COMMODITY FUTURES TRADING COMMISSION
Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5326
eflaherty@cftc.gov

Division of Swap Dealer
and
Intermediary Oversight

Eileen T. Flaherty
Director

CFTC Letter No. 16-68
No-Action
August 8, 2016
Division of Swap Dealer and Intermediary Oversight

Re: No-Action Relief With Respect to CFTC Regulation 1.25 Regarding Money Market Funds

Regulatory Background

Subject to the specified terms and conditions, futures commission merchants ("FCMs") are permitted to invest customer funds in the investments listed in Regulation 1.25. Commission Regulation 1.25 includes money market funds ("MMFs") as permitted investments.

On August 14, 2014, the Securities and Exchange Commission ("SEC") published final revisions to Rule 2a-7 (17 CFR 270.2a-7) ("Rule 2a-7"), which governs MMFs. These revisions are effective October 14, 2016. Revised Rule 2a-7 requires a MMF to retain the authority under defined conditions to impose "liquidity fees" or suspend participant redemptions. These provisions are mandatory for MMFs that invest primarily in corporate debt securities ("Prime MMF"), and the provisions may be voluntarily adopted by MMFs that invest primarily in U.S. government securities ("Government MMF").[1] The Division has received many questions

[1] According to revised Rule 2a-7(a)(16) and (c)(2)(iii), a "Government MMF" is an MMF investing at least 99.5% of the fund's total assets in cash, government securities, or fully collateralized repurchase agreements and is not required to comply with the new liquidity fee and redemption restrictions but may choose to do so. If the operator of a Government MMF elects to adopt the new liquidity fee and redemption restrictions, the Government MMF would not be a permissible investment under CFTC Regulation 1.25 for the reasons discussed in this letter.

regarding the permissibility of investing customer funds under Regulation 1.25 in MMFs once the SEC revisions take effect. This letter addresses the permissibility and provides no-action relief from certain requirements in Regulation 1.25.

No-Action Relief

The liquidity fee[2] and redemption restrictions[3] introduced by revised Rule 2a-7 conflict with two provisions of Regulation 1.25: (b)(1) (general terms and conditions for investments) and (c)(5) (terms and conditions for investments in MMFs). Consequently, when the revisions to Rule 2a-7 take effect on October 14, 2016, FCMs will no longer be permitted to invest customer funds in Prime MMFs, or in Government MMFs that voluntarily elect to be subject to liquidity fees or redemption restrictions ("Electing Government MMFs").

Although investment of customer funds in Prime MMFs and Electing Government MMFs will not be permitted under Regulation 1.25, the Division has reviewed whether the FCM's funds in the segregated account, secured account or cleared swaps account should be permitted to be invested in Prime MMFs and Electing Government MMFs.

---

[2] The liquidity fees in Rule 2a-7 include both a default liquidity fee and a discretionary liquidity fee. Both fees conflict with Regulation 1.25(b)(1) which requires all investments of customer funds by FCMs to be 'highly liquid' such that they have the ability to be converted into cash within one business day without material discount in value. The fact that a Prime MMF or a Government MMF that has voluntarily elected to adopt liquidity fees might be required to impose a fee of up to 2% of the value of shares redeemed would prevent an FCM from redeeming its interest in the fund without a material discount in value. As a result, revised Rule 2a-7 causes Prime MMFs and such Government MMFs to be prohibited investments for customer funds under Regulation 1.25(b)(1).

[3] Pursuant to Regulation 1.25(c), a MMF is a permissible investment for customer funds by an FCM only if the FCM can redeem 100% of its investment "by the business day following the request." A MMF is a permitted investment even if it can suspend redemptions, so long as the fund may do so only in certain circumstances specifically defined under Regulation 1.25(c)(5)(ii). However, the redemption restrictions described in Rule 2a-7 are not covered by the exceptions enumerated in Regulation 1.25(c)(5)(ii) and, therefore, conflicts with the next-day redemption requirement of Regulation 1.25(c) rendering Prime MMFs and Government MMFs that voluntarily elect to adopt redemption restrictions ineligible for the investment of customer funds.

