

COMMODITY FUTURES  
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SOCIETE GENERALE GROUP  
March 10, 1998

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Ms. Jean A. Webb  
Secretariat  
Commodity Futures Trading Commission  
Three Lafayette Center,  
1155 21st Street, NW  
Washington, DC 20581

## COMMENT

Re: Early Warning Amendments to CFTC Regulation §1.12.

Dear Ms. Webb:

FIMAT USA, Inc. is pleased to submit its views and comments regarding the proposed amendments to Commodity Futures Trading Commission Regulation § 1.12 to require immediate notification by futures commission merchants to the Commission and their designated self regulatory organization when an FCM knows or should know that it is undersegregated or undersecured. Although FIMAT USA appreciates the desire of the Commission to be advised on a more timely basis of events that may call into question the likelihood that customers will receive their funds timely from an FCM, we respectfully caution the CFTC against adopting an amendment that is not administratively practical. Accordingly, we support the CFTC proposed amendment, but with technical amendments.

As background, FIMAT USA is a wholly subsidiary of FIMAT International Banque, SA, which itself is a wholly owned subsidiary of Societe Generale. The FIMAT Group, which comprises FIMAT Banque and all its subsidiaries and branches, is present on more than 30 derivatives exchanges in 14 countries. FIMAT USA is registered with the CFTC and the Securities and Exchange Commission as a futures commission merchant and a broker dealer, respectively.

As a registered FCM and member of the National Futures Association that is a clearing member of all principal exchanges in the United States, FIMAT USA is already subject to a number of special event type reporting requirements. Indeed, FIMAT USA must already report to the Chicago Mercantile Exchange within 24 hours if it knows or should know that it fails to maintain sufficient funds in segregation or set aside in separate accounts. See CME Rule § 971(C). Accordingly, FIMAT USA, has no objection to a Commission requirement mandating that FIMAT USA also report to the Commission the same information pursuant to the same time frame.

Indeed, it seems sensible to us that FCMs should be required to report an undersegregated status no less urgently than they are required to report a failure to maintain sufficient net capital as required by CFTC Regulation § 1.17: namely within 24 hours from when it knows or should have know of such an event. This is common sense, given the importance of segregated and secured funds under the CFTC's regulatory scheme, and the failure of the CFTC Regulations to provide for this, has been an oversight. Compare CFTC Regulation § 1.12 with CME Rule 971 (notice of undersegregation within 24 hours); NYFE Rule 710 (notice of undersegregation "forthwith.")

That being said, FIMAT USA believes that the CFTC's proposal to require FCMs to provide immediate telephone notice, to be confirmed immediately by facsimile or telegram when it knows or should know that it has failed to maintain sufficient funds in segregation or in

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separate set-aside accounts, is too severe, as a matter of reality as well as practicality.

First, given the 24 hour nature of most FCMs activities as well as the nature of the process of how many orders are executed and processed (i.e., overseas orders executed by third parties and given-in to FCMs after the fact), events that give rise to a possible undersegregation situation may happen after normal business hours for both the FCM as well as the Commission. Therefore, applying a "should know" standard to the need to report immediately a possible undersegregation status is exceptionally severe as well as impractical, as the reportable event might not be reasonably discovered until the next business day by the FCM. In addition, the Commission may not have staff available 24 hours every day to receive such telephone calls.

Second, not all events that might on first blush trigger a reportable event are susceptible to sufficiently quick analysis to justify an immediate filing; indeed, it might be irresponsible to make an immediate filing. For example, an FCM might receive a rumor that two or three large clients will default on an obligation to an FCM; however, upon investigation, it might turn out the rumor was incorrect.<sup>1</sup> Moreover, because of the 24 hour nature of trading and reporting, an FCM may not have all available information sufficient to determine the status of its secured funds on an immediate basis; it must rely on its carrying FCMs or overseas clearing houses of which it is a member to provide this information in their normal reporting cycle.

Finally, a large market move could, in fact, cause an FCM temporarily to be undersegregated because of the mechanics of clearing. Even before most FCM personnel arrive each business day morning, the clearing houses of which it is a member have debited its segregated bank accounts for amounts such clearing houses claim they are owed as margin. FCMs then make margin calls to customers to replenish such accounts. As they make calls, which depending on the number of customers could take some time, the FCMs move from a potentially undersegregated status to a segregated status.<sup>2</sup> However, these routine calls, even absent a problem, do not happen immediately; an earlier report of a problem under an "immediate" standard of undersegregation, therefore, would be misleading.<sup>3</sup>

Accordingly, FIMAT USA, believes that the standard for reporting a status of undersegregation should be no less severe than the current standard for reporting capital inadequacy: 24 hours. Notwithstanding, FCMs should be encouraged voluntarily to alert earlier than 24 hours the Commission and their designated self regulatory organization of any information that might call into question the likelihood that customers will be repaid in full their segregated and/or secured funds, or that might have systemic implications

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<sup>1</sup> FCMs are already required to report to the CFTC margin calls in excess of their adjusted net capital. See CFTC Regulation § 1.12(f)(3).

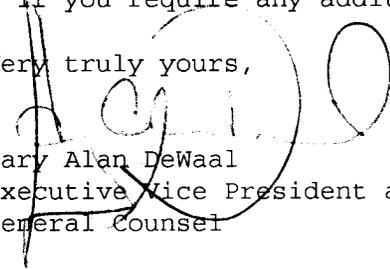
<sup>2</sup> FCMs may effectively include as segregated funds amounts called but not received until trade date plus four days.

<sup>3</sup> Indeed, given a potential problem of the magnitude or near magnitude that the Commission is concerned with, FCM staff should immediately direct its corporate attention to understanding the severity and ameliorating the problem. Less important, as a matter of practicality, is performing immediately a ministerial calculation to determine whether a precise violation has occurred; all severe problems should be addressed immediately.

for the entire industry; mandating such requirement, however, poses legal difficulties that are too severe.<sup>4</sup>

Feel free to telephone me at (212) 504-7495 if you require any additional information.

Very truly yours,



Gary Alan DeWaal  
Executive Vice President and  
General Counsel

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<sup>4</sup> FIMAT USA encourages the CFTC and all U.S. self regulatory organizations to work together to agree on a standard list of reportable events. It seems reasonable that the Commission might require that all events reported thereunder to any self regulatory organization should also be reported to it.