Net liquidating equity - Tentative secured amount #1	<u>\$15,500</u>	<u>\$12,000</u>	<u>\$10,000</u>	<u>\$ 6,000</u>	<u>\$ 4,000</u>	<u>(\$1,000)</u>
B.1. Margin required - fgn. fut/opt	\$ 5,000	\$ 1,000	\$10,000	\$ 5,000	\$ 5,000	\$ 3,000
B.2. Unrealized gain (loss) - fgn. fut/	500	2,500	(2,000)	7,000	-0-	2,000
B.3. Long option value minus Short option value	<u>500</u>	<u>500</u>	<u>1,000</u>	<u>1,000</u>	<u>-0-</u>	<u>1,000</u>
B.4. Tentative Secured Amount #2 (B.1 + B.2. + B.3)	<u>\$ 6,000</u>	<u>\$ 4,000</u>	<u>\$ 9,000</u>	<u>\$13,000</u>	<u>\$ 5,000</u>	<u>\$ 6,000</u>
C.1. Margin required - fgn. fut/opt (B.1.)	\$ 5,000	\$ 1,000	\$10,000	\$ 5,000	\$ 5,000	\$3,000
C.2. Funds required - other non-regulated	<u>-0-</u>	<u>5,000</u>	<u>3,000</u>	<u>-0-</u>	<u>1,000</u>	<u>2,000</u>
C.3. Total funds required in account (C.1. + C.2.)	\$ 5,000	\$ 6,000	\$13,000	\$ 5,000	\$6,000	\$ 5,000
C.4. Net liquidating equity (A.5.)	<u>15,500</u>	<u>12,000</u>	<u>10,000</u>	<u>6,000</u>	<u>4,000</u>	<u>(1,000)</u>
C.5. Excess equity in account (C.4. - C.3)	\$10,500	\$6,000	\$ -0-	\$ 1,000	\$ -0-	\$ -0-
C.6. Margin required - fgn. fut/opt (B.1.)	5,000	1,000	10,000	5,000	5,000	3,000
C.7. Tentative Secured Amount #3 (C.5. + C.6.)	<u>\$15,500</u>	<u>\$ 7,000</u>	<u>\$10,000</u>	<u>\$ 6,000</u>	<u>\$ 5,000</u>	<u>\$ 3,000</u>
D.1. Secured Amount required to be set aside (Least of A.5, B.4, or C.7)	<u>\$ 6,000</u>	<u>\$ 4,000</u>	<u>\$ 9,000</u>	<u>\$ 6,000</u>	<u>\$4,000</u>	<u>\$ -0-</u>

Summary of Secured Amounts:

Customer	Amount	Least from Line
A	\$ 6,000	B.4.
B	4,000	B.4.
C	9,000	B.4.
D	6,000	A.5. or C.7.
E	4,000	A.5.
F	-0-	A.5. (deficit)
Total	<u>\$26,000</u>	

(Example continues on next page.)

Note that, when an FCM computes its secured amount based on the net liquidating equity in each customer's account, it must make the computation on an account-by-account basis to ensure that only accounts with net credit balances are included in the secured amount computation; consequently, the deficit in Customer F's account cannot offset the secured amount in any other accounts. Also, the same type of calculation would be made if the FCM included accounts of foreign-domiciled customers.

EXAMPLE OF SECURED AMOUNT CALCULATION FOR COMBINED ACCOUNTS – CONTINUED

Daily Statement of Secured Amounts and Funds in Separate Accounts

Secured amounts required to be set aside in customers' accounts		\$26,000
Funds in separate section 30.7 accounts:		
Cash in banks		\$ 2,000
Equity with clearing broker	8,000	
Margin with clearing organization	22,000	
Amount due from (to) clearing organization [a]	1,000	
Treasury bills at bank	<u>9,500</u>	<u>42,500</u>
Excess funds in section 30.7 accounts		<u>\$16,500</u>

[a] = Customer A in this example is assumed to be trading on an exchange whose clearing organization does not make daily monetary settlements with its clearing-member FCMs. Since Customer A's unrealized gain of \$1,000 on her open foreign futures position (Line A.3) must be included in the secured amount, the FCM may also reflect on its segregation statement for this day a receivable from the clearing organization. Likewise, if this customer had an unrealized loss on her open position which the FCM used to reduce the secured amount, it would be required also to reflect a payable to the clearing organization for the same amount.

The margin requirement referred to in the definition of the secured amount required to be set aside is the risk margin adjusted requirement imposed by the FCM. The amount imposed by the FCM must be no less than that required by exchange margin rules.

The FCM must set aside funds in separate accounts for U.S.- domiciled customers trading on foreign markets, but may include such amounts calculated for foreign-domiciled customers.

Pursuant to Regulation 30.7(a), the FCM may not include in the secured amount required to be set aside calculation any amounts for persons who are classified as noncustomers.

If the FCM is subject to the rules of a foreign jurisdiction that require it to segregate, or hold in separate accounts, funds of foreign-domiciled customers, the FCM may still include the accounts of such foreign-domiciled customers in the calculation of the secured amount. It may do so, although the amount set aside in separate Regulation 30.7 accounts may then be no less than the secured amounts required to be set aside as calculated for domestic-based customers plus the amount required to be segregated, or set aside, by the foreign jurisdiction for such foreign-domiciled customers. An example of the calculation follows.

**EXAMPLE OF SECURED AMOUNT CALCULATION FOR COMBINED ACCOUNTS
WHERE FCM MUST PROVIDE SEGREGATION FOR FOREIGN-DOMICILED CUSTOMERS**

Location of Customer	<u>Customers</u>		
	Foreign*	U.S.	U.S.
A.1. Customer ledger balance (dr) cr	\$ 7,000	(\$ 5,000)	\$10,000
A.1a. Market value of securities held by customer	0	0	0
A.2. Unrealized gain (loss) - fgn. fut/opt	1,000	3,000	(1,000)
A.3. Unrealized gain (loss) - other non-regulated	-0-	4,000	1,000
A.4. Net liquidating equity (Tentative secured amount #1)	<u>\$ 8,000</u>	<u>\$ 2,000</u>	<u>\$10,000</u>
B.1. Margin required - fgn. fut/opt	\$ 5,000	\$ 1,000	\$10,000
B.2. Unrealized gain (loss) - fgn. futures	500	2,500	(2,000)
B.3. Long opt. value minus short opt. value	500	500	1,000
B.4. Tentative secured amount #2 (B.1+ B.2.+B3)	<u>\$ 6,000</u>	<u>\$ 4,000</u>	<u>\$ 9,000</u>
C.1. Margin required - fgn. fut/opt (B.1.)	5,000	\$ 1,000	\$10,000
C.2. Funds required - other non-regulated	-0-	5,000	3,000
C.3. Total funds required in account (C.1. + C.2.)	\$ 5,000	\$ 6,000	\$13,000
C.4. Net liquidating equity (A.4.)	8,000	2,000	10,000
C.5. Excess equity in account (C.4. - C.3)	\$ 3,000	\$ -0-	\$ -0-
C.6. Margin required - fgn. fut/opt (B.1.)	5,000	1,000	10,000
C.7. Tentative secured amount #3 (C.5. + C.6.)	<u>\$ 8,000</u>	<u>\$ 1,000</u>	<u>\$10,000</u>
D.1. Secured amount required to be set aside	<u>\$ 8,000</u>	<u>\$1,000</u>	<u>\$ 9,000</u>

* = In this example, the foreign regulator requires the FCM to segregate funds for customers domiciled in the regulator's country in an amount that is the greater of each such customer's net liquidating equity or the margin required in the account.

Summary of Secured Amounts Required to Be Set Aside

Customer	Amount	
A	\$ 8,000	Equity (A.4) is greater than margin required (B.1). If the foreign rules had not required segregation, the FCM could have included the account in the secured amount at \$6,000 (B.4).
B	1,000	Line C.7. is least of A.4, B.4, and C.7.
C	<u>9,000</u>	Line B.3. is least of A.4, B.4, and C.7.
Total	<u>\$18,000</u>	

The FCM may set aside funds for the net liquidating equities in its customers' accounts (including the market value of any securities held by such customers in their accounts) rather than calculating the secured amount required to be set aside for each customer account. If the FCM chooses to set aside funds for the net liquidating equity in each account, it may not net accounts that

liquidate to a deficit against accounts that liquidate to an equity unless such accounts have identical ownership.

If an FCM deposits funds received from foreign-domiciled customers into a Part 30 set-aside funds account in which it also deposits funds received from U.S.-domiciled customers, it must include in the amount of funds required to be set aside as the secured amount both U.S.-domiciled and foreign domiciled customers' accounts.

