

# FarrFinancial

December 3, 2010

David A. Stawick  
Secretary of the Commodity  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, NW  
Washington, DC 20581

**RE: Proposed Rule 75 FR 67642**

Dear Mr. Stawick:

Farr Financial Inc. thanks the Commodity Futures Trading Commission (“Commission”) for the opportunity to comment on the proposed rulemaking concerning amendments to Regulation 1.25 and Regulation 30.7.

We believe that the proposed changes generally reflect the requirements of the Dodd-Frank Act, however, we recommend a few changes that need to be made. Some points of the proposed rules are onerously restrictive on an FCM’s ability to invest customer segregated property. These restrictions may unintentionally force FCMs to make less than ideal investment decisions.

Specifically we believe the proposed rules for Money Market Mutual Funds and Certificates of Deposit discourage FCMs from making investments in these investment vehicles. Because the FCMs are only allowed to invest small percentages of customer property in these investments, FCMs are indirectly encouraged to invest in a fewer number of other asset-based categories. Ultimately, as FCMs hold fewer categories of asset-based investments, those assets then wind up being held in aggregate at a smaller number of financial institutions – this increases systemic risk to the industry.

## **Money Market Mutual Funds**

We understand the Commission’s concerns regarding Money Market Mutual Funds (“MMMFs”) risk of “breaking the buck”. However, amended SEC Rule 2a-7 substantially decreases the risks associated with MMMFs. Further, the few MMMFs that historically (over the 35+ year history of MMMFs) did “break the buck” only lost a few cents on the dollar.

We believe that these minimal risks to customer accounts outweigh the huge benefits of MMMFs. All other acceptable forms of investment of customer funds either incur withdrawal penalties, transaction

costs (bid/ask spreads and/or commissions), and/or must be marked-to-market and therefore have daily price exposure risk.

While U.S. Treasuries can play an important role for investment of customer segregated funds and are guaranteed as to principal payment by the U.S. Government, U.S. Treasuries are not necessarily less risky than MMMFs. U.S. Treasuries entail risk because Treasury prices fall as interest rates rise.

Farr Financial does not perceive that investments today in U.S. Treasuries represent the best risk-to-reward outlook of available investment choices. While Farr Financial does invest in U.S. Treasuries we do not perceive that encouraging a portfolio concentrated and dedicated to U.S. Treasuries is a logical or sound investment approach. For example, today, the two year treasuries have a yield-to-maturity of approximately 0.50%. If 2-year rates were to double in the near-term (increase from yielding 0.50% to 1%), our models indicate that would translate into a real loss of approximately 1% that would occur to the market value of customer funds invested in 2-year notes. An FCM needing to sell U.S. Treasuries (to meet a large client redemption request, for example), may take a small loss on U.S. Treasuries that would not have happened had the FCM invested in MMMFs. U.S. Treasuries are not necessarily a safer investment than MMMFs.

Futures customers are protected by these movements through the haircuts that are charged to the FCMs (in the case of 2-year treasuries, a 2% haircut which more than adequately covers any associated risk of that investment). But FCMs should not be forced to make less favorable risk-to-reward investments solely because those investments are guaranteed as to principal by the U.S. Government and because they are the only investment that the Commission allows at an asset-based concentration limit of 100%.

We believe that the proposed 2% limit per MMMF family of funds and 10% concentration limit for MMMFs are inappropriately too restrictive and may have the counter effect of discouraging FCMs from investing in MMMFs. MMMFs are safe investments for customer funds and FCMs should be encouraged to invest in these highly liquid investments.

We would recommend a 10% limit of customer funds to be invested in a single MMMF and a limit of 15% per a MMMF "family of funds". An asset-based concentration limit of 50% for MMMFs should be the minimum limit that the Commission approves and we feel that a 100% asset-based concentration is most appropriate.

### **Certificate of Deposits**

Attached is an email from the FDIC indicating that customer funds held at an FCM are eligible for pass-through insurance of up to \$250,000 per underlying customer. With this pass-through insurance, FCMs could easily structure a portfolio of Certificate of Deposits ("CDs") that could be fully or almost fully be protected by FDIC insurance.

The benefit of non-negotiable CDs is that the risks associated with them are generally known by the FCM (the early withdrawal penalty) and unlike U.S. Treasuries there is no market risk.

