Commodity Futures Trading Commission

Office of Public Affairs

Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581
cftc.gov

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Fact Sheet and Q&A – Final Rule Regarding Investment of Customer Funds by Futures Commission Merchants and Derivatives Clearing Organizations

The Commodity Futures Trading Commission ("Commission" or "CFTC") is amending its regulations governing the safeguarding and investment of customer funds by futures commission merchants ("FCMs") and derivatives clearing organizations ("DCOs") to: (i) revise the list of permitted investments and make certain related changes; (ii) replace the London Interbank Offered Rate ("LIBOR") with the Secured Overnight Financing Rate ("SOFR") as a permitted benchmark for permitted investments with adjustable rates of interest; and (iii) eliminate the requirement that an FCM deposit customer funds with depositories that provide the Commission with read-only electronic access to transaction and account balance information.

Background

Commission Regulation 1.25 permits FCMs to invest funds deposited by customers to margin futures, foreign futures, and cleared swaps transactions ("Customer Funds") in specified categories of investments. Commission Regulation 1.25 further permits DCOs to invest Customer Funds that FCMs post with the DCOs as margin for their customers' positions in the same specified categories of investments.

Commission Regulation 1.25(a)(1) currently lists seven investments that FCMs and DCOs may enter into with Customer Funds: (i) obligations of the U.S. and obligations fully guaranteed as to principal and interest by the U.S.; (ii) general obligations of any State or political subdivision of a State; (iii) obligations of any U.S. government corporation or enterprise sponsored by the U.S.; (iv) certificates of deposit issued by a bank; (v) commercial paper fully guaranteed by the U.S. under the Temporary Liquidity Guarantee Program ("TLGP"); (vi) corporate notes and bonds fully guaranteed by the U.S. under the TLGP; and (vii) interests in money market funds ("MMF"). FCMs and DCOs are also permitted to buy and sell the permitted investments pursuant to repurchase and reverse repurchase agreements with defined counterparties.

Commission Regulation 1.25(b) requires FCMs and DCOs to manage the permitted investments consistent with the objectives of preserving principal and maintaining liquidity. To this end, the permitted investments must be highly liquid such that the investments may be converted into cash within one business day without material discount in value.

Separately, Commission Regulations 1.20 and 30.7, and certain related appendices, require that FCMs deposit Customer Funds only with depositories that agree to provide staff in the Market Participants Division with direct, read-only electronic access to accounts holding Customer Funds ("read-only access provisions").

As part of its periodic assessment of Commission Regulation 1.25 and in consideration of information submitted in two industry petitions,[1] the Commission proposed amendments to its rules governing the safeguarding and investment of Customer Funds.[2] Following analysis of comments received, the Commission is adopting the amendments, subject to certain modifications discussed below.[3]

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[1] Petition for Order under Section 4(c) of the Commodity Exchange Act submitted by the Futures Industry Association and CME Group Inc. ("CME"), dated May 24, 2023, and Letter from Anna Paglia, Chief Executive Officer, Invesco Capital Management LLC, dated September 28, 2023.

[2] Investment of Customer Funds by Futures Commission Merchants and Derivatives Clearing Organizations, 88 FR 81236 (Nov. 21, 2023).

[3] The final rulemaking adopting the amendments is referred to as "Final Rule."

Overview of the Final Rule

The Final Rule:

1. Revises the list of permitted investments in Commission Regulation 1.25 to: (i) add two new asset classes (*i.e.*, certain foreign sovereign debt instruments issued by Canada, France, Germany, Japan, and the United Kingdom, and certain short-term U.S. Treasury exchange-traded funds ("ETFs")), subject to conditions; (ii) limit the scope of MMFs whose interests qualify as permitted investments; and (iii) remove certificates of deposit issued by a bank, corporate notes, corporate bonds, and commercial paper;
2. Makes certain related and conforming changes to reflect the amendments to the list of permitted investments, including:
    a. Specifying the capital charges that apply to the new categories of permitted investments;
    b. Changing the counterparty and depository requirements of Commission Regulation 1.25(d)(2) and (7) to effectively permit FCMs and DCOs to purchase and sell specified foreign sovereign debt instruments pursuant to repurchase and reverse repurchase agreements;
    c. Revising the concentration limits for permitted investments in Commission Regulation 1.25(b)(3);
    d. Updating the required contents of:
        i. The Segregation Investment Detail Reports ("SIDR") that FCMs file on a bi-monthly basis with the Commission and the FCM's designated self-regulatory organization ("DSRO"), to reflect the changes to the list of permitted investments;
        ii. The template acknowledgement letters to be signed by the depositories holding customer funds to reflect the elimination of the read-only electronic access provisions and the revised scope of permitted MMFs;
        iii. The customer risk disclosure statement required under Commission Regulation 1.55, to reflect the changes to the list of permitted investments;
3. Amends Commission Regulation 22.3(d) to clarify that DCOs are financially responsible for any losses resulting from investments of cleared swaps customer collateral in permitted investments, consistent with Commission Regulation 1.29, which addresses financial responsibility for losses resulting from investment of futures customer funds;
4. Replaces LIBOR with SOFR as a permitted benchmark for variable and floating interest rates for securities that qualify as permitted investments; and
5. Eliminates the read-only access provisions.