FOREIGN FUTURES AND FOREIGN OPTIONS SECURED AMOUNTS - SUMMARY

Line I. - Method of calculating amount required to be set aside

The FCM should check the appropriate box to identify the method it is using to calculate the secured amount required to be set aside. It is possible that the FCM may be using more than one method because of requirements imposed by foreign regulatory bodies and may need to check more than one box. The method used for the 1-FR-FCM should be consistent with that used for the daily secured amount calculation prepared by the FCM, subject to the following exception. For ease of calculation, an FCM may use the net liquidating equity method during a month to make its daily secured amount calculation in accordance with Commission Regulation 30.7(f) and use the account-by-account method at month's end for its Form 1-FR Statement of Secured Amounts and Funds Held in Separate Accounts.

Line II. - Change in method of secured amount calculation

If the FCM changed its method of calculating the secured amount required to be set aside since the last report it filed, it should answer "yes" to the question and explain the change at the bottom of page 13, including the nature of the change, the reason for the change, and the date of the change.

Line 1. - Amount to be set aside in separate 30.7 accounts

The amount to be shown here is the amount calculated using the method identified under Line I. above. The amount will agree with page 4, Line 22.B, of the Statement of Financial Condition only if the FCM's set aside requirement is the sum of the net liquidating equities in accounts of U.S.-and foreign-domiciled customers trading on foreign markets.

Line 2. - Total funds in separate section 30.7 accounts

The amount on this line should agree with the amount on Line 8, "Total funds in separate section 30.7 accounts", of the Statement of Secured Amounts and Funds Held in Separate Accounts – Funds Deposited in Separate Regulation 30.7 Accounts.

Line 3. - Excess (deficiency)

Subtract Line 1. from Line 2.

A deficiency in set-aside funds requires immediate corrective action and immediate telephonic notification by the FCM to the Commission and the FCM's DSRO whenever the FCM knows or should have known of the deficiency. Such notice must also be confirmed in writing to the Commission and the FCM's DSRO. The FCM should consult with its DSRO or the Commission. Other SROs of which the FCM is a member also may require the FCM to report immediately any deficiency in set-aside funds.

FUNDS DEPOSITED IN SEPARATE REGULATION 30.7 ACCOUNTS

Set-Aside Accounts

An FCM may set aside funds with a U.S. bank, a foreign bank designated by the Commission, another registered FCM, a clearing organization of a foreign board of trade, a member of a foreign board of trade, and other depositories designated by a member of a foreign board of trade or by the foreign clearing organization.

An FCM may not include any amounts as set-aside funds on Lines 1 through 6 of the Statement of Funds Deposited in Separate Regulation 30.7 Accounts, unless:

1. The account is titled to identify the funds in the account as being set aside pursuant to U.S. CFTC Regulation 30.7, and
2. the FCM has received a written statement from the depository, dated and signed by an officer of the depository, acknowledging its understanding of the nature of the funds in the account.

In the United Kingdom, the Financial Services Authority ("FSA") may require accounts for deposit of customers' funds to use the term "Client Monies" in the account title. It is permissible to title a Part 30.7 depository account in the U.K. a "Client Monies" account, provided the depository acknowledges in the acknowledgment letter obtained for the account under 30.7 that funds in the account will be treated in accordance with the segregation requirements of the FSA.

Commission Recognition of Banks and Trust Companies Located Outside of the United States

If an FCM maintains separate account funds (cash or securities) in an account with a bank or trust company located outside the United States (Lines 1.B. and 2.B.), then pursuant to Commission Regulation 30.7, the bank or trust company must have in excess of \$1 billion of regulatory capital or be an entity whose commercial paper or long-term debt instrument, or if part of a holding company system, its holding company's commercial paper or long-term debt instrument, is rated in one of the two highest rating categories by at least one nationally recognized statistical rating organization, or be designated by the Commission.

The Commission does not maintain ratings of nationally recognized statistical rating organizations. An FCM must make such determination independently. If an institution is not rated in the specified categories, an FCM should contact the Commission's Division of Clearing and Intermediary Oversight to determine whether a depository has been recognized by the Commission.

Depositories Designated by Members of Foreign Boards of Trade and Foreign Clearing Organizations

A designated depository of a member of a foreign board of trade or of a foreign clearing organization (Line 6), is any depository used by the member of the foreign board of trade or the foreign clearing organization for margin purposes consistent with the law of the jurisdiction where such member or clearing organization is located.

Set-Aside Funds on Hand

The Form 1-FR-FCM also includes Line 7 for reporting funds on hand. Any securities or other property that is "on hand" must be marked as belonging to customers trading on foreign exchanges and physically segregated from other property not belonging to such customers in order for such securities or other property to be considered a part of set-aside funds. Customer property must be safeguarded against loss, theft, and physical destruction in order for such property to be considered properly set-

aside. For example, securities held in a fire-proof vault to which access is controlled would be considered properly safeguarded, whereas securities held in desk drawer would not.

Permissible Investments of Part 30 Set-Aside Funds

In investing funds required to be maintained in separate section 30.7 account(s), FCMs are bound by their fiduciary obligations to customers and the requirement that the secured amount required to be set aside be at all times liquid and sufficient to cover all obligations to such customers. Regulation 1.25 investments would be appropriate, as would investments in any other readily marketable securities. (See the definition of **Readily Marketable** on page 2-3 of these instructions.)

An FCM may request a determination by the Commission whether specific instruments are appropriate investments for Part 30 secured amounts required to be set aside. Such requests should be filed with the Commission's Division of Clearing and Intermediary Oversight, 1155 21st St. N.W., Washington, D.C. 20581.

Wherever a line is provided for reporting securities, such securities should be reflected at market value. However, for convenience, any security held for a particular customer which is included in a set-aside account may be reported at face value if face value exceeds market value.

Letters of Credit

Letters of credit, whether received from customers or obtained by the FCM, should not be reported as set-aside assets in this statement.

Line 1. - Cash in banks

Include on Line 1.A. cash deposited in domestic banks and trust companies. Include on line 1.B. the name(s) and amount of cash deposited in foreign banks and trust companies that have been recognized by the Commission as appropriate depositories.

Overdrafts in accounts used to set aside funds for customers trading on foreign commodity exchanges should be reported here as a reduction of total set aside assets.

Line 2. - Securities

Include on Line 2.A. the market value of readily marketable securities deposited in domestic banks and trust companies. Show on Line 2.B. the market value of readily marketable securities deposited in foreign banks and trust companies which have been recognized by the Commission as appropriate depositories, and the names of such foreign depositories. Include securities held for particular customers if such securities have been included in the secured amount.

Line 3. - Equities with registered futures commission merchants

Line 3.A. - Cash

Show the net credit or debit cash ledger balance with other registered FCMs.

Line 3.B. - Securities

Show the current market value of readily marketable securities deposited with other FCMs. Include securities held for particular customers to the extent such securities are included in the calculation of the secured amount required to be set aside for such customers. Exclude such securities

held for particular customers if they were not included in the determination of the secured amount required to be set aside for such customer.

Line 3.C. - Unrealized gain (loss) on open futures contracts

Include the net gain or (loss) on all open futures positions carried by other registered FCMs.

Lines 3.D. and E. - Value of long/short option contracts

Include the current value of long and short options positions.

Line 4. - Amounts held by clearing organizations of foreign boards of trade

List the names of all clearing organizations of foreign boards of trade where cash or securities are deposited.

Line 4.A. - Cash

Show cash margins deposited with clearing organizations of foreign board of trades to margin customers' positions. Do not include guarantee deposits.

Line 4.B. - Securities

Show the current market value of readily marketable securities deposited as margin for customers' positions. Include securities held for particular customers which have been deposited as margin, if such securities have been included in the secured amount.

Line 4.C. - Amount due from (to) clearing organization - daily variation

This is the net of all amounts due from (asset), or due to (reduction of set-aside assets) foreign clearing organizations in settlement of cleared customer trades. In addition, include the mark-to-market value of trades not yet cleared (outtrades) as of the date of the report in the determination of this amount.

Lines 4.D. and E. - Value of long/short option contracts

Include the current value of long and short options positions.

Line 5. - Amounts held by members of foreign boards of trade

List the names of all members of foreign boards of trade where cash and/or securities are deposited.

Line 5.A. - Cash

Show the net credit or debit cash ledger balance with members of foreign boards of trade.

Line 5.B. - Securities

Show the current market value of readily marketable securities deposited as margin for customers' positions. Include securities held for particular customers which have been deposited as margin, if such securities have been included in the secured amount.

Line 5.C. - Unrealized gain (loss) on open futures contracts

Include the net gain or (loss) on all open futures positions carried by members of foreign boards of trade.

Lines 5.D. and E. - Value of long/short option contracts

Include the current value of long and short options positions.

Line 6. - Amounts with other depositories designated by a foreign board of trade

List the name(s) and amount of cash, and the market value of readily marketable securities, in other depositories designated by a foreign board of trade. Include securities held for particular customers which have been deposited as margin, if such securities have been included in the calculation of such customer's secured amount required to be set aside.

Line 7. - Set Aside funds on hand

Any money, securities, or other property which is "on hand" must be physically marked as being set aside pursuant to Regulation 30.7 in order for the funds to be considered a part of set aside funds. Such funds must be safeguarded against loss, theft and physical destruction in order for such property to be considered properly set aside.

