

MEMO# 18702

March 28, 2005

DRAFT ICI COMMENT LETTER ON CFTC PROPOSAL REGARDING USE OF THIRD-PARTY CUSTODIAL ACCOUNTS FOR FUTURES MARGIN

[18702] March 28, 2005 TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 13-05 SEC RULES COMMITTEE No. 25-05 RE: DRAFT ICI COMMENT LETTER ON CFTC PROPOSAL REGARDING USE OF THIRD- PARTY CUSTODIAL ACCOUNTS FOR FUTURES MARGIN As indicated previously, the Commodity Futures Trading Commission staff recently proposed to withdraw Financial and Segregation Interpretation No. 10.* Interpretation No. 10 permits customers of a futures commission merchant (FCM), including registered investment companies, to use third-party bank custodial accounts to maintain futures margin under specified conditions. The Institute has prepared a draft comment letter expressing concerns with the proposal. The draft letter is attached and summarized below. Comments on the proposal must be filed by Monday, April 4th. Please provide any comments on the draft letter to me by phone at (202) 326-5822 or by email at frances@ici.org by Thursday, March 31st. The draft letter urges the CFTC staff to refrain from withdrawing Interpretation No. 10. It states that there are no compelling reasons for taking this action. It also asserts that the resulting disruption and costs to investment companies that are forced to restructure existing custody relationships will outweigh any theoretical benefits. The draft letter notes that Rule 17f-6 under the Investment Company Act of 1940 permits funds to deposit margin directly with an FCM, but does not require them to do so (nor does it express any preference for doing so). It discusses the operating efficiencies that may flow from using a single bank to maintain custody of all fund assets, including futures margin, and emphasizes the costs and burdens of eliminating this ability. [Members – if possible, please provide hard data regarding these costs and burdens (e.g., number of funds that rely on third-party custodial accounts, anticipated costs and other burdens of renegotiating existing arrangements).] * See Memorandum to Closed-End Investment Company Committee No. 7-05 and SEC Rules Committee No. 14-05 [18541], dated February 15, 2005. 2 The draft letter questions the various rationales cited by the CFTC staff in support of withdrawing Interpretation No. 10. It states that the proposal would not meaningfully address the staff's stated concerns. The draft letter urges the CFTC to refrain from withdrawing Interpretation No. 10 or, in the alternative, to institute a factual study to assess fully the costs and benefits of the proposal before taking further action. It recommends that, if the staff nevertheless determines to proceed with the withdrawal of Interpretation No. 10, it provide a transition period of at least nine months for investment companies to restructure existing futures margin arrangements. [Do members agree with this recommended transition period?] Frances M. Stadler Deputy Senior Counsel

Attachment (in .pdf format)

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