Objective

The Commission is amending its requirements governing the safeguarding and investment of Customer Funds to: (i) account for certain regulatory reforms and market developments that have impacted instruments included in the list of permitted investments in Commission Regulation 1.25 since that list was last revised in 2011; (ii) provide a degree of investment flexibility and opportunity for capital efficiencies to FCMs and DCOs without compromising the safety of Customer Funds; and (iii) address certain practical challenges and potential risks associated with the Commission maintaining read-only electronic access to accounts holding customer funds.

Final Rule Q & A

1. **Who is affected by the changes?**

    - FCMs and DCOs investing Customer Funds.
    - FCMs safeguarding Customer Funds at permitted depositories.

2. **What policy considerations motivated the changes?**

    With respect to the amendments to the list of permitted investments:

- In adding certain foreign sovereign debt instruments issued by Canada, France, Germany, Japan, and the United Kingdom, the Commission has considered the foreign currency fluctuation risk that FCMs and DCOs face if they convert the foreign currency that they hold to U.S. dollars to invest the funds in permitted investments. Consistent with its prior statements indicating that the Commission is amendable to consider requests for exemptions to permit FCMs and DCOs to invest Customer Funds in certain sovereign issuances subject to a country-by-country analysis,[4] the Commission analyzed the liquidity, volatility, and credit characteristics of the specified foreign sovereign debt instruments and determined that including such instruments as permitted investments, subject to the conditions of the Final Rule, is consistent with the overall objectives of preserving principal and maintaining liquidity of Customer Funds in Commission Regulation 1.25;
- In adding certain short-term Treasury ETFs, the Commission has considered the liquidity characteristics of the relevant ETFs and the diversification opportunity that such ETFs provide for Customer Funds. The Commission is thus expanding the range of available permitted investments to provide FCMs and DCOs with greater flexibility and opportunities for capital efficiency in the investment of Customer Funds without unacceptably increasing risk to customers. In that regard, the Commission considered the similarity between short-term Treasury ETFs and currently permitted investments such as government MMFs, as well as the efficiencies that ETFs provide by offering a means to invest in another permitted asset class – U.S. Treasury securities – while allowing FCMs and DCOs to reduce the expenses and resources required to manage individual, direct investments in such instruments;
- The revision of the scope of permitted MMFs addresses the impact of certain reforms to the Securities and Exchange Commission's ("SEC") rules governing MMFs and is designed to ensure that permitted MMFs remain consistent with the general principles of preserving principal and maintaining liquidity of Customer Funds in Commission Regulation 1.25;
- The elimination of corporate notes, corporate bonds, and commercial paper is a consequence of the expiration of the TLGP. Commission Regulations 1.25(a)(1)(v) and (vi) permitted FCMs and DCOs to invest Customer Funds in commercial paper and corporate notes and bonds, provided that such investments were fully guaranteed as to principal and interest under the TLGP as administered by the Federal Deposit Insurance Corporation. The TLGP expired in 2012, and such investments have not been available to FCMs and DCOs since 2012;
- The elimination of certificates of deposit issued by a bank is motivated by an observed lack of use; and
- Replacing LIBOR with SOFR as a permitted benchmark for the interest rate of adjustable-rate securities seeks to facilitate the transition away from LIBOR and ensure that instruments qualifying as permitted investments use a reliable benchmark as a reference rate.

The revisions to the concentration limits support the preservation of principal and maintenance of liquidity of Customer Funds through sound diversification standards. The revisions to the concentration limits also mitigate the potential risk that a large portion of Customer Funds could become inaccessible due to operational incidents, among other events.