Note A.

The note instructs FCMs that if any securities which are included in the set-aside schedule are other than the type referred to in Regulation 1.25, the FCM must attach a separate schedule which provides details of such securities. (See **Permissible Investments of Part 30 Set-Aside Funds** on page 12-9 and **Investments of Customers' Funds** on page 10-8.)

The separate schedule should include, as a minimum, the FCM's name, the "as of" date of the report, a caption similar to "Attachment to Set-Aside Schedule -- Non-Regulation 1.25 Securities", and a description of the securities by line number. The description for each line number should include the quantity, issuer, and market value.

APPLICANTS FOR REGISTRATION

A person who files an application for registration as an FCM, and who will not be succeeding to and continuing the business of another FCM, must file a Form 1-FR-FCM with its application for registration. The applicant has two options in regard to the financial report it files with the application:

1. The applicant can file an audited report with an "as of" date which is not more than 45 days prior to the date on which the application is filed. The audited report need not be on Form 1-FR-FCM. However, if it is not, it must be accompanied by a Statement of the Computation of the Minimum Capital Requirements which is found in Form 1-FR-FCM. A reconciliation between the latter statement and the audited financial report also must be included.
2. The applicant can file an audited report which is not older than one year at the date of filing the application. The audited report must be accompanied by an unaudited Form 1-FR-FCM which is not more than 17 business days old at the time of filing of the application.

An applicant for registration as an FCM must also include with its application form and initial financial report, a written narrative statement which:

1. describes the source of the applicant's current assets; and
2. represents that the applicant's capital has been contributed for the purpose of operating as an FCM and that it will continue to be used for such purpose. This statement must be signed by the same person who signs the Form 1-FR-FCM attestation.

Each Form 1-FR-FCM filed by an applicant must include each of the statements found in the Form 1-FR-FCM. The Form 1-FR-FCM, any other financial statements, and the supplemental statement must be filed with National Futures Association and the Commission's regional office nearest the applicant's headquarters office. (See **Where to File Financial Reports** on page 1-3 for location of CFTC offices.)

If the applicant carries subordinated debt on its books, it must also file with the application and financial report an executed copy of each subordinated loan agreement (and secured demand note, if applicable) and a narrative statement which sets forth the name and address of the lender, the business relationship of the lender to the applicant, and whether the applicant carried any funds or securities for the lender at or about the time the agreement was filed. This agreement need only be filed with the NFA and the applicant's DSRO, if any.

Applicant Succeeding to the Business of Another FCM

An applicant who will be succeeding to and continuing the business of another FCM is not required to file a financial report prior to it being registered, unless the Commission or a self-regulatory organization requires the applicant to do so. The application must be accompanied by the required narrative statement concerning the source and continued use of capital in the business.

Once the successor FCM is registered, it must file a Form 1-FR-FCM as of the first month-end following the date on which its registration became effective. The report must be filed with the NFA, the Commission, and the FCM's DSRO, if any, not more than 17 business days after the date for which the report is made. That report must include each of the statements included in the Form 1-FR-FCM. (See Example below.)

Example

XYZ, an applicant for FCM registration, will be taking over all of the customer commodity accounts of ABC, a registered FCM.

10/14/04 - XYZ files its application for registration as an FCM. No financial report need be filed unless specifically requested by the Commission or SRO. The supplemental source and continued use of capital statement must be filed with the application.

11/05/04 - XYZ is notified by NFA that its registration will be effective 11/06/04.

12/23/04 - XYZ must file an 11/30/2004 unaudited Form 1-FR-FCM by no later than 12/23/04.

Monthly Filing

An FCM must file an unaudited Form 1-FR-FCM for each month of each fiscal year, including the last month. With the exception of any certified Form 1-FR-FCM required to be filed as of the close of an FCM's fiscal year, each required monthly Form 1-FR-FCM must be filed no later than 17 business days after the date for which the report is made. An FCM must also file with the Commission a copy of each financial report it files with its DSRO.

Election of Fiscal Year

An applicant for registration as an FCM may elect to establish a fiscal year other than the calendar year. An applicant who does not notify the NFA and the Commission of its election of a fiscal year other than the calendar year will be deemed to have elected the calendar year as its fiscal year.

To elect a fiscal year other than the calendar year, an applicant must notify the NFA, in writing, of its election. The applicant must file the written notice concurrently with its Form 1-FR-FCM filed with its application for registration. A copy of the fiscal year election notice must also be filed with the regional office of the Commission nearest the applicant's principal place of business.

An FCM must continue to use the fiscal year it has elected until the DSRO approves the registrant's request for a change in fiscal year, and the FCM gives written notice of the approval of such change to the Commission.

**REPORTING REQUIREMENTS WHEN AN FCM'S ADJUSTED NET CAPITAL IS BELOW THE
FCM'S "EARLY WARNING" LEVEL**

Initial Notice

An FCM whose adjusted net capital is less than its "early warning" level, as defined by Section 1.12(b) of the Regulations, must file a written notice with the principal office of the Commission in Washington, D.C., with the appropriate regional office of the Commission (see **Where to File Financial Reports** on page 1-3 of these instructions), and with its DSRO. If the FCM is also a registered securities broker/dealer, it must notify the SEC. An applicant for registration as an FCM must file notice with NFA and the Commission. The notice must be filed within 24 hours of when the firm knew or should have known that its adjusted net capital first was below the "early warning" level.

**REPORTING REQUIREMENTS WHEN AN FCM'S ADJUSTED NET CAPITAL IS BELOW THE
MINIMUM REQUIREMENTS (UNDERCAPITALIZATION)**

An FCM who knows, or should have known, that its adjusted net capital at any time is less than the minimum net capital required by Section 1.17 of the Regulations, or the capital rule of any self-regulatory organization of which the FCM is a member, must give telephonic notice, confirmed in writing, of its undercapitalization to the principal office of the Commission in Washington, D.C., to the appropriate regional office of the Commission (see **Where to File Financial Reports** on page 1-3 of these instructions), to its DSRO, if any, to the NFA, if the firm is an applicant for registration, and to the SEC, if the FCM is a securities broker/dealer. Such notice must be given immediately after the FCM knows, or should have known, of its undercapitalization.

Within 24 hours after giving notice an FCM must file, with the same organizations to which it gave telephonic notice, the following statements as of the date of its undercapitalization:

1. Statement of Financial Condition;
2. Statement of the Computation of the Minimum Capital Requirements Pursuant to Section 1.17 of the Regulations;
3. Statement of Segregation Requirements and Funds in Segregation for Customers Trading on U.S. Commodity Exchanges;
4. Statement of Segregation Requirements and Funds in Segregation for Customers' Dealer Options Accounts; and
5. Statement of Secured Amounts and Funds Held in Separate Accounts for Foreign Futures and Foreign Options Customers in Accordance with Section 30.7 of the Regulations.

**SUMMARY OF
"EARLY WARNING" NOTICE REQUIREMENTS
UNDER SECTION 1.12 OF THE COMMISSION'S REGULATIONS**

Introduction

Section 1.12 of the Commission's Regulations requires FCMs to report certain events and situations both to the Commission and to the FCM's DSRO. These reports are referred to as "early warning notices". The notices required to be filed by Section 1.12 of the Regulations are summarized in the following chart:

Rule / Requirement	Comment	Notification Required
1.12(a) Undercapitalization	If an FCM knows or should have known that it is not meeting the minimum capital requirements of the CFTC or of its DSRO, it is required to report that immediately.	Immediate notice by telephone, followed up in writing. Within 24 hours, file a statement of financial condition, a net capital computation, a segregation statement, and a secured amount statement.
1.12(b) Adjusted net capital declines below early warning minimum capital requirement.	As long as adjusted net capital does not decline below the minimum requirement, the FCM is not in violation of the net capital rule. However, the decline below the early warning level must be reported.	File written notice within 24 hours of when the FCM knows, or should have known, of the event.
1.12(c) A firm fails to make or keep current the books and records required by Commission Regulations.	For example, a firm is not preparing books and records required to be prepared within the time frames specified by the Regulations.	Same day notice in writing by fax. Specify records that are not current. Within 48 hours after giving notice, file a written report on what steps have been and are being taken to correct the situation.
1.12(d) Firm discovers or is notified of a material inadequacy ("MI") in its internal accounting controls.	Material inadequacies may occur in a firm's accounting system, internal controls or procedures for safeguarding firm and customer assets. MIs include conditions which could reasonably be expected to: • inhibit a firm from discharging its responsibilities to customers or other creditors; • result in material financial loss • result in material misstatement of the firm's financial statements; or • result in violations of the	Within 24 hours of learning of an MI, a firm must file notice in writing by fax. Within 48 hours of giving notice, the firm must file a written report stating what steps have been and are being taken to correct the situation.

