

MEMO# 26872

January 14, 2013

ICI Letter on CFTC's Proposal to Enhance Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations

[26872]

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 6-13
DERIVATIVES MARKETS ADVISORY COMMITTEE No. 7-13
INVESTMENT ADVISER MEMBERS No. 4-13
SEC RULES MEMBERS No. 7-13
RE:

ICI LETTER ON CFTC'S PROPOSAL TO ENHANCE PROTECTIONS AFFORDED CUSTOMERS AND CUSTOMER FUNDS HELD BY FUTURES COMMISSION MERCHANTS AND DERIVATIVES CLEARING ORGANIZATIONS

The Commodity Futures Trading Commission ("CFTC" or "Commission") has proposed new rules and rule amendments to require enhanced customer protections, risk management programs, internal monitoring and controls, capital and liquidity standards, customer disclosure, and auditing and examination programs for futures commission merchants ("FCMs"). [\[1\]](#) The Proposal is intended to provide greater protections to customers and to the funds deposited by customers with FCMs and DCOs in the aftermath of the two recent failures of FCMs. ICI has submitted a comment letter to the CFTC, which is attached and briefly summarized below.

Customer Funds

The letter generally supports the CFTC's proposal to provide greater protection to customer funds. The letter supports those provisions that would address, in part, fellow customer risk in the event of a shortfall upon a default of an FCM and would prohibit FCMs and DCOs from making inappropriate withdrawals or using customer funds in an unauthorized manner. The letter states that the proposal to require filing of daily segregation calculations with the CFTC, which also will be publicly available, will facilitate monitoring of compliance by FCMs

of the customer fund segregation requirements.

Depositories of Customer Funds

The CFTC proposes to require the depository holding customer funds to grant at all times read-only electronic access to the accounts to the Commission and, in the case of an FCM, to the FCM's designated self-regulatory organization ("DSRO"). [\[2\]](#) In addition to the read-only access to the accounts for the benefit of an FCM's customers, depositories would be required to agree that the accounts may be examined at any reasonable time by an appropriate officer, agent or employee of the CFTC. The CFTC also is proposing an additional acknowledgment letter template form for money market mutual funds when they are permissible investments for customer funds under rule 1.25.

The letter supports the CFTC's efforts to better monitor the account balances of FCM customers although the letter expresses concerns with respect to the method by which the information is proposed to be provided. The letter states that money market funds providing read-only access to the Commission would raise significant operational and privacy concerns for the funds, as well as practical concerns for the Commission. In lieu of read-only access, the letter suggests that money market funds provide to the CFTC electronically identifying and balance information of an FCM account within 48 hours upon request by the CFTC.

The letter also seeks confirmation that the CFTC is proposing to require only those money market funds in which FCMs directly invest customer funds to agree to provide the FCM account information. The letter explains that many investor accounts in mutual funds are held in intermediated positions. Because the money market fund's transfer agent does not know the individual identity or specific transaction activities of each underlying investor, it would be impossible for the fund transfer agent to know whether any of the underlying investors within the omnibus account would be an FCM account. For accounts held through intermediaries, the intermediaries would have to provide the FCM account information.

Risk Management Program for FCMs

The CFTC proposes to require each FCM that carries customer accounts (for transacting in futures, options on futures, and swaps) to establish a risk management program designed to monitor and manage the risks associated with its activities as an FCM. The letter fully supports these proposals, which would require FCMs to evaluate and monitor for risks of their businesses.

The letter also supports a requirement to maintain an adequate targeted amount of excess funds in customer accounts, which would assist FCMs to maintain compliance with the segregation requirements. The letter states that the CFTC's proposed requirement for FCMs to maintain an adequate target amount of excess funds in customer accounts and to comply with segregation requirements would help ensure that one customer's funds would not be used to satisfy another customer's obligations and would properly re-allocate costs from customers with excess margin to undermargined customers.

Disclosure to Regulators

Existing CFTC regulations require FCMs to provide the Commission and the FCM's DSRO with prompt notice of potential adverse conditions at the FCM that may indicate or lead to a threat to the financial condition of the firm or the protection of customer funds held by the FCM. The CFTC proposes amendments to include several additional reportable events and to submit reportable events to the Commission and DSROs through an electronic filing

system. These amendments would require reporting if the FCM: (1) cannot compute or document its actual capital at the time it knows that it is undercapitalized; (2) fails to hold sufficient funds in segregated accounts for cleared swaps customers to meet its obligation; (3) discovers or is informed that it has invested funds held for customers in investments that are not permitted investments or holds permitted investments in a manner that is not in compliance with rule 1.25; (4) does not hold an amount of funds in segregated accounts for futures customers or for cleared swaps customers or does not hold sufficient funds in separate accounts for 30.7 customers sufficient to meet the firm's targeted residual interest in one or more of these accounts or if its residual interest is less than the sum of outstanding margin deficits for such accounts; and (5) experiences a material adverse impact to its creditworthiness or its ability to fund its obligations (or of its parent or a material affiliate). In addition, an FCM would be required to provide notice in the event of a material adverse impact to the financial condition of the firm or a material change in the firm's operations.

The letter argues that these reportable events, including most of the proposed additional triggering events, also should trigger a requirement to disclose the information to customers for a couple of reasons. [3] First, this type of information is critical for customers to monitor their FCMs to determine whether they should continue to do business with their FCMs. The notice would permit customers to be aware of potential issues and to evaluate on a more informed basis the risks involved with a particular FCM. Second, the letter states that a requirement to disclose would provide a level playing field for all customers with respect to information about the FCMs. The letter also requests that the CFTC specify that the information should be posted on the FCM's website in a location that would be easily accessible to all customers.

Public Disclosures by FCMs

The CFTC proposes to enhance the disclosures provided to customers and potential customers, including certain firm specific information regarding the FCM's financial condition and operations to allow customers and potential customers to assess the risks of engaging the firm and the risk of entrusting their funds to the FCM. The letter supports these provisions that would provide important information to customers of the FCM with respect to their businesses and their financial condition. The letter requests that the information provided to customers should be posted on an easily accessible place on the FCM's website.

Jennifer S. Choi
Senior Associate Counsel – Securities Regulation

[Attachment](#)

endnotes

[1] Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations, 77 FR 67866 (Nov. 14, 2012) ("Proposal"), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-26435a.pdf>. The Proposal also addresses certain issues concerning derivatives clearing organizations ("DCOs") and chief compliance officers ("CCOs").

[2] A DSRO is the SRO that is appointed to be primarily responsible for conducting ongoing financial surveillance of an FCM under a joint agreement submitted to and approved by the CFTC.

[3] The letter states that we would not expect SEC or SRO examination reports and other non-public correspondence from regulators to be disclosed to customers.

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