CDs should be limited on a per issuer basis to encourage diversification. We recommend a limit of 10% per issuer. We do not believe that an asset-based concentration limit is necessary or prudent given that FDIC coverage applies. FCMs should be encouraged to invest in FDIC insured CDs and to purchase from as many issuers as possible. Therefore, an asset-based concentration limit of 100% should be applicable.

The proposed rules on withdrawal penalties for non-negotiated CD state that “any penalty for early withdrawal limited to any accrued interest earned”. The addition of this statement nearly makes non-negotiated CDs an impermissible investment. It is standard practice for CDs with a term of 1 year or less to have an early withdrawal penalty of up to 90 days simple interest and for CDs with a term of more than one year to have an early withdrawal penalty of 180 days. These penalties are trivial amounts for FCMs, particularly given that FCMs will already be taking haircuts against the purchase of the CDs. These are standard early withdrawal penalties and the proposed rules need to be modified to allow them.

Finally, with respect to CDs, the Commission should allow investments in negotiable CDs. As long as these investments meet the Commission’s definition of being “highly liquid”, FCMs should not be prevented from investing in these FDIC insured products. FCMs will account for these CDs on a marked-to-market basis and will take appropriate haircuts for holding these investments. There is no reasonable basis to preclude investment in “highly liquid” negotiable CDs.

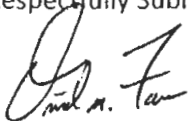
#### “Highly Liquid”

We recommend that the Commission adopt the definition of “highly liquid” to mean “having the ability to be converted into cash within one business day, without a material discount in value”. If “highly liquid” was to include any calculated approach (for example, if one-percent was determined be the maximum discount in value), this could create systemic risk as FCMs are forced to liquidate investments (causing prices to spiral down) solely because they are now perceived to be able to move by greater than 1.0% (even if that amount is only 1.1%). We would regard a calculated approach to be similar to the existing framework (which the Commission is proposing to eliminate) of identifying acceptable investments based upon credit rating standards.

Again, FCMs are required to take appropriate haircuts and hold the assets on a marked-to-market basis. Therefore there is no perceptible benefit to a calculated approach in determining the definition of “highly liquid”.

We would be happy to discuss our comments with the Commission. Please do not hesitate to call me at 408-246-9000 or via email: [ofarr@farrfinancial.com](mailto:ofarr@farrfinancial.com).

Respectfully Submitted,



Omid M. Farr

Enclosure

**From:** FDIC STARSMail [mailto:StarsMail@FDIC.gov]  
**Sent:** Tuesday, March 10, 2009 12:39 PM  
**To:** Omid Farr  
**Subject:** FDIC Reply [SCC2009W-003235-0]

Date: March 10, 2009

Ref No: SCC2009W-003235-0

Dear Mr. Farr:

Thank you for contacting the FDIC. In your e-mail, you described a deposit account at one or more FDIC-insured banks with the following account title "Farr Financial Inc. Customer Segregated Funds." Your company, Farr Financial Inc. deposits funds in this account on behalf of your clients. A portion of the funds belong to Farr Financial. Farr Financial keeps records detailing how much of the deposit account balance belongs to each client and to Farr Financial. Your basic question was stated as follows:

"If we were to invest hypothetically one million dollars of our customer segregated funds, how would the FDIC coverage apply? Would the coverage apply with an aggregate maximum of \$250,000 or would the coverage apply to a maximum of \$250,000 per each underlying customer that makes-up our customer segregated funds account?"

You also asked how deposit insurance coverage applies to Farr Financial's portion of the deposit account.

Based on the facts presented in your e-mail, Farr Financial is acting as a fiduciary on behalf of their clients and placing client funds on deposit in FDIC-insured banks. We provide pass-through deposit insurance coverage to your clients, the principals, provided the following requirements are met:

- 1) The fiduciary nature of the account must be disclosed in the account title (e.g. XYZ Company, as agent), and
- 2) The identities and interests of the principals for whom the fiduciary is acting must be ascertainable from either the deposit account records of the bank or records maintained in good faith and the regular course of business by the fiduciary.

A bank account titled as "Farr Financial Inc. Customer Segregated Funds" satisfies the first requirement. According to your e-mail, Farr Financial's internal records can satisfy the second requirement as well. If so, deposit insurance coverage passes through to your clients based on your client's ownership rights and capacities.

