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By Electronic Mail

September 4, 2019

Mr. Christopher J. Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
1155 21st Street NW
Washington DC 20581

Re: Petition for Order under Section 4(c) of the Commodity Exchange Act

Dear Mr. Kirkpatrick:

The Futures Industry Association ("**FIA**")[1] requests the Commodity Futures Trading Commission ("**Commission**") to adopt an order pursuant to section 4(c) of the Commodity Exchange Act ("**Act**"),[2] or grant such other relief as the Commission may deem appropriate, authorizing FIA's FCM member firms and similarly situated FCMs (i) to invest customer funds[3] in Specified Foreign Sovereign Debt described below,[4] and (ii) to buy and sell such Specified Foreign Sovereign Debt

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1 FIA is the leading global trade organization for the futures, options, and centrally cleared derivatives markets, with offices in London, Brussels, Singapore and Washington DC. FIA's mission is to support open, transparent and competitive markets; protect and enhance the integrity of the financial system; and promote high standards of professional conduct. FIA's membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry. FIA's core constituency consists of firms that operate as clearing members in global derivatives markets, including firms registered with the Commodity Futures Trading Commission as futures commission merchants ("**FCMs**"). The majority of these FCMs, including the 25 largest FCMs measured by adjusted net capital, are also registered as broker-dealers with the Securities and Exchange Commission ("**BD/FCMs**").

2 Section 4(c) authorizes the Commission, by rule, regulation or order, to grant an exemption from any provision of the Act "[i]n order to promote responsible economic or financial innovation and fair competition". The Commission must find that the exemption is consistent with the public interest and the purposes of the Act and will not have a material adverse effect on the ability of the Commission or any contract market to discharge its regulatory or self-regulatory responsibilities under the Act. The relief requested herein will provide an exemption from certain provisions of section 4d of the Act and Commission Rules 1.25 and 1.49 thereunder.

3 For purposes of this request for no-action, we define the term "**customer funds**" to include both "futures customer funds" and the "foreign futures and foreign options secured amount", as each term is defined in Commission Rule 1.3, and cleared swaps customer collateral, as defined in Commission Rule 22.1.

4 For purposes of this request, the term "**Specified Foreign Sovereign Debt**" means the sovereign debt of Canada, France, Germany, Japan and the United Kingdom (each, a "**Specified Jurisdiction**") that, in each case, satisfy the terms and conditions set out herein.

pursuant to agreements for resale or repurchase (collectively, "**repurchase agreements**"). As discussed below, the requested relief expands upon the relief that the Commission granted to derivatives clearing organizations ("**DCOs**") by Order dated July 19, 2018 ("**2018 Order**").[5]

Separately, FIA requests relief from the provisions of Commission Rule 1.25(d) to authorize FCMs to enter into repurchase agreements with a counterparty that is an affiliate of the FCM and, further, requests the Commission to authorize FCMs to engage in so-called "in-house" transactions, which the Commission had previously authorized in Commission Rule 1.25(e), in effect prior to the Commission's 2011 amendments to Rule 1.25 ("**2011 Amendments**").[6] Finally, we ask the Commission to authorize FCMs to invest in adjustable rate securities that correlate closely to the Secured Overnight Financing Rate ("**SOFR**"), consistent with the provisions of Commission Rule 1.25(b)(2)(iv).[7]

I. Investments in Foreign Sovereign Debt

A. The 2018 Order. On July 19, 2018, the Commission issued an Order granting DCOs an exemption from the provisions of Commission Rule 1.25(a), pursuant to which DCOs are authorized to invest euro-denominated futures and cleared swaps customer funds in euro-denominated sovereign debt issued by the French Republic and the Federal Republic of Germany ("**Designated Foreign Sovereign Debt**"), subject to the terms and conditions set out in the Order. The 2018 Order further granted DCOs an exemption from the provisions of Commission Rule 1.25(d) to authorize such DCOs to enter into repurchase agreements with respect to Designated Foreign Sovereign Debt with foreign banks and foreign securities brokers or dealers[8] and to hold Designated Foreign Sovereign Debt in a safekeeping account at a foreign bank.[9]

The 2018 Order was issued following receipt of an application for exemption under section 4(c) of the Act submitted by ICE Clear US Inc., ICE Clear Credit LLC, and ICE Clear Europe Limited

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[5] 83 Fed. Reg. 35241 (July 25, 2018).

[6] 78 Fed. Reg. 78776 (Dec. 19, 2011).