With regard to the elimination of the read-only access provisions, the Commission has considered the practical challenges associated with the implementation of the read-only access provisions and the resulting potential cybersecurity risk, as well as the availability of efficient and effective alternative means of obtaining account balance and transaction information for accounts holding Customer Funds. Commission staff will rely primarily on the automated daily segregation confirmation system developed by CME and the National Futures Association ("NFA").

3. **Why is the Commission allowing investments in certain foreign sovereign debt at this time, given that the Commission had previously eliminated it from the list of permitted investments?**

[4] *Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions*, 76 FR 78776 (Dec. 19, 2011) ("2011 Permitted Investments Amendment"), at 78782 (stating that the Commission would consider permitting foreign sovereign debt investments to the extent that: (i) the petitioner has balances in segregated accounts owed to customers or clearing member FCMs in that country's currency; and (ii) the sovereign debt serves to preserve principal and maintain liquidity of Customer Funds as required for all other investments of Customer Funds).

The Commission initially added foreign sovereign debt to the list of permitted investments in 2000, to provide an opportunity for FCMs and DCOs to address their potential exposures to foreign currency fluctuation risk.[5] Following the 2000 amendments to Commission Regulation 1.25, FCMs and DCOs were permitted to invest in the general obligations of any country whose sovereign debt was rated in the highest category by at least one nationally recognized statistical rating organization, provided that the instruments were limited to balances owed by FCMs or DCOs to customers denominated in the currency of the applicable foreign sovereign debt.

The Commission subsequently eliminated all foreign sovereign debt as a permitted investment in 2011, citing an interest in both simplifying the regulation and safeguarding Customer Funds due to economic crises experienced by a number of foreign sovereigns.[6] In addition, according to a review conducted in 2007 by Commission staff, foreign sovereign debt was minimally used as an investment at the time.[7] The Commission, however, simultaneously recognized that the safety of sovereign debt issuances of one country may vary greatly from those of another country, and that investment in certain sovereign debt may be consistent with the objective of preserving principal and maintaining liquidity of investments set forth in Commission Regulation 1.25. Accordingly, the Commission invited FCMs and DCOs seeking to invest Customer Funds in foreign sovereign debt to petition the Commission pursuant to Section 4(c) of the Commodity Exchange Act ("CEA" or the "Act").[8]

In 2018, the Commission issued an order pursuant to Section 4(c) of the CEA providing a limited exemption from the requirements of Section 4d of the Act to permit DCOs to invest euro-denominated futures customer funds and cleared swaps customer collateral in the foreign sovereign debt of France and Germany.[9]

The Commission is expanding the exemptive relief in the 2018 Order by permitting FCMs and DCOs to invest Customer Funds in sovereign debt instruments issued by Canada, France, Germany, Japan, and the United Kingdom, subject to the strict conditions discussed in the question immediately below.[10] The Commission has analyzed the liquidity, volatility, and credit characteristics of the specified foreign sovereign debt instruments and determined that these characteristics are comparable to those of U.S. Treasury securities (i.e., instruments that already qualify as permitted investments).[11] The five issuer jurisdictions, along with the U.S., are members of the Group of 7, which represents the world's largest industrial democracies. Moreover, there is a greater need for a mechanism to hedge foreign currency fluctuation risk, given that the amount of Customer Funds denominated in the currencies of Canada, France, Germany, Japan, and the United Kingdom that FCMs hold has increased since 2007 and that such amount represents approximately 12 percent of the total Customer Funds held in segregated accounts.[12]

4. Under what conditions are FCMs and DCOs allowed to invest Customer Funds in foreign sovereign debt?

Under the terms of the Final Rule, FCMs and DCOs can invest Customer Funds in specified foreign sovereign debt, subject to the following conditions that are consistent with the 2018 Order:

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[5] *Rules Relating to Intermediaries of Commodity Interest Transactions*, 65 FR 77993 (Dec. 13, 2000) (final rules); and *Investment of Customer Funds*, 65 FR 82270 (Dec. 28, 2000) (making technical corrections and accelerating the effective date of the final rules from February 12, 2001 to December 28, 2000).

[6] 2011 Permitted Investments Amendment at 78781-78782. Separately, to address the conduct of two FCMs, which undertook speculative proprietary investments involving debt issued by certain European countries experiencing economic distress and/or unlawfully used Customer Funds, the Commission adopted major revisions to its rules to enhance the protection of Customer Funds. *See generally Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations*, 78 FR 68506 (Nov. 14, 2013). The Commission's proposal to eliminate foreign sovereign debt from the list of permitted investments was motivated by considerations preceding and independent from the FCM conduct that prompted the 2013 rulemaking. *See Investment of Customer Funds and Funds Held in an Account for Foreign Futures and Foreign Options Transactions*, 75 FR 67642 at 67645 (Nov. 3, 2010). Except for the elimination of the read-only access provisions, which is addressed by alternative means of accessing account information, the amendments in this Final Rule do not affect the safeguards adopted in 2013.