For example, John Doe is one of your clients. In his individual capacity, he owns \$200,000 that is on deposit in the "Farr Financial Inc. Customer Segregated Fund" account at Bank ABC. In

addition, John Doe has a single ownership checking account at the same bank with a \$60,000 balance. In the unlikely event of a bank failure, we will aggregate John Doe's single ownership funds at the bank (i.e. \$260,000) and insure the combined balance up to \$250,000. Thus, the remaining \$10,000 is uninsured.

You also noted that Farr Financial owns a portion of the "Customer Segregated Funds." As with John Doe, Farr Financial's portion of the Customer Segregated Fund (currently estimated at 5% of balance) will be aggregated with any other funds owned by Farr Financial at the same bank. The combined balance is insured up to \$250,000 per bank.

Our above response uses \$250,000 as the basic insurance limit but this figure is scheduled to revert to \$100,000 as of January 1, 2010. At that point, the figures in our response will be lowered accordingly.

The following provides additional information you should know about your deposit insurance coverage.

On October 3, 2008, President George W. Bush signed the Emergency Economic Stabilization Act of 2008, which temporarily raises the basic limit on federal deposit insurance coverage from \$100,000 to \$250,000 per depositor. The temporary increase in deposit insurance coverage became effective immediately upon the President's signature.

The statute currently **does not** provide for any extension of the temporary insurance increase beyond the December 31, 2009 expiration date. On January 1, 2010, the basic insurance amount will revert to \$100,000 per depositor, except for certain retirement accounts. Insurance coverage for certain retirement accounts was increased permanently by the Federal Deposit Insurance Reform Act of 2005, so coverage for certain retirement accounts will remain at \$250,000 after the temporary insurance increase expires.

In addition, effective September 26, 2008, FDIC rules for insurance coverage of revocable trust deposits were amended to simplify the calculation of coverage for individual revocable trust accounts.

Furthermore, on October 14, 2008, the FDIC announced a new program - the *Temporary Liquidity Guarantee Program* - to strengthen confidence and encourage liquidity in the banking system by guaranteeing newly issued senior unsecured debt of banks, thrifts and certain holding companies, **and by providing full coverage of non-interest bearing deposit transaction accounts (such as non-interest bearing checking accounts), regardless of dollar amount.**

### **FDIC INSURANCE COVERAGE**

FDIC insurance protects all bank deposits, including checking and savings accounts, money market deposit accounts and certificates of deposit (CDs). If your FDIC-insured bank were to fail, your deposits would be covered, dollar for dollar, including principal and any accrued interest, up to the insurance limit. These funds are available to you usually on the next business day. (The FDIC does not cover other financial products and services that insured banks may offer, such as stocks, bonds, mutual fund shares, life insurance policies or annuities.)

The FDIC provides separate insurance coverage for deposits that you hold in different account ownership capacities such as single accounts, joint accounts, Individual Retirement Accounts (IRAs) and trust deposits. The \$250,000 limit applies separately to all deposits you have at one

insured bank in each account ownership category. The account ownership categories that apply to most individuals and families are described below.

**SINGLE ACCOUNTS** - All deposits you own in your name alone at the same bank are added together and insured up to \$250,000. Your spouse also can have single accounts at the same bank insured up to \$250,000.

**JOINT ACCOUNTS** - All deposits that you own jointly with another person at one insured bank are insured up to \$250,000 per co-owner. If two people co-own and have equal access to one or more joint accounts at one bank, the joint accounts would be insured up to \$500,000 (\$250,000 per co-owner). (Note that each co-owner must personally sign the signature card except for CDs, negotiable instruments or agent accounts.)

**IRAS AND CERTAIN RETIREMENT ACCOUNTS** - All deposits that you own in IRAs, Section 457 deferred compensation plan accounts, and certain other self-directed retirement plan accounts are aggregated and insured up to \$250,000 at one insured bank.

**REVOCABLE TRUST ACCOUNTS** - Revocable trust accounts are deposits held in either payable-on-death (POD) accounts or living trust accounts. All revocable trust deposits that you own at one bank are insured up to \$250,000 for each beneficiary provided the beneficiary is a natural person, charity or nonprofit organization (recognized by the Internal Revenue Service). If a revocable trust provides equal interests to all beneficiaries, or if a revocable trust provides unequal interests and the trust identifies five or fewer beneficiaries, insurance coverage for the owner's trust deposits at one bank is calculated as \$250,000 times the number of beneficiaries identified in the trust.