[7] The Federal Reserve Bank of New York defines SOFR as "a broad measure of the cost of borrowing cash overnight collateralized by Treasury Securities."

[8] Commission Rule 1.25(d)(2) provides that an FCM may enter into repurchase agreements only with a bank as defined in section 3(a)(6) of the Securities Exchange Act of 1934, a domestic branch of a foreign bank insured by the Federal Deposit Insurance Corporation, a securities broker or dealer, or a government securities broker or government securities dealer registered with the Securities and Exchange Commission ("**SEC**"). Under the 2018 Order, a foreign bank must qualify as a permitted depository under Commission Rule 1.49(d)(3) and must be located in a money center country or another jurisdiction that has adopted the euro as its currency; a foreign dealer must be located in a money center country and subject to regulation by a national financial regulator.

[9] Commission Rule 1.25(d)(7) provide that securities transferred to an FCM under a repurchase agreement must be held in a safekeeping account with a bank as referred to in Rule 1.25(d)(2), a Federal Reserve Bank, a DCO, or the Depository Trust Company. Under the 2018 Order, the foreign bank must meet the location and qualification requirements set out in Commission Rule 1.49(c) and (d).

(collectively, the "**ICE DCOs**").[10] FIA submitted a comment letter in response to the Commission's request for comment on the ICE DCOs' application in December 2017, in which FIA generally supported the application, but also recommended several amendments to the proposed terms and conditions, which we discuss below.[11] Importantly, FIA also encouraged the Commission to extend any relief granted to all DCOs and FCM clearing members.

The Commission elected to extend the requested relief to all DCOs but declined to extend the relief to FCMs, noting that FCMs are "a separate class of registrant subject to differing regulatory obligations that the Commission would need to consider on their own terms."[12] Although FCMs are clearly a separate class of registrant, we submit FCMs have identical regulatory obligations with respect to the protection of customer funds. That is: (i) FCMs are required to "treat and deal with all money, securities, and property received by [an FCM] to margin, guarantee, or secure the trades or contracts of any customer . . . as belonging to such customer";[13] (ii) such customer funds may only be deposited with a bank or trust company, a DCO or another FCM;[14] (iii) investments of customer funds are subject to the requirements of Commission Rules 1.25 and 1.26;[15] and (iv) customer funds may only be held in such denominations and depositories that meet the requirements of Commission Rule 1.49.

FCMs also face the same challenges in assuring the protection of foreign currencies received from customers to margin cleared transactions. As a matter of appropriate risk management, and in certain cases as a result of governmental guidance, many clearing organizations located outside of the United States restrict the amount of cash that they may hold overnight.[16] Consequently,

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10 The ICE DCOs' application may be found at https://www.cftc.gov/sites/default/files/idc/groups/public/@requestsandactions/documents/ifdocs/icedcos4cappl6-22-17.pdf.

11 Letter from Walt L. Lukken, President and Chief Executive Officer, FIA, to Christopher J. Kirkpatrick, Secretary to the Commission (Jan. 16, 2018). FIA's letter may be found at https://fia.org/sites/default/files/uploaded/CFTC%20ICE%20DCOs%20Section%20Exemption%20011618.pdf. The Commission's request for comment may be found at 82 Fed. Reg. 59586 (Dec.15, 2017).

12 83 Fed. Reg. at 35243 (July 25, 2018).

13 Act, § 4d(a)(2).

14 Commission Rule 1.20.

15 Unless the context clearly requires otherwise, reference to "investment of customer funds" hereafter should be read to include both direct investments in sovereign debt denominated in specified currencies, *i.e.*, purchases of Specified Foreign Sovereign Debt unaccompanied by a contemporaneous agreement to resell the securities, and repurchase agreements involving such sovereign debt.

16 For example, Article 45 of the regulatory technical standards on requirements for central counterparties, which gives effect to the provisions in EMIR governing the investment policies of EU central counterparties, provides:

> Where cash is maintained overnight in accordance with paragraph 1 then not less than 95% of such cash, calculated over an average period of one calendar month, shall be deposited through arrangements that ensure the collateralization of the cash with highly liquid financial instruments meeting the requirements under Article 45.

clearing organizations subject to EMIR impose strict cut-off times for FCMs and other clearing members to withdraw cash margin. On the other hand, non-US clearing organizations allow an FCM later cutoff times for withdrawal of securities margin.