[7] 2011 Permitted Investments Amendment at 78781.

[8] *Id.* at 78782.

[9] *Order Granting Exemption from Certain Provisions of the Commodity Exchange Act Regarding Investment of Customer Funds and from Certain Related Commission Regulations*, 83 FR 35241 (Jul. 25, 2018) ("2018 Order").

[10] All five jurisdictions are members of the Group of 7 ("G7"). The Final Rule, however, does not include all G7 countries as issuers of permitted foreign sovereign debt.

[11] The Commission considered and compared the amounts of outstanding marketable debt instruments issued by each of the jurisdictions; the price risk of the relevant debt; and the 2-year credit default swap spreads of each of the jurisdictions.

[12] As of August 13, 2024, FCMs collectively held an aggregate of a U.S. dollar equivalent of $64 billion of Customer Funds denominated in Canadian dollars, euros, Japanese yen, and Great British pounds. The $64 billion represented approximately 12 percent of the total $511 billion of Customer Funds held by FCMs in segregated accounts on August 13, 2024.

- If the debt instruments are issued by Canada, France, Germany, Japan, or the United Kingdom;
- To the extent the FCM or DCO holds balances owed to customers denominated in the currency of the specified foreign sovereign debt;
- Provided that the two-year credit default spread of the issuing sovereign is 45 basis points or less; and
- To the extent the dollar-weighted average time-to-maturity of the portfolio of investments in the specified foreign sovereign debt does not exceed 60 calendar days and the remaining time-to-maturity of each individual instrument does not exceed 180 calendar days.

5. Under what conditions are FCMs and DCOs allowed to invest Customer Funds in ETFs?

Under the terms of the Final Rule, FCMs and DCOs can invest Customer Funds in ETFs subject to the following primary conditions:

- The ETF is a registered investment company under the Investment Company Act of 1940 with the SEC and holds itself out as an ETF under SEC Rule 6c-11;
- The ETF is passively managed and seeks to replicate the performance of a published short-term U.S. Treasury security index. Short-term US. Treasury securities are bonds, notes, and bills with a remaining maturity of 12 months or less, issued by, or unconditionally guaranteed as to the timely payment of principal and interest by, the U.S. Department of the Treasury;
- The ETF invests at least 95 percent of its assets in securities comprising the U.S. Treasury securities index whose performance the fund seeks to replicate; and
- The purchase and liquidation of interests in the ETF conform to the following requirements:
  - *For primary market transactions*: The FCM or DCO purchases or redeems interests in the ETF on a delivery versus payment basis at the net asset value and the FCM or DCO: (i) has ability to convert ETF interests into cash within one business day of the redemption request, when the FCM/DCO acts in a capacity of an authorized participant, as defined in SEC Rule 6c-11, or (ii) has a contractual arrangement in place obligating an authorized participant to pay in cash within one business day of the redemption request, when the FCM/DCO transacts with the ETF through an authorized participant.
  - *For secondary market transactions*: The FCM or DCO acquires or sells interests in the ETF on a national securities exchange registered with the SEC.

6. How will the Commission obtain account balance and transaction information for accounts holding Customer Funds following the elimination of the read-only access provisions?

Commission staff will rely primarily on the automated daily segregation confirmation system developed by CME and NFA.

In addition, pursuant to Commission Regulations 1.20(d)(5) and (6), 1.26(b), 22.5(a) and (b), and 30.7(d)(5) and (6), FCMs may deposit Customer Funds only with depositories that agree that accounts containing Customer Funds may be examined by Commission or DRSO staff at any reasonable time and that agree to reply promptly and directly to any request from Commission or DSRO staff for confirmation of account balances or provision of any other information regarding or related to an account.

Compliance Dates

The compliance date for the Final Rule is 30 days after publication in the Federal Register, except for the amendments to the SIDR report, which are specified in Commission Regulations 1.32, 22.2(g)(5), and 30.7(l)(5), and the amendments to the customer risk disclosure statement required under Commission Regulation 1.55.

For the amendments to the SIDR report and risk disclosure statement required under Commission Regulation 1.55, the compliance date is March 31, 2025.