It is possible for a husband and wife with two children to qualify for up to \$2.5 million in coverage at one FDIC-insured bank - excluding retirement accounts -- as illustrated below:

- Husband's single accounts - up to \$250,000
- Wife's single accounts - up to \$250,000
- Husband & wife's joint accounts - up to \$500,000
- Husband's revocable trust accounts/wife as beneficiary - up to \$250,000
- Wife's revocable trust accounts/husband as beneficiary - up to \$250,000
- Husband & wife's joint revocable trust accounts/two children as beneficiaries - up to \$1 million

Total maximum coverage for all of these deposit accounts - \$2.5 million. This coverage is separate from coverage that is available for either spouse's retirement accounts.

These deposit insurance coverage limits refer to the total of all deposits that an accountholder (or accountholders) has at each FDIC-insured bank. The listing above shows only the most common ownership categories that apply to individual and family deposits, and assumes that all FDIC requirements are met.

#### OTHER ACCOUNT OWNERSHIP CATEGORIES

In addition to these common ownership categories, deposit insurance is also provided to the following account ownership categories:

**IRREVOCABLE TRUST ACCOUNTS** - Irrevocable trust accounts are deposits held by a trust established by statute or a written trust agreement in which the grantor (the creator of the trust - also referred to as a trustor or settlor) contributes deposits or other property and gives up all power to cancel or change the trust. Since irrevocable trusts often contain conditions that affect the interests of the beneficiaries or provide a trustee or a beneficiary with the authority to invade the principal, deposit insurance for an irrevocable trust account usually is limited to a total of \$250,000.

**EMPLOYEE BENEFIT PLAN ACCOUNTS** - Employee Benefit plan Accounts are deposits of a pension plan, profit-sharing plan or other employee benefit plan. Employee benefit plan deposits are insured up to \$250,000 for each participant's non-contingent interest in the plan.

**CORPORATION/PARTNERSHIP/UNINCORPORATED ASSOCIATION ACCOUNTS** - Corporations, partnerships, and unincorporated associations, including for-profit and not-for-profit organizations, are insured under the same ownership category. Deposits owned by a corporation, partnership, or unincorporated association are insured up to \$250,000 at a single insured bank, but are insured separately from the personal accounts of the entity's stockholders, partners, or members.

**GOVERNMENT ACCOUNTS** - Government accounts are also known as public unit accounts. Insurance coverage of a public unit account is extended to the official custodian of the deposits belonging to the public unit rather than the public unit itself. Each official custodian may receive up to \$500,000 in insurance coverage - \$250,000 in time and savings deposits and \$250,000 in demand deposits - provided the deposits are held in an insured bank located in the same state as the public unit.

If you have additional questions about FDIC coverage limits and requirements, please visit EDIE the Estimator at [www.myFDICinsurance.gov](http://www.myFDICinsurance.gov) <<http://www.myFDICinsurance.gov>>, call the FDIC toll-free 1-877-ASK-FDIC, or ask your bank representative.

## **WHEN A BANK FAILS**

The FDIC places a very high importance on ensuring that depositors have quick and easy access to their insured deposits after a bank fails. Historically, the FDIC pays insurance usually the next business day, by either (1) providing each depositor with a new account at another insured bank in an amount equal to the insured balance of his or her account, or (2) issuing a check to each depositor for the insured account balance.

If your FDIC-insured bank were to fail, the FDIC would notify you in writing using your address on record with the bank. This notification would be mailed immediately after the bank is closed. When the failed bank is acquired by another bank, the assuming bank also notifies the depositors.

For more information about this process and other questions about bank failures please review our publication, When a Bank Fails, at <<http://www.fdic.gov/consumers/banking/facts/>>

We hope you found this information helpful.

Sincerely,

Federal Deposit Insurance Corporation

Division of Supervision and Consumer Protection

550 17th Street, N.W.

Washington, DC 20429

**The opinions expressed herein should only be considered advisory in nature. Such opinions are not binding upon the FDIC or its Board of Directors. In addition, the information provided is not meant to be all inclusive and the opinions expressed herein are based upon the facts presented in the request. Any changes in the facts or circumstances may result in different conclusions.**