For other reasons, *e.g.*, capital requirements or balance sheet management, not all banks will accept foreign currencies, and those that do may place limits on the amount of foreign currencies they are willing to accept. FCMs have found that, in certain cases, banks will charge an FCM high rates for holding foreign currencies deposited by customers.[17] As a result, FCMs face significant challenges in appropriately managing the risks of holding foreign currencies that customers deposit.

For all of the above reasons, FCMs, no less than DCOs, should have an opportunity to invest customer funds in Specified Foreign Sovereign Debt, provided such investments would meet the objectives of Commission Rule 1.25, *i.e.*, preserving principal and maintaining liquidity.[18]

Therefore, consistent with the 2018 Order, we hereby ask the Commission to exercise its authority under section 4(c) of the Act to authorize FCMs to invest customer funds in certain Specified Foreign Sovereign Debt, subject to the terms and conditions below. Further, we ask that the Commission exempt FCMs from the provisions of Commission Rule 1.25(d)(2) and authorize such FCMs to enter into repurchase agreements with respect to Specified Foreign Sovereign Debt with foreign banks and foreign securities brokers or dealers and to hold Specified Foreign Sovereign Debt in a safekeeping account at a foreign bank. As discussed below, however, we are also asking that the terms and conditions of this Order differ in certain important respects from the terms and conditions of the 2018 Order.

B. Terms and Conditions under the 2018 Order. FIA expects that any Order the Commission would issue in connection with this petition would contain several conditions comparable to those set out in the 2018 Order. Specifically, we anticipate that:

- An FCM would be permitted to invest customer funds only in Specified Foreign Sovereign Debt denominated in specified currencies to the extent that customers hold balances in such specified currencies in segregation.

- Any foreign bank with which an FCM enters into repurchase agreements will qualify as a permitted depository under Commission Rule 1.49(d)(3) and will be located in a money center country; any foreign broker or dealer with which an FCM enters into repurchase agreements will be located in a money center country and will be subject to regulation by a national financial regulator.

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[17] Customers depositing such foreign currencies absorb these costs.

[18] Commission Rule 1.25(b).

- An FCM must hold customer Specified Foreign Sovereign Debt in a depository that meets the location and qualification requirements of Commission Rule 1.49(c) and (d).

- If the two-year credit default spread of an issuing sovereign is greater than 45 basis points, an FCM (i) must discontinue investing customer funds in the relevant debt through repurchase agreements as soon as practicable, and (ii) may not make any new direct investments using customer funds.[19]

C. Additional Terms and Conditions.

1. Specified Foreign Sovereign Debt. The 2018 Order was limited to investments in the euro-denominated sovereign debt of France and Germany. It was the ICE DCOs' position that restricting the proposed relief to investments in the publicly traded sovereign debt of France and Germany would be consistent with the objectives of Rule 1.25, *i.e.*, preserving principal and maintaining liquidity. The ICE DCOs demonstrated that the euro-denominated sovereign debt of France and Germany compared favorably to the sovereign debt of the United States, particularly in presenting a low risk of default and maintaining significant liquidity. We agree with the analysis of the ICE DCOs and incorporate that analysis herein.

In addition to investments in the euro-denominated sovereign debt of France and Germany, FIA requests the Commission to extend the exemption to include investments in the sovereign debt of (i) Canada, (ii) Japan and (iii) the United Kingdom, in each case denominated in the respective currency of each country. As demonstrated below, the Specified Foreign Sovereign Debt presents a low risk of default and maintains significant liquidity.

2. Time to maturity. The 2018 Order provides that the dollar-weighted average of the time-to-maturity of each DCO's portfolio of investments in Designated Foreign Sovereign Debt, both direct investments and reverse repurchase agreements, may not exceed 60 days. In lieu of the 60-day weighted-average time to maturity, FIA member firms believe that a dollar-weighted average of the time-to-maturity of six months would better assure sufficient liquidity, while preserving principal consistent with the provisions of Rule 1.25(b). FIA member firms report that the 60-day weighted-average of the time-to-maturity would be too limiting. The new issuance supply of the Specified Foreign Sovereign Debt meeting this restriction is limited and would be thinly traded/quoted, forcing participants to invest in the less-liquid secondary market securities.

