

MEMO# 12463

August 9, 2000

INSTITUTE COMMENT LETTER ON CFTC PROPOSAL TO PERMIT FCM'S AND CLEARING ORGANIZATIONS TO INVEST IN MONEY MARKET FUNDS

[12463] August 9, 2000 TO: SEC RULES COMMITTEE No. 104-00 MONEY MARKET FUNDS ADVISORY COMMITTEE No. 3-00 RE: INSTITUTE COMMENT LETTER ON CFTC PROPOSAL TO PERMIT FCM'S AND CLEARING ORGANIZATIONS TO INVEST IN MONEY MARKET FUNDS The Institute has filed a comment letter with the Commodity Futures Trading Commission ("Commission") on its rule proposal that would permit futures commission merchants ("FCMs") and clearing organizations to invest customer funds in money market funds. The Institute's comment letter supports the proposal but provides comment on the Commission's proposed conditions under which such investments may occur. The attached letter is summarized below, and is substantially similar to the draft letter we sent to you earlier.¹ At the outset, the Institute's letter expresses concern that the proposed conditions would limit the use of money market funds as a permitted investment. It argues that the existing regulations governing money market funds render any such conditions largely unnecessary, and recommends instead that FCMs and clearing organizations should be able to invest in any money market fund that meets the requirements of Rule 2a-7 under the Investment Company Act of 1940. The Ratings Requirement. The Institute's letter disagrees with the proposed imposition of a rating requirement on money market funds. It notes that the stringent regulations under Rule 2a-7 obviate the need for any such requirement, and adds that a money market fund's portfolio of investments are already subject to numerous risk-limiting conditions of Rule 2a-7. Moreover, imposing a rating requirement on a money market fund itself would add an unnecessary layer of regulation that would provide few, if any, additional safeguards for customer funds. The Limitation on Investments in Affiliated Entities. The proposal would prohibit a money market fund from investing in any instrument issued by a FCM, clearing organization, or affiliate thereof. For this purpose, the Commission proposes a rather broad definition of the term "affiliate." The Institute's letter notes that this provision is not needed in light of the affiliated transactions prohibitions contained in the Investment Company Act. Alternatively, the letter recommends that if the provision is retained, the proposed definition of "affiliate" should be narrowed to only cover control relationships. The SEC Registration Requirement. The proposal would require money market funds to register as such with the SEC. The letter clarifies that a money market fund does not register with the SEC as a money market fund, but rather as a mutual fund, which may hold itself out to the public as a money market fund. 1 See Memorandum to SEC Rules Committee No. 101-00, and Money Market Funds Advisory Committee No. 2-00, dated July 27, 2000. 2The Sponsor Requirement. The letter notes that the Commission's proposed list

of permitted “sponsors” to a money market fund includes only financial institutions and does not include registered investment advisers. It argues that because most money market funds are advised by registered investment advisers (or by advisers exempt from registration under the Investment Advisers Act of 1940) they should be included in the list. To exclude them would significantly limit the universe of money market funds available to FCMs and clearing organizations. The Custody and Acknowledgement Letter Requirement. The letter disagrees with the proposed requirement that would require an acknowledgement letter to be provided by the sponsor of the fund and the fund itself to an FCM or clearing organization, if the FCM or clearing organization holds fund shares with the fund’s shareholder servicing agent. The letter points out that mutual fund shares are generally uncertificated and are transferred via a book-entry system, and that shareholder servicing agents for mutual funds generally provide pricing and bookkeeping related services and do not custody fund shares for shareholders. The letter recommends that the provision be revised to (1) require the ownership of fund shares to be noted (by book-entry or otherwise) in a custody account of the FCM or clearing organization, and (2) require that the FCM or clearing organization that purchases money market fund shares with customer funds maintain the confirmation relating to the purchase in its records. The Morning Pricing Requirement. The letter notes that the proposed requirement that a money market fund compute its net asset value by 9:00 a.m. each business day and make it available to the FCM or clearing organization by that time is problematic for money market funds since they tend to price their securities later in the day. Therefore, to avoid disrupting the current pricing practices of money market funds, the letter recommends that this provision be modified to permit the use of the current day’s NAV when it is calculated by the fund. The One-Day Redemption Requirement. The letter notes that the requirement that an interest in a money market fund be able to be liquidated by the business day following a liquidation request by the FCM or clearing organization is inconsistent with the Investment Company Act, which permits a fund up to seven days in which to satisfy a redemption request. The letter thus recommends that this condition be revised to permit a money market fund to satisfy a redemption request within the seven day time frame permitted under Section 22(e) of the Investment Company Act. Barry E. Simmons Assistant Counsel Attachment Attachment (in .pdf format)