	segregation of funds and secured amount rules; recordkeeping or reporting rules.	
1.12(f)(2) FCM determines that any position it carries for another FCM must be liquidated or transferred, or the account carried for another FCM may trade for liquidation only.	This event is reportable if liquidation or transfer is due to the other FCM's failure to meet a call for margin or to make other required deposits.	Immediate telephonic notice, along with immediate written confirmation by fax, to the Commission's Washington, D.C. office.
1.12(f)(3) FCM determines that an account it carries is undermargined by an amount that exceeds the FCM's adjusted net capital.	An FCM is required to file notice whether or not a margin call has actually been issued. Applies to any type of commodity account carried by the firm. DSRO may exempt firms from filing notice with respect to particular accounts if DSRO monitors the account.	Immediate telephonic notice, along with immediate written confirmation by fax, to its DSRO and to the Commission's Washington, D.C. office.
1.12(f)(4) Any commodity account carried is subject to a margin call in an amount that exceeds the FCM's excess adjusted net capital, <i>and</i> the call is not answered by COB of the day after the margin call is issued.	In addition to actual margin deposits, favorable market moves may be considered, as set out in the Joint Audit Committee's "Margin Handbook", in determining whether a margin call has been satisfied and whether notice must be filed.	Immediate telephonic notice, along with immediate written confirmation by fax, to its DSRO and to the Commission's Washington, D.C. office.
1.12(f)(5) Excess adjusted net capital is less than 6% of maintenance margin required in all noncustomers' accounts.	Exclude noncustomers who are subject to financial requirements as an FCM, or BD registered with SEC. Maintenance margin is the total amount a noncustomer is required to have on deposit in order to maintain its open position.	Immediate telephonic notice, along with immediate written confirmation by fax, to its DSRO and to the Commission's Washington, D.C. office.
1.12(g)(1) -- 20% or more decline in net capital from that most recently reported on a financial report filed with the Commission.		Written notice within 2 business days of event or series of events causing the decline to the Commission's office nearest the FCM's place of business, to its DSRO, and to the Commission's Washington, D.C. office. Regulation 1.12(g) does not require separate notice with respect to repayment or prepayment of subordinated debt since an FCM must always get approval from its DSRO for prepayment of subordinated debt.

1.12(g)(2) -- 30% or more decline in excess net capital from that amount most recently reported on a financial report filed with the Commission, and the decline was planned.		Notice to be filed at least 2 business days prior to the capital reduction to the Commission's office nearest the FCM's place of business, to its DSRO, and to the Commission's Washington, D.C. office.
1.12(h) FCM has insufficient funds in segregation for customers trading on U.S. markets, or has insufficient funds set aside for customers trading on non-U.S. markets.		Immediate telephonic notice, along with immediate written confirmation by fax, to its DSRO and to the Commission's Washington, D.C. office whenever the FCM knows or should have known of the deficiency in segregated or Part 30 set-aside funds.

APPENDICES

CHARGES FOR REPURCHASE AND REVERSE REPURCHASE AGREEMENTS

This appendix is an excerpt from the SEC rule relating to net capital treatment of reverse repurchase (asset) and repurchase (liability) agreements, and the charges to be taken against such accounts. See 17 CFR 240.15c3-1 (c) (2) (iv) (F). The charges specified herein are to be shown on page 7, lines 13.A and 13.B., of the Form 1-FR-FCM. While the rule refers to brokers and dealers, the charges are applicable to FCMs' positions also.

DEFINITIONS

F)(1) For purposes of this paragraph:

(i) The term reverse repurchase agreement deficit shall mean the difference between the contract price for resale of the securities under a reverse repurchase agreement and the market value of those securities (if less than the contract price).

(ii) The term repurchase agreement deficit shall mean the difference between the market value of securities subject to the repurchase agreement and the contract price for repurchase of the securities (if less than the market value of the securities).

(iii) As used in paragraph (c)(2)(iv)(F)(1) of this section, the term contract price shall include accrued interest.

(iv) Reverse repurchase agreement deficits and the repurchase agreement deficits where the counterparty is the Federal Reserve Bank of New York shall be disregarded.

Charges For Reverse Repurchase Agreements

(2)(i) In the case of a reverse repurchase agreement, the deduction shall be equal to the reverse repurchase agreement deficit.

(ii) In determining the required deductions under paragraph (c)(2)(iv)(F)(2)(i) of this section, the broker or dealer may reduce the reverse repurchase agreement deficit by:

(A) Any margin or other deposits held by the broker or dealer on account of the reverse repurchase agreement;

(B) Any excess market value of the securities over the contract price for resale of those securities under any other reverse repurchase agreement with the same party;

(C) The difference between the contract price for resale and the market value of securities subject to repurchase agreements with the same party (if the market value of those securities is less than the contract price); and

(D) Calls for margin, marks to the market, or other required deposits which are outstanding one business day or less.

CHARGES FOR REPURCHASE AGREEMENTS

(3) (i) In the case of repurchase agreements, the deduction shall be:

(A) The excess of the repurchase agreement deficit over 5 percent of the contract price for resale of United States Treasury Bills, Notes and Bonds, 10 percent of the contract price for the resale of securities issued or guaranteed as to principal or interest by an agency of the United States or mortgage related

Charges – Repurchase and Reverse-Repurchase Agreements

securities as defined in section 3(a)(41) of the Act and 20 percent of the contract price for the resale of other securities and;

(B) The excess of the aggregate repurchase agreement deficits with any one party over 25 percent of the broker or dealer's net capital before the application of paragraph (c)(2)(vi) of this section (less any deduction taken with respect to repurchase agreements with that party under paragraph c)(2)(iv)(F)(3)(i)(A) of this section) or, if greater;

(C) The excess of the aggregate repurchase agreement deficits over 300 percent of the broker's or dealer's net capital before the application of paragraph (c)(2)(vi) of this section.

(ii) In determining the required deduction under paragraph (c)(2)(iv)(F)(3)(i) of this section, the broker or dealer may reduce a repurchase agreement deficit by:

(A) Any margin or other deposits held by the broker or dealer on account of a reverse repurchase agreement with the same party to the extent not otherwise used to reduce a reverse repurchase deficit;

(B) The difference between the contract price and the market value of securities subject to other repurchase agreements with the same party (if the market value of those securities is less than the contract price) not otherwise used to reduce a reverse repurchase agreement deficit; and

(C) Calls for margin, marks to the market, or other required deposits which are outstanding one business day or less to the extent not otherwise used to reduce a reverse repurchase agreement deficit.

[LINK TO WEBSITE]

http://a257.g.akamaitech.net/7/257/2422/14mar20010800/edocket.access.gpo.gov/cfr_2003/aprqrtr/17cfr240.15c3-1.htm

CHARGES FOR SECURITIES POSITIONS

This appendix is an excerpt from the SEC rule relating to charges against net capital for securities positions, non-marketable securities and open contractual commitments. See 17 CFR 240.15c3-1(c) (2) (vi), (vii), (viii and (ix). The charges specified herein are to be shown on page 7, lines 12.A through 12.F., of the Form 1-FR-FCM. While the rule refers to brokers and dealers, the charges are applicable to FCMs' positions also.

U.S. Government Securities

(A) (1) In the case of a security issued or guaranteed as to principal or interest by the United States or any agency thereof, the applicable percentages of the market value of the net long or short position in each of the categories specified below are:

Category 1

- (i) Less than 3 months to maturity--0 percent.
- (ii) 3 months but less than 6 months to maturity-- $\frac{1}{2}$ of 1 percent.
- (iii) 6 months but less than 9 months to maturity-- $\frac{3}{4}$ of 1 percent.
- (iv) 9 months but less than 12 months to maturity--1 percent.

Category 2

- (i) 1 year but less than 2 years to maturity-- $\frac{1}{2}$ percent.
- (ii) 2 years but less than 3 years to maturity--2 percent.

Category 3

- (i) 3 years but less than 5 years to maturity--3%.
- (ii) 5 years but less than 10 years to maturity--4%.

Category 4

- (i) 10 years but less than 15 years to maturity-- $\frac{1}{2}$ %.
- (ii) 15 years but less than 20 years to maturity--5%.
- (iii) 20 years but less than 25 years to maturity-- $\frac{5}{2}$ %.
- (iv) 25 years or more to maturity--6%.

Brokers or dealers shall compute a deduction for each category above as follows: Compute the deductions for the net long or short positions in each subcategory above. The deduction for the category shall be the net of the aggregate deductions on the long positions and the aggregate deductions on the short positions in each category plus 50% of the lesser of the aggregate deductions on the long or short positions.

Charges for Securities Positions

(2) A broker or dealer may elect to deduct, in lieu of the computation required under paragraph (c)(2)(vi)(A)(1) of this section, the applicable percentages of the market value of the net long or short positions in each of the subcategories specified in paragraph (c)(2)(vi)(A)(1) of this section.

(3) In computing deductions under paragraph (c)(2)(vi)(A)(1) of this section, a broker or dealer may elect to exclude the market value of a long or short security from one category and a security from another category, Provided, That:

(i) Such securities have maturity dates:

(A) Between 9 months and 15 months and within 3 months of one another.