3. Remaining maturity. The 2018 Order provided that an FCM may not make a direct investment in any Specified Foreign Sovereign Debt with a remaining maturity greater than 180 days. We ask that the Order issued to FCMs provide that an FCM may not make a direct investment in any Specified Foreign Sovereign Debt with a remaining maturity greater than two years. An expansion to a two-year remaining maturity standard will help assure sufficient

[19] The 2018 Order did not indicate whether the calculation of the basis point spread was to be based on the bid, offer or mid-level. We propose that the basis point spread be determined using the mid-level.

new issuances of Specified Foreign Sovereign Debt to provide additional supply and liquidity. An expansion to a two-year remaining maturity standard is consistent, further, with the two-year weighted average time-to-maturity in Rule 1.25(b)(4).

D. Specified Foreign Sovereign Debt Compared with US Treasury Securities. As noted above, in their request for exemption, the ICE DCOs demonstrated that the euro-denominated sovereign debt of France and Germany compared favorably to the sovereign debt of the United States, particularly in presenting a low risk of default and maintaining significant liquidity. As such, authorizing investments in such sovereign debt would be consistent with the purposes of Commission Rule 1.25, *i.e.*, preserving capital and maintaining liquidity. We suggest that it similarly would be consistent with the purposes of Rule 1.25 if the Commission were to authorize FCMs to invest in Specified Foreign Sovereign Debt, subject to the terms and conditions above.

1. Low risk of default. In their request for exemption, the ICE DCOs demonstrated that the Designated Foreign Sovereign Debt, *i.e.*, the sovereign debt of France and Germany, was generally regarded as having a low risk of default by comparing the credit ratings of France and Germany with the credit ratings of the US. The credit ratings of the Specified Foreign Debt similarly compare favorably to US credit ratings. The S&P credit rating for the US and France is AA, while the credit rating for Germany is AAA. The S&P credit ratings for Canada (AAA), Japan (A+) and the United Kingdom (AA) are comparable, reflecting the view that each jurisdiction is well able to service its public debt.[20]

We believe the low risk of default among the Specified Jurisdictions is further demonstrated by the relatively narrow spreads in credit default swaps on each jurisdiction's sovereign debt, as reflected in the chart on the following page. The chart shows the mid-level current spreads and

[20] The following chart confirms that Moody's and Fitch share the same views on the ability of each jurisdiction to service its debt.

Credit Ratings			
Country	**S&P**	**Moody's**	**Fitch**
United States	AA	Aaa	AAA
Canada	AAA	Aaa	AAA
France	AA	Aa2	AA
Germany	AAA	Aaa	AAA
United Kingdom	AA	Aa2	AA
Japan	A+	A1	A

historic mid-level high and low spreads for the period August 2014 – August 2019. In each case, the spreads are within the 45 basis point limit the Commission set in the 2018 order.

Mid Levels - 2 Year CDS Spreads in bp's (August 2014 - August 2019)			
Country	**Current Level**	**Historical High**	**Historical Low**
United States	9.06	35.00	8.60
Canada	16.25	21.20	9.90
France	9.39	43.80	4.30
Germany	4.14	12.00	
United Kingdom		24.00	4.30
Japan	7.65	34.90	5.10

Based on the foregoing, we submit that the risk of default among the Specified Jurisdictions is comparable to the risk of default by the US government. Consequently, investments in such Specified Foreign Sovereign Debt would be consistent with the objective of preserving capital, as set forth in Rule 1.25(b).

2. Significant Liquidity. As reflected in Appendix 1 to this request, the trading markets for each of the Specified Jurisdictions demonstrate high liquidity and accessibility at various maturities. Among other data, Appendix 1 sets out the outstanding debt of each Specified Jurisdiction and the US (both marketable and non-marketable) and the marketable public debt (in USD equivalents) where the time-to-maturity is two years or less.[21] As Appendix 1 also demonstrates, there is also an active secondary market for each of the Specified Foreign Sovereign Debt. In addition, there are active repo markets for the Specified Foreign Sovereign Debt as supported by the chart set out in Appendix 2, published by the Bank of International Settlements. Appendix 2 provides data on total repurchase and reverse repurchase transactions against sovereign debt as of mid-2016.[22]

The high level of liquidity is further reflected in the relatively tight bid-offer spreads among bills and short coupons and evidences our belief that the markets in Specified Foreign Sovereign Debt is sufficiently liquid to permit FCM's to sell any such investments when necessary to obtain cash without substantial devaluation.[23]

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[21] Source: Bloomberg, as of February 15, 2019.

