MEMO# 35569

January 3, 2024

ICI Draft Letter on CFTC Proposal Regarding Investment of Customer Funds by FCMs and DCOs: Your Comments Requested by Wednesday, January 10

[35569]

January 03, 2024

TO: Derivatives Markets Advisory Committee
ETF (Exchange-Traded Funds) Committee
Money Market Funds Advisory Committee RE: ICI Draft Letter on CFTC Proposal Regarding Investment of Customer Funds by FCMs and DCOs: Your Comments Requested by Wednesday, January 10

On November 3, the Commodity Futures Trading Commission (CFTC or "Commission") issued proposed amendments ("Proposal") to its rules governing the safeguarding and investment of funds deposited by customers to margin futures, foreign futures, and cleared swap transactions ("Customer Funds"). The Proposal primarily would amend Regulation 1.25 under the Commodity Exchange Act, which specifies Permitted Investments ("Permitted Investments") by futures commission merchants (FCMs) of Customer Funds, and by derivatives clearing organizations (DCOs) of Customer Funds that FCMs post with them as margin for their customers' positions.[1] Among other things, the Proposal would include, as Permitted Investments, certain government money market funds (MMFs) and short-term Treasury exchange-traded funds ("Treasury ETFs").

Comments on the Proposal are due to the CFTC on January 17, 2024. ICI has drafted, for your review and feedback, the attached comment letter, which we summarize briefly below. Please provide your written comments on the letter to Sarah Bessin (sarah.bessin@ici.org) and Kevin Ercoline (kevin.ercoline@ici.org) no later than Wednesday, January 10.

ICI's draft letter supports including government MMFs and Treasury ETFs as Permitted Investments. We explain that these investments are consistent with the regulatory objective of Regulation 1.25 to limit Permitted Investments to safe, short-term investments "consistent with the objectives of preserving principal and maintaining liquidity." We believe, however, that certain of the CFTC's conditions proposed for Treasury ETFs to qualify as Permitted Investments are unnecessary to achieve Regulation 1.25's regulatory objectives. Specifically, we recommend that:

- An FCM or DCO should not be required to be an authorized participant (AP) of a Treasury ETF for the ETF to qualify as a Permitted Investment. The CFTC should revise this condition so that an FCM or DCO may either be an AP of the Treasury ETF or have entered into a participation agreement with an AP to execute agency transactions on the FCM's or DCO's behalf.
- Treasury ETFs should not be required to redeem in cash to be Permitted Investments. Instead, the CFTC should permit redemptions to be in cash or in-kind with a same-day redemption option.
- The CFTC should revise the proposed condition that, to qualify as a Permitted Investment, eligible US Treasury securities represent at least 95% of a Treasury ETF's portfolio. Instead, the threshold should be at least 80% of the ETF's portfolio, which would better align the CFTC's regulations with Rule 35d-1 under the Investment Company Act of 1940 ("1940 Act").

We also recommend that the CFTC revise the provision in Regulation 1.25 that permits MMFs to postpone redemption and payment under specified circumstances, consistent with Section 22(e) of the 1940 Act and Rule 22e-3 thereunder, to also make postponement of redemption and payment, under the same circumstances, available to Treasury ETFs.

Further, we argue that the proposed concentration limits for both government MMFs and Treasury ETFs, in particular the issuer concentration limits, are overly restrictive and not properly calculated to balance the CFTC's underlying policy objectives with potential risk concerns. Collectively, these conditions and limitations would unduly restrict the ability of FCMs and DCOs to utilize government MMFs and Treasury ETFs as Permitted Investments. ICI therefore recommends that the Commission revise the issuer-based concentration limits for Permitted Government MMFs and Treasury ETFs to be 25%, rather than 5% as the Commission proposes. A 25% issuer-based concentration limit would be consistent with the current concentration limit for US agency obligations. We explain that failing to appropriately calibrate the proposed concentration limits will result in the reduced utility of Permitted Government MMFs and Treasury ETFs for many FCMs and DCOs, especially smaller firms, and will undermine the Commission's stated policy objectives of increasing diversification of Permitted Investments.

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Notes

[1] For a summary of the Proposal, please see ICI Memorandum No. 35520 (Nov. 30, 2023), available at https://www.ici.org/memo35520.