(B) Between 2 years and 4 years and within 1 year of one another; or

(C) Between 8 years and 12 years and within 2 years of one another.

(ii) The net market value of the two excluded securities shall remain in the category of the security with the higher market value.

(4) In computing deductions under paragraph (c)(2)(vi)(A)(1) of this section, a broker or dealer may include in the categories specified in paragraph (c)(2)(vi)(A)(1) of this section, long or short positions in securities issued by the United States or any agency thereof that are deliverable against long or short positions in futures contracts relating to Government securities, traded on a recognized contract market approved by the Commodity Futures Trading Commission, which are held in the proprietary or other accounts of the broker or dealer. The value of the long or short positions included in the categories shall be determined by the contract value of the futures contract held in the account. The provisions of Appendix B to Rule 15c3-1 (17 CFR 240.15c3-1b) will in any event apply to the positions in futures contracts.

(5) In the case of a Government securities dealer that reports to the Federal Reserve System, that transacts business directly with the Federal Reserve System, and that maintains at all times a minimum net capital of at least \$50,000,000, before application of the deductions provided for in paragraph (c)(2)(vi) of this section, the deduction for a security issued or guaranteed as to principal or interest by the United States or any agency thereof shall be 75 percent of the deduction otherwise computed under paragraph (c)(2)(vi)(A) of this section.

Municipals

(B)(1) In the case of any municipal security which has a scheduled maturity at date of issue of 731 days or less and which is issued at par value and pays interest at maturity, or which is issued at a discount, and which is not traded flat or in default as to principal or interest, the applicable percentages of the market value on the greater of the long or short position in each of the categories specified below are:

(i) Less than 30 days to maturity--0%.

(ii) 30 days but less than 91 days to maturity-- $\frac{1}{8}$ of 1%.

(iii) 91 days but less than 181 days to maturity-- $\frac{1}{4}$ of 1%.

(iv) 181 days but less than 271 days to maturity-- $\frac{3}{8}$ of 1%.

(v) 271 days but less than 366 days to maturity-- $\frac{1}{2}$ of 1%.

(vi) 366 days but less than 456 days to maturity-- $\frac{3}{4}$ of 1%.

(vii) 456 days but less than 732 days to maturity--1%.

(2) In the case of any municipal security, other than those specified in paragraph (c)(2)(vi)(B)(1), which is not traded flat or in default as to principal or interest, the applicable percentages of the market value of the greater of the long or short position in each of the categories specified below are:

- (i) Less than 1 year to maturity--1%.
- (ii) 1 year but less than 2 years to maturity--2%.
- (iii) 2 years but less than 3½ years to maturity--3%.
- (iv) 3½ years but less than 5 years to maturity--4%.
- (v) 5 years but less than 7 years to maturity--5%.
- (vi) 7 years but less than 10 years to maturity--5½%.
- (vii) 10 years but less than 15 years to maturity--6%.
- (viii) 15 years but less than 20 years to maturity--6½%.
- (ix) 20 years or more to maturity--7%.

Canadian Debt Obligations

(C) In the case of any security issued or unconditionally guaranteed as to principal and interest by the Government of Canada, the percentages of market value to be deducted shall be the same as in paragraph (A) of this section.

Certain Municipal Bond Trusts and Liquid Asset Funds

(D)(1) In the case of redeemable securities of an investment company registered under the Investment Company Act of 1940, which assets consist of cash or money market instruments and which is generally known as a "money market fund," the deduction shall be 2% of the market value of the greater of the long or short position.

(2) In the case of redeemable securities of an investment company registered under the Investment Company Act of 1940, which assets are in the form of cash or securities or money market instruments of any maturity which are described in paragraph (c)(2)(vi) (A) through (C) or (E) of this section, the deduction shall be 7% of the market value of the greater of the long or short positions.

(3) In the case of redeemable securities of an investment company registered under the Investment Company Act of 1940, which assets are in the form of cash or securities or money market instruments which are described in paragraphs (c)(2)(vi) (A) through (C) or (E) and (F) of this section, the deduction shall be 9% of the market value of the long or short position.

Commercial Paper, Bankers Acceptances and Certificates of Deposit

(E) In the case of any short term promissory note or evidence of indebtedness which has a fixed rate of interest or is sold at a discount, and which has a maturity date at date of issuance not exceeding nine months exclusive of days of grace, or any renewal thereof, the maturity of which is likewise limited and is rated in one of the three highest categories by at least two of the nationally recognized statistical rating organizations (Provided, That effective January 1, 1977, and until September 1, 1977, this paragraph shall be deemed to require only one such rating), or in the case of any negotiable certificates of deposit or bankers acceptance or similar type of instrument issued or guaranteed by any bank as defined in section 3(a)(6) of

Charges for Securities Positions

the Securities Exchange Act of 1934, the applicable percentage of the market value of the greater of the long or short position in each of the categories specified below are:

- (1) Less than 30 days to maturity--0 percent.
- (2) 30 days but less than 91 days to maturity $\frac{1}{8}$ of 1 percent.
- (3) 91 days but less than 181 days to maturity $\frac{1}{4}$ of 1 percent.
- (4) 181 days but less than 271 days to maturity $\frac{3}{8}$ of 1 percent.
- (5) 271 days but less than 1 year to maturity $\frac{1}{2}$ of 1 percent; and
- (6) with respect to any negotiable certificate of deposit or bankers acceptance or similar type of instrument issued or guaranteed by any bank, as defined above, having 1 year or more to maturity, the deduction shall be on the greater of the long or short position and shall be the same percentage as that prescribed in paragraph (c)(2)(vi)(A) of this section.

Nonconvertible Debt Securities

(F) (1) In the case of nonconvertible debt securities having a fixed interest rate and a fixed maturity date and which are not traded flat or in default as to principal or interest and which are rated in one of the four highest rating categories by at least two of the nationally recognized statistical rating organizations, the applicable percentages of the market value of the greater of the long or short position in each of the categories specified below are:

- (i) Less than 1 year to maturity--2%
- (ii) 1 year but less than 2 years to maturity--3%
- (iii) 2 years but less than 3 years to maturity--5%
- (iv) 3 years but less than 5 years to maturity--6%
- (v) 5 years but less than 10 years to maturity--7%
- (vi) 10 years but less than 15 years to maturity-- $7\frac{1}{2}$ %
- (vii) 15 years but less than 20 years to maturity--8%
- (viii) 20 years but less than 25 years to maturity-- $8\frac{1}{2}$ %
- (ix) 25 years or more to maturity--9%

(2) A broker or dealer may elect to exclude from the above categories long or short positions that are hedged with short or long positions in securities issued by the United States or any agency thereof or nonconvertible debt securities having a fixed interest rate and a fixed maturity date and which are not traded flat or in default as to principal or interest and which are rated in one of the four highest rating categories by at least two of the nationally recognized statistical rating organizations if such securities have maturity dates:

- (i) Less than five years and within 6 months of each other;
- (ii) Between 5 years and 10 years and within 9 months of each other;
- (iii) Between 10 years and 15 years and within 2 years of each other; or

- (iv) 15 years or more and within 10 years of each other.

The broker-dealer shall deduct the amounts specified in paragraphs (c)(2)(vi)(F) (3) and (4) of this section.

(3) With respect to those positions described in paragraph (c)(2)(vi)(F)(2) of this section that include a long or short position in securities issued by the United States or any agency thereof, the broker or dealer shall exclude the hedging short or long United States or agency securities position from the applicable haircut category under paragraph (c)(2)(vi)(A) of this section. The broker or dealer shall deduct the percentage of the market value of the hedged long or short position in nonconvertible debt securities as specified in each of the categories below:

- (i) Less than 5 years to maturity-- $1\frac{1}{2}\%$
- (ii) 5 years but less than 10 years to maturity-- $2\frac{1}{2}\%$
- (iii) 10 years but less than 15 years to maturity-- $2\frac{3}{4}\%$
- (iv) 15 years or more to maturity--3%

(4) With respect to those positions described in paragraph (c)(2)(vi)(F)(2) of this section that include offsetting long and short positions in nonconvertible debt securities, the broker or dealer shall deduct a percentage of the market value of the hedged long or short position in nonconvertible debt securities as specified in each of the categories below:

- (i) Less than 5 years to maturity-- $1\frac{3}{4}\%$
- (ii) 5 years but less than 10 years to maturity--3%
- (iii) 10 years but less than 15 years to maturity-- $3\frac{1}{4}\%$
- (iv) 15 years or more to maturity-- $3\frac{1}{2}\%$

(5) In computing deductions under paragraph (c)(2)(vi)(F)(3) of this section, a broker or dealer may include in the categories specified in paragraph (c)(2)(vi)(F)(3) of this section, long or short positions in securities issued by the United States or any agency thereof that are deliverable against long or short positions in futures contracts relating to Government securities, traded on a recognized contract market approved by the Commodity Futures Trading Commission, which are held in the proprietary or other accounts of the broker or dealer. The value of the long or short positions included in the categories shall be determined by the contract value of the futures contract held in the account.

