



Commodity Futures Trading Commission

Office of Public Affairs

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Fact Sheet and Q&A – Notice of Proposed Rulemaking Regarding Investment of Customer Funds by Futures Commission Merchants and Derivatives Clearing Organizations

The Commodity Futures Trading Commission (“Commission” or “CFTC”) is proposing to amend 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 the interest rate of adjustable rate securities that qualify as permitted investments; and (iii) eliminate the requirement that a depository holding customer funds must 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 swap transactions (“Customer Funds”) in specified categories of investments. 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.

Regulation 1.25(a)(1) currently lists seven specific 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”) as administered by the Federal Deposit Insurance Corporation (“FDIC”); (vi) corporate notes and bonds fully guaranteed as to principal and interest by the U.S. under the TLGP; and (vii) interests in money market funds (“MMF”).

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, 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 Regulation 1.25 and in consideration of information submitted in two industry petitions,¹ the Commission is proposing for comment amendments to its rules governing the safeguarding and investment of Customer Funds that would:

1. Revise the list of permitted investments in 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 certain conditions; (ii) limit the scope of MMFs

¹ See 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.

whose interests qualify as permitted investments; and (iii) remove corporate notes, corporate bonds, and commercial paper;

2. In connection with the proposed amendments to the list of permitted investments, specify the capital charges that would apply to proposed new categories of permitted investments and make certain changes to: (i) the counterparty and depository requirements of 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; (ii) the concentration limits for permitted investments set forth in Regulation 1.25(b)(3); (iii) the required contents of 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 proposed changes to the list of permitted investments; and (iv) the template acknowledgement letters to be signed by the depositories holding customer funds;
3. Amend Regulation 22.3(d) to clarify that DCOs are financially responsible for any losses resulting from investments of cleared swap customer collateral in permitted investments, consistent with Regulation 1.29, which addresses financial responsibility for losses resulting from investment of futures customer funds;
4. Replace LIBOR with SOFR as a permitted benchmark for variable and floating interest rates for securities that qualify as permitted investments; and
5. Eliminate the read-only access provisions.

In addition, the Commission is seeking comment on the potential elimination of certificates of deposit issued by a bank from the list of permitted investments in Regulation 1.25.

Objective

The Commission is seeking to amend 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 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 maintaining by the Commission of read-only electronic access to accounts holding customer funds.

Proposed Rulemaking Q & A

1. Who would be affected by the proposed changes?

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

2. What policy considerations motivated the proposed changes?

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

- In proposing to add 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 currently face if they convert the foreign currency 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,² the Commission analyzed the liquidity, volatility, and credit characteristics of the specified foreign sovereign debt instruments and preliminarily believes that including such instruments as permitted investments, subject to the proposed conditions, would be consistent

² See *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).

with overall objectives set forth in Regulation 1.25 of preserving principal and maintaining liquidity of Customer Funds;

- In proposing to add 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 thus seeks to expand 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 dispense with the resources required to manage individual investments in such instruments.
- The proposed revision of the scope of permitted MMFs seeks to address the impact of certain reforms to the Securities and Exchange Commission’s (“SEC”) rules governing MMFs and ensure that permitted MMFs remain consistent with Regulation 1.25’s general principles of preserving principal and maintaining liquidity of Customer Funds.
- The elimination of corporate notes, corporate bonds, and commercial paper is a consequence of the expiration of the TLGP. Specifically, Regulation 1.25(a)(1)(v) and (vi) currently permits FCMs and DCOs to invest Customer Funds in commercial paper and corporate notes and bonds, provided that such investments are fully guaranteed as to principal and interest under the TLGP as administered by the FDIC. The TLGP program expired in 2012, and such investments have not been available to FCMs and DCOs since 2012; and
- Replacing LIBOR with SOFR as a permitted benchmark for the interest rate of adjustable rate securities would facilitate the transition away from LIBOR and ensure that instruments qualifying as permitted investments use a reliable benchmark as a reference rate.

