MEMO# 35586

January 17, 2024

ICI Submits Comment Letter on CFTC Proposed Revisions to Regulation 1.25 Permitted Investments Related to Treasury ETFs and Government Money Market Funds

[35586]

January 17, 2024

TO: ICI Members
ETF (Exchange-Traded Funds) Committee
Money Market Funds Advisory Committee
Registered Fund CPO Advisory Committee SUBJECTS: Exchange-Traded Funds (ETFs)
Money Market Funds RE: ICI Submits Comment Letter on CFTC Proposed Revisions to Regulation 1.25 Permitted Investments Related to Treasury ETFs and Government Money Market Funds

On January 17, 2024, Investment Company Institute (ICI) submitted comments to the Commodity Futures Trading Commission (CFTC) regarding its proposed amendments to Regulation 1.25 under the Commodity Exchange Act (CEA), 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 amendments, the CFTC proposed to allow short-term Treasury exchange-traded funds ("Treasury ETFs") meeting certain conditions to qualify as Permitted Investments, limit the scope of money market funds (MMFs) as Permitted Investments to government MMFs, within the meaning of SEC Rule 2a-7, that do not elect to apply a discretionary liquidity fee ("Permitted Government MMFs"), and amend the concentration limits that a FCM or DCO may invest customer funds into Permitted Investments.

ICI supported including Permitted Government MMFs and Treasury ETFs as Permitted Investments. 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."[2] ICI argued, however, that certain of the CFTC's conditions proposed for Treasury ETFs to qualify as Permitted

Investments should be broadened to better to achieve Regulation 1.25's regulatory objectives. Further, the proposed concentration limits for both Permitted Government MMFs and Treasury ETFs, in particular the issuer limitations, were overly restrictive and not properly calibrated 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 Permitted Government MMFs and Treasury ETFs as Permitted Investments. Our letter focused on these issues and recommended targeted revisions to Regulation 1.25, summarized below.

For Treasury ETFs as Permitted Investments, ICI recommended the following revisions to the proposed conditions:

- To better align with existing ETF market structure, ICI strongly urged the CFTC to revise its proposed condition of requiring an FCM or DCO to be an authorized participant (AP) of a Treasury ETF to allow an FCM or DCO to either be an AP of the Treasury ETF or have entered into an agreement with an AP to execute agency transactions on the FCM's or DCO's behalf.
- As opposed to requiring Treasury ETFs to redeem in cash, ICI recommended that the CFTC should permit redemptions to be in 1) cash or 2) in-kind with a same-day redemption option.
- In response to the CFTC proposing a 95% threshold for portfolio investment in eligible US Treasury securities, ICI recommended that, for the avoidance of doubt, the CFTC explicitly confirm that it is establishing a separate portfolio test for a Treasury ETF and not requiring such Treasury ETF to change any existing investment policy, potentially adopted pursuant to SEC Rule 35d-1 ("Names Rule"), or associated disclosure. ICI also recommended that any final portfolio requirement should include cash as satisfying the threshold.
- ICI also recommended that redemption exceptions for MMFs under Regulation 1.25(c)(5)(ii) should be extended to Treasury ETFs.

For concentration limits, ICI recommended that the CFTC revise its proposed issuer-based concentration limits for Permitted Government MMFs and Treasury ETFs from 5% to 25%, consistent with the current concentration limits for US agency obligations. The CFTC's stated concerns did not support stricter concentration limits for these investment products and the proposed 5% issuer-based concentration limit was arbitrary.

Kevin Ercoline
Assistant General Counsel

Sarah A. Bessin
Deputy General Counsel - Markets, SMAs & CITs

Notes

[1] Investment of Customer Funds by Futures Commission Merchants and Derivatives Clearing Organizations, 88 Fed. Reg. 81236 (Nov. 21, 2023) ("Proposing Release" or "Proposal"), available at https://www.govinfo.gov/content/pkg/FR-2023-11-21/pdf/2023-24774.pdf.

[2] Regulation 1.25(b).