(6) The provisions of Appendix B to Rule 15c3-1 (17 CFR 240.15c3-1b) will in any event apply to the positions in futures contracts.

Convertible Debt Securities

(G) In the case of a debt security not in default which has a fixed rate of interest and a fixed maturity date and which is convertible into an equity security, the deductions shall be as follows: If the market value is 100 percent or more of the principal amount, the deduction shall be determined as specified in paragraph (c)(2)(vi)(J) of this section; if the market value is less than the principal amount, the deduction shall be determined as specified in paragraph (F) of this section; if such securities are rated as required of paragraph (F) of this section;

Charges for Securities PositionsCumulative, Nonconvertible, Preferred Stock

(H) In the case of cumulative, nonconvertible preferred stock ranking prior to all other classes of stock of the same issuer, which is rated in one of the four highest rating categories by at least two of the nationally recognized statistical rating organizations and which are not in arrears as to dividends, the deduction shall be 10% of the market value of the greater of the long or short position.

(I) [Reserved]

All Other Securities

(J) In the case of all securities or evidences of indebtedness, except those described in Appendix A, Sec. 240.15c3-1a, which are not included in any of the percentage categories enumerated in paragraphs (c)(2)(vi) (A) through (H) of this section or paragraph (c)(2)(vi)(K)(ii) of this section, the deduction shall be 15 percent of the market value of the greater of the long or short positions and to the extent the market value of the lesser of the long or short positions exceeds 25 percent of the market value of the greater of the long or short positions, the percentage deduction on such excess shall be 15 percent of the market value of such excess. No deduction need be made in the case of: (1) A security that is convertible into or exchangeable for another security within a period of 90 days, subject to no conditions other than the payment of money, and the other securities into which such security is convertible or for which it is exchangeable, are short in the accounts of such broker or dealer; or (2) A security that has been called for redemption and that is redeemable within 90 days.

Securities with a Limited Market

(K) In the case of securities (other than exempted securities, nonconvertible debt securities, and cumulative nonconvertible preferred stock) which are not: (1) Traded on a national securities exchange; (2) designated as "OTC Margin Stock" pursuant to Regulation T under the Securities Exchange Act of 1934; (3) quoted on "NASDAQ"; or (4) redeemable shares of investment companies registered under the Investment Company Act of 1940, the deduction shall be as follows:

(i) In the case where there are regular quotations in an inter-dealer quotations system for the securities by three or more independent market-makers (exclusive of the computing broker or dealer) and where each such quotation represents a bona fide offer to brokers or dealers to both buy and sell in reasonable quantities at stated prices, or where a ready market as defined in paragraph (c)(11) (ii) is deemed to exist, the deduction shall be determined in accordance with paragraph (c)(2)(vi)(J) of this section;

(ii) In the case where there are regular quotations in an inter-dealer quotations system for the securities by only one or two independent market-makers (exclusive of the computing broker or dealer) and where each such quotation represents a bona fide offer to brokers or dealers both to buy and sell in reasonable quantities, at stated prices, the deduction on both the long and short position shall be 40 percent.

(L) Where a broker or dealer demonstrates that there is sufficient liquidity for any securities long or short in the proprietary or other accounts of the broker or dealer which are subject to a deduction required by paragraph (c)(2)(vi)(K) of this section, such deduction, upon a proper showing to the Examining Authority for the broker or dealer, may be appropriately decreased, but in no case shall such deduction be less than that prescribed in paragraph (c)(2)(vi)(J) of this section.

Undue Concentration

(M)(1) In the case of money market instruments, or securities of a single class or series of an issuer, including any option written, endorsed or held to purchase or sell securities of such a single class or series of an issuer (other than "exempted securities" and redeemable securities of an investment company registered pursuant to the Investment Company Act of 1940), and securities underwritten (in

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which case the deduction provided for herein shall be applied after 11 business days), which are long or short in the proprietary or other accounts of a broker or dealer, including securities that are collateral to secured demand notes defined in Appendix D, Sec. 240.15c3-1d, and that have a market value of more than 10 percent of the ``net capital" of a broker or dealer before the application of paragraph (c)(2)(vi) of this section or Appendix A, Sec. 240.15c3-1a, there shall be an additional deduction from net worth and/or the Collateral Value for securities collateralizing a secured demand note defined in Appendix D, Sec. 240.15c3-1d, equal to 50 percent of the percentage deduction otherwise provided by this paragraph (c)(2)(vi) of this section or Appendix A, Sec. 240.15c3-1a, on that portion of the securities position in excess of 10 percent of the ``net capital" of the broker or dealer before the application of paragraph (c)(2)(vi) of this section and Appendix A, Sec. 240.15c3-1a. In the case of securities described in paragraph (c)(2)(vi)(J), the additional deduction required by this paragraph (c)(2)(vi)(M) shall be 15 percent.

(2) This paragraph (c)(2)(vi)(M) shall apply notwithstanding any long or short position exemption provided for in paragraph (c)(2)(vi)(J) of this section (except for long or short position exemptions arising out of the first proviso to paragraph (c)(2)(vi)(J)) and the deduction on any such exempted position shall be 15 percent of that portion of the securities position in excess of 10 percent of the broker or dealer's net capital before the application of paragraph (c)(2)(vi) of this section and Appendix A, Sec. 240.15c3-1a.

(3) This paragraph (c)(2)(vi)(M) shall be applied to an issue of equity securities only on the market value of such securities in excess of \$10,000 or the market value of 500 shares, whichever is greater, or \$25,000 in the case of a debt security.

(4) This paragraph (c)(2)(vi)(M) will be applied to an issue of municipal securities having the same security provisions, date of issue, interest rate, day, month and year of maturity only if such securities have a market value in excess of \$500,000 in bonds (\$5,000,000 in notes) or 10 percent of tentative net capital, whichever is greater, and are held in position longer than 20 business days from the date the securities are received by the syndicate manager from the issuer.

(5) Any specialist that is subject to a deduction required by this paragraph (c)(2)(vi)(M), respecting its specialty stock, that can demonstrate to the satisfaction of the Examining Authority for such broker or dealer that there is sufficient liquidity for such specialist's specialty stock and that such deduction need not be applied in the public interest for the protection of investors, may upon a proper showing to such Examining Authority have such undue concentration deduction appropriately decreased, but in no case shall the deduction prescribed in paragraph (c)(2)(vi)(J) of this section above be reduced. Each such Examining Authority shall make and preserve for a period of not less than 3 years a record of each application granted pursuant to this paragraph (c)(2)(vi)(M)(5), which shall contain a summary of the justification for the granting of the application.

(N) Any specialist that limits its securities business to that of a specialist (except for an occasional non-specialist related securities transaction for its own account), that does not transact a business in securities with other than a broker or dealer registered with the Commission under section 15 or 15C of the Act or a member of a national securities exchange, and that is not a clearing member of The Options Clearing Corporation need not deduct from net worth in computing net capital those deductions, as to its specialty securities, set forth in paragraph (c)(2)(vi) of this section or Appendix A to this section, except for paragraph (e) of this section limiting withdrawals of equity capital and Appendix D to this section relating to satisfactory subordination agreements. As to a specialist that is solely an options specialist, in paragraph (e) the term ``net capital" shall be deemed to mean ``net capital before the application of paragraph (c)(2)(vi) of this section or Appendix A to this section" and ``excess net capital" shall be deemed to be the amount of net capital before the application of paragraph (c)(2)(vi) of this section or Appendix A to this section in excess of the amount of net capital required under paragraph (a) of this section. In reports filed pursuant to Sec. 240.17a-5 and in making the record required by Sec. 240.17a-3(a)(11) each specialists shall include the deductions that would otherwise have been required by paragraph (c)(2)(vi) of this section or Appendix A to this section in the absence of this paragraph (c)(2)(vi)(N).

Non-Marketable Securities

(vii) Non-Marketable Securities. Deducting 100 percent of the carrying value in the case of securities or evidence of indebtedness in the proprietary or other accounts of the broker or dealer, for which there is no ready market, as defined in paragraph (c)(11) of this section, and securities, in the proprietary or other accounts of the broker or dealer, which cannot be publicly offered or sold because of statutory, regulatory or contractual arrangements or other restrictions.

Open Contractual Commitments

(viii) Deducting, in the case of a broker or dealer that has open contractual commitments (other than those option positions subject to Appendix A, Sec. 240.15c3-1a), the respective deductions as specified in paragraph (c)(2)(vi) of this section or Appendix B, Sec. 240.15c3-1b, from the value (which shall be the market value whenever there is a market) of each net long and each net short position contemplated by any open contractual commitment in the proprietary or other accounts of the broker or dealer.

(A) The deduction for contractual commitments in those securities that are treated in paragraph (c)(2)(vi)(J) of this section shall be 30 percent unless the class and issue of the securities subject to the open contractual commitment deduction are listed for trading on a national securities exchange or are designated as NASDAQ National Market System Securities.

