

Joint Audit Committee

Regulatory Update

TO: Chief Financial Officers
Chief Compliance Officers

0002

DATE: May 18, 2000

SUBJECT: Regulatory Treatment of Various Investment Instruments

Recently, we have received several questions regarding the valuation and recording of various investment instruments. The purpose of this update is to summarize the current regulatory treatment of these instruments.

Securities

Firm owned securities (including investment of segregated and secured funds) *must be stated at market value plus accrued interest on the financial statements*. Due to the increase in interest rates, be advised that other methods of valuing securities, such as the amortized cost method, may no longer approximate market value. Further, accrued interest and any gain or loss on the market value of securities must be reported in income.

For convenience, U.S. Treasury obligations that are owned by customers or noncustomers may be stated at their face value if face value exceeds market value.

Reverse Repurchase and Sale-and-Buy-Back Transactions

Attached is a Guide that summarizes various issues regarding reverse-repurchase type transactions. In particular, we would like to highlight:

- Customer segregated and secured reverse-repurchase type transactions must be stated at the lower of transaction cost plus accrued interest *or* market value plus accrued interest of the underlying collateral on the segregation and secured statements.
- A counterparty to a house reverse repurchase transaction cannot hold the underlying collateral. A separate depository must be used. The counterparty may hold the collateral for customer segregated and secured reverse-repurchase type transactions, provided the account is titled as segregated or secured and the appropriate acknowledgement letter is obtained.

If you have any questions, please contact your DSRO.