[22] Source: *Repo market functioning*, CGFS Papers, No. 59, Committee on the Global Financial System, Bank for International Settlements, Committee on the Global Financial System, dated April 2017. The depth of liquidity in the European market for repurchase and reverse repurchase transactions is described in detail in the most recent survey published by the International Capital Market Association, available at https://www.icmagroup.org/assets/documents/Market-Info/Repo-Market-Surveys/No-36-December-2018/ICMA-European-repo-market-survey-number-36-conducted-December-2018-040419.pdf.

[23] We note that securities are marked-to-market daily and any change in value is reflected in the daily segregation calculation required under Commission Rules 1.32, 30.7 and 22.2. Therefore, any devaluation in Specified

F g 2.60

18.35

In sum, we believe the Specified Foreign Sovereign Debt would constitute a conservative and prudent investment consistent with the purposes of Rule 1.25. Subject to the terms and conditions set out above, we request the Commission to authorize FCMs to invest in Specified Foreign Sovereign Debt.

II. Affiliate Transactions

We also ask that the Commission's Order exempt FCMs from the prohibition on engaging in repurchase agreements with affiliates as currently set forth in Commission Rule 1.25(d)(3). The exemption would be subject to the condition that an FCM's repurchase agreements with one or more affiliates would not exceed 25 percent (25%) of total assets held in the appropriate segregated account.[24] As the Commission is aware, prior to the 2011 Amendments, Rule 1.25(d) permitted FCMs to enter into repurchase agreements with affiliates that were banks or were registered with the SEC as broker-dealers. In prohibiting repurchase agreements with affiliates, the Commission expressed its concern that "the concentration of credit risk increases the likelihood that the default of one party could exacerbate financial strains and lead to the default of its affiliate."[25] We disagree.

Although affiliates within a financial holding company are not immune from the strains that another affiliate may experience, it does not follow that assets held in an FCM's customer segregated account pursuant to a repurchase transaction with an affiliate would be at greater risk. To the contrary, we submit that funds or securities held in connection with such transactions are at no greater risk in the event of a default than they would be in the event of a default (or financial distress) of a non-affiliated counterparty.

The provisions of Rule 1.25(d), both prior to the 2011 Amendments and currently, were designed to assure that, whether a transaction is with an affiliate or a non-affiliate, the customer segregated account is never at risk. Pursuant to Rule 1.25(d), agreements to repurchase or resell securities are subject to a number of requirements, including: (i) the transaction is made pursuant to a written agreement signed by the parties to the agreement, which is consistent with the conditions set forth in the rule and which states that the parties intend the transaction to be treated as a purchase and sale of securities; (ii) the term of the agreement is no more than one business day, or reversal of the transaction is possible on demand; (iii) securities transferred to the FCM or DCO under the agreement are held in a safekeeping account with a bank, a DCO, or the Depository Trust Company in an account that complies with the requirements of Commission Rule 1.26; (iv) the FCM or DCO may not use securities received under the agreement in another similar transaction and may not otherwise hypothecate or pledge such securities, except securities may be pledged on behalf of

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Foreign Sovereign Debt securities is taken into account in the FCM's relevant segregation computation. If the devaluation in securities impairs the FCM's excess residual interest, the FCM is required to increase residual interest to maintain their Targeted Residual Interest amount, effectively protecting the customer.

24 This requirement is consistent with the counterparty concentration requirements set out in Rule 1.25(b)(3)(v).

25 75 Fed.Reg. 67642, 67651 (Nov. 3, 2010).

customers at another FCM or DCO;[26] (v) the transfer of securities to the customer segregated account is made on a delivery versus payment basis in immediately available funds;[27] (vi) an actual transfer of securities to the customer segregated custodial account by book entry is made consistent with Federal or State commercial law, as applicable; (vii) the agreement makes clear that, in the event of the bankruptcy of the FCM or DCO, any securities purchased with customer funds that are subject to an agreement may be immediately transferred; and (viii) the agreement also makes clear that, in the event of an FCM or DCO bankruptcy, the counterparty has no right to compel liquidation of securities subject to the agreement or to make a priority claim for the difference between the current market value of the securities and the price agreed upon for resale of the securities to the counterparty, if the former exceeds the latter.[28]

Although not a term or condition of Rule 1.25(d), we further note that, in the event that the mark-to-market value of the securities purchased pursuant to a repurchase agreement declines below 100 percent of the amount invested, the FCM would be required to assure that its residual interest exceeds its targeted residual interest by an amount at least equal to the difference between the mark-to-market value and the amount invested. In light of the above, we submit that the protections afforded securities held in customer segregated accounts resulting from repurchase agreements with affiliates should be more than sufficient to assure that an FCM's customer accounts are protected in the event of an FCM bankruptcy and, in particular, that such funds receive the priority established in the commodity broker liquidation provisions of subchapter IV, Chapter 7, of the Bankruptcy Code.