The proposed revisions to the concentration limits would support the preservation of principal and maintenance of liquidity of Customer Funds through sound diversification standards and would mitigate the potential risk of access to a large portion of Customer Funds becoming unavailable due to operational incidents, among other events.

With regards 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. In that regard, Commission staff intends to rely primarily on the automated daily segregation confirmation system developed by CME and the National Futures Association (“NFA”).

3. Why has the Commission proposed to allow investments in certain foreign sovereign debt at this time, given that the Commission had previously eliminated it from the list of permitted investments?

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.³ Following the 2000 amendments to 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 in light of economic crises experienced by a number of foreign sovereigns.⁴ In addition, according to a review conducted in 2007 by Commission staff, foreign sovereign debt was minimally used as an investment at the time.⁵ The Commission, however, also recognized at the same time that the safety of sovereign debt issuances of one country may vary greatly from the sovereign debt issuances of another country, and that investment in certain sovereign debt may be consistent with Regulation 1.25’s

³ See *Rules Relating to Intermediaries of Commodity Interest Transactions*, 65 FR 77993 (Dec. 13, 2000) (publishing 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).

⁴ See 2011 Permitted Investments Amendment.

⁵ *Id.*, at 78781.

objective of preserving principal and maintaining liquidity of investments. Accordingly, the Commission invited FCMs and DCOs that seek 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”).⁶

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.⁷

The Commission is proposing to expand 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.⁸ As noted above, prior to issuing the proposal, the Commission has analyzed the liquidity, volatility, and credit characteristics of the specified foreign sovereign debt instruments and preliminarily believes that these characteristics are comparable to those of instruments that already qualify as permitted investments. The Commission also notes that there may be a greater need of a tool to hedge foreign currency fluctuation risk, given that the amount of Customer Funds denominated in foreign currency that FCMs hold has increased since 2007 and represents approximately 10 percent of the total Customer Funds held in segregated accounts.⁹

4. Under what conditions would FCMs and DCOs be able to invest Customer Funds in foreign sovereign debt?

Currently, DCOs are able to invest Customer Funds in sovereign debt instruments issued by France and Germany, subject to conditions set forth in the 2018 Order discussed above.¹⁰

Under the proposal, FCMs and DCOs would be able to invest Customer Funds in specified foreign sovereign debt, subject to the following conditions, which are consistent with the 2018 Order:

- 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 would FCMs and DCOs be able to invest Customer Funds in ETFs?

Under the proposal, FCMs and DCOs would be able to invest Customer Funds in ETFs subject to the following primary conditions, among other requirements:

- 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. For purposes of the proposal, short-term U.S. 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;

⁶ *Id.*, at 78782.

⁷ *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”).

⁸ The Commission notes that all five jurisdictions are members of the Group of 7 (“G7”). The proposal, however, does not include all G7 countries as issuers of permitted foreign sovereign debt.

⁹ Specifically, as of August 15, 2023, FCMs collectively held an aggregate of a U.S. dollar equivalent of \$51 billion of Customer Funds denominated in Canadian dollars, euros, Japanese yen, and Great British pounds. The \$51 billion represented approximately 10 percent of the total \$490 billion of Customer Funds held by FCMs in segregated accounts on August 15, 2023.

¹⁰ *See* 2018 Order.

- The ETF's interests are redeemable in cash by an FCM or a DCO in its capacity as an authorized participant pursuant to an authorized participant agreement, as defined in SEC Rule 6c-11; and
- The ETF's interests are acceptable as performance bond by a derivatives clearing organization.

6. If the read-only access provisions are eliminated, with what means would the Commission dispose to obtain account balance and transaction information for accounts holding Customer Funds?

Commission staffs intends to rely primarily on the automated daily segregation confirmation system developed by CME and NFA.

In addition, the existing requirement in Regulations 1.20(d)(5) and (6), 1.26(b), 22.5(a) and (b), and 30.7(d)(5) and (6), that FCMs 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, would be maintained.