(B) A broker or dealer that maintains in excess of \$250,000 of net capital may add back to net worth up to \$150,000 of any deduction computed under this paragraph (c)(2)(viii)(B).

(C) The deduction with respect to any single commitment shall be reduced by the unrealized profit in such commitment, in an amount not greater than the deduction provided for by this paragraph (or increased by the unrealized loss), in such commitment, and in no event shall an unrealized profit on any closed transactions operate to increase net capital.

(ix) Deducting from the contract value of each failed to deliver contract that is outstanding five business days or longer (21 business days or longer in the case of municipal securities) the percentages of the market value of the underlying security that would be required by application of the deduction required by paragraph (c)(2)(vi) of this section. Such deduction, however, shall be increased by any excess of the contract price of the failed to deliver contract over the market value of the underlying security or reduced by any excess of the market value of the underlying security over the contract value of the failed to deliver contract, but not to exceed the amount of such deduction. The designated examining authority for the broker or dealer may, upon application of the broker or dealer, extend for a period up to 5 business days, any period herein specified when it is satisfied that the extension is warranted. The designated examining authority upon expiration of the extension may extend for one additional period of up to 5 business days, any period herein specified when it is satisfied that the extension is warranted.

§ 240.15c3-1a Options (Appendix A to 17 CFR 240.15c3-1).

(a) *Definitions.* (1) The term *unlisted option* shall mean any option not included in the definition of listed option provided in paragraph (c)(2)(x) of §240.15c3-1.

(2) The term *option series* refers to listed option contracts of the same type (either a call or a put) and exercise style, covering the same underlying security with the same exercise price, expiration date, and number of underlying units.

(3) The term *related instrument* within an option class or product group refers to futures contracts and options on futures contracts covering the same underlying instrument. In relation to options on foreign currencies a related instrument within an option class also shall include forward contracts on the same underlying currency.

(4) The term *underlying instrument* refers to long and short positions, as appropriate, covering the same foreign currency, the same security, or a security which is exchangeable for or convertible into the underlying security within a period of 90 days. If the exchange or conversion requires the payment of money or results in a loss upon conversion at the time when the security is deemed an underlying instrument for purposes of this Appendix A, the broker or dealer will deduct from net worth the full amount of the conversion loss. The term underlying instrument shall not be deemed to include securities options, futures contracts, options on futures contracts, qualified stock baskets, or unlisted instruments.

(5) The term *options class* refers to all options contracts covering the same underlying instrument.

(6) The term *product group* refers to two or more option classes, related instruments, underlying instruments, and qualified stock baskets in the same portfolio type (see paragraph (b)(1)(ii) of this section) for which it has been determined that a percentage of offsetting profits may be applied to losses at the same valuation point.

(b) The deduction under this Appendix A to §240.15c3–1 shall equal the sum of the deductions specified in paragraphs (b)(1)(v)(C) or (b)(2) of this section.

Theoretical Pricing Charges

(1)(i) *Definitions.* (A) The terms *theoretical gains and losses* shall mean the gain and loss in the value of individual option series, the value of underlying instruments, related instruments, and qualified stock baskets within that option's class, at 10 equidistant intervals (valuation points) ranging from an assumed movement (both up and down) in the current market value of the underlying instrument equal to the percentage corresponding to the deductions otherwise required under §240.15c3–1 for the underlying instrument (See paragraph (a)(1)(iii) of this section). Theoretical gains and losses shall be calculated using a theoretical options pricing model that satisfies the criteria set forth in paragraph (a)(1)(i)(B) of this section.

(B) The term *theoretical options pricing model* shall mean any mathematical model, other than a broker-dealer proprietary model, approved by a Designated Examining Authority. Such Designated Examining Authority shall submit the model to the Commission, together with a description of its methods for approving models. Any such model shall calculate theoretical gains and losses as described in paragraph (a)(1)(i)(A) of this section for all series and issues of equity, index and foreign currency options and related instruments, and shall be made available equally and on the same terms to all registered brokers or dealers. Its procedures shall include the arrangement of the vendor to supply accurate and timely data to each broker-dealer with respect to its services, and the fees for distribution of the services. The data provided to brokers or dealers shall also contain the minimum requirements set forth in paragraphs (b)(1)(v)(C) of this section and the product group offsets set forth in paragraphs (b)(1)(v)(B) of this section. At a minimum, the model shall consider the following factors in pricing the option:

- (1) The current spot price of the underlying asset;
- (2) The exercise price of the option;
- (3) The remaining time until the option's expiration;
- (4) The volatility of the underlying asset;
- (5) Any cash flows associated with ownership of the underlying asset that can reasonably be expected to occur during the remaining life of the option; and
- (6) The current term structure of interest rates.

(C) The term *major market foreign currency* shall mean the currency of a sovereign nation whose short-term debt is rated in one of the two highest categories by at least two nationally recognized statistical rating organizations and for which there is a substantial inter-bank forward currency market. For purposes of this section, the European Currency Unit (ECU) shall be deemed a major market foreign currency.

(D) The term *qualified stock basket* shall mean a set or basket of stock positions which represents no less than 50% of the capitalization for a high-capitalization or non-high-capitalization diversified market index, or, in the case of a narrow-based index, no less than 95% of the capitalization for such narrow-based index.

(ii) With respect to positions involving listed options in a single specialist's market-maker account, and, separately, with respect to positions involving listed option positions in its proprietary or other account, the broker or dealer shall group long and short positions into the following portfolio types:

- (A) Equity options on the same underlying instrument and positions in that underlying instrument;
- (B) Options on the same major market foreign currency, positions in that major market foreign currency, and related instruments within those options' classes;
- (C) High-capitalization diversified market index options, related instruments within the option's class, and qualified stock baskets in the same index;
- (D) Non-high-capitalization diversified index options, related instruments within the index option's class, and qualified stock baskets in the same index; and
- (E) Narrow-based index options, related instruments within the index option's class, and qualified stock baskets in the same index.

(iii) Before making the computation, each broker or dealer shall obtain the theoretical gains and losses for each options series and for the related and underlying instruments within those options' class in each specialist's market-maker account guaranteed, endorsed, or carried by a broker or dealer, or in the proprietary or other accounts of that broker or dealer. For each option series, the theoretical options pricing model shall calculate theoretical prices at 10 equidistant valuation points within a range consisting of an increase or a decrease of the following percentages of the daily market price of the underlying instrument:

- (A) $\pm 15\%$ for equity securities with a ready market, narrow-based indexes, and non-high-capitalization diversified indexes;
- (B) $\pm 6\%$ for major market foreign currencies;
- (C) $\pm 20\%$ for all other currencies; and
- (D) $\pm 10\%$ for high-capitalization diversified indexes.

(iv)(A) As to non-clearing option specialists and market-makers, the percentages of the daily market price of the underlying instrument shall be:

- (1) $\pm 4 \frac{1}{2}\%$ for major market foreign currencies; and
- (2) $\pm 8\%$ for high-capitalization diversified indexes.
- (3) $\pm 10\%$ for a non-clearing market-maker, or specialist in non-high capitalization diversified index product group.

(B) The provisions of this paragraph (b)(1)(iv) shall expire two years from September 1, 1997, unless otherwise extended by the Commission.

(v)(A) The broker or dealer shall multiply the corresponding theoretical gains and losses at each of the 10 equidistant valuation points by the number of positions held in a particular options series, the related instruments and qualified stock baskets within the option's class, and the positions in the same underlying instrument.

(B) In determining the aggregate profit or loss for each portfolio type, the broker or dealer will be allowed the following offsets in the following order, provided, that in the case of qualified stock baskets, the broker or dealer may elect to net individual stocks between qualified stock baskets and take the appropriate deduction on the remaining, if any, securities:

(1) First, a broker or dealer is allowed the following offsets within an option's class:

(i) Between options on the same underlying instrument, positions covering the same underlying instrument, and related instruments within the option's class, 100% of a position's gain shall offset another position's loss at the same valuation point;

(ii) Between index options, related instruments within the option's class, and qualified stock baskets on the same index, 95%, or such other amount as designated by the Commission, of gains shall offset losses at the same valuation point;

(2) Second, a broker-dealer is allowed the following offsets within an index product group:

(i) Among positions involving different high-capitalization diversified index option classes within the same product group, 90% of the gain in a high-capitalization diversified market index option, related instruments, and qualified stock baskets within that index option's class shall offset the loss at the same valuation point in a different high-capitalization diversified market index option, related instruments, and qualified stock baskets within that index option's class;

(ii) Among positions involving different non-high-capitalization diversified index option classes within the same product group, 75% of the gain in a non-high-capitalization diversified market index option, related instruments, and qualified stock baskets within that index option's class shall offset the loss at the same valuation point in another non-high-capitalization diversified market index option, related instruments, and qualified stock baskets within that index option's class or product group;

(iii) Among positions involving different narrow-based index option classes within the same product group, 90% of the gain in a narrow-based market index option, related instruments, and qualified stock baskets within that index option's class shall offset the loss at the same valuation point in another narrow-based market index option, related instruments, and qualified stock baskets within that index option's class or product group;

(iv) No qualified stock basket should offset another qualified stock basket; and

(3) Third, a broker-dealer is allowed the following offsets between product groups: Among positions involving different diversified index product groups within the same market group, 50% of the gain in a diversified market index option, a related instrument, or a qualified stock basket within that index option's product group shall offset the loss at the same valuation point in another product group;

(C) For each portfolio type, the total deduction shall be the larger of:

(1) The amount for any of the 10 equidistant valuation points representing the largest theoretical loss after applying the offsets provided in paragraph (b)(1)(v)(B) if this section; or

(2) A minimum charge equal to 25% times the multiplier for each equity and index option contract and each related instrument within the option's class or product group, or \$25 for each option on a major market foreign currency with the minimum charge for futures contracts and options on futures contracts adjusted for contract size differentials, not to exceed market value in the case of long positions in options and options on futures contracts; plus

(3) In the case of portfolio types involving index options and related instruments offset by a qualified stock basket, there will be a minimum charge of 5% of the market value of the qualified stock basket for high-capitalization diversified and narrow-based indexes; and

(4) In the case of portfolio types involving index options and related instruments offset by a qualified stock basket, there will be a minimum charge of 7 1/2% of the market value of the qualified stock basket for non-high-capitalization diversified indexes.