From a practical perspective, FCMs are finding that Basel III is making it increasingly difficult to find qualified banks and broker-dealers willing to act as counterparties in repurchase agreements. As the Commission is aware, Basel III introduced leverage and liquidity requirements to safeguard against excessive borrowings and ensure that banks have sufficient liquidity during financial stress. In particular, the supplementary leverage ratio, computed as Tier 1 capital divided by the total of

[26] For purposes of this petition, we request that the Commission confirm that an FCM may, in addition, also pledge such securities to those permitted depositories identified in Commission Rule 30.7(b), including, *inter alia*: (i) the clearing organization of any foreign board of trade; (ii) a member of any foreign board of trade; or (iii) such member's or clearing organization's designated depositories.

[27] Specifically, as set forth in the rule, the transfer of funds to the customer segregated cash account is made on a payment versus delivery basis. The transfer is not recognized as accomplished until the funds and/or securities are actually received by the custodian of the FCM's or DCO's funds or securities purchased on behalf of customers. The transfer or credit of securities covered by the agreement to the FCM's or DCO's customer segregated custodial account is made simultaneously with the disbursement of funds from the FCM's or DCO's customer segregated cash account at the custodian bank. On the sale or resale of securities, the FCM's or DCO's customer segregated cash account at the custodian bank must receive same-day funds credited to such segregated account simultaneously with the delivery or transfer of securities from the customer segregated custodial account.

[28] Master Repurchase Agreements typically require 102 percent "collateralization," protecting the value of the account in the event of a decline in the market value of the underlying securities that are transferred. The FCM monitors the value of the securities and, if the value of the securities approaches 100 percent, issues a margin call to the counterparty. In the event the value of the securities declines below the cash invested, the FCM must take a capital charge for the deficiency.

on and off-balance assets less intangible assets, was set at three percent (3%).[29] Basel III, therefore, has caused banks and their broker-dealer affiliates to consider more carefully the capital implications of any transactions they might enter into. Because repurchase agreements with third parties increase a bank or broker-dealer's balance sheet assets, such entities have limited interest in entering into such repurchase agreements, especially the type of plain vanilla Treasury repurchase agreements that FCMs are permitted to enter into under Rule 1.25.

Affiliate transactions, as well as the in-house transactions discussed immediately below, therefore, would provide FCMs an important tool to manage balance sheet exposure by allowing an FCM to realize a one-day duration on the repurchase agreement. This allows an FCM to align its client's overnight interest rate investment terms to an overnight interest rate investment exposure. It further assures that the investment may be unwound within one business day, as required under Rule 1.25

III. In-House Transactions

For many of these same reasons, we request the Commission to permit FCMs that are also registered broker-dealers to engage in transactions that were authorized under Rule 1.25(e), in effect prior to the 2011 Amendments. Although an FCM cannot contract with itself, prior Rule 1.25(e) imposed requirements that were carefully designed to provide protections comparable to those set out in Rule 1.25(d), summarized above.[30]

In this regard, for example, prior Rule 1.25(e) provided that securities could be transferred to or from the customer segregated account under the rule only in accordance with the following requirements, including: (i) the securities were priced each day based on the current mark-to-market value; (ii) the securities were held in a safekeeping account with a bank, a DCO, or the Depository Trust Company in an account that complied with the requirements of Commission Rule 1.26; (iii) the securities could not be used in another similar transaction and could not otherwise be hypothecated or pledged, except such securities could be pledged on behalf of customers at another FCM or DCO;[31] (iv) no transfer of securities to the customer segregated custodial account would be recognized as accomplished until the securities were actually received by the custodian of such account, and upon unwinding of the transaction, the customer segregated cash account

[29] Several US prudential regulators adopted rules implementing Basel III in October 2013. See, *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule*, 78 Fed. Reg. 62018 (Oct. 11, 2013).

[30] We note that we do not anticipate that the in-house transactions contemplated herein would be subject to a 25 percent concentration limit. Because there is no third party to the transaction, there is no counterparty risk with which the FCM must be concerned or which these procedures must address.

