

MEMO# 13039

January 12, 2001

CFTC FINALIZES RULE PERMITTING FCM'S AND CLEARING ORGANIZATIONS TO INVEST IN MONEY MARKET FUNDS

[13039] January 12, 2001 TO: SEC RULES COMMITTEE No. 5-01 MONEY MARKET FUNDS ADVISORY COMMITTEE No. 1-01 RE: CFTC FINALIZES RULE PERMITTING FCM'S AND CLEARING ORGANIZATIONS TO INVEST IN MONEY MARKET FUNDS The Commodity Futures Trading Commission has adopted rule amendments to Commodity Exchange Act Rule 1.25, which, among other things, permits futures commission merchants ("FCMs") and clearing organizations to invest customer funds in money market funds, subject to certain conditions.¹ The adopted amendments reflect the majority of recommendations that were made by the Institute in its comment letter on the CFTC's rule proposal.² The Adopting Release is attached, and it is summarized below. The rule amendments become effective on February 12, 2001. The Ratings Requirement. The proposed amendments to Rule 1.25 would have permitted FCMs and clearing organizations to invest in a money market fund provided that the fund was rated in the highest category by a nationally ranked statistical rating organization ("NRSRO"). The Institute's comment letter noted that the stringent regulations of Rule 2a-7 under the Investment Company Act of 1940 ("ICA") obviated the need for any such requirement, and that imposing it would add an additional, unnecessary layer of regulation. In response, the final rule eliminates the ratings requirement with respect to unrated money market funds, but imposes it for those funds that are already rated by an NRSRO. The Limitation on Investments in Affiliated Entities. The proposed amendments would have prohibited an investment in a money market fund if the fund invested in any instrument issued by an FCM or clearing organization or an affiliate thereof. The final rule deletes this condition in light of the Institute's comment that it is not needed given the prohibitions on affiliated transactions contained in the ICA. 1 Rules Relating to Intermediaries of Commodity Interest Transactions, 65 Fed. Reg. 77993 (Dec. 13, 2000) ("Adopting Release"). 2 See Memorandum to SEC Rules Committee No. 104-00, and Money Market Funds Advisory Committee No. 3-00, dated August 9, 2000. 2The SEC Registration Requirement. The proposed amendments would have permitted investment in a money market fund that is registered as a money market fund. In response to the Institute's comment, the final rule clarifies that technically a fund should register with the SEC as an investment company under the ICA and hold itself out to investors as a money market fund. The Sponsor Requirement. The proposed amendments would have permitted investment in a money market fund that is sponsored by one of the financial institutions listed in the proposing release. That list, however, excluded registered investment advisers. The Institute's comment letter questioned this omission, and in response, the final rule adds registered investment advisers to the list of permitted sponsors. The Custody and

Acknowledgement Letter Requirement. In recognition that fund shares are usually uncertificated, the final rule has been amended to require the recording of fund ownership (by book-entry or otherwise) in a custody account of the FCM or clearing organization. The final rule also requires the FCM or clearing organization to maintain in its records the confirmation relating to the purchase of fund shares. The Morning Pricing Requirement. The final rule has been amended to permit investment in a money market fund that computes its net asset value by 9:00 a.m. of the business day following each business day. This change clarifies more precisely the CFTC's intention to require valuation by 9:00 a.m. the business day following the investment by the FCM or clearing organization. The One-Day Redemption Requirement. The final rule retains the requirement that in order to invest in a money market fund, the fund must be able to provide for a one-day redemption of its shares. The Institute strongly opposed this requirement noting that, among other things, it is inconsistent with ICA Section 22(e), which permits a fund up to seven days in which to satisfy a redemption request. Nevertheless, the CFTC explains in the Adopting Release that imposing a one-day liquidity requirement is necessary to ensure that FCMs will meet their funding requirements. The Adopting Release also provides that evidence of satisfaction of this condition may include "either an appropriate provision in the offering memorandum of the fund or a separate side agreement between the fund and an FCM or clearing organization."³ Barry E. Simmons Associate Counsel Attachment Attachment (in .pdf format) ³ See Adopting Release at 78003.

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