

MEMO# 12394

July 27, 2000

CFTC PROPOSES RULE AMENDMENTS TO PERMIT FUTURES COMMISSION MERCHANTS AND CLEARING ORGANIZATIONS TO INVEST IN MONEY MARKET FUNDS

[12394] July 27, 2000 TO: SEC RULES COMMITTEE No. 101-00 MONEY MARKET FUNDS ADVISORY COMMITTEE No. 2-00 RE: CFTC PROPOSES RULE AMENDMENTS TO PERMIT FUTURES COMMISSION MERCHANTS AND CLEARING ORGANIZATIONS TO INVEST IN MONEY MARKET FUNDS The Commodity Futures Trading Commission ("Commission") issued a release proposing to revise its rules under the Commodity Exchange Act relating to intermediation of commodity futures and commodity options.¹ The proposed amendments would expand the list of permitted investments in which futures commission merchants ("FCMs") and clearing organizations may invest customer funds to include, among other things, money market mutual funds. The Institute has prepared a draft comment letter, which is attached, along with a copy of the Commission's release. Both are summarized below. The comment period for the Commission's proposal is Monday, August 7th. Please review the draft comment letter at your earliest convenience and provide any comments that you may have to Barry Simmons by phone (202) 3236-5923, by fax (202) 326-5827, or by email at bsimmons@ici.org, by Wednesday, August 2nd. The Commission's proposal to permit FCMs and clearing organizations to invest in money market funds would be subject to numerous conditions that are intended to minimize credit, volatility and liquidity risks. The Institute's draft letter comments on various aspects of these conditions, but notes at the outset that they are largely unnecessary given that money market funds are already subject to a strict regulatory regime under the Securities and Exchange Commission. The draft letter thus recommends that for these purposes, a money market fund should be included as a permitted investment if it satisfies the requirements of the Investment Company Act and Rule 2a-7 thereunder. The Commission's proposed conditions would do the following:

- Subject money market funds to a ratings requirement. The Institute's draft letter disagrees with this condition and notes that Rule 2a-7 already imposes very strict regulations relating to quality, diversification and maturity that obviates the need for any such requirement.
- Impose investment limitations on money market funds. The proposal would prohibit FCMs and clearing organizations from investing customer funds in obligations of any entity affiliated with the FCM or clearing organization. The draft letter recommends that the definition of "affiliate," which is 1 Rules Relating to Intermediaries of Commodity Interest Transactions, 65 Fed. Reg. 39008 (June 22, 2000). 2defined broadly in

the proposing release, be narrowed to only cover “control” arrangements as provided in Section 2 (a)(3)(C) of the Investment Company Act. • Require money market funds to be registered as such with the SEC, but permit a fund’s sponsor to petition the Commission for an exemption from this requirement. The draft letter clarifies that a money market fund does not register as such with the SEC, but rather as a mutual fund, which may hold itself out to the public as a money market fund. The letter also warns that an unregistered money market fund could run afoul of Rule 2a-7 if it holds itself out as a money market fund but does not operate in accordance with Rule 2a-7. • Limit who may be a sponsor of a money market fund to one of several financial institutions listed in the release. The draft letter notes that limiting the sponsor of a money market fund would have no impact on the risk of that fund. The letter adds that a money market fund sponsored by a financial institution is no more or less risky than any other money market fund – they are all subject to the same stringent Rule 2a-7 requirements regardless of the sponsor. • Require that an acknowledgement letter be provided by the sponsor of the fund and the fund itself to an FCM or clearing organization if the FCM or clearing organization held fund shares with the fund’s shareholder servicing agent. The draft letter points out that mutual fund shares are generally uncertificated and are transferred via a book-entry system, and that servicing agents do not custody mutual fund shares. The letter recommends certain changes to the condition that take this into account. • Require the net asset value of money market funds to be computed by 9:00 a.m. each business day and reported to the FCM or clearing organization at that time. The draft letter notes that this would be highly problematic because most mutual funds price their securities at 4:00 p.m. each business day. The letter suggests that this condition be amended to permit the use of the current day’s net asset value when it is calculated by the fund. • Require that money market fund shares be liquidated by the next business day following a liquidation request by the FCM or clearing organization. The draft letter recommends that this condition be revised to permit money market funds up to seven days in which to satisfy a redemption request, as currently permitted under Section 22(e) of the Investment Company Act. Barry E. Simmons Assistant Counsel Attachments Attachment (in .pdf format)

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