[31] As with affiliate transactions, for purposes of this petition, we request that the Commission confirm that an FCM may, in addition, also pledge such securities to those permitted depositories identified in Commission Rule 30.7(b), including, *inter alia*: (i) the clearing organization of any foreign board of trade; (ii) a member of any foreign board of trade; or (iii) such member's or clearing organization's designated depositories.

must have received funds credited to such account simultaneously with the delivery or transfer of securities from the customer segregated custodial account; and (v) no transfer of money to the customer segregated cash account would be recognized as accomplished until the money was actually received by the custodian of the customer segregated cash account and upon unwinding of the transaction, the customer segregated custodial account must have received the securities simultaneously with the disbursement of money from the customer segregated cash account; (vi) an actual transfer of securities by book entry was made consistent with Federal or State commercial law, as applicable; and (vii) at all times, securities transferred to the customer segregated account were reflected as "customer property."

We further note that, in computing the weighted average date-to-maturity, unlike repurchase and reverse repurchase agreements, which have a one-day time-to-maturity, in-house transactions' time-to-maturity is based on the actual remaining time-to-maturity of the underlying securities. This is because the above-described in-house transactions are not repurchase transactions, but rather are more in the nature of a direct purchase and sale or transfer of unencumbered securities as allowed in current Rule 1.25(e).[32] In addition, as with affiliate repurchase agreements, if the mark-to-market value of the securities declines below the amount of the cash invested, the FCM would be required to assure that its residual interest exceeds its targeted residual interest by an amount at least equal to the difference between the mark-to-market value of the securities and the amount invested.

As with affiliate transactions, these terms and conditions are more than sufficient to assure that customer funds are protected in the event of an FCM bankruptcy and, in particular, that such funds receive the priority established in the commodity broker liquidation provisions of subchapter IV, Chapter 7, of the Bankruptcy Code.

IV. Adjustable Rate Securities

Investments in certain adjustable rate securities are permitted under Commission Rule 1.25(b)(2)(iv) provided, *inter alia*, that (i) the interest payments on variable rate securities must correlate closely and on an unleveraged basis to certain benchmarks, including the one-month or three-month LIBOR rate, and (ii) the interest payment, in any period, on floating rate securities must be determined solely by reference, on an unleveraged basis, to certain benchmarks, including the one-month or three-month LIBOR rate.

As the Commission is aware, LIBOR is being phased out as a reliable benchmark and its use likely will not be permitted past the end of 2021. Although the financial markets have not settled on one

[32] Notwithstanding that these in-house transactions are not repurchase transactions, we propose that, as described in footnote 21 above, an FCM that wishes to engage in in-house transactions should assure that any such securities received have an initial value that is at least 102 percent of the amount invested. Further, in the event the value of the securities declines below the amount of the cash invested, the FCM would be required to take a capital charge with respect to such decrease.

successor benchmark, SOFR is becoming more widely accepted and used.[33] As noted earlier, SOFR is based on the cost of borrowing cash overnight collateralized by Treasury securities. SOFR is calculated every day by the Federal Reserve Bank of New York and published on its website by 8:00 am. SOFR is a reliable benchmark and is utilized as a benchmark for certain US Treasury instruments. We ask the Commission to authorize FCMs to invest in adjustable rate securities that correlate to SOFR, consistent with the provisions of Commission Rule 1.25(B)(2)(iv).

V. Additional Matters

A. Short Term Treasury ETFs. FIA is considering whether to request the Commission to authorize FCMs to invest customer funds in Short Term Treasury ETFs. (As the Commission may know, certain DCOs are also considering whether to accept Short Term Treasury ETFs as initial margin for open positions.) Based on our analysis to date, it appears that Short-Term Treasury ETFs have characteristics that may be consistent with already permitted investments under Rule 1.25 and may provide FCMs an opportunity to diversify further their investments of customer funds. We hope to follow-up with you when we have completed our analysis of these investment vehicles.

In the meantime, we ask the Commission to confirm that Short Term Treasury ETFs will be subject to the same capital haircuts as the Securities and Exchange Commission ("**SEC**") permits. ETFs currently fall under "All Other Securities" for haircuts as defined by SEC Rule 15c3-1 and require a minimum haircut of 15 percent.[34] However, in 2018, the SEC's Division of Trading and Markets issued a no-action letter allowing broker-dealers to apply a haircut deduction of two percent (2%) on the greater of the market value of the portion of the broker-dealer's long or short position in units of shares eligible for redemption, as defined in the letter, and a haircut deduction of six percent (6%) on the greater of the market value of the portion of the broker-dealer's long or short position in units of shares not eligible for redemption.[35] We ask the Commission to confirm that, with respect to Short Term Treasury ETFs that have received no-action relief from the SEC-related haircuts, FCMs may apply the haircuts as prescribed by the SEC no-action relief for the funds pledged by customers for initial margin, capital and segregation purposes.