Alternative Strategy Based Method

(2) A broker or dealer may elect to apply the alternative strategy based method in accordance with the provisions of this paragraph (b)(2).

(i) *Definitions.* (A) The term *intrinsic value* or *in-the-money amount* shall mean the amount by which the exercise value, in the case of a call, is less than the current market value of the underlying instrument, and, in the case of a put, is greater than the current market value of the underlying instrument.

Charges for Securities Positions

(B) The term *out-of-the-money amount* shall mean the amount by which the exercise value, in the case of a call, is greater than the current market value of the underlying instrument, and, in the case of a put, is less than the current market value of the underlying instrument.

(C) The term *time value* shall mean the current market value of an option contract that is in excess of its intrinsic value.

(ii) Every broker or dealer electing to calculate adjustments to net worth in accordance with the provisions of this paragraph (b)(2) must make the following adjustments to net worth:

(A) Add the time value of a short position in a listed option; and

(B) Deduct the time value of a long position in a listed option, which relates to a position in the same underlying instrument or in a related instrument within the option class or product group as recognized in the strategies enumerated in paragraph (b)(2)(iii)(D) of this section; and

(C) Add the net short market value or deduct the long market value of listed options as recognized in the strategies enumerated in paragraphs (b)(2)(iii)(E)(1) and (2) of this section.

(iii) In computing net capital after the adjustments provided for in paragraph (b)(2)(ii) of this section, every broker or dealer shall deduct the percentages specified in this paragraph (b)(2)(iii) for all listed option positions, positions covering the same underlying instrument and related instruments within the options' class or product group.

Uncovered Calls

(A) Where a broker or dealer is short a call, deducting the percentage required by paragraphs (c)(2)(vi) (A) through (K) of §240.15c3-1 of the current market value of the underlying instrument for such option reduced by its out-of-the-money amount, to the extent that such reduction does not operate to increase net capital. In no event shall this deduction be less than the greater of \$250 for each short call option contract for 100 shares or 50% of the aforementioned percentage.

Uncovered Puts

(B) Where a broker or dealer is short a put, deducting the percentage required by paragraphs (c)(2)(vi) (A) through (K) of §240.15c3-1 of the current market value of the underlying instrument for such option reduced by its out-of-the-money amount, to the extent that such reduction does not operate to increase net capital. In no event shall the deduction provided by this paragraph be less than the greater of \$250 for each short put option contract for 100 shares or 50% of the aforementioned percentage.

Long Positions

(C) Where a broker or dealer is long puts or calls, deducting 50 percent of the market value of the net long put and call positions in the same options series.

Certain Security Positions With Offsetting Options

(D)(1) Where a broker or dealer is long a put for which it has an offsetting long position in the same number of units of the same underlying instrument, deducting the percentage required by paragraphs (c)(2)(vi) (A) through (K) of §240.15c3-1 of the current market value of the underlying instrument for the long offsetting position, not to exceed the out-of-the-money amount of the option. In no event shall the deduction provided by this paragraph be less than \$25 for each option contract for 100 shares, provided that the minimum charge need not exceed the intrinsic value of the option.

(2) Where a broker or dealer is long a call for which it has an offsetting short position in the same number of units of the same underlying instrument, deducting the percentage required by paragraphs (c)(2)(vi) (A)

through (K) of §240.15c3–1 of the current market value of the underlying instrument for the short offsetting position, not to exceed the out-of-the-money amount of the option. In no event shall the deduction provided by this paragraph be less than \$25 for each option contract for 100 shares, provided that the minimum charge need not exceed the intrinsic value of the option.

(3) Where a broker or dealer is short a call for which it has an offsetting long position in the same number of units of the same underlying instrument, deducting the percentage required by paragraphs (c)(2)(vi) (A) through (K) of §240.15c3–1 of the current market value of the underlying instrument for the offsetting long position reduced by the short call's intrinsic value. In no event shall the deduction provided by this paragraph be less than \$25 for each option contract for 100 shares.

Certain Spread Positions

(E)(1) Where a broker or dealer is short a listed call and is also long a listed call in the same class of options contracts and the long option expires on the same date as or subsequent to the short option, the deduction, after adjustments required in paragraph (b) of this section, shall be the amount by which the exercise value of the long call exceeds the exercise value of the short call. If the exercise value of the long call is less than or equal to the exercise value of the short call, no deduction is required.

(2) Where a broker or dealer is short a listed put and is also long a listed put in the same class of options contracts and the long option expires on the same date as or subsequent to the short option, the deduction, after the adjustments required in paragraph (b) of this section, shall be the amount by which the exercise value of the short put exceeds the exercise value of the long put. If the exercise value of the long put is equal to or greater than the exercise value of the short put, no deduction is required.

(c) With respect to transactions involving unlisted options, every broker or dealer shall determine the value of unlisted option positions in accordance with the provision of paragraph (c)(2)(i) of §240.15c3–1, and shall deduct the percentages of all securities positions or unlisted options in the proprietary or other accounts of the broker or dealer specified in this paragraph (c). However, where computing the deduction required for a security position as if the security position had no related unlisted option position and positions in unlisted options as if uncovered would result in a lesser deduction from net worth, the broker or dealer may compute such deductions separately.

Uncovered Calls

(1) Where a broker or dealer is short a call, deducting 15 percent (or such other percentage required by paragraphs (c)(2)(vi) (A) through (K) of §240.15c3–1) of the current market value of the security underlying such option reduced by any excess of the exercise value of the call over the current market value of the underlying security. In no event shall the deduction provided by this paragraph be less than \$250 for each option contract for 100 shares.

Uncovered Puts

(2) Where a broker or dealer is short a put, deducting 15 percent (or such other percentage required by paragraphs (c)(2)(vi) (A) through (K) of §240.15c3–1) of the current market value of the security underlying the option reduced by any excess of the market value of the underlying security over the exercise value of the put. In no event shall the deduction provided by this paragraph be less than \$250 for each option contract for 100 shares.

Covered Calls

(3) Where a broker or dealer is short a call and long equivalent units of the underlying security, deducting 15 percent (or such other percentage required by paragraphs (c)(2)(vi) (A) through (K) of §240.15c3–1) of the current market value of the underlying security reduced by any excess of the current market value of the underlying security over the exercise value of the call. No reduction under this paragraph shall have the effect of increasing net capital.

Charges for Securities Positions*Covered Puts*

(4) Where a broker or dealer is short a put and short equivalent units of the underlying security, deducting 15 percent (or such other percentage required by paragraphs (c)(2)(vi) (A) through (K) of §240.15c3-1) of the current market value of the underlying security reduced by any excess of the exercise value of the put over the market value of the underlying security. No such reduction shall have the effect of increasing net capital.

Conversion Accounts

(5) Where a broker or dealer is long equivalent units of the underlying security, long a put written or endorsed by a broker or dealer and short a call in its proprietary or other accounts, deducting 5 percent (or 50 percent of such other percentage required by paragraphs (c)(2)(vi) (A) through (K) of §240.15c3-1) of the current market value of the underlying security.

(6) Where a broker or dealer is short equivalent units of the underlying security, long a call written or endorsed by a broker or dealer and short a put in his proprietary or other accounts, deducting 5 percent (or 50 percent of such other percentage required by paragraphs (c)(2)(vi) (A) through (K) of §240.15c3-1) of the market value of the underlying security.

Long Options

(7) Where a broker or dealer is long a put or call endorsed or written by a broker or dealer, deducting 15 percent (or such other percentage required by paragraphs (c)(2)(vi) (A) through (K) of §240.15c3-1) of the market value of the underlying security, not to exceed any value attributed to such option in paragraph (c)(2)(i) of §240.15c3-1.

[LINK TO WEBSITE]

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