Commission regulations provide that all funds held in customer segregated accounts, secured accounts and cleared swaps accounts are subject to Regulation 1.25, including the FCM's residual interest.[4] The Division notes, however, that an FCM is permitted to withdraw its own funds from these customer accounts that exceed the FCM's targeted residual interest in such accounts, and to hold such excess funds in the FCM's proprietary accounts. The Division believes that allowing an FCM to invest the amount of its own funds held in segregated accounts that is in excess of the targeted residual interest in Prime MMFs and Electing Government MMFs avoids a potential undue influence on the FCM's decision whether to deposit proprietary funds above the targeted residual interest amount in such customer accounts. The Division also believes that an FCM provides additional benefits to customers by holding excess funds in such accounts in an amount above the targeted residual interest as such additional funds would benefit customers in the event of the insolvency of the FCM. Accordingly, the Division will not recommend an enforcement action under Regulation 1.25 against an FCM that continues to invest, on or after October 14, 2016, its own funds held in customer segregated, secured and cleared swaps accounts in Prime MMFs and Electing Government MMFs provided that the funds invested in such MMFs represent the FCM's residual interest that is in excess of the targeted residual interest amount for each such account. The Division notes that the relief provided by this letter should not impact a firm's targeted residual interest calculation, and that a firm should continue to maintain appropriate written policies and procedures for establishing the total amount of targeted residual interest in the customer segregated, secured and cleared swap accounts in

[4] See Regulations 1.23(a), 22.2(e), and 30.7(g).

accordance with Regulation 1.11(e)(3)(i)(D). The Division will continue to monitor each FCM's calculation of its targeted residual interest as part of its financial surveillance program.

The Division also notes that Regulation 1.25(b)(3)(i)(E) currently does not impose a concentration limit on the investment of customer funds in a MMF that is comprised only of U.S. government securities, provided that such MMF is comprised of $1 billion or more in assets and the management company for the MMF has $25 billion or more in assets under management. The Division notes that the requirement in Regulation 1.25(b)(3)(i)(E) that the MMF must be comprised of only U.S. government securities differs from Rule 2a-7's definition of a Government MMF. Rule 2a-7 defines a Government MMF as a fund that invests at least 99.5 percent of its total assets in U.S. government securities, cash, or repurchase agreements that are fully collateralized. To provide consistency in the definition of a Government MMF, the Division also will not recommend an enforcement action if an FCM invests customer funds in Government MMFs as defined in SEC Rule 2a-7 provided that they are not subject to SEC Rule 2a-7 liquidity fees and redemption restrictions (i.e., provided they are not Electing Government MMFs) and the FCM treats such investments as consistent with CFTC Regulation 1.25(b)(3)(i)(E) and, therefore, not subject to asset-based concentration limits. This position is conditioned upon the Government MMF meeting the conditions in Regulation 1.25(b)(i)(3)(G), provided however that the level of assets be increased from the current $1 billion to $5 billion.

This letter, and the positions taken herein, represent the view of this Division only, and do not necessarily represent the position or view of the Commission or of any other office or division of the Commission. The relief issued by this letter does not excuse an FCM from

compliance with any other applicable requirements contained in the Act or in the Commission's regulations issued thereunder, including any other provisions applicable to MMFs under Regulation 1.25. Finally, the Division retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the relief provided herein, in its discretion.

If you have any questions concerning this letter, please contact Mark H. Bretscher, Special Counsel, at 312-596-0529, Joshua Beale, Special Counsel, at 202-418-5446, or Thomas Smith, Deputy Director, at (202) 418-5495.

Very truly yours,

Eileen T. Flaherty
Director
Division of Swap Dealer and
Intermediary Oversight