B. Cleared Repurchase Agreements

The SEC recently approved the Fixed Income Clearing Corporation's ("**FICC's**") expansion of its Sponsored Service, which broadens the category of market participants that can participate as sponsors in cleared repurchase agreements and permits such sponsors to authorize their clients to

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33 We understand that the Chicago Mercantile Exchange accepts adjustable rate securities that reference SOFR as performance bond.

34 SEC Rule 15c3-1(c)(2)(vi)(J)

35 Letter from Michael A. Macchiaroli, Associate Director, Division of Trading and Markets, to Mark D. Fitterman, Senior Counsel, Morgan, Lewis & Bockius LLP, dated March 6, 2018.

trade with counterparties other than themselves. We appreciate that a properly structured program in which a registered clearing agency acts as a counterparty to a repurchase agreement may provide significant benefits to FCMs and their customers in connection with the investment of customer funds, and we look forward to learning more about this program.

We further understand, however, that, in order to take advantage of such a program, FCMs would likely require relief from the provisions of Rule 1.25(d), which currently restrict permitted repurchase agreement counterparties to banks and broker-dealers. In this regard, we are aware that the Commission's Division of Clearing and Risk ("**DCR**") previously adopted a no-action position permitting an FCM to enter into repurchase agreements that would be cleared by a registered clearing agency.[36] In support of its position, DCR noted that, when the Commission amended Rule 1.25 to authorize FCMs to engage in repurchase agreements, the Commission limited permitted counterparties to banks and broker-dealers because, as regulated financial institutions, they were expected to present less credit risk. DCR concluded that, as a regulated financial institution, an SEC-registered securities clearing agency would be expected to present no greater credit risk than banks or broker dealers. To the contrary, DCR recognized that clearing agencies may reduce credit risk by eliminating the risks presented by individual counterparties that are subject to financial stress associated with their activities in the financial markets. If FCMs determine to take advantage of the FICC program to enter into cleared repurchase agreements, we expect that we will request the Commission (or its staff) to extend the relief provided in CFTC Letter No. 12-34 from the current restrictions on permitted counterparties in Commission Rule 1.25(d) to all FCMs.

Conclusion

FIA respectfully requests the Commission to adopt an order pursuant to section 4(c) of the Act, or grant such other relief as the Commission may deem appropriate, authorizing FIA's FCM member firms and similarly situated FCMs, notwithstanding sections 4d(a) and 4d(f) of the Act and the provisions of Rule 1.25, to:

- Invest customer funds in the sovereign debt of Canada, France, Germany, Japan and the United Kingdom, subject to terms and conditions set forth above;

- Buy and sell such Specified Foreign Sovereign Debt pursuant to agreements for resale or repurchase;

- Enter into repurchase agreements with a counterparty that is an affiliate of the FCM and, further, engage in so-called "in-house" transactions, notwithstanding the provisions of Commission Rule 1.25(d); and

[36] CFTC Letter No. 12-34, November 19, 2012.

- Invest in adjustable rate securities that correlate closely to the Secured Overnight Financing Rate, consistent with the provisions of Commission Rule 1.25(b)(2)(iv).

For the reasons set forth above, we believe that that requested relief is consistent with the public interest and the purposes of the Act and the Commission's rules. In particular, such relief will be consistent with the objectives of preserving principal and maintaining liquidity as required under Commission Rule 1.25(b), while permitting FCMs to manage more efficiently the investment of customer funds. Further, because the FCMs that will take advantage of the relief requested herein will be subject to the continued oversight of the Commission and the joint audit committee with respect to such activities, the requested relief "will not have a material adverse effect on the ability of the Commission or any contract market . . . to discharge its regulatory or self-regulatory duties under this Act".[37]

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If the Commission or the staff have any questions regarding this request for exemption, please contact Allison Lurton, FIA's General Counsel and Chief Legal Officer, at 202.466.5460 or alurton@fia.org.

Sincerely,

Walt Lukken
President & Chief Executive Officer

cc: M. Clark Hutchison III, Director, Division of Clearing and Risk
Joshua B. Sterling, Director, Division of Swap Dealer and Intermediary Oversight

Enclosure: Appendix 1 and Appendix 2

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37